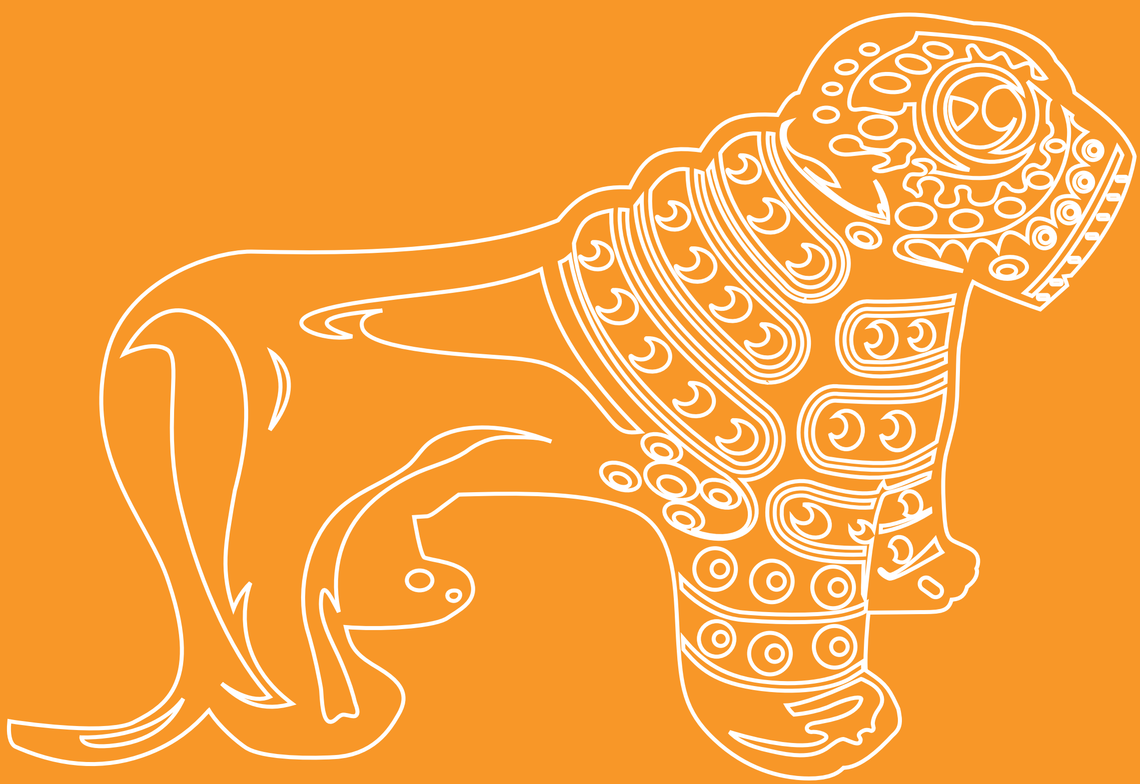
საქართველოს ბანკი
BANK OF GEORGIA

# ANNUAL REPORT 2008



# BANK OF GEORGIA HIGHLIGHTS

| | Year as at period end | | Change |
|---|---|---|---|
| **Statement of Income Figures** | | | |
| *GEL mln* | **2008** | **2007** | |
| Revenue [1] | 336 | 236 | 42% |
| Costs [2] | 212 | 128 | 66% |
| Net Income | 0.2 | 76 | |
| | | | |
| **Balance Sheet Highlights** | | | |
| *GEL mln* | **2008** | **2007** | |
| Total Assets | 3,259 | 2,954 | 10% |
| Loans | 2,039 | 1,676 | 22% |
| Deposits | 1,193 | 1,355 | -12% |
| Equity | 719 | 558 | 29% |
| | | | |
| Tier I Capital Adequacy Ratio (BIS) [3] | 25.5% | 22.0% | 16% |
| Total Capital Adequacy Ratio (BIS) [3] | 24.8% | 25.0% | -1% |
| | | | |
| **Selected Operating Data** | | | |
| | **2008** | **2007** | |
| Branches | 186 | 157 | -7% |
| ATMs | 454 | 278 | 63% |
| Current Accounts | 893,865 | 851,334 | 5% |
| Retail Clients | 687,834 | 612,335 | 12% |
| Employees (full-time) | 4,979 | 4,459 | 12% |
| | | | |
| **Ratings** | **Foreign Currency** | **Local Currency** | |
| | *(Long-term/Short-term)* | | |
| Standard & Poor's [4] | 'B/B' | 'B/B' | |
| Fitch Ratings | 'B'/'B' | 'B'/'B' | |
| Moody's Investor Service | 'B3/NP' | 'Ba3/NP' | |

## Awards

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

[2] *Costs (or Expenses) equal Other non-interest expenses less Net insurance claims incurred (as presented in the Audited Financial Statements)*

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

[4] *S&P Sovereign rating of Georgia is B/B. Bank of Georgia is rated at the sovereign ceiling*

# BANK OF GEORGIA BUSINESS MIX

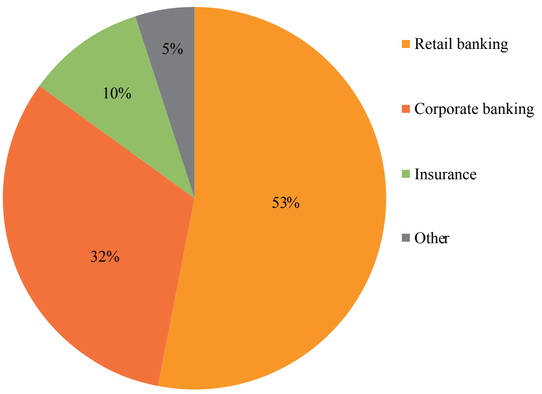
JSC Bank of Georgia (LSE: BGEO; GSE: GEB) is the leading Georgian bank with operations in Georgia, Ukraine and Belarus. It is the largest bank by assets, loans, deposits and equity in Georgia with 32.9% market share[(1)] by assets as of 31 December 2008. The Bank offers a broad range of retail banking and corporate banking services to its clients. It is also the leading provider of brokerage, insurance and wealth management services in Georgia

Bank of Georgia's activities are divided across business and geographical lines, with strong commercial banking footprint.

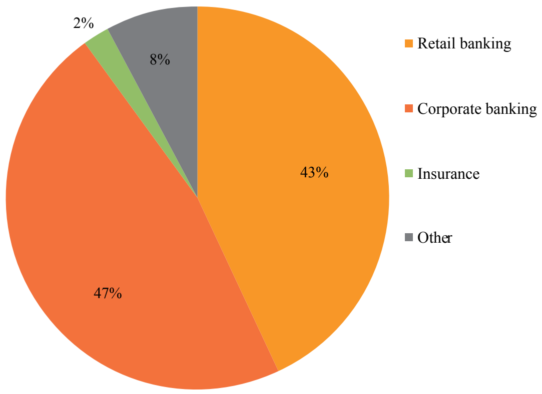
Retail banking is the most significant source of Bank of Georgia's revenue, generating approximately 53% of the total revenue. Corporate banking accounts for approximately 32% of the total revenue.

Georgia is principal market of Bank of Georgia, with only 8% of revenues derived from Ukraine, the second largest market for the Bank.

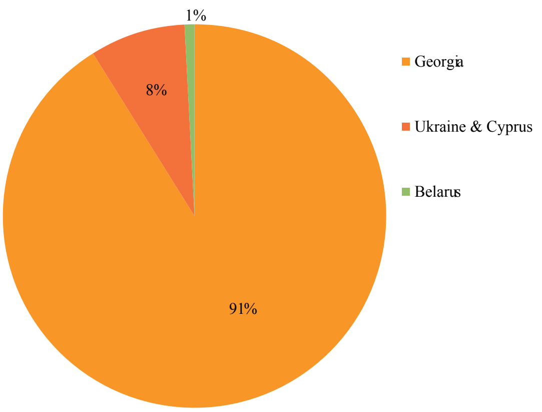
**Revenue by business segments**[2]



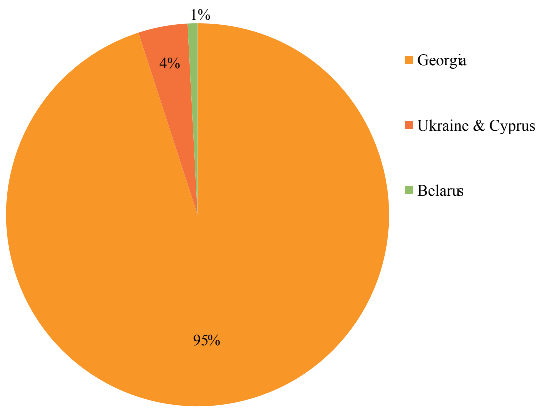

**Assets by business segments**




**Revenue by geographic segments**[2]




**Assets by geographic segments**




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

*[(2)] Calculated per segment information data of the accompanying Notes to 2008 Consolidated Financial Statements*

საქართველოს ბანკი

BANK OF GEORGIA

# ANNUAL REPORT 08

# CONTENTS

ᲡᲐᲥᲐᲠᲗᲕᲔᲚᲝᲡ ᲑᲐᲜᲙᲘ
BANK OF GEORGIA

# STATEMENT OF THE CHAIRMAN OF THE SUPERVISORY BOARD

# Dear Shareholders,

2008 was a very eventful and difficult year for Georgia. During the year we witnessed highly emotional presidential and parliamentary elections, military conflict between Russia and Georgia (the “Conflict”) and the worst financial and economic crisis in recent history, which resulted in sharp economic slowdown, capital markets dislocation and currency devaluation in our principal markets.

On behalf of Bank of Georgia’s supervisory board I would like to thank our employees for remarkable commitment and courage displayed in these difficult and dangerous conditions and our shareholders for the understanding and support they showed us despite our declining share price.

In this volatile market environment we had to act quickly to adjust the bank’s strategy and business model to new realities. In 2006 and 2007 our strategy aimed at rapid growth, market share gains and expansion into new markets and business lines were shaped by favorable capital markets and strong economic growth across the region. In 2008, tightening credit markets and slowing economy prompted us to first scale down our balance sheet growth and expansion targets and then, following the Conflict in August and the start of global financial and economic crisis, altogether reassess our business priorities.

Today Bank of Georgia is focused on operational efficiency, liquidity and risk management.

In Q4 2008 we announced a significant reorganization of our banking business in Georgia, which involved major scaling down of the Bank’s retail lending businesses resulting in the reduction of the Bank’s headcount by about 19%. Similar cost optimization measures were also implemented at the Bank’s subsidiaries in Georgia and abroad.

The development of the Bank’s IT systems is critical for further improving our operating efficiency and positioning the bank for future growth. In 2008 we launched several important IT projects across the group, which once completed will help us become more cost efficient, improve group’s management and position us to capture growth opportunities once the economy and the markets turn.

Our liquidity position is solid. We have been maintaining liquidity ratios significantly above the NBG requirement. US$240 million of long-term financing raised from EBRD, IFC and OPIC allowed us to comfortably meet our wholesale funding obligations and careful management of our loan book has helped us offset outflow of deposits due to the Conflict and economic downturn.

Unfortunately, weakening of the loan portfolio is unavoidable in this difficult economic environment. We have responded to this challenge by tightening our lending standards, reducing our lending volumes and strengthening our risk management department. We created specialized corporate and retail restructuring teams which work on developing a customer-focused loan restructuring solutions in Georgia and appointed new head of risk at BG Bank in Ukraine. Our decision to reduce Bank’s exposure to Georgian real estate development and construction industries taken in early 2008 is a key factor determining lower level of NPLs at BOG compared to our peers. Managing risk will undoubtedly remain one of our top management priorities throughout 2009.

Banking stocks have shown very poor performance across the globe. Unfortunately, our stock was no exception. Fall in our share price due to the global financial crisis was amplified by impact of the Conflict. As shareholders, members of our management team fully shared the disappointment felt by our shareholders. I would like to assure you that in these extreme market conditions, the bank’s management remains fully focused on delivering shareholder value.

**Yours sincerely,**

**Nicholas Enukidze**
**Chairman of the Supervisory Board**

# MANAGEMENT REPORT

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

## Statement of Income overview

Bank of Georgia reported 2008 Net income of GEL 0.2 million, or GEL 0.13 per share, and total Net operating income (Revenue)[1] of GEL 335.7 million, compared with record Net income of GEL 75.6 million, or GEL 2.96 per share and total Net operating income of GEL 235.8 million in 2007. The decline in Net income for the year was primarily a result of a significantly higher Impairment charge on Loans to customers of GEL 122.8 million, reflecting the addition of GEL 77.7 million to the Bank's Allowance for loan impairment; Losses from trading and investment securities in the amount of GEL 4.9 million; and Expenses from impairment of other assets and guarantee provisions of GEL 4.6 million in 2008.

### Revenue

Revenue of GEL 335.7 million increased by 42.3% compared to 2007, with most of the revenue items contributing to the growth.

**Revenue distribution by item**

| *GEL thousands* | **2007** | **2008** | **Change** |
|---|---|---|---|
| Net interest income | 130,219 | 220,840 | 70% |
| Net fee & commission income | 41,748 | 49,969 | 20% |
| Net (losses) gains from trading securities | 2,930 | -5,447 | NMF |
| Net gains from investment securities available-for-sale | 2,481 | 513 | -79% |
| Net (losses) gains from revaluation of investment properties | 16,362 | -389 | NMF |
| Net gains from foreign currencies | 26,710 | 47,134 | 76% |
| Net insurance revenue | 5,461 | 9,016 | 65% |
| Other operating income | 9,766 | 14,747, | 51% |
| Share of (loss) profit of associates | 137 | -713 | NMF |
| **Total Revenue** | **235,814** | **335,670** | **42%** |

Net interest income rose by 69.6% from 2007 to GEL 220.8 million primarily due to the loan book (Loans to customers) growth of 21.7% and an increase of average lending interest rates from 15.0% for the loans in foreign currency and 21.2% for the loans in Lari in 2007 to 16.2% for the loans in foreign currency and 26.0% for the loans in Lari in 2008. The loan book growth was partially offset by a 63.4% increase in the interest expense, attributable mostly to the 34.8% increase of non-deposit funding (Borrowings from international credit institutions). *(See Interest expense discussion)*

Interest income, comprising of interest income on the gross loans, interest income on the Bank's securities portfolio (interest income on Investment securities), interest income on Amounts due from credit institutions and Finance lease receivables, grew by 66.7% to GEL 403.9 million in 2008. The increase in Interest income was attributable primarily to the 78.2% increase in interest income on loan book to GEL 363.0 million.

Interest income on Bank of Georgia's securities portfolio (interest income from Investment securities) decreased by GEL 1.3 million to GEL 23.2 million in 2008, a result of the reduction of debt securities held by the Bank from GEL 228.1 million in 2007 to GEL 34.9 million in 2008. The Bank's debt securities in 2008 comprised of Certificates of deposit of central banks and State debt securities, both Held-to-maturity, and Available-for-sale securities such as Corporate bonds and Ministry of Finance treasury bills. The decrease of the securities portfolio in 2008 was mostly due to the reduction of Certificates of deposit placed with the National Bank of Georgia at the end of 2007 (from GEL 146.0 million in 2007 to GEL 14.8 million in 2008) and State debt securities (from GEL 38.1 million in 2007 to GEL 8.0 million in 2008. The decrease of the Available-for-sale securities from GEL 42.4 million in 2007 to GEL 33.7 million in 2008 was mostly attributable to the disposal of the Corporate bonds in the aggregate value of GEL 18.1 million.

Interest earned on Amounts due from credit institutions increased by 7.9% to GEL 10.7 million in 2008, with the growth mostly driven by the interest earned from the interbank deposits (Time deposits with effective maturity of more than 90 days or overdue) placed at several international banking institutions. In 2008 Amounts due from credit institutions comprised of interbank deposits, short-term interbank loans and Obligatory reserve with the Central banks. Obligatory reserve with the Central banks decreased from GEL 144.6 million in 2007 to GEL 57.9 million in 2008, a result of the decrease of the obligatory minimum reserve requirement by the National Bank of Georgia from 13% to 5% as of October 2008.

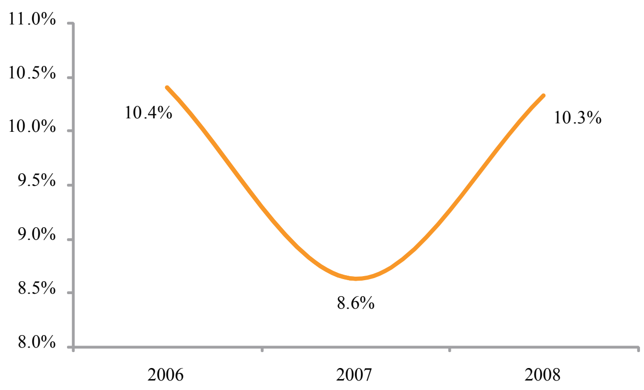
In 2008 Income from Finance lease receivables grew by 69.5% to GEL 7.0 million.

Interest expense, consisting of interest expense on the Amounts due to credit institutions, interest expense on deposits (Amounts due to customers) and interest expense on Debt securities issued, increased by 63.4% to GEL 183.1 million as of 31 December 2008. The growth resulted primarily from increased Interest expense on Amounts due from credit institutions and Interest expense on deposits. The increase in amounts Due to credit institutions was driven by the increased non-deposit funding (Borrowings from international credit institutions) in 2008. The growth of interest expense on deposits was attributed to increase of interest rates in 2008, which was in part due to competitive pressures causing the Bank to raise interest rates on customer accounts. In 2008 effective average interest rates paid on customer account balances were 8.2% for GEL deposits and 6.0% for foreign currency deposits (5.2% and 6.2% in 2007, respectively). The share of fixed term debt (Borrowings from international institutions and term deposits) in interest-bearing liabilities[2] increased from 66.4% in 2007 to 73.9% in 2008.

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

*(2) Interest-bearing liabilities equal sum of Amounts due to credit institutions, Amounts due to customers and Debt securities issued*

**Net Interest Margin**[3]




Bank of Georgia's Net Interest Margin (NIM) stood at healthy 10.3% in 2008, an increase of 170 basis points compared to 2007. The growth was driven by the increase of Net interest income, supported by larger proportion of higher yielding retail loans in the Bank's loan book. In 2008 Net interest income grew by 69.6% compared to the lower growth rate of total average interest-earning assets[4] which increased by 41.7% from GEL 1,508 million in 2007 to GEL 2,136 million in 2008. Total interest earning assets grew by 6.5% to GEL 2.2 billion, driven by the loan book growth in 2008. Cost of funds in 2008 increased from 7.4% in 2007 to 7.8% in 2008.

**Interest Earning Assets**

| *GEL thousands* | 2007 | 2008 | Change |
|---|---|---|---|
| Loans to credit institutions | 154,560, | 99,633 | -36% |
| Loans to customers | 1,675,681 | 2,039,022 | 22% |
| Finance lease receivables | 46,674 | 41,605 | -11% |
| Investment securities held to maturity | 192,464 | 22,845 | -88% |
| **Total interest earning assets** | **2,069,379** | **2,203,105** | **6%** |
| ***Average interest earning assets*** | ***1,508,016*** | ***2,136,242*** | ***42%*** |

Net fee and commission income rose by 19.7% to GEL 50.0 million. Net fee and commission income comprised fee and commission income from settlement operations, guarantees, letters of credit, cash collections, currency conversion operations, fees from brokerage and other advisory services and other fees. This growth was driven by the increases in sales of fee generating products and services listed above and an increase in the number of retail customer accounts in the first half of 2008.

The Bank's Other non-interest income grew 26.3% to GEL 91.8 million in 2008. Net Losses from Trading Securities amounted to GEL 5.4 million in 2008, compared to the Net Gain of GEL 2.9 million in 2007, a result of the loss on the proprietary trading book of Galt & Taggart Securities, reflecting the falling equity markets in Georgia and Ukraine against the background of the global financial crisis. Due to the declining real estate prices driven by the economic slowdown, the revaluation of investment properties mostly owned by the Bank through its subsidiaries resulted in the Net losses in the amount of GEL 0.4 million (Net gains of GEL 16.4 million in 2007). Gains from foreign currencies increased 76.5% to GEL 47.1 million in 2008. Net insurance revenue comprised of Net premiums earned less Net claims incurred increased by 65.1% to GEL 9.0 million, mostly a result of the increase in Net insurance premiums earned driven by the rise of the premiums earned on the Life and Health insurance.

The Bank's Share of loss of associates, where the Bank owned less than or equal to 50% equity interest, resulted in the total Share of loss of GEL 317 thousand in 2008 compared to the Share of profit of GEL 137 thousand in 2007.

Other Operating Income, which primarily comprised of other operating income of the Bank, fee income from the Bank's leasing, card processing, insurance and asset management operations, increased by 51.0% from GEL 9.8 million in 2007 to GEL 14.7 million in 2008.

## Expenses

In 2008 Bank of Georgia's expenses increased by 65.9% to GEL 212.3 million. Salaries and other employee benefits accounted for 51.2% of the Expenses (compared to 59.1% in 2007) and amounted to GEL 108.8 million, a 43.8% increase from 2007. The increase was mainly attributed to the headcount growth in the first half of 2008 and one-off expense of GEL 2.2 million related to the headcount reduction as a result of the restructuring that took place in December 2008. The number of personnel of the Bank reached 4,979 employees at the year-end 2008 compared to 6,064 employees as of 30 November 2008 and 4,459 employees as of 31 December 2007.

General and administrative expenses, which grew by 89.8% to GEL 68.7 million, comprised of expenses for occupancy and rent, marketing and advertisement, legal and other professional services, communications, repairs and maintenance, security, operating taxes, travel expenses, insurance expenses, office supplies, banking services, corporate hospitality and entertainment, penalties, personnel training and recruitment, and other General and administrative expenses. The main contributors to the increase in the General and administrative expenses in 2008 were Occupancy and rent related expenses driven by the growth of the Bank's operations in the first half of 2008 and Marketing and advertising expenses attributed to the post-Conflict public relations and advertising campaigns.

Depreciation increased by 108.2% to GEL 20.5 million, mostly due to the following factors: In 2008 depreciation expense included the depreciation expense of BG Bank for the full year compared to only fourth quarter depreciation expense of the BG Bank in the 2007 consolidated results; 2008 depreciation expense included six month depreciation expense of the BNB Bank, acquired by the Bank in 2008; Revaluation gain from Property and equipment of the Bank in the amount of GEL 70 million recognized in 2007 started to depreciate in 2008.

Impairment charge on other assets and provisions increased to GEL 4.6 million in 2008, compared to reversal of impairment on other assets and provision in 2007 of GEL 0.4 million. The increase was driven by the Provision for guarantees and commitments in the amount of GEL 3.7 million in 2008.

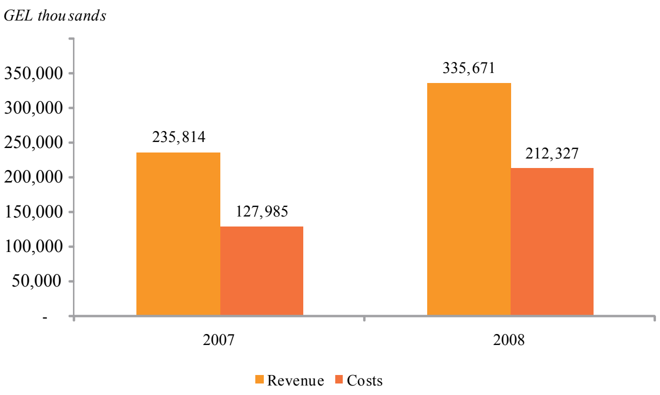
In 2008 Cost / Income ratio increased and amounted to 63.3% as compared to 54.3% in 2007.

---

*(3) For the calculation of Net Interest Margin in the years presented, annual average numbers are used*

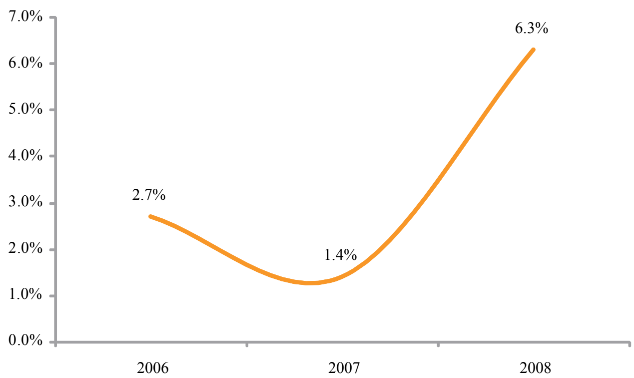
*(4) Average interest earning assets are calculated as a sum of interest earning assets at YE 2007 and interest earning assets at YE 2008 divided by two*

**Revenue and Expenses**




The increase in Loan impairment charge from GEL 17.4 million in 2007 to GEL 122.8 million in 2008 was attributed to extraordinary Loan impairment charges on the Bank's loan book in Georgia largely due to the Conflict (approximately GEL 110.6 million in 2008 compared to approximately GEL 17.8 million in 2007) and Loan impairment charges on the loan book of BG Bank in Ukraine (approximately GEL 18.0 million in 2008 compared to approximately GEL 0.1 million for the fourth quarter in 2007)[5], a result of deteriorating market environment in Ukraine in the second half of 2008. As a result of the increased Loan impairment charges, cost of risk grew from 1.4% in 2007 to 6.3% in 2008.

**Loan impairment charge/Average gross loans (Cost of Risk)**




Income tax benefit for 2008 amounted to GEL 1.0 million, due to the Loss before income expense for the year compared to Income before income tax expense in 2007. Income tax charge in 2007 amounted to GEL 14.1 million.

## Balance Sheet highlights

### Assets

As of 31 December 2008 Bank of Georgia had Total assets of GEL 3,259 million, as compared to Total Assets of GEL 2,954 million in 2007, an increase of 10.3%. The increase was mainly attributable to the loan book (Loans to customers) growth, which stood at GEL 2,039 million, an increase of GEL 363.3 million, or 21.7% from 2007.

Cash and cash equivalents, which accounted for 12.2% of Total assets, decreased by 2.0% to GEL 397.6 million in 2008, mostly a result of the decrease in the amount of short-term interbank deposits. The average liquidity ratio, based on the NBG standards, was 31.4% in 2008, higher than the NBG's 20% requirement.

In 2008 gross loan book increased by 25.9% to GEL 2,146 million. The growth was mostly attributable to the increased commercial, consumer and residential mortgage lending which grew 11.6% to GEL 1,045 million, 49.9% to GEL 496.2 million, and 65.7% to GEL 391.6 million, respectively. The majority of lending was accounted for by commercial loans in 2008.

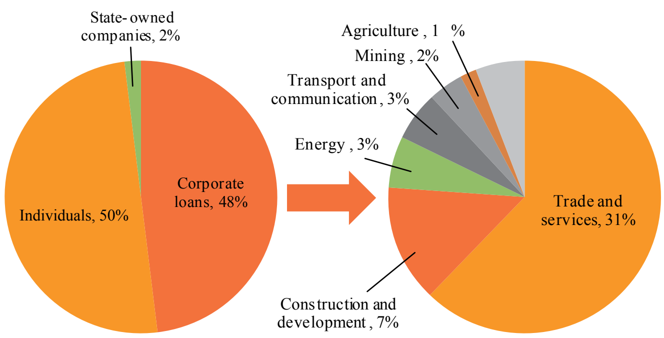
**Gross Loans**

| *GEL thousands* | 2007 | 2008 | Change |
|---|---|---|---|
| Commercial loans | 936,668 | 1,044,959 | 12% |
| Consumer loans | 331,082 | 496,197 | 50% |
| Residential mortgage loans | 236,397 | 391,606 | 66% |
| Micro loans | 152,436 | 151,313 | -1% |
| Gold - pawn loans | 28,158 | 46,374 | 65% |
| Others | 19,869 | 15,174 | -24% |
| Loans to customers, gross | 1,704,610 | 2,145,623 | 26% |
| Less - Allowance for loan impairment | (28,929) | (106,601) | 268% |
| **Loans to customers, net** | **1,675,681** | **2,039,022** | **22%** |

Private companies accounted for 48.0% of total gross loan book (includes portion of Micro Loans), increasing to GEL 1,029 million or 6.4% in 2008. Loans to individuals of GEL 1,080 million grew 54.4% compared to 2007, and representing 50.3% of total gross loans. Loans extended to State-owned entities in the amount of GEL 36.7 million, or a 3.8% decrease from 2007, continued to hold the smallest share with 1.7% of the total gross loan book.

Bank of Georgia maintained the diversified loan book across various sectors of the economy. By the end of 2008, ten largest borrowers accounted for 11% of the total gross loan book, down from 13% in 2007.

**Gross loans by customer type and by sector**




Allowance for the loan impairment increased from the prior year due to an increase in estimated losses predominantly for consumer and commercial loans due to the effects of the weakening of economic environment. As a result, the Allowance for the loan impair-

*(5) BG Bank's (formerly UBDP) fourth quarter results were included in the Bank's 2007 consolidated results*

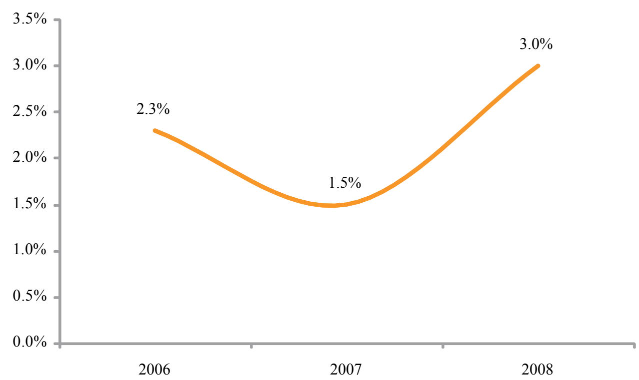
ment amounted to GEL 106.6 million, compared to GEL 28.9 million in 2007. Allowance for the loan impairment to gross loans ratio in 2008 increased to 5.0% from 1.7% in 2007.

**Allowance for loan impairment**

| *GEL thousands* | 2007 | 2008 | Change |
|---|---|---|---|
| Commercial loans | 11,120 | 45,754 | 311% |
| Consumer loans | 13,158 | 42,155 | 220% |
| Residential mortgage loans | 2,757 | 7,969 | 189% |
| Micro loans | 1,676 | 4,921 | 194% |
| Other | 218 | 5,802 | 2561% |
| **Total Allowance for loan impairment** | **28,929** | **106,601** | **268%** |

As of 31 December 2008 the non-performing loans (NPLs) accounted for 3.0% of total loans (NPLs are more than 90 days overdue loans including principal and interest payment). The chart below shows the development of non-performing loans in terms of total gross loans over three years.

**NPLs/Total gross loans**



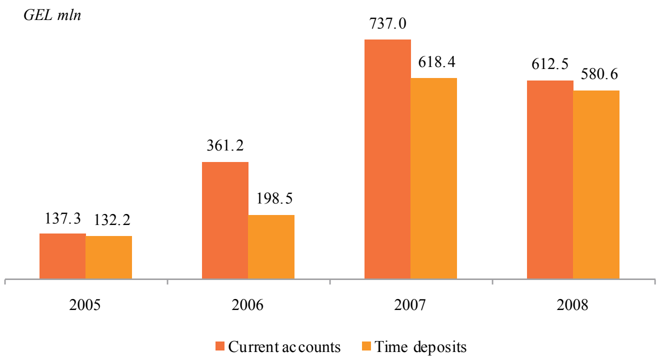

The Bank's loan book remains highly collateralized, with 87.3% of the total volume of gross loans to clients secured by mostly property inventory and trade receivables for commercial lending and by mortgages over residential properties for individual lending.

## Liabilities

Total liabilities increased 6.0% to GEL 2,540 million, primarily due to the 34.9% increase in the Amounts due to credit institutions to GEL 1,217 million as of 31 December 2008. The Bank's borrowings in 2008 include the new loans from FMO, DEG, and OPIC, and the Loan Passthrough Notes issued by the Bank. *(See pages 21 and 22 for more information on the Bank's wholesale funding transactions in 2008).*

Amounts due to Customers, or deposits, decreased by 12.0% to GEL 1,193 million in 2008. The decrease of deposits in Georgia was primarily the result of retail and corporate deposit withdrawals during the Conflict and slow deposit inflows in its aftermath. The decrease of deposits in Ukraine was attributed to the worsening of economic environment and the devaluation of Ukrainian Hryvna against Georgian Lari. The decrease in deposits was driven by 16.9% decline in current accounts to GEL 612.5 million, while time deposits decreased by 6.1% to GEL 580.6 million as of 31 December 2008.

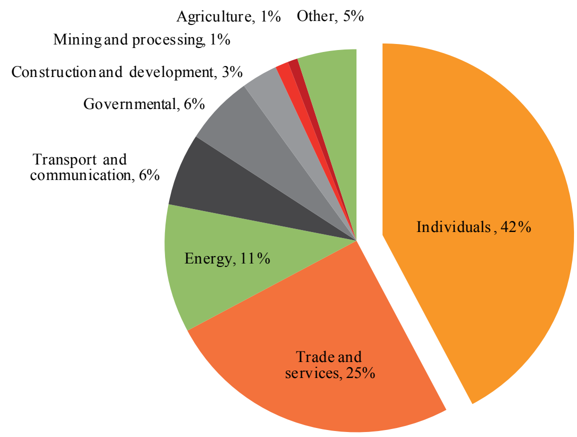
**Deposits by type**




Private companies accounted for 52.6% of the deposits, decreasing to GEL 627.1 million or 5.4% in 2008. Individual deposits of GEL 495.8 million, decreased 15.0% compared to 2007, comprising 41.6% of total deposits. Deposits of State-owned entities in the amount of GEL 70.3 million, or a 35.9% decrease from 2007, continued to hold the smallest share with 5.9% of total deposits.

As of 31 December 2008, ten largest customers accounted for 27% (or GEL 323.7 million), of the deposits. The diversification of Bank of Georgia's deposit base according to the customer deposits by industry is reflected below.

**Deposits by industry**




## Equity

As of 31 December 2008, authorized share capital comprised of 39,835,619 ordinary shares, of which 31,253,283 were Ordinary shares issued and fully paid compared to 27,154,918 Ordinary shares issued and fully paid as of 31 December 2007.

The increase of the Ordinary shares issued and fully paid was primarily attributed to the offering of four million new ordinary shares in the form of Global Depositary Receipts (GDRs) by the Bank in February 2008. *(See page 22 for information on the offering).*

In addition, the ordinary share issuance during 2008 was related to issuance of 89,000 ordinary shares in relation to the acquisition of Europace insurance company in 2005.

### Regulatory capital and Capital adequacy (BIS)

Bank of Georgia maintained a well-capitalised position, based on Tier I and Total Capital Ratios (BIS) as of 31 December 2008 and 31 December 2007.

| *GEL thousands, unless otherwise noted* | **2007** | **2008** |
|---|---|---|
| Ordinary shares | 27,155 | 31,253 |
| Share premium | 312,434 | 468,732 |
| Retained eranings | 124,928 | 150,903 |
| **Tier I capital** | **464,517** | **650,888** |
| General loan loss provisions | 21,861 | 28,607 |
| Revaluation reserves | 50,515 | 46,698 |
| Subordinated term debt | 87,538 | 157,535 |
| **Tier II capital** | **159,914** | **232,840** |
| Deductions from capital | (214,615) | (249,373) |
| **Total capital** | **409,816** | **634,355** |
| Risk weighted assets | 1,859,330 | 2,560,696 |
| **Tier I capital adequacy ratio** | **25.0%** | **25.4%** |
| **Total capital adequacy ratio** | **22.0%** | **24.8%** |

Total capital was GEL 634.3 million at 31 December 2008, compared with GEL 409.8 million in 2007, an increase of GEL 225.5 million. The increase in Total capital was largely attributable to the 40.3% increase of Tier I capital to GEL 650.9 million driven by sale of four million ordinary shares of the Bank in February 2008. The Bank's Tier II capital 45.6% growth to GEL 232.8 million was a result of the issuance of the subordinated term loan in 2008.

Risk-weighted assets increased by 37.7% to GEL 2,561 million in 2008 from GEL 1,859 million in 2007, largely due to the reduction of the risk weighing of foreign currency loan from 200% in 2007 to 175% in 2008 by the National Bank of Georgia. National Bank of Georgia requires capital adequacy calculation based on the NBG methodology, which is done on a standalone basis. Based on the NBG calculation method, Bank of Georgia's Tier I and Total Capital Ratios as of 31 December 2008 were at 16.6%, and 13.5%, respectively, and above the statutory minimum of 8% for Tier I and 12% for Total Capital. In 2007, Tier I and Total Capital, based on the NBG methodology, amounted to 13.2% and 13.1%, respectively.

## SHAREHOLDERS

As of 31 December 2008, Bank of Georgia continued to maintain a diversified shareholder base, with more than 80 Western institutional shareholders owning approximately 85% of the Bank's equity both through Global Depositary Receipts (GDRs) and ordinary shares. As of 31 December 2008, the following companies held more than five percent of Bank of Georgia shares.

| **December 31, 2008** | |
|---|---|
| Bank of New York (Nominees), Limited | 77.45% |
| Firebird Avrora Fund | 4.68% |
| Firebird Republics Fund | 4.58% |
| East Capital Financial Institutions | 4.37% |
| Others (less than 5% individually) | 8.92% |
| **Total** | **100.00%** |

As of 31 December 2008 the members of the Supervisory Board and Management Board owned 468,827 shares of Bank of Georgia. In addition, the members of the Supervisory Board and Management Board and employees were awarded 245,139 and 371,179 GDRs in 2008 and 2007, respectively. The following table depicts the interest of the members of the Supervisory Board and Management Board as of 31 December 2008.

| | **31 December, 2008** | |
|---|---|---|
| **Shareholder** | **Shares held** | **GDRs vested** |
| Sulkhan Gvalia, Deputy CEO, Chief Risk Officer | 166,907 | 26,857 |
| Irakli Gilauri, CEO | 136,303 | 134,716 |
| Nicholas Enukidze, Chairman of the Supervisory Board | 75,377 | 74,332 |
| Ramaz Kukuladze, Deputy CEO, Corporate Banking | 52,092 | 52,092 |
| Avto Namicheishvili, Deputy CEO, Legal Affairs | 12,489 | 11,667 |
| Allan Hirst, Vice Chairman of the Supervisory Board | 10,685 | - |
| Irakli Burdiladze, Chief Operating Officer | 10,036 | 9,666 |
| Kaha Kiknavelidze, Member of the Supervisory Board | 4,938 | 4,000 |
| **Total** | **468,827** | **313,330** |

# Events since the year end 2008

**Senior appointments**

In February 2009 Mikheil Gomarteli, formerly Co-Head of Retail Banking in Georgia was appointed Deputy Chief Executive Officer overseeing Retail Banking operations in Georgia.

Shahram Sharifi, formerly Global Head of Retail Banking was appointed as Head of Strategic Projects.

Constantine Tsereteli, formerly Co-Head of Retail Banking in Georgia was seconded for a year as a Deputy Chief Executive Officer of BNB in Belarus.

**Wholesale debt funding**

As of 17 March 2009 the Bank drew down US$ 200 million of the IFC and EBRD financing package. The financing package was comprised of:

**IFC facility**

- US$50 million senior loan at LIBOR +5.5% annual interest rate and maturity of 55 months
- US$24 million subordinated loan at LIBOR +10% annual interest rate and maturity of 120 months
- US$26 million subordinated, convertible loan at LIBOR +8% annual interest rate and maturity of 120 months

**EBRD facility**

- US$50 million senior loan at LIBOR +5.5% annual interest rate and maturity of 61 months
- US$24 million subordinated loan at LIBOR +10% annual interest rate and maturity of 120 months
- US$26 million subordinated, convertible loan at LIBOR +8% annual interest rate and maturity of 120 months

**Repayment of wholesale debt funding**

The Bank repaid a total of US$199.5 million of the wholesale debt financing, including a US$65 million loan facility arranged by Merrill Lynch, repaid in January 2009 and US$ 43.5 million, the second tranche of the syndicated loan a US$43.5 million received by the Bank in August 2007, repaid in February 2009.

The Bank repurchased Loan Passthrough Notes issued in June 2008 and maturing in June 2009 with the face value of US$91 million

As of 30 April 2008 repayment schedule for the Bank's key wholesale debt funding facilities was as follows:

| *US$ mln, unless otherwise noted* | **2009** | **2010** | **2011** | **2012** |
|---|---|---|---|---|
| WorldBusiness Capital | 0.8 | 1.1 | 1.1 | 1.1 |
| WBC (Georgian Leasing Company) | 0.5 | 0.7 | 0.9 | 0.5 |
| Loan passthrough notes | 49.0 | - | - | - |
| FMO | 1.1 | 2.3 | 2.3 | 2.3 |
| Syndicated Loan Tranche C (ADB) | 8.3 | 16.7 | - | - |
| Eurobonds | - | - | - | 200.0 |
| OPIC | - | 3.2 | 3.2 | 3.2 |
| IFC 2013 | - | - | 16.7 | 16.7 |
| EBRD 2014 | - | - | 14.3 | 14.3 |
| **Total** | **59.8** | **24.0** | **38.5** | **238** |

# RISK MANAGEMENT

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

Risk is an inherent part of business activities of Bank of Georgia. The Bank's risk management system is based on the principle of continually assessing risk throughout the life of any operation. Risk is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to Bank of Georgia's continuing profitability and each individual within the bank is accountable for the risk exposures relating to his or her responsibilities.

The major risk types identified by the bank are liquidity risk, market risk, credit risk and operational risk.

## Risk Management Structure

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

*Supervisory* Board approves the Bank's Credit Policy, which outlines credit risk control and monitoring procedures and the Bank's credit risk management systems and approves certain decisions which fall outside the scope of the Credit Committee's authority.

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

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

*The Internal Audit* department ensures that the Bank's policies conform to the legislation and regulation and professional norms and ethics. The Internal Audit department is responsible for monitoring and assessing the adequacy of compliance with internal procedures at all levels of the Bank's management. The Internal Audit department regularly inspects the integrity, reliability and legality of the operations conducted by the Bank's risk management departments, analyses and reports on risks connected with the introduction of new services or products and reviews the reliability of the Bank's information systems at least once a year. It also assess the reliability and security of financial information and monitors the Bank's internal controls and reporting procedures.

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

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

| **Subcommitee** | **Chair** | **Approval Limit for Corporate Loans (US$)** | **Approval Limit for Retail Loans (US$)** |
|---|---|---|---|
| Tier I | Deputy Director of Credit Risk Management department | <500,000 | <150,000 |
| Tier II | Director of Credit RiskManagement Department | 500,000-1,000,000 | 150,000-300,000 |
| Tier III | Deputy CEO/Chief Risk Officer | 1,000,000-3,000,000 | 300,000-2,000,000 |
| Tier IV | CEO | >3,000,000 | >2,000,000 |
| | Supervisory Board | >4,000,000 | |

Since September 2008, as a temporary measure, loan applications of borrowers, whose business activities fall within the following sectors: construction, materials, real estate management, auto dealing, electrical products and tourism are submitted for approval to the third and fourth tier subcommittees irrespective of the relevant borrower's total exposure.

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

- Sets interbank lending limits, open currency position limits with respect to overnight and intraday positions and stop-loss limits;
- monitors compliance with established value-at-risk ("VAR") limits on possible losses
- Sets ranges of interest rates for different maturities
- Reviews financial reports and indices

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

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

Legal department is also responsible for providing legal support to structural units of the Bank.

### Risk Management and Reporting

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

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

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

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

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

### Risk Mitigation and Excessive Risk Concentration

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

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

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

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

## Liquidity Risk

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

The liquidity risk management framework models the ability of the Bank to fund under both normal conditions and during a crisis situation. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

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

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

| | **2007, %** | **2008, %** |
|---|---|---|
| Average liquidity ratio for the year | 47.5% | 31.4% |
| Maximum Liquidity ratio | 92.7% | 48.6% |
| Minimum Liquidity ratio | 19.5% | 20.8% |

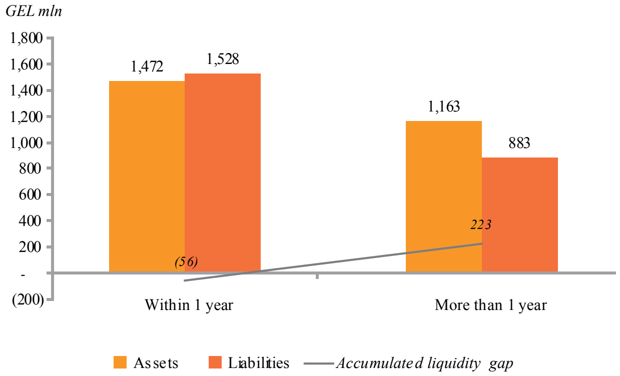
Average liquidity ratio is calculated on a stand- alone basis for JSC Bank of Georgia as annual average of daily liquidity ratios computed as percentage of liquidity assets in liabilities determined by National Bank of Georgia as follows:

Liquid assets - comprise cash, cash equivalents and other assets that can be immediately converted into cash. Those assets include investment securities issued by Georgian Government plus Certified Deposits issued by NBG 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 debts securities of Government and Central Banks of non-OECD countries, amounts due to Nostro Accounts that are under lien, impaired Inter-bank deposits, amounts on obligatory reserve with NBG that are pledged due to borrowings from NBG.

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

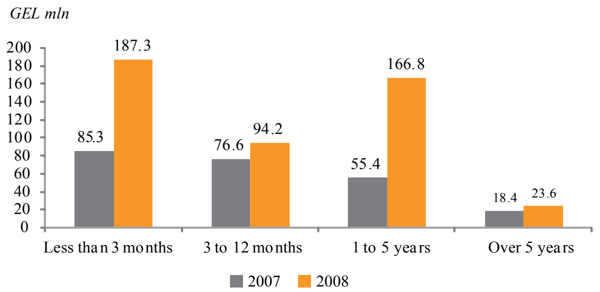
The table below shows the analysis of assets and liabilities according to which they are expected to be recovered and settled as of 31 December 2008. *(For the detailed breakdown of the underlying assets and liabilities as well as the summary of the maturity profile of the financial liabilities, please see the accompanying Notes to the Consolidated Financial Statements)*

**Assets/Liabilities by Maturities**




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

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




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

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

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

# Funding

## Sources of funds

Diversification of funding is an important component of Bank of Georgia's liquidity management strategy. The principal sources of liquidity are debt issues, borrowings, deposits (or Amounts due to customers), interbank deposits, principal repayments on loans, interest income, and fees and commissions income. As of 31 December 2008, all of Bank of Georgia's funding was unsecured as it was bound by negative pledge commitments to its lenders.

Deposits (or Amounts due to customers) are a consistent source of funding for Bank of Georgia. As of 31 December 2008, total deposits were GEL 1,193 million, representing 47% of Total liabilities.

Funding flexibility is also provided by Bank of Georgia's ability to raise wholesale funding from international markets. Borrowings from international credit institutions reached GEL 1,108 million as of 31 December 2008. During 2008, Bank of Georgia raised in aggregate US$ 262.9 million in long-term funding. These include:

In April 2008 Bank of Georgia introduced a short-term local currency denominated promissory note program, issuing its first local currency denominated promissory notes in the amount of GEL 63.9 million.

In June 2008 Bank of Georgia issued US$110 million two-year (with a put option in June 2009) Loan Passthrough Notes (BKGORG), with J.P. Morgan acting as arranger and dealer. The issue was increased by US$30 million in July 2008, resulting in an aggregate issue size of US$140 million.

In June 2008 Bank of Georgia received US$30 million 10-year subordinated loan from Nederlandse Financierings-Maastchappij voor Ontwikkelingslanden N.V. ("FMO"), the Duch development bank, and Deutsche Investitions und Entwicklungsgesellshaft mbH ("DEG"). Bank of Georgia has an option to prepay the loan after five years, according to the terms of the loan agreement.

In December 2008 Bank of Georgia drew down US$39 million from the United States Overseas Private Investment Corporation ("OPIC") financing package. The package comprised of a US$29 million 10-year senior mortgage facility and a US$10 million 10-year subordinated loan facility.

In December 2008 Bank of Georgia signed agreements with International Finance Corporation ("IFC) and European Bank for Reconstruction and Development ("EBRD") providing loan facilities to the Bank in the aggregate amount of US$200 million. The US$100 million provided by each financial institution comprised of a senior loan, subordinated loan and convertible subordinated loan. As of 17 March 2009, Bank of Georgia drew down the entire US$ 200 million of the IFC and EBRD financing package. *(See more information on IFC and EBRD package on page 16)*.

The foregoing loans bear fixed or floating interest rates tied to LIBOR or EURIBOR. Interest rates for the Bank's US$ borrowings ranged from 5.75% to LIBOR plus 9%, including subordinated facilities in 2008, and from 4% to LIBOR plus 8.65% in 2007 and 2006.

In addition, Bank of Georgia has trade finance lines from various international financial institutions and credit lines for interbank operations from both Georgian and non-resident banks. Notably, in September 2008 Bank of Georgia received trade finance line of US$20 million from IFC upon joining IFC's Trade Finance Program.

In February 2008 raised US$100 million as a result of the offering of four million new ordinary shares of the Bank in the form of global depositary receipts ("GDR"s) at a price of US$25 per GDR. Each GDR represents one ordinary share of the Bank. The offering represented approximately 14.7% of the issued share capital before the offering.

*See information on wholesale debt funding repayment schedule on page 16*

## Market Risk

Bank of Georgia is exposed to market risk, which is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. Bank of Georgia aims to limit and reduce the amount of possible losses on open market positions, which may be incurred by the Bank due to negative changes in currency exchange rates and interest rates.

Bank of Georgia classifies exposures to market risk into either trading or non-trading portfolios. Trading and non-trading positions are managed and monitored using other sensitivity analysis. Except for the concentrations within foreign currency, Bank of Georgia has no significant concentration of market risk.

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments.

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2008. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2008 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of Bank of Georgia's income statement. *(For the exposure to interest rates as of 31 December 2007, please see the accompanying Note to Consolidated Financial Statements).*

| | **Increase in basis points** | **Sensitivity of net interest income** | **Sensitivity of equity** |
|---|---|---|---|
| **Currency** | **2008** | **2008** | **2008** |
| UAH | 0.75% | - | - |
| EUR | 1.50% | 79 | - |
| USD | 0.55% | 23,434 | - |

| | **Increase in basis points** | **Sensitivity of net interest income** | **Sensitivity of equity** |
|---|---|---|---|
| **Currency** | **2008** | **2008** | **2008** |
| UAH | -1.25% | - | (121) |
| EUR | -1.50% | (79) | - |
| USD | -0.55% | 23,434 | - |

During 2008 and 2007 sensitivity analysis did not reveal significant potential effect on Bank of Georgia's equity.

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

The tables below indicate the currencies to which Bank of Georgia had significant exposure at 31 December 2008 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.

| | **Change in currency rate in %** | **Effect on profit before tax** | **Effect on equity** | **Change in currency rate in %** | **Effect on profit before tax** | **Effect on equity** |
|---|---|---|---|---|---|---|
| **Currency** | **2008** | **2008** | **2008** | **2007** | **2007** | **2007** |
| EUR | 14.90% | (832) | - | 4.60% | 104 | |
| GBP | 24.90% | 17 | - | 5.00% | (137) | |
| RUR | 0.30% | (6) | - | 0.10% | 24 | |
| UAH | 2.80% | 8 | - | 0.70% | (38) | |
| USD | 9.20% | (1,216) | - | 3.50% | (2,450) | |

During 2008 and 2007 sensitivity analysis did not reveal significant potential effect to Bank of Georgia's equity.

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

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

## Credit Risk

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

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

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

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

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

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

The table below shows the maximum exposure to credit risk of the balances sheet, including derivatives as of 31 December 2008 and 31 December 2007. The maximum gross exposure is shown before the effect of mitigation through the use of master netting and collateral agreements. Those financial instruments that are recorded at fair value represent the current credit risk exposure but not the maximum exposure that could arise in the future as the result of changes in values. *(For more detail on the maximum exposure to credit risk for each class of financial instrument please see the accompanying Notes to the Consolidated Financial Statements).*

| *GEL thousands, unless otherwise noted* | **Gross maximum exposure 2008** | **Gross maximum exposure 2008** |
|---|---|---|
| Cash and cash equivalents (excluding cash on hand) | 233,128 | 312,060 |
| Amounts due from credit institutions | 99,633 | 154,560 |
| Loans to customers | 2,039,022 | 1,675,681 |
| Finance lease receivables | 41,605 | 46,674 |
| Investment securities: | | |
| Available for sale | 33,737 | 42,387 |
| Held to maturity | 22,845 | 192,464 |
| | **2,469,970** | **2,423,826** |
| Financial commitments and contingencies | 397,322 | 208,299 |
| **Total credit risk exposure** | **2,867,292** | **2,632,125** |

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

The table below reflects credit quality of each class of asset for the non-related balance sheet lines as of 31 December 2008. *(For the credit quality of each class of asset as of 31 December 2007, please see the accompanying Notes to the Consolidated Financial Statements)*

| | Neither past due nor impaired | | | | |
|---|---|---|---|---|---|
| | **High grade** | **standard grade** | **Sub-standard grade** | **Past due or individually impaired** | **Total** |
| *GEL thousands, unless otherwise noted* | **2008** | **2008** | **2008** | **2008** | **2008** |
| Amounts due from credit institutions | 99,633 | - | - | - | 99,633 |
| Loans to customers: | | | | | |
| Corporate lending | 639,988 | 112,558 | 23,428 | 268,985 | 1,044,959 |
| Corporate lending | 381,299 | 42,126 | 11,576 | 61,196 | 496,197 |
| Residential mortgages | 337,445 | 13,477 | 1,868 | 38,816 | 391,606 |
| Micro-loans | 129,666 | 4,894 | 5,182 | 11,571 | 151,313 |
| Gold Pawn Loans | 46,374 | - | - | - | 46,374 |
| Other | 713 | 2,514 | 9,414 | 2,533 | 15,174 |
| | **1,535,485** | **175,569** | **51,468** | **383,101** | **2,145,623** |
| Finance lease receivables | 12,201 | 2,232 | 204 | 29,131 | 43,768 |
| Investsment securities: | | | | | |
| Available-for-sale | 33,737 | - | - | - | 33,737 |
| Held-to-maturity | 22,845 | - | - | - | 22,845 |
| | **56,582** | **-** | **-** | **-** | **56,582** |
| **Total** | **1,703,901** | **177,801** | **51,672** | **412,232** | **2,345,606** |

Past due loans to customers include those that are only past due by a few days. An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired. *(For analysis of the past due loan by age as of 31 December 2007, please see the accompanying Notes to the Consolidated Financial Statements).*

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.

| | **Less than 30 days** | **31 to 60 days** | **61 to 90 days** | **More than 90 days** | **Total** |
|---|---|---|---|---|---|
| *GEL thousands, unless otherwise noted* | **2008** | **2008** | **2008** | **2008** | **2008** |
| **Loans to customers:** | | | | | |
| Corporate lending | 12,107 | 4,937 | 6,990 | 15,118 | 39,152 |
| Micro-loans | 2,751 | 270 | 67 | 196 | 3,284 |
| Consumer lending | 21,375 | 764 | 336 | 2,469 | 24,944 |
| Residential mortgages | 6,887 | 6 | - | 86 | 6,979 |
| Other | 256 | 712 | 2,160 | 3,128 | 6,256 |
| Finance lease receivables | - | 46 | - | 24,380 | 24,426 |
| **Total** | **43,376** | **6,735** | **9,553** | **45,377** | **105,041** |

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

Bank of Georgia determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the 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.

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

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

The following table shows the geographical concentration of the Bank's monetary assets and liabilities. (*For the geographical con-*

*centration of the Bank's monetary assets as of 31 December 2007, please see the accompanying Notes to the Consolidated Financial Statements*

**Operational Risk**

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

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

| | 2008 | | | |
|---|---|---|---|---|
| *GEL thousands, unless otherwise noted* | **Georgia** | **OECD** | **CIS and other** | **CIS and other foreign countries** |
| **Assets:** | | | | |
| Cash and cash equivalents | 153,236 | 208,997 | 35,358 | 397,591 |
| Amounts due from credit institutions | 64,081 | 3,414 | 32,138 | 99,633 |
| Loans to customers | 2,008,652 | - | 30,370 | 2,039,022 |
| Finance lease receivables | 37,405 | - | 4,200 | 41,605 |
| Investment securities | | | | |
| Available for sale | 33,420 | 201 | 116 | 33,737 |
| Held to maturity | 22,845 | - | - | 22,845 |
| All other assets | 586,214 | 1,210 | 37,050 | 624,474 |
| | **2,905,853** | **213,822** | **139,232** | **3,258,907** |
| **Liabilities:** | | | | |
| Amounts due to credit institutions | 129,091 | 1,080,179 | 7,452 | 1,216,722 |
| Amounts due to customers | 1,152,244 | 2,477 | 38,403 | 1,193,124 |
| All other liabilities | 118,978 | 7,216 | 4,018 | 130,212 |
| | **1,400,313** | **1,089,872** | **49,873** | **2,540,058** |
| **Net balance sheet position** | **1,505,540** | **(876,050)** | **89,359** | **718,849** |

The Operational Risk Management department is responsible for identification and assessment of operational risk categories with the Bank's processes and operations, detecting critical risk areas or groups of operations with an increased risk level, developing response actions and the imposition of restrictions in critical risk zones and developing business- process optimization schemes, including document circulation, information streams, distribution of functions, permissions and responsibilities. An operational risk manager, who reports to the Deputy CEO, Chief Risk Officer is responsible for the oversight for the oversight of the Bank's operational risks.

**Compliance and Internal Control**

The Compliance and Internal Control department is responsible for developing and updating policies and procedures and ensuring that these policies and procedures meet or exceed applicable legal and regulatory requirements. It is also responsible for monitoring and assessing the levels of the Bank's internal control systems to detect any infringement or errors on the part of the Bank's departments and divisions. Bank of Georgia has procedures and operative documents aimed at preventing money laundering and terrorist financing, including a general anti-money laundering policy and internal control procedures and rules on counteracting money laundering and financing of individuals and legal entities engaged in terrorist activities, as well as procedures for reporting to the FMS. The FMS was established in 2003 and serves as Georgia's financial intelligence unit. These procedures aim to, among other things, minimise the risk to Bank of Georgia of being used as a vehicle for money laundering or terrorist financing, protect Bank of Georgia from financing and reputation risks of being associated with money laundering or terrorist financing activities and ensure that banking services are provided only to bona fide clients.

Anti-money laundering procedures include (i) KYC procedures that require clear identification of clients, verification of their identity and appraisal of risk of their engaging in money laundering and/or terrorist financing, (ii) "know your correspondent bank" procedures that carefully screen the Bank's potential partners with regard to their anti-money laundering policies, and (iii) "know your employee" procedures that ensure prevention of a Bank employee's possible involvement in money laundering and terrorism financing. KYC procedures require clear identification of the beneficial ownership of a transaction. The Bank practices a risk-based approach and therefore enhanced due diligence procedures are implemented if the risk of particular clients engaging in money laundering and/or terrorist financing is determined to be significant.

Bank of Georgia identifies transactions that must be monitored and reported pursuant to Georgian anti-money laundering legislation. Such legislation requires Bank of Georgia to monitor and report suspicious transactions and activity over a certain threshold amount (currently GEL 30,000 or foreign currency equivalent). Bank of Georgia maintains a database containing information on all clients and transactions in which they engage, which facilitates identification of unusual transactions. In addition, Bank of Georgia verifies each client's identity, legal status and authority to engage in particular transactions. Bank of Georgia does not enter into business relationships with clients that refuse to provide sufficient identity and authority information.

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

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

In 2008, the Bank has further enhanced its technological facilities by implementing AML software allowing fully-automated monitoring of all transactions for live detection of possible matches with international and local “black-listed” entities. Bank of Georgia is in process of implementing another AML software product that will allow sophisticated transaction pattern analysis and client behavior modeling for early detection of possible risks associated with money laundering and terrorist financing.

# RISKS AND UNCERTAINTIES

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

## Emerging Market Risks

Emerging markets are subject to greater risk than more developed markets, including in some cases significant political, economic and legal risks. In addition to its principal banking operations in Georgia, the Bank has business operations and assets in Ukraine and Belarus. Emerging economies, such as the Georgian, Ukrainian and Belarusian economies, are subject to rapid change and are particularly vulnerable to market conditions and economic downturns elsewhere in the world and the information set out in this Annual Report may become outdated relatively quickly.

## Risks Relating to the Bank's Business

### *Current Economic and Market Conditions*

The global economy has entered the most severe downturn for 80 years, with the financial services industry facing extraordinary turbulence. A shortage of liquidity, lack of funding, pressure on capital and extreme price volatility across a wide range of asset classes are putting financial institutions under considerable pressure. This is leading governments and central banks to undertake unprecedented intervention designed to stabilise the global and domestic financial systems, to stimulate new lending and to support systemically important institutions at risk of failing. Many developed economies have entered recession and growth has slowed in many emerging economies, with serious adverse consequences for asset values, employment, consumer confidence and levels of economic activity. Commodity prices have significantly retrenched, in many cases from recent historical highs, interest rate yield curves have flattened, interest rates have fallen in absolute terms in many markets (although not in Georgia) and trade flows have contracted. Global equity markets have experienced severe declines and various currencies have depreciated significantly against the U.S. Dollar. Numerous governments and central banks have responded by proposing programmes to make substantial funds and guarantees available to boost liquidity and confidence in their financial systems, as well as cutting taxes and lowering interest rates. It is not known whether these responses will be effective in addressing the severe economic and market conditions or whether recently proposed measures will be implemented as initially proposed.

The Bank's financial condition and business prospects are affected by global and local economic and market conditions. A worsening of these conditions in the Bank's principal markets of Georgia, Ukraine and Belarus (the "**Principal Markets**") may exacerbate the impact of these difficult market conditions on the Bank and other financial institutions and could have an adverse effect on the Bank's business, financial condition, results of operations and prospects.

### *Dependence on Banking and Other Licenses*

Bank of Georgia is subject to banking regulations and requirements in Georgia, which have been adopted by the Georgian Parliament and the Financial Supervisory Agency of Georgia (the "FSA"), established as an independent agency under the auspices of the National Bank of Georgia ("NBG").

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

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

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

### *Geographical Diversification*

In accordance with its strategy, the Bank has made investments into countries of the CIS, in particular Ukraine and Belarus, and may continue to increase these investments and its business activities in such countries.

The Bank's international presence exposes it to risks that it would not face as a purely domestic bank, including certain political and economic risks, compliance risks, liquidity risks, foreign currency exchange risk as well as the risk of failure to market adequately to potential customers in other countries. To the extent the Bank expands its international operations further, it will be exposed to additional risks. Any failure to manage such risks may cause the Bank to incur increased liabilities in respect of such operations.

### *Liquidity Risks*

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

The extreme market conditions facing the financial services industry have been reflected in shortages of liquidity, lack of funding, pressure on capital and extreme price volatility across a wide range of asset classes. The extreme market conditions and economic downturn have resulted in a reduction of deposits in the banking systems in the Principal Markets generally, leading to increased competition for such deposits and the risk of deposit migration.

In recent months, the Bank has been unable to access the international capital markets and has relied predominantly on funding received from international financial institutions.

While it is difficult to predict how long the conditions described above will prevail and the extent to which (and to what extent) the Bank's banking and non-banking businesses will be affected, continuation or worsening of these factors could have an adverse effect on the Bank's business, financial condition, results of operations and prospects.

### *Exposure to Credit Risk of Corporate and Retail Clients*

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

The majority of loans to customers are denominated in U.S. Dollars or Euro. A customer's ability to repay such loans may be impaired due to the devaluation of the Lari, if such customer's principal income is predominantly in Lari. While the substantial majority of the Bank's loans to customers are secured by collateral, if a significant number of its corporate or individual borrowers and/or guarantors experience poor financial performance due to a significant deterioration in domestic or regional economic conditions, including a devaluation of the Lari, or volatility in certain sectors of the domestic or regional economies or if their financial condition deteriorates significantly for any reason, this could have a material adverse effect on the Bank's financial performance and results of operations.

### *Allowance for Impairment Loss Risk*

As of 31 December 2008, the Bank's net allowance for impairment losses on loans to customers was GEL 106.6 million, the ratio of the Bank's allowance for impairment losses to total gross loans to customers was 5.0%, and the ratio of the Bank's allowance for impairment recognised losses to impaired loans was 35.2%. The Bank establishes provisions for impairment losses of financial assets when there is objective evidence that a financial asset or group of financial assets is impaired. The Bank creates provisions by reference to the particular borrower's financial condition and the number of days the relevant loan is overdue. If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by an adjusted provision account. The determination of provisions for impairment losses is based on FSA regulations and on an analysis of the assets at risk and reflects the amount which, in the judgement of Management, is adequate to provide for losses incurred. Provisions are made as a result of an individual appraisal of financial assets. If the impairment allowances prove to be inadequate, this may have a material adverse effect on the Bank's business, financial condition, results of operations and prospects.

### *Enforcement of Security*

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

### *Foreign Exchange and Currency Risk*

The Bank is exposed to the effects of fluctuation in the prevailing foreign currency exchange rates on its financial position. Approximately 20% of the Bank's liabilities are denominated in GEL, while approximately 37% of its assets are denominated in GEL. Assets associated with operations in Ukraine and Belarus are denominated predominantly in hryvnia and Belarus roubles, respectively. The Bank translates such assets and liabilities, as well as interest earned or paid on such assets and liabilities, and gains/(losses) realised upon the sale of such assets, into Lari when preparing its financial statements. As a result, the Bank's reported income is affected by changes in the value of the Lari with respect to such foreign currencies. The overall effect of exchange rate movements on the Bank's results of operations depends upon the rate of depreciation or appreciation of the Lari against its principal trading and financing currencies.

Partly in response to the increased demand for foreign currencies during the months following the armed conflict between Georgia and Russian that broke out in August 2008 (the "Conflict") and partly as a result of the downturn in the global economy and its impact on the Georgian economy (including a reduction in FDI, lower remittances to Georgia from abroad and a slowing of exports), the NBG allowed the Lari to depreciate by 17% at the beginning of November 2008. Such depreciation principally resulted in foreign exchange losses at the subsidiary level as well as a deterioration in Bank of Georgia's capital adequacy ratios. The ability of the Government and the NBG to limit any further depreciation of the Lari will depend on a number of political and economic factors, including the Government's ability to control inflation, the availability of foreign currency reserves and FDI inflows. Annual inflation rates in Georgia (as measured by the end-of-period Consumer Price Index (the "CPI")) for 2006, 2007 and 2008 were 8.8%, 11.0% and 5.5%, respectively, according to the information provided by the State Department of Statistics.

Any additional depreciation of the Lari may lead to further erosion of the Bank's regulatory capital and pressure on its capital adequacy ratios, which could adversely affect the Bank's business, financial condition, results of operations and prospects.

### *Interest Rate Risk*

The Bank is also exposed to risks resulting from mismatches between the interest rates on its interest-bearing liabilities and interest-earning assets. While the Bank monitors interest rates with respect to its assets and liabilities, and believes that its interest margin is sufficient to absorb movements in interest rates, to the extent the Bank is unable to pass on increases in interest rates to its customers, interest rate movements my adversely affect the Bank's financial position. The Bank's results of operations largely depend on its net interest income. Although, currently, net interest margins in the Principal Markets are generally higher than those in most Western jurisdictions, interest rates are highly sensitive to many factors beyond the Bank's control, including the reserve policies of the central banks and domestic and international economic and political factors. There can be no assurance that the Bank will be able to protect itself from the negative effects of future interest rate declines. Any declines in the market interest rates, global benchmark rates and/or increases in rates payable on deposits could lead to a reduction in net interest income and net interest margin. Such a reduction in net interest income and net interest margin could have a material adverse effect on the Bank's business, financial condition, results of operations and prospects.

### *Risks Associated with Cost-Control Measures and Planned Disposals*

The Bank is implementing a cost control programme as one of the Bank's strategic priorities for 2009. As part of this strategy, the Bank intends to close certain branches in Georgia and Ukraine, optimise its staff in the Principal Markets as well as focus on operational efficiencies and improvement of delivery channels. In the event that planned cost control measures fail to result in the cost savings anticipated by the Bank, this could have a material adverse effect on the Bank's financial condition and prospects.

The Bank also plans to dispose of certain non-core and non-performing assets over the next two to three years. Achievement of the Bank's disposal strategy will be dependent on a number of conditions beyond the Bank's control, including stabilisation of the global financial markets and global economic recovery as well as political and economic stability in Georgia. There can be no assurance that disposals will be completed in a timely fashion, on commercial terms acceptable to the Bank or at all, or will result in the anticipated benefits to the Bank's business, or will not result in unforeseen liabilities and losses. In the event that planned cost control measures fail to result in the cost savings anticipated by the Bank, or planned disposals are delayed, not consummated or result in unforeseen liabilities, this could have a material adverse effect on the Bank's financial condition and prospects.

### *Competition*

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

In the near future, the Bank expects increased competition for deposits in particular. If the Bank is unable to continue to compete successfully in the Principal Markets or to execute its business strategy, this could have a material adverse effect on the Bank's business, financial condition, results of operations or prospects.

### *Technological Risks*

The Bank relies heavily on information systems to process a large number of transactions efficiently and accurately and is currently upgrading a number of its information systems. A new core banking system was recently launched at BG Bank. In the near future, the Bank plans to implement a new core banking system in Georgia, a payroll management system and a cash management system. However, there can be no assurance that the new systems will be implemented in a timely manner, or without cost overruns, that the new systems will address all of the shortcomings of the current systems or will be sufficient to meet the needs of the Bank's business. In addition, although the Bank has developed back-up systems and a fully-equipped disaster recovery centre, and may continue some of its operations through branches in case of emergency, if the Bank's information technology systems fail, even for a short period of time, then it could be unable to serve some or all of its clients' needs in a timely manner and could lose business as a result. A temporary shutdown of the Bank's information systems could result in unexpected costs that may be required for information retrieval and verification. Any failure or interruption of the Bank's information technology systems could result in failures or interruptions in the Bank's decision-making processes and risk management procedures or a disruption in the Bank's business activities, any of which could have a material adverse effect on its business, financial condition, results of operations and prospects.

### *Restrictive Covenants*

Bank of Georgia and/or its subsidiaries are parties to a number of loan agreements that contain covenants imposing significant operating and financial restrictions on the borrower. These restrictions require Bank of Georgia and/or its subsidiaries, among other things, to maintain compliance with specified financial ratios and significantly limit, and in some cases prohibit, among other things, the ability of Bank of Georgia and certain of its subsidiaries to incur additional indebtedness, create liens on assets, undertake corporate reorganisations, enter into business combinations or engage in certain transactions with companies within the Bank. From time to time in the past, Bank of Georgia and its subsidiaries have breached certain of these covenants. While Bank of Georgia and its subsidiaries have obtained waivers from the relevant lenders in respect of its past breaches when they took place, there can be no assurance that waivers will be granted for any breaches that may occur in the future.A failure by Bank of Georgia and/or its subsidiaries to comply with the covenants in their loan agreements would constitute a default under the relevant agreements and could trigger a cross-default under other agreements to which such entity is a party, including in the case of Bank of Georgia, its outstanding Eurobonds. In the event of such a default, the Bank's obligations under one or more of these agreements could, under certain circumstances, become immediately due and payable, which could have a material adverse effect on the Bank's business, financial condition, results of operations or prospects.

### *Dependence on Key Management and Qualified Personnel*

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

## Risks Related to Georgia and the Other Principal Markets

### *Political Risk*

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

On 7 November 2007, after five days of demonstrations blocking the main avenue outside the Parliament, riot police broke up the protests and a two-week state of emergency banning all privately-owned broadcast media and public gatherings was imposed. On 8 November 2007, President Saakashvili announced that early presidential elections would be held on 5 January 2008, thereby reducing his constitutional term by a year, and that a plebiscite would be held on rescheduling parliamentary elections for spring 2008. President Saakashvili was re-elected on 5 January 2008 with 53.5% of the vote and the National Movement Party won the majority of votes in the parliamentary elections held in May 2008. Following the further deterioration of already strained political relations between Russia and Georgia, the Conflict took place, after which Russia formally recognised the independence of South Ossetia and Abkhazia. See "—Regional Tensions".

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

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

### *Regional Tensions*

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

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

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

After mediation by the European Union, the parties reached a preliminary ceasefire agreement on 12 August, signed by Georgia and Russia by 16 August, the terms of which called for the prohibition of force, cessation of all military action, full withdrawal of Russian troops to pre-Conflict positions and free access to humanitarian aid. On 26 August 2008, Russia formally recognised the independence of South Ossetia and Abkhazia. On 29 August 2008, Georgia severed direct diplomatic relations with Russia and currently conducts humanitarian discussions via special interest sections at the Swiss Embassy.

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

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

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

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

### *Economic Instability*

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

Over the past five years, the Government has aggressively implemented economic reforms, which have resulted in increasing GDP growth and foreign direct investment ("FDI"), relative stability of the Lari and a stable rate of inflation. The Conflict and global financial crisis has affected Georgia through economic slowdown, as well as a decrease in exports and private capital inflows. Based on preliminary statistics provided by the State Department of Statistics, real GDP growth year-on-year was 2.1% from 2007 to 2008 as compared to 12.3% from 2006 to 2007. FDI in 2008 decreased by 22.4% compared to 2007. Furthermore, in the wake of the global financial crisis, the Lari has depreciated by 17% relative to the U.S. Dollar as a result of the NBG's one-off correction in November 2008, which also resulted in the depreciation of the Lari relative to other major currencies. Although the foreign exchange market stabilised and a portion of donor pledges have been distributed, resulting in greater econominc stability, there can be no assurance that the depreciation of Lari will not continue or that FDI will not decrease further.

Further material depreciation of the Lari relative to the U.S. Dollar, changes in monetary policy, inflation, delays in private capital inflows, reduction of remittances, protracted suspension of trade activities or other factors could adversely affect Georgia's economy in the future and could negatively affect the Bank's business, results of operations, financial condition and prospects.

### *Dependence on Donor Pledges*

On 22 October 2008, the European Commission and World Bank sponsored a Georgia donor's conference in Brussels in order to rally support for Georgia in the wake of the Conflict . At the conference, a total of over US$4.5 billion was pledged to Georgia by the European Community, EU Member States, the United States, Japan, the EBRD, EIB, ADB, World Bank and IFC, among others, with disbursements to be made through 2010. The Georgian banking sector was specifically allocated over US$852 million from total pledges.

The donor money is intended to help stabilise the Georgian economy and in particular, provide funding to the Georgian banking sector. There can be no assurance that Georgia will receive the total amount pledged, or that the donor money will result in the expected improvements to the Georgian economy, which could adversely affect the Georgian economy as a whole and thus the Bank's business.

### *Currency Regulation*

Although the Lari is a fully convertible currency, there is generally no market outside Georgia for the exchange of the Lari. A market exists within Georgia for the conversion of Lari into other currencies, but it is limited in size. According to the NBG, in 2008, the total volume of trading turnover in the Lari-U.S. Dollar market amounted to U.S.$2.25 billion. The exchange rate of the Lari against the U.S. Dollar is fixed at the Tbilisi Interbank Foreign Exchange, which is used to determine the official exchange rate of the Lari against foreign currencies. According to the NBG, the NBG had in excess of U.S.$ 1.5 billion worth of currency reserves as at 31 December 2008. While the Government believes that the reserves will be sufficient to sustain the domestic currency market in the short-term, there can be no assurance that a relatively stable market will continue indefinitely and a lack of growth of this currency market may hamper the development of Georgia's economy, negatively affect the Bank's business and the businesses of its corporate clients, and in turn, the Bank's business, results of operations, financial condition and prospects.

### *Developing Legal Systems*

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

In addition, the court system is understaffed and under-funded, and judges and courts in Georgia are generally inexperienced in the area of business and corporate law. Most court decisions are not readily available to the public, and enforcement of court judgments can, in practice, be difficult in Georgia. The uncertainties of the Georgian judicial system could have a negative effect on the economy and the Bank's ability to operate in Georgia could be adversely affected by difficulties in protecting and enforcing its rights and by future changes to local laws and regulations. Similar risks are characteristic of the Ukrainian and Belarus legal systems.

### *Risks Related to Money Laundering and/or Terrorist Financing*

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

### *Uncertainties of Tax Systems*

In the Principal Markets, tax laws have not been in force for significant periods of time, compared to more developed market economies, and often result in unclear or non-existent implementing regulations. Moreover, such tax laws are subject to frequent changes and amendments, which can result in unusual complexities for the Bank and its business generally. Differing opinions regarding the interpretation of various provisions exist both among and within governmental ministries and organisations, including the tax authorities, creating uncertainties, inconsistencies and areas of conflict. While the Bank believes that it is currently in compliance with the tax laws affecting its operations, it is possible that the relevant authorities could take differing positions with regard to interpretative issues, which may result in the Bank facing tax adjustments and/or fines.

### *Statistical Information*

A range of ministries and institutions, including the State Department of Statistics, the Ministry of Finance, the NBG and the Ministry of Economic Development, produce statistics relating to Georgia and its economy. Georgia adheres to the IMF General Data Dissemination Standards. However, these statistics may be more limited in scope and published less frequently than in the case of other countries such that adequate monitoring of key fiscal and economic indicators may be difficult. Statistical data appearing in this Prospectus has, unless otherwise stated, been obtained from public sources and documents. Similar statistics may be obtainable from other sources, but the underlying assumptions, methodology and, consequently, the resulting data may vary from source to source.

### *Possible Non-enforceability of Foreign Judgments and Arbitral Awards*

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

Generally, foreign court judgments are recognised and enforceable in Georgia unless there is a pending case on the same matter in Georgian courts, the courts of the country rendering the judgment do not recognise the judgments of Georgian courts, the judgment contradicts basic legal principles of Georgia, or one of several other conditions is not satisfied. No treaty exists between Georgia and most Western jurisdictions (including the United Kingdom and the United States) for the reciprocal enforcement of foreign court judgments, which may require new proceedings to be brought in Georgia in respect of a judgment already obtained in any such jurisdiction against Bank of Georgia or its directors or executive officers. In addition, Georgian courts have limited experience in the enforcement of foreign court judgments. The limitations described above, including the general procedural grounds set out in Georgian legislation for the refusal to recognise and enforce foreign court judgments in Georgia, may significantly delay the enforcement of any such judgment, or potentially deprive an interested party of effective legal recourse for claims.

Holders of GDRs may enforce their rights by arbitration. Georgia is a party to the New York Convention. Therefore, an arbitral award obtained in a country which is also a party to the New York Convention, such as the United Kingdom, would be enforceable in Georgia, subject to the terms of the New York Convention, compliance with the Law of Georgia on Arbitration, the Georgian civil procedure regulations and other procedures, and requirements established by Georgian legislation. However, it may be difficult in practice to enforce arbitral awards in Georgia due to a number of factors, including the lack of experience of Georgian courts in international commercial transactions, certain procedural ambiguities, official and unofficial political resistance to enforcement of awards against Georgian companies in favour of foreign investors and Georgian courts' inability to enforce such orders, thereby introducing delay and unpredictability into the process of enforcing any foreign judgment or any foreign arbitral award in Georgia.

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

### *Volatility of the Trading Market*

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

# Directors' Responsibility Statement

We hereby confirm that to the best of our knowledge:

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

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

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

Irakli Gilauri

Chief Executive Officer

28 April 2009

# Forward-Looking Statements

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

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

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

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

საქართველოს ბანკი
BANK OF GEORGIA

# BANK OF GEORGIA SUPERVISORY AND MANAGEMENT BOARD

*Nicholas Enukidze,*
*Chairman of the Supervisory Board*
*since February 2008*

*Allan Hirst,*
*Vice Chairman of the Supervisory Board*
*since February 2008; member since November 2006*

*Ian Hague,*
*Member of the Supervisory Board*
*since December 2004*

*Jyrkie Talvitie,*
*Member of the Supervisory Board*
*since May 2006*

*Kaha Kiknavelidze,*
*Member of the Supervisory Board*
*since February 2008*

*Irakli Gilauri,*
*Chief Executive Officer*

*George Chiladze,*
*Chief Financial Officer*

*Avto Namicheishvili,*
*Deputy Chief Executive Officer, Legal Affairs*

*Murtaz Kikoria,*
*Deputy Chief Executive Officer, Compliance*

*Ramaz Kukuladze,*
*Deputy Chief Executive Officer, Corporate Banking*

*Sulkhan Gvalia,*
*Deputy Chief Executive Officer, Risk Management*

*Mikheil Gomarteli,*
*Deputy Chief Executive Officer, Retail Banking*
*since February 2009*

საქართველოს ბანკი
BANK OF GEORGIA

# JSC Bank of Georgia and Subsidiaries Consolidated Financial Statement

*Year Ended 31 December 2008 Together with Independent Auditor's Report*

## CONTENTS

## INDEPENDENT AUDITORS' REPORT



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Ernst & Young Audit LLC
Kote Abkhazi Street, 44
Tbilisi, 0105, Georgia

Tel: +995 (32) 43 9375
Fax: +995 (32) 43 9376
www.ey.com/georgia

შპს ერნსტ ენდ იანგ აუდიტი
საქართველო, 0105 თბილისი
კოტე აფხაზის ქუჩა 44

ტელ: +995 (32) 439 375
ფაქსი: +995 (32) 439 376

*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 2008, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

31 March 2009

ERNST & YOUNG LLC

## CONSOLIDATED BALANCE SHEET

As of 31 December 2008
(Thousands of Georgian Lari)

| | Notes | 2008 | 2007 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 7 | 397,591 | 405,770 |
| Amounts due from credit institutions | 8 | 99,633 | 154,560 |
| Loans to customers | 9 | 2,039,022 | 1,675,681 |
| Finance lease receivables | 10 | 41,605 | 46,674 |
| Investment securities: | | | |
| - available–for-sale | 11 | 33,737 | 42,387 |
| - held–to-maturity | 11 | 22,845 | 192,464 |
| Investments in associates | 12 | 16,716 | 5,208 |
| Investment properties | 13 | 47,289 | 35,065 |
| Property and equipment | 14 | 301,784 | 204,656 |
| Goodwill and other intangible assets | 15 | 152,459 | 115,989 |
| Current and deferred income tax assets | 16 | 12,786 | 1,557 |
| Prepayments | | 18,319 | 5,942 |
| Other assets | 18 | 75,121 | 67,658 |
| **Total assets** | | **3,258,907** | **2,953,611** |
| **Liabilities** | | | |
| Amounts due to credit institutions | 19 | 1,216,722 | 901,795 |
| Amounts due to customers | 20 | 1,193,124 | 1,355,476 |
| Current and deferred income tax liabilities | 16 | 24,394 | 37,209 |
| Provisions | 17,22 | 4,263 | 1,003 |
| Other liabilities | 18 | 101,555 | 100,137 |
| **Total liabilities** | | **2,540,058** | **2,395,620** |
| **Equity** | 21 | | |
| Share capital | | 31,253 | 27,155 |
| Additional paid-in capital | | 468,732 | 315,415 |
| Treasury shares | | (2,018) | (1,737) |
| Other reserves | | 26,201 | 67,354 |
| Retained earnings | | 141,491 | 136,342 |
| **Total equity attributable to shareholders of the Bank** | | **665,659** | **544,529** |
| Minority interests | | 53,190 | 13,462 |
| **Total equity** | | **718,849** | **557,991** |
| **Total liabilities and equity** | | **3,258,907** | **2,953,611** |

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

Irakli Gilauri — Chief Executive Officer

David Vakhtangishvili — Chief Financial Officer

31 March 2009

*The accompanying notes on pages 5 to 69 are an integral part of these consolidated financial statements.*

## CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2008
(Thousands of Georgian Lari)

| | Notes | 2008 | 2007 |
|---|---|---|---|
| **Interest income** | | | |
| Loans to customers | | 363,013 | 203,759 |
| Investment securities - held-to-maturity | | 16,457 | 23,394 |
| Amounts due from credit institutions | | 10,732 | 9,942 |
| Finance lease receivables | | 7,010 | 4,136 |
| Investment securities – available-for-sale | | 6,727 | 1,073 |
| | | **403,939** | **242,304** |
| **Interest expense** | | | |
| Amounts due to credit institutions | | (97,035) | (58,072) |
| Amounts due to customers | | (85,358) | (53,419) |
| Debt securities issued | | (706) | (594) |
| | | **(183,099)** | **(112,085)** |
| **Net interest income before impairment charge on interest-earning assets** | | **220,840** | **130,219** |
| Impairment charge on loans to customers | 9 | (122,812) | (17,409) |
| Impairment charge on finance lease receivables | 10 | (1,335) | (708) |
| **Net interest income after impairment charge** | | **96,693** | **112,102** |
| Fee and commission income | | 63,503 | 48,358 |
| Fee and commission expense | | (13,534) | (6,610) |
| **Net fee and commission income** | 23 | **49,969** | **41,748** |
| Net (losses) gains from for trading securities | | (5,447) | 2,930 |
| Net gains from investment securities available-for-sale | 21 | 513 | 2,481 |
| Net (losses) gains from revaluation of investment properties | 13 | (389) | 16,362 |
| Net gains from foreign currencies: | | | |
| - dealing | | 39,443 | 22,395 |
| - translation differences | | 7,691 | 4,315 |
| Net insurance premiums earned | 24 | 35,911 | 14,260 |
| Share of (loss) profit of associates | 12 | (713) | 137 |
| Other operating income | | 14,747 | 9,766 |
| **Other non-interest income** | | **91,756** | **72,646** |
| Salaries and other employee benefits | 25 | (108,767) | (75,639) |
| General and administrative expenses | 25 | (68,649) | (36,164) |
| Depreciation, amortization and impairment | 14, 15 | (20,532) | (9,863) |
| Net insurance claims incurred | 24 | (26,895) | (8,799) |
| Impairment (charge) reversal on other assets and provisions | 17 | (4,551) | 365 |
| Other operating expenses | | (9,828) | (6,684) |
| **Other non-interest expenses** | | **(239,222)** | **(136,784)** |
| **(Loss) profit before income tax benefit (expense)** | | **(804)** | **89,712** |
| Income tax benefit (expense) | 16 | 978 | (14,070) |
| **Profit for the year** | | **174** | **75,642** |
| **Attributable to:** | | | |
| - shareholders of the Bank | | 3,897 | 72,484 |
| - minority interests | | (3,723) | 3,158 |
| | | **174** | **75,642** |
| **Earnings per share:** | 21 | | |
| - basic earnings per share | | 0.129 | 2.958 |
| - diluted earnings per share | | 0.129 | 2.947 |

*The accompanying notes on pages 5 to 69 are an integral part of these consolidated financial statements.*

2

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2008

(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 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 properties, net of tax | – | – | – | 59,295 | – | 59,295 | 964 | 60,259 |
| Increase in share capital arising from share-based payments (Note 21) | 146 | 948 | – | – | – | 1,094 | – | 1,094 |
| Depreciation of revaluation reserve, net of | – | – | – | (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 21) | 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 | – | – | – | – | – | – | 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** |
| Net change in investment securities available-for-sale, net of tax | – | – | – | (8,670) | – | (8,670) | – | (8,670) |
| Revaluation of property and equipment, | – | – | – | (8,796) | – | (8,796) | – | (8,796) |
| Issuance of shares arising from business combination (Note 21) | 89 | 573 | – | – | – | 662 | | 662 |
| Increase in share capital arising from share-based payments (Note 21) | 9 | 8,590 | 341 | – | – | 8,940 | – | 8,940 |
| Depreciation of revaluation reserve, net of tax | – | – | – | (1,252) | 1,252 | – | – | – |
| Share offering costs adjustment | – | (357) | – | – | – | (357) | – | (357) |
| Currency translation differences | – | – | – | (22,435) | – | (22,435) | – | (22,435) |
| **Total income and expenses recognised directly in equity** | **98** | **8,806** | **341** | **(41,153)** | **1,252** | **(30,656)** | **–** | **(30,656)** |
| 2008 profit | – | – | – | – | 3,897 | 3,897 | (3,723) | 174 |
| **Total income and expenses for the year** | **98** | **8,806** | **341** | **(41,153)** | **5,149** | **(26,759)** | **(3,723)** | **(30,482)** |
| Increase in share capital from issuance of GDRs (Note 21) | 4,000 | 146,594 | – | – | – | 150,594 | – | 150,594 |
| Acquisition of additional interests in existing subsidiaries by minority shareholders | – | – | – | – | – | – | 31,278 | 31,278 |
| Minority interests arising on acquisition of | – | – | – | – | – | – | 12,173 | 12,173 |
| Sale of treasury shares | – | 5,544 | 256 | – | – | 5,800 | – | 5,800 |
| Purchase of treasury shares | – | (7,627) | (878) | – | – | (8,505) | – | (8,505) |
| **31 December 2008** | **31,253** | **468,732** | **(2,018)** | **26,201** | **141,491** | **665,659** | **53,190** | **718,849** |

*The accompanying notes on pages 5 to 69 are an integral part of these consolidated financial statements.*

## CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2008
(Thousands of Georgian Lari)

| | Notes | 2008 | 2007 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Interest received | | 384,802 | 234,083 |
| Interest paid | | (173,534) | (88,027) |
| Fees and commissions received | | 63,503 | 48,357 |
| Fees and commissions paid | | (13,534) | (6,608) |
| Net realized (losses) gains from trading securities | | (5,432) | 2,764 |
| Net realized gains from investments securities | | 498 | 2,481 |
| Net realized gains from foreign currencies | | 39,443 | 22,395 |
| Recoveries of loans to customers | 9 | 11,176 | 7,918 |
| Insurance premiums received | | 24,262 | 19,336 |
| Insurance claims paid | | (11,095) | (6,554) |
| Other operating income received | | 11,499 | 9,504 |
| Salaries and other employee benefits paid | | (106,605) | (53,838) |
| General and administrative and operating expenses paid | | (62,174) | (41,298) |
| **Cash flows from operating activities before changes in operating assets and liabilities** | | **162,809** | **150,513** |
| *Net (increase) decrease in operating assets* | | | |
| Amounts due from credit institutions | | 62,312 | (82,753) |
| Loans to customers | | (488,574) | (774,471) |
| Finance lease receivables | | 3,722 | (38,078) |
| Prepayments and other assets | | (3,678) | (17,672) |
| *Net increase (decrease) in operating liabilities* | | | |
| Amounts due to credit institutions | | 339,654 | 604,576 |
| Amounts due to customers | | (211,774) | 537,984 |
| Other liabilities | | (9,813) | 2,970 |
| **Net cash flows (used in) from operating activities before income tax** | | **(145,342)** | **383,069** |
| Income tax paid | | (19,580) | (3,854) |
| **Net cash (used in) from operating activities** | | **(164,922)** | **379,215** |
| **Cash flows from investing activities** | | | |
| Acquisition of subsidiaries, net of cash acquired | 5 | (41,740) | (12,256) |
| Proceeds from sale of investment securities | | 166,175 | – |
| Purchase of investment securities | | – | (11,838) |
| Purchase of investments in associates | 12 | (13,355) | (5,275) |
| Proceeds from sale of investments in associates | 12 | 860 | 700 |
| Purchase of investment properties | 13 | (12,613) | (10,499) |
| Purchase of property and equipment and intangible assets | 14,15 | (122,881) | (74,238) |
| **Net cash used in investing activities** | | **(23,554)** | **(113,406)** |
| **Cash flows from financing activities** | | | |
| Proceeds from increase in share capital | | 150,594 | 38,908 |
| Purchase of treasury shares | | (8,505) | (11,728) |
| Sale of treasury shares | | 5,800 | 9,600 |
| Purchase of additional interests by minority shareholders | | 31,794 | 3,494 |
| Purchase of additional interests in existing subsidiaries, net of cash acquired | | – | 303 |
| Proceeds from debt securities issued | | – | (9,045) |
| Redemption of debt securities issued | | (4,988) | 49 |
| **Net cash from financing activities** | | **174,695** | **31,581** |
| Effect of exchange rates changes on cash and cash equivalents | | 5,602 | 335 |
| **Net (decrease) increase in cash and cash equivalents** | | **(8,179)** | **297,725** |
| **Cash and cash equivalents, beginning** | | **405,770** | **108,045** |
| **Cash and cash equivalents, ending** | 7 | **397,591** | **405,770** |

*The accompanying notes on pages 5 to 69 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 ("JSC") under the laws of Georgia, and was formerly known as State Bank Binsotsbanki. The Bank operates under a general banking license issued by the National Bank of Georgia ("NBG"; the Central Bank of Georgia) on 15 December 1994. The Bank is the ultimate parent of a group of companies (the "Group") incorporated in Georgia, Ukraine, Belarus, Cyprus, Moldova and Azerbaijan, 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 2008 the Bank has 151 operating outlets in all major cities of Georgia (2007: 117). The Bank's registered legal address is 3 Pushkin Street, Tbilisi 0105, Georgia.

As of 31 December 2008 and 2007 the following shareholders owned more than 4% of the outstanding shares of the Bank. Other shareholders individually owned less than 4% of the outstanding shares.

| **Shareholder** | *31 December 2008, %* | *31 December 2007, %* |
|---|---|---|
| Bank of New York (Nominees), Limited | 77.45% | 71.38% |
| Firebird Avrora Fund | 4.68% | 5.39% |
| Firebird Republics Fund | 4.58% | 5.27% |
| East Capital Financial Institutions | 4.37% | 5.03% |
| Others (less than 5% individually) | 8.92% | 12.93% |
| **Total** | **100.00%** | **100.00%** |

As of 31 December 2008, the members of the Supervisory Board and Board of Directors owned 468,827 shares and Global Depositary Receipts ("GDRs") (1.500%; 2007: 214,146 shares and GDRs 0.787%) of the Bank. Interests of the members of the Supervisory Board and Management Board were as follows:

| **Shareholder** | *31 December 2008, shares held* | *31 December 2007, shares held* |
|---|---|---|
| Sulkhan Gvalia | 166,907 | 188,050 |
| Irakli Gilauri | 136,303 | 1,587 |
| Nicholas Enukidze | 75,377 | 1,045 |
| Ramaz Kukuladze | 52,092 | 23,094 |
| Avto Namicheishvili | 12,489 | – |
| Allan Hirst | 10,685 | – |
| Irakli Burdiladze | 10,036 | 370 |
| Kakha Kiknavelidze | 4,938 | – |
| **Total** | **468,827** | **214,146** |

In addition to shares held, the members of the Supervisory Board and Management Board were awarded 198,139 and 244,617 Global Depository Receipts ("GDR") in 2008 and 2007, respectively. The awards are subject to three-year vesting. As of 31 December 2008 313,330 GDRs owned by the members of the Supervisory Board and Management Board vested and comprised as follows (in 2007: 31,665):

| **Member of the Supervisory Board and/or Management Board** | *31 December 2008, GDRs vested* | *31 December 2007, GDRs vested* |
|---|---|---|
| Irakli Gilauri | 134,716 | 16,666 |
| Nicholas Enukidze | 74,332 | – |
| Ramaz Kukuladze | 52,092 | 1,666 |
| Sulkhan Gvalia | 26,857 | 13,333 |
| Avto Namicheishvili | 11,667 | – |
| Irakli Burdiladze | 9,666 | – |
| Kakha Kiknavelidze | 4,000 | – |
| **Total** | **313,330** | **31,665** |

## 2. Basis of Preparation

### General

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

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

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

### Subsidiaries

The consolidated financial statements as of 31 December 2008 and 2007 include the following direct and indirect subsidiaries:

| | *Ownership / voting, %* | | | | | |
|---|---|---|---|---|---|---|
| **Subsidiaries** | *December 31, 2008* | *December 31, 2007* | *Country of incorporation* | *Industry* | *Date of incorporation* | *Date of acquisition* |
| JSC BG Bank (formerly known as United Bank of Development and Partnership) | 99.4% | 98.8% | Ukraine | Banking | 26/01/1994 | 01/10/2007 |
| Valimed, LLC | 100.0% | - | Belarus | Investment | 14/09/2000 | 03/06/2008 |
| ⇒ JSC Belaruskiy Narodniy Bank | 70.0% | - | Belarus | Banking | 16/04/1992 | 03/06/2008 |
| ⇒ BNB Leasing, LLC | 76.0% | - | Belarus | Leasing | 30/03/2006 | 03/06/2008 |
| JSC Galt and Taggart Securities | 100.0% | 100.0% | Georgia | Brokerage and asset management | 19/12/1995 | 28/12/2004 |
| ⇒ JSC Caucasus Energy and Infrastructure | (c) | 100.0% | Georgia | Investment | 07/06/2007 | - |
| ⇒ Galt &Taggart Tax Advisory, LLC | 100.0% | 100.0% | Georgia | Tax consulting | 25/09/2007 | - |
| ⇒ Galt and Taggart Holdings Limited | 100.0% | 100.0% | Cyprus | Investment | 03/07/2006 | - |
| ⇒ Galt &Taggart Trading Limited | 100.0% | 100.0% | Cyprus | Investment | 26/03/2007 | - |
| ⇒ JSC Galt and Taggart Securities, SA (Moldova) | 95.1% | - | Moldova | Investment | 07/07/2008 | - |
| ⇒ Galt and Taggart Securities (Ukraine), LLC | 100.0% | 100.0% | Ukraine | Brokerage | 23/10/2006 | - |
| ⇒ Galt and Taggart Securities (Belarus), LLC | 100.0% | - | Belarus | Brokerage | 19/02/2008 | - |
| ⇒ Brooksby Investments Limited | 100.0% | - | Cyprus | Investments | 04/03/2008 | 18/06/2008 |
| ⇒ Galt&Taggart Securities MMC, LLC | 75.0% | - | Azerbaijan | Investment banking and brokerage services | 30/06/2008 | - |
| ⇒ GTAM Limited | 80.0% | 80.0% | Cyprus | Investment activity | 23/10/2007 | - |
| ⇒ Galt and Taggart Asset Management, LLC | 100.0% | 100.0% | Georgia | Asset management | 31/05/2007 | - |
| ⇒ JSC Belorussian Investments | 100.0% | - | Georgia | Consumer goods production & distribution | 14/05/2008 | - |
| ⇒ JSC Liberty Financial Opportunities | 100.0% | - | Georgia | Investment | 03/09/2008 | - |
| ⇒ JSC Galt and Taggart Holdings | 100.0% | - | Georgia | Investment | 04/11/2008 | - |

(Thousands of Georgian Lari)

## 2. Basis of Preparation (continued)

**Subsidiaries (continued)**

| Subsidiaries | Ownership / voting, % 'December 31, 2008 | 'December 31, 2007 | Country of incorporation | Industry | Date of incorporation | Date of acquisition |
|---|---|---|---|---|---|---|
| JSC Liberty Consumer (formerly JSC Galt and Taggart Capital) | 65.4% | 71.6% | Georgia | Investment | 24/05/2006 | - |
| ⇒ JSC SB Real Estate | 52.1% | 100.0% | Georgia | Real estate | 27/09/2006 | - |
| ⇒ Vere+, LLC | 100.0% | 100.0% | Georgia | Real estate | 22/05/1996 | 06/02/2007 |
| ⇒ Alegro, LLC | 100.0% | - | Georgia | Commercial | 09/09/1996 | 12/03/2008 |
| ⇒ JSC SB Outdoor & Indoor | 100.0% | 100.0% | Georgia | Advertising | 09/06/2006 | - |
| ⇒ Intertour, LLC | 83.6% | 83.6% | Georgia | Travel agency | 29/03/1996 | 25/04/2006 |
| ⇒ Holiday Travel, LLC | 100.0% | 100.0% | Georgia | Travel agency | 11/02/2005 | 04/09/2006 |
| ⇒ JSC Prime Fitness | 100.0% | 100.0% | Georgia | Fitness centre | 03/07/2006 | - |
| ⇒ MetroNet, LLC | 100.0% | 100.0% | Georgia | Communication services | 23/04/2007 | - |
| ⇒ SB Transport, LLC | 100.0% | 100.0% | Georgia | Transportation | 20/02/2007 | - |
| ⇒ Real Estate Brokerage-Presto, LLC | 100.0% | 100.0% | Georgia | Real estate brokerage | 16/11/2007 | - |
| ⇒ JSC SB Immobiliare | 100.0% | - | Georgia | Real estate, Construction | 12/03/2008 | - |
| JSC Insurance Company Aldagi BCI | 100.0% | 100.0% | Georgia | Insurance | 22/06/2007 | - |
| ⇒ JSC My Family Clinic | 100.0% | 100.0% | Georgia | Healthcare | 03/10/2005 | - |
| ⇒ JSC Kutaisi St. Nicholas Surgery Hospital | 55.0% | - | Georgia | Medical | 03/11/2000 | 20/05/2008 |
| Georgian Leasing Company, LLC | 100.0% | 100.0% | Georgia | Leasing | 29/10/2001 | 31/12/2004 |
| ⇒ JSC DBL.ge | 100.0% | 100.0% | Georgia | Investment | 23/04/2007 | - |
| ⇒ JSC DBL Capital | 100.0% | 100.0% | Georgia | Brokerage | 27/04/2007 | - |
| ⇒ Tavazi, LLC | (b) | 100.0% | Georgia | Brokerage | 31/03/2001 | 20/04/2006 |
| ⇒ Hedji, LLC | (b) | 100.0% | Georgia | Brokerage | 22/05/2002 | 17/04/2006 |
| ⇒ Georgian Securities, LLC | (b) | 100.0% | Georgia | Brokerage | 19/06/2000 | 08/10/2007 |
| ⇒ Georgian Brokers Company, LLC | (b) | 100.0% | Georgia | Brokerage | 23/06/1999 | 21/12/2006 |
| GC Holdings, LLC | 100.0% | 100.0% | Georgia | Investment | 29/10/2007 | - |
| ⇒ GC Ukraine, LLC | 100.0% | - | Ukraine | Card processing | 30/07/2008 | - |
| ⇒ JSC Georgian Card | 55.7% | 55.7% | Georgia | Card processing | 17/01/1997 | 20/10/2004 |
| ⇒ JSC Nova Technology | 51.0% | 51.0% | Georgia | Electronic payment services | 19/03/2007 | 11/11/2007 |
| ⇒ Direct Debit Georgia, LLC | 100.0% | 100.0% | Georgia | Electronic payment services | 07/03/2006 | - |
| JSC United Securities Registrar of Georgia | 100.0% | - | Georgia | Registrar | 29/05/2006 | - |
| ⇒ JSC SB Reestri | (a) | 100.0% | Georgia | Registrar | 29/05/2006 | - |
| ⇒ United Securities Registrar of Georgia, LLC | (a) | 100.0% | Georgia | Registrar | 25/01/1999 | 30/09/2006 |
| Club 24, LLC | 100.0% | 100.0% | Georgia | Entertainment | 27/11/2007 | - |
| JSC SB Trade | 100.0% | 100.0% | Georgia | Import and distribution | 26/02/2007 | - |
| Metro Service +, LLC | 100.0% | 100.0% | Georgia | Business servicing | 10/05/2006 | - |
| JSC Galt and Taggart Bank | (d) | 100.0% | Georgia | Banking | 30/12/1996 | 31/05/2007 |

(a) United Securities Registrar of Georgia, LLC (subsidiary) merged with JSC SB Reestri (parent) in 2008. Name of JSC SB Reestri was changed to JSC United Securities Registrar of Georgia
(b) Merged with JSC DBL Capital in 2008
(c) No longer Group subsidiary due to sale in 2008
(d) Merged with JSC Bank of Georgia in 2008

## 3. Summary of Significant Accounting Policies

**Adoption of new or revised standards and interpretations**

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

*Reclassification of Financial Assets – Amendments to IAS 39 "Financial instruments: Recognition and measurement" and IFRS 7 "Financial instruments: Disclosures"*

Amendments to IAS 39 and IFRS 7 were issued on 13 October 2008 and allow reclassification of non-derivative financial assets out of the held for trading category in particular circumstances. The amendments also allow transfer of certain financial assets from the available-for-sale category to loans and receivables category. The effective date of those amendments is 1 July 2008. Any reclassification made in periods beginning on or after 1 November 2008 shall take effect only from the date when the reclassification is made.

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- a financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Group has the intention and ability to hold it for the foreseeable future or until maturity;
- other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available-for-sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Group has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.

The Group did not reclassify any financial assets from held for trading or available-for-sale categories and hence these amendments did not have any impact on the financial position or performance of the Group.

*IFRIC 11 "IFRS 2 - Group and Treasury Share Transactions"*

IFRIC Interpretation 11 became effective for annual periods beginning on or after 1 March 2007 and requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed. This Interpretation has no impact on the Group.

*IFRIC 14 "IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction"*

IFRIC Interpretation 14 was issued in July 2007 and became effective for annual periods beginning on or after 1 January 2008. This Interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognized as an asset under IAS 19 Employee Benefits. This Interpretation has no impact on the financial position or performance of the Group.

(Thousands of Georgian Lari)

## 3. Summary of Significant Accounting Policies (continued)

### Reclassifications

The following reclassifications were made to 2007 balances to conform to 2008 presentation requirements:

| Caption | As previously reported | As reclassified | Comment |
|---|---|---|---|
| **Consolidated balance sheet:** | | | |
| Trading securities | 6,342 | – | Reclassified to Other Assets due to immaterial balance |
| Other assets | 61,316 | 67,658 | Included Trading Securities |
| Debt securities issued | 4,993 | – | Reclassified to Other Liabilities due to immaterial balance |
| Other liabilities | 95,144 | 100,137 | Included Debt Securities Issued |
| **Consolidated income statement:** | | | |
| Impairment charge on finance lease receivables | – | (708) | Presented separately from Other Operating Expenses due to increased exposure of credit risks associated with impairment of finance lease receivables |
| Other operating expenses | (7,392) | (6,684) | Reclassified and shown separately Impairment Charge on Finance Lease Receivables |
| Share of (loss) profit of associates | – | 137 | Presented separately from Other Operating Income due to increased significance of the amount |
| Other operating income | 9,903 | 9,766 | Reclassified and shown separately Share of (Loss) Profit of Associates |

* Risk management disclosures for 2007 have been updated respectively, as well.

### 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.

## 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.

## 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 income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

*Available-for-sale financial assets*

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for sale financial assets are measured at fair value with 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 central banks, excluding obligatory reserves with central banks, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

## 3. Summary of Significant Accounting Policies (continued)

**Derivative financial instruments**

In the normal course of business, the Group enters into various derivative financial instruments including forwards 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 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.

## 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.

## 3. Summary of Significant Accounting Policies (continued)

**Impairment of financial assets (continued)**

*Held-to-maturity financial investments*

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

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

*Available-for-sale financial assets*

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.

## 3. Summary of Significant Accounting Policies (continued)

**De-recognition of financial assets and liabilities (continued)**

*Financial liabilities*

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

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

**Financial guarantees**

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

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

**Taxation**

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

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

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

**Investment properties**

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

## 3. Summary of Significant Accounting Policies (continued)

**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 income statement. A revaluation deficit is recognised in the consolidated income statement, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

An annual transfer from the revaluation reserve for property and equipment to retained earnings is made for the difference between depreciation based on the 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.

## 3. Summary of Significant Accounting Policies (continued)

### Goodwill (continued)

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.

### Other intangible assets

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

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

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

## 3. Summary of Significant Accounting Policies (continued)

**Insurance and reinsurance receivables**

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

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

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

**Insurance liabilities**

*General insurance liabilities*

General insurance contract liabilities are based on the estimated ultimate cost of all claims incurred but not settled at the 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.

## 3. Summary of Significant Accounting Policies (continued)

**Share-based payment transactions**

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

*Equity-settled transactions*

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

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

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

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

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

**Share capital**

*Share capital*

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

*Treasury shares*

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

*Dividends*

Dividends are recognised as a liability and deducted from equity at the 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.

## 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.

## 3. Summary of Significant Accounting Policies (continued)

**Income and expense recognition**

*Insurance premium income*

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

*Insurance claims*

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

**Functional and reporting currencies and foreign currency translation**

The consolidated financial statements are presented in Georgian Lari, which is the Bank's presentation currency. The Bank's functional currency is US Dollar effective 1 January 2007. Prior to 1 January 2007, Georgian Lari was its functional currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into functional currency at functional currency rate of exchange ruling at the 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 2008 and 2007 were 1.6670 and 1.5916 Lari to USD 1 and 2.3648 and 2.3315 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.

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

**Standards and interpretations that are issued but not yet effective**

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

*Improvements to IFRS*

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

## 3. Summary of Significant Accounting Policies (continued)

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

*IAS 1 Presentation of Financial Statements (Revised)*

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

*IAS 23 "Borrowing Costs"(Revised)*

A revised IAS 23 Borrowing costs was issued in March 2007, and becomes effective for financial years beginning on or after 1 January 2009. The standard has been revised to require capitalisation of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the Standard, the Group 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.

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

These amendments were issued in February 2008, and become effective for annual periods beginning on or after 1 January 2009. The amendments require puttable instruments that represent a residual interest in an entity to be classified as equity, provided they satisfy certain conditions. These amendments will have no impact on the Group.

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

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

*Amendments to IFRS 1 "First-time Adoption of IFRSs" and IAS 27 "Consolidated and Separate Financial Statements" - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*

These amendments were issued in May 2008, and become effective for annual periods beginning on or after 1 January 2009. The revision to IAS 27 will have to be applied prospectively. The amendments to IFRS 1 allow an entity to determine the cost of investments in a subsidiary, jointly controlled entity or associate in its opening IFRS financial statements in accordance with IAS 27 or using a deemed cost. The amendment to IAS 27 requires all dividends from a subsidiary, jointly controlled entity or associate to be recognized in the income statement in the separate financial statements. The new requirements affect only the parent's separate financial statements and do not have an impact on the consolidated financial statements.

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

Amendment to IFRS 2 were issued in January 2008 and become effective for annual periods beginning on or after 1 January 2009. This amendment clarifies the definition of vesting conditions and prescribes the accounting treatment of an award that is effectively cancelled because a non-vesting condition is not satisfied. This amendment will have no impact on the financial position or performance of the Group.

## 3. Summary of Significant Accounting Policies (continued)

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

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

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

*IFRS 8 "Operating Segments"*

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

*IFRIC 13 "Customer Loyalty Programmes"*

IFRIC Interpretation 13 was issued in June 2007 and becomes effective for annual periods beginning on or after 1 July 2008. This Interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. The Group expects that this interpretation will have no impact on the Group's financial statements as no such schemes currently exist.

*IFRIC 15 "Agreements for the Construction of Real Estate"*

IFRIC Interpretation 15 was issued in July 2008 and is applicable retrospectively for annual periods beginning on or after 1 January 2009. IFRIC 15 clarifies when and how revenue and related expenses from the sale of a real estate unit should be recognized if an agreement between a developer and a buyer is reached before the construction of the real estate is completed. The interpretation also provides guidance on how to determine whether an agreement is within the scope of IAS 11 "Construction Contracts" or IAS 18 "Revenue" and supersedes the current guidance for real estate in the Appendix to IAS 18. The Group expects that this interpretation will have no impact on the Group's financial statements.

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

IFRIC Interpretation 16 was issued in July 2008 and is applicable for annual periods beginning on or after 1 October 2008. This Interpretation provides guidance on identifying the foreign currency risks that qualify for hedge accounting in the hedge of net investment, where within the group the hedging instrument can be held and how an entity should determine the amount of foreign currency gain or loss, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment. The Group expects that this interpretation will have no impact on the Group's financial statements.

*IFRIC 17 "Distribution of Non-Cash Assets to Owners"*

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

## 3. Summary of Significant Accounting Policies (continued)

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

*IFRIC 18 Transfers of Assets from Customers*

IFRIC 18 was issued in January 2009 and becomes effective for financial years beginning on or after 1 July 2009 with early application permitted, provided valuations were obtained at the date those transfers occurred. This interpretation should be applied prospectively. IFRIC 18 provides guidance on accounting for agreements in which an entity receives from a customer an item of property, plant and equipment that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services or to do both. The interpretation clarifies the circumstances in which the definition of an asset is met, the recognition of the asset and its measurement on initial recognition, the identification of the separately identifiable services, the recognition of revenue and the accounting for transfers of cash from customers. The Group expects that his interpretation will have no impact on the Group's financial statements.

*Amendments to IFRS 7 "Improving Disclosures about Financial Instruments"*

Amendments to IFRS 7 "Improving Disclosures about Financial Instruments" were issued in March 2009 and become effective for periods beginning on or after 1 January 2009 with early application permitted. These Amendments introduce a three-level fair value disclosure hierarchy that distinguishes fair value measurements by the significance of the inputs used. In addition, the amendments enhance disclosure requirements on the nature and extent of liquidity risk arising from financial instruments to which an entity is exposed. The Group expects that his interpretation will have no impact on the Group's financial statements.

## 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 and finance lease receivables*

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

*Contingent liabilities*

The Group is subject to the possibility of various loss contingencies arising in the ordinary course of business. The Group considers the likelihood of the loss or the incurrence of a liability as well as its ability to reasonably estimate the amount of loss in determining loss contingencies. An estimated loss contingency is accrued when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Group regularly evaluates current information available to determine whether such accruals are required. As of 31 December 2008, the Group did not record any contingent liabilities.

*Impairment of goodwill*

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

(Thousands of Georgian Lari)

## 4. Significant Accounting Estimates (continued)

**Estimation uncertainty (continued)**

*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 Belarusky Narodny Bank**

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

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

The net cash outflow on acquisition was as follows:

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

(Thousands of Georgian Lari)

## 5. Business Combinations (continued)

**JSC Belarusky Narodny Bank (continued)**

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

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

**JSC Kutaisi St. Nickolas Surgery Clinic**

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

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

The net cash outflow on acquisition was as follows:

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

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

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

(Thousands of Georgian Lari)

## 5. Business Combinations (continued)

**Acquisitions in 2007**

**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 as follows:

| | *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** | |

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.

(Thousands of Georgian Lari)

## 5. Business Combinations (continued)

**Acquisitions in 2007 (continued)**

**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 as follows:

| | *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** |

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.

## 5. Business Combinations (continued)

**Acquisitions in 2007 (continued)**

**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.

## 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 Banking | Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers. |
| Brokerage | Principally providing brokerage, custody and corporate finance services to its individual as well as corporate customers. Brokerage also possesses its own proprietary book for trading as well as for non-trading purposes, comprising primarily of trading and investment securities. |
| Wealth Management | Principally providing wealth management services to VIP individual customers. |
| Asset Management | Principally providing asset management services to VIP corporate customers. |
| Insurance | Principally providing wide-scale insurance services to corporate and individual customers. |
| Corporate Centre | Principally providing back office services to all 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, Management has combined Brokerage, Asset Management 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 Banking | |

Corporate and Investment Banking was renamed into Corporate Banking in 2008.

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.

(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 2008:

| | *Retail banking* | *Corporate banking* | *Brokerage and asset and wealth management* | *Corporate center* | *Insurance* | *Inter – company elimination* | *Total* |
|---|---|---|---|---|---|---|---|
| *Revenue* | | | | | | | |
| External operating income: | | | | | | | |
| Net interest income | 155,290 | 89,724 | 597 | (24,677) | (94) | – | 220,840 |
| Net fees and commission income | 30,317 | 17,047 | 5,684 | 2,259 | (5,338) | – | 49,969 |
| Net foreign currency gains | 3,918 | 7,471 | 3,259 | 32,486 | – | – | 47,134 |
| Other external revenues | 3,862 | 1,181 | (699) | 1,993 | 38,285 | – | 44,622 |
| Operating income from other segments | (744) | (284) | (3,944) | – | (466) | 5,438 | – |
| **Total operating income** | **192,643** | **115,139** | **4,897** | **12,061** | **32,387** | **5,438** | **362,565** |
| Impairment charge on interest earning assets | 57,343 | 62,947 | 1,596 | 7,907 | – | (5,646) | 124,147 |
| *Results* | | | | | | | |
| Segment results | 33,003 | 24,222 | (14,971) | (30,260) | (6,951) | 5,647 | 10,690 |
| Unallocated expenses | | | | | | | (11,494) |
| **Loss before tax benefit** | | | | | | | **(804)** |
| Income tax benefit | | | | | | | 978 |
| **Profit for the year** | | | | | | | **174** |
| **Assets and liabilities** | | | | | | | |
| Segment assets | 1,401,747 | 1,538,783 | 134,974 | 113,061 | 51,377 | 6,179 | 3,246,121 |
| Unallocated assets | | | | | | | 12,786 |
| **Total assets** | | | | | | | **3,258,907** |
| Segment liabilities | 965,078 | 1,275,716 | 135,977 | 80,903 | 57,990 | – | 2,515,664 |
| Unallocated liabilities | | | | | | | 24,394 |
| **Total liabilities** | | | | | | | **2,540,058** |
| **Other segment information** | | | | | | | |
| Capital expenditures: | | | | | | | |
| Property, plant and equipment | 44,403 | 50,971 | 9,073 | 2,601 | 2,834 | – | 109,882 |
| Intangible assets | 6,790 | 5,571 | 387 | 241 | 8 | – | 12,997 |
| Depreciation | 9,263 | 7,583 | 1,388 | 271 | 409 | – | 18,914 |
| Amortization | 993 | 450 | 65 | 80 | 30 | – | 1,618 |

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 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 foreign currency 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** |
| Impairment charge on interest earning assets | (12,338) | (9,696) | (332) | (274) | 4,523 | – | (18,117) |
| *Results* | | | | | | | |
| Segment results | 35,343 | 36,819 | 21,339 | (4,209) | 6,437 | – | 95,729 |
| Unallocated expenses | | | | | | | (6,017) |
| **Profit before tax expense** | | | | | | | **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 |

(Thousands of Georgian Lari)

## 6. Segment Information (continued)

**Secondary segment information – geographical segment**

The Group operates in two main geographical markets: (a) Georgia, and (b) Ukraine, Belarus 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 2008:

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

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* | *Belarus 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 foreign currency 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** |

## 7. Cash and Cash Equivalents

| | *2008* | *2007* |
|---|---|---|
| Cash on hand | 164,463 | 93,710 |
| Current accounts central banks, excluding obligatory reserves | 25,731 | 35,497 |
| Current accounts with other credit institutions | 44,080 | 20,208 |
| Time deposits with credit institutions up to 90 days | 163,317 | 256,355 |
| **Cash and cash equivalents** | **397,591** | **405,770** |

As of 31 December 2008 GEL 222,332 (2007: GEL 207,065) 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 1.16 % interest per annum on these deposits (2007: 2.70%).

(Thousands of Georgian Lari)

## 8. Amounts Due from Credit Institutions

| | *2008* | *2007* |
|---|---|---|
| Obligatory reserves with central banks | 57,891 | 144,631 |
| Time deposits with effective maturity of more than 90 days | 37,414 | 5,838 |
| Inter-bank loan receivables | 4,328 | 4,091 |
| **Amounts due from credit institutions** | **99,633** | **154,560** |

Obligatory reserves with central banks represent amounts deposited with NBG ("National Bank of Georgia"), NBU ("National Bank of Ukraine") and NBB (National Bank of Belarus) relating to daily settlements and other activities. Credit institutions are required to maintain an interest earning cash deposit (obligatory reserve) with central banks, the amount of which depends on the level of funds attracted by the credit institution. The Group's ability to withdraw these deposits is restricted by the statutory legislature. The Group earned up to 2% annual interest on obligatory reserve with NBG in 2008 and 2007.

As of 31 December 2008 GEL 3,913 (2007: GEL 610) was placed on current accounts and inter-bank deposits with three (2006: two) internationally recognised OECD banks. Those amounts were pledged to the counterparty bank as security for open commitments.

As of 31 December 2008 inter-bank loan receivables include GEL 4,328 (2007: GEL 3,979) placed with an Azerbaijani bank.

## 9. Loans to Customers

| | *2008* | *2007* |
|---|---|---|
| Commercial loans | 1,044,959 | 936,668 |
| Consumer loans | 496,197 | 331,082 |
| Residential mortgage loans | 391,606 | 236,397 |
| Micro loans | 151,313 | 152,436 |
| Gold – pawn loans | 46,374 | 28,158 |
| Others | 15,174 | 19,869 |
| **Loans to customers, gross** | **2,145,623** | **1,704,610** |
| Less – Allowance for loan impairment | (106,601) | (28,929) |
| **Loans to customers, net** | **2,039,022** | **1,675,681** |

(Thousands of Georgian Lari)

## 9. Loans to Customers (continued)

### Allowance for loan impairment

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

| | Commercial loans 2008 | Consumer loans 2008 | Residential mortgage loans 2008 | Micro loans 2008 | Gold-pawn loans 2008 | Others 2008 | Total 2008 |
|---|---|---|---|---|---|---|---|
| **At 1 January 2008** | **11,120** | **13,158** | **2,757** | **1,676** | – | **218** | **28,929** |
| Charge | 53,349 | 50,190 | 7,164 | 5,415 | – | 6,694 | 122,812 |
| Recoveries | 3,265 | 5,088 | 1,327 | 1,496 | – | – | 11,176 |
| Write-offs | (17,685) | (22,082) | (2,724) | (3,221) | – | – | (45,712) |
| Interest accrued on impaired loans | (3,067) | (3,730) | (199) | (333) | – | – | (7,329) |
| Currency translation difference | (1,227) | (471) | (356) | (112) | – | (1,109) | (3,275) |
| **At 31 December 2008** | **45,755** | **42,153** | **7,969** | **4,921** | **–** | **5,803** | **106,601** |
| Individual impairment | 37,904 | 25,920 | 5,068 | 3,071 | – | 651 | 72,614 |
| Collective impairment | 7,850 | 16,235 | 2,901 | 1,850 | – | 5,151 | 33,987 |
| | **45,754** | **42,155** | **7,969** | **4,921** | **–** | **5,802** | **106,601** |
| **Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance** | **290,561** | **42,338** | **35,280** | **8,505** | **–** | **857** | **377,541** |

| | Commercial loans 2007 | Consumer loans 2007 | 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** |

### Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized as at 31 December 2008 comprised GEL 10,241 (2007: GEL 2,324).

(Thousands of Georgian Lari)

## 9. Loans to Customers (continued)

### Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

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

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

### Concentration of loans to customers

As of 31 December 2008 concentration of loans granted by the Group to ten largest third party borrowers comprised GEL 230,733 accounting for 11% of gross loan portfolio of the Group (2007: GEL 226,989 and 13% respectively). An allowance of GEL 10,224 (2007: GEL 1,705) was established against these loans.

As of 31 December 2008 and 2007 loans are principally issued within Georgia, and their distribution by industry sector is as follows:

| | *2008* | *2007* |
|---|---|---|
| Individuals | 1,079,945 | 699,456 |
| Trade and services | 667,557 | 648,086 |
| Construction and development | 158,702 | 157,797 |
| Energy | 66,145 | 11,512 |
| Transport and communication | 52,631 | 8,084 |
| Mining | 34,526 | 55,053 |
| Agriculture | 20,134 | 64,567 |
| Others | 65,983 | 60,055 |
| **Loans to customers, gross** | **2,145,623** | **1,704,610** |
| Less – allowance for loan impairment | (106,601) | (28,929) |
| **Loans to customers, net** | **2,039,022** | **1,675,681** |

Loans have been extended to the following types of customers:

| | *2008* | *2007* |
|---|---|---|
| Individuals | 1,079,945 | 699,456 |
| Private companies | 1,029,008 | 967,023 |
| State-owned entities | 36,670 | 38,131 |
| **Loans to customers, gross** | **2,145,623** | **1,704,610** |
| Less – allowance for loan impairment | (106,601) | (28,929) |
| **Loans to customers, net** | **2,039,022** | **1,675,681** |

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

| | *2008* | | | *2007* | | |
|---|---|---|---|---|---|---|
| | *Individual impairment* | *Collective impairment* | *Total* | *Individual impairment* | *Collective impairment* | *Total* |
| | *2008* | *2008* | *2008* | *2007* | *2007* | *2007* |
| **At 1 January** | **9,659** | **19,270** | **28,929** | **12,633** | **8,387** | **21,020** |
| Charge (reversal) for the year | 73,311 | 49,501 | 122,812 | (4,207) | 21,616 | 17,409 |
| Recoveries | 6,690 | 4,486 | 11,176 | 5,706 | 2,212 | 7,918 |
| Write-offs | (12,757) | (32,955) | (45,712) | (3,945) | (11,630) | (15,575) |
| Interest accrued on impairment loans to customers | (1,933) | (5,396) | (7,329) | (588) | (1,315) | (1,903) |
| Currency translation differences | (2,356) | (919) | (3,275) | 60 | – | 60 |
| **At 31 December** | **72,614** | **33,987** | **106,601** | **9,659** | **19,270** | **28,929** |

(Thousands of Georgian Lari)

## 10. Finance Lease Receivables

| | 31 December 2008 | 31 December 2007 |
|---|---|---|
| Minimum lease payments receivables | 50,565 | 54,844 |
| Less - Unearned finance lease income | (6,797) | (7,354) |
| | **43,768** | **47,490** |
| Less - Allowance for impairment | (2,163) | (816) |
| **Finance lease receivables, net** | **41,605** | **46,674** |

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 2008, concentration of investments in five largest lessees comprised GEL 32,112 or 73.4% of total finance lease receivables (2007: GEL 38,723 or 83%) and finance income received from them as of 31 December 2008 comprised GEL 3,512 or 50.1% of total finance income from lease (2006: GEL 2,627 or 64%).

As of 31 December 2008 lease receivables amounting to GEL 24,380 represent receivables from a Government agency.

Future minimum lease payments to be received after 31 December 2008 and 31 December 2007 are as follows:

| | 31 December 2008 | 31 December 2007 |
|---|---|---|
| Within 1 year | 37,550 | 34,087 |
| From 1 to 5 years | 13,015 | 20,757 |
| More than 5 years | – | – |
| **Minimum lease payment receivables** | **50,565** | **54,844** |

Minimum lease payments to be received after 31 December 2008 and 2007 are denominated in the following currencies:

| | 31 December 2008 | 31 December 2007 |
|---|---|---|
| US Dollars | 41,959 | 48,208 |
| Euros | 5,919 | 6,636 |
| Belarussian Roubles | 2,687 | – |
| **Minimum lease payment receivables** | **50,565** | **54,844** |

The equipment the Group leases out at 31 December 2008 and 2007 can be segregated into the following categories:

| | 31 December 2008 | | 31 December 2007 | |
|---|---|---|---|---|
| | Amount | Number of projects | Amount | Number of projects |
| Air and land transport | 37,650 | 126 | 44,035 | 87 |
| Construction equipment | 8,985 | 46 | 9,306 | 29 |
| Machinery & equipment | 3,930 | 46 | 1,503 | 16 |
| **Minimum lease payment receivables** | **50,565** | **218** | **54,844** | **132** |

(Thousands of Georgian Lari)

## 10. Finance Lease Receivables (continued)

**Allowance for impairment of finance lease receivables**

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

| | *Finance lease receivables 2008* | *Finance lease receivables 2007* |
|---|---|---|
| **At 1 January** | **816** | **108** |
| Charge/(reversal) | 1,335 | 708 |
| Currency translation difference | 12 | – |
| **At 31 December** | **2,163** | **816** |
| Individual impairment | 1,600 | 318 |
| Collective impairment | 563 | 498 |
| | **2,163** | **816** |
| **Gross amount of lease receivables, individually determined to be impaired, before deducting any individually assessed impairment allowance** | **2,730** | – |

## 11. Investment Securities

**Available-for-sale securities comprise:**

| | *2008* | *2007* |
|---|---|---|
| Corporate shares | 21,723 | 6,763 |
| Corporate bonds | 6,748 | 24,879 |
| Ministry of Finance treasury bills | 5,266 | 10,745 |
| **Available-for-sale securities** | **33,737** | **42,387** |

Corporate shares as of 31 December 2008 are primarily comprised of investments in Georgian retail chain of GEL 9,175 (2007: GEL 3,998) and meat processing company of GEL 6,842 (2007: wine producing company of GEL 1,555).

Corporate bonds as of 31 December 2008 are comprised of GEL 6,748 investments in several financial institutions in Ukraine (2007: GEL 15,542).

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

| | *31 December 2008* | | *31 December 2007* | |
|---|---|---|---|---|
| | *%* | *Maturity* | *%* | *Maturity* |
| Corporate bonds | 14.41% | 1-3 years | 14.47% | 1-6 years |
| Ministry of Finance treasury bills | 11.95% | 1-3 years | 9.61% | 1-4 years |

**Held-to-maturity securities comprise:**

| | *2008* | | *2007* | |
|---|---|---|---|---|
| | *Carrying value* | *Nominal value* | *Carrying value* | *Nominal value* |
| Certificates of deposit of central banks | 14,826 | 15,000 | 146,016 | 149,151 |
| State debt securities | 8,019 | 8,047 | 38,115 | 37,930 |
| Corporate bonds | – | – | 8,263 | 7,958 |
| Ministry of Finance treasury bills | – | – | 70 | 70 |
| **Held-to-maturity securities** | **22,845** | **23,047** | **192,464** | **195,109** |

(Thousands of Georgian Lari)

## 11. Investment Securities (continued)

**Held-to-maturity securities comprise (continued)**

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

| | *31 December 2008* | | *31 December 2007* | |
|---|---|---|---|---|
| | *%* | *Maturity* | *%* | *Maturity* |
| Corporate bonds | – | – | 9.50% | 2010 |
| Ministry of Finance treasury bills | – | – | 13.00% | 2008 |
| Certificates of deposit of central banks | 11.79% | 2009 | 9.79% | 2008 |
| State debt securities | 13.00% | 2009 | 13.00% | 2009 |

## 12. Investments in Associates

The following associates are accounted for under the equity method:

**2008**

| **Associates** | *Ownership / Voting, %* | *Country* | *Date of incorporation* | *Industry* | *Date of acquisition* |
|---|---|---|---|---|---|
| JSC SB Iberia | 49,00% | Georgia | 13/12/2007 | Construction | 20/03/2008 |
| JSC SB Iberia 2 | 49.00% | Georgia | 28/03/2008 | Construction | |
| JSC Teliani Valley | 27.19% | Georgia | 30/06/2000 | Wine production | 13/02/2007 |
| JSC One team | 25.00% | Georgia | 23/04/2007 | Entertainment | |
| JSC iCall | 27.03% | Georgia | 22/03/2005 | Call centre | 22/11/2006 |
| JSC N Tour | 30.00% | Georgia | 1/11/2001 | Travel Services | 29/05/2008 |
| JSC Hotels and Restaurants | 50.00% | Georgia | | Food retail | 29/05/2008 |
| JSC Info Georgia XXI | 50.00% | Georgia | 26/04/2001 | Business service | 20/05/2008 |
| JSC Caucasus Automotive Retail | 30.00% | Georgia | 18/04/2008 | Car retail | 2/05/2008 |
| Style +, LLC | 32.45% | Georgia | 1/08/2005 | Advertising | 7/08/2008 |

**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 +, LLC | 28.00% | Georgia | 29/06/2005 | Advertising | 15/12/2006 |

(Thousands of Georgian Lari)

## 12. Investments in Associates (continued)

Movements in investments in associates were as follows:

| | *2008* | *2007* |
|---|---|---|
| **Investments in associates, beginning of year, gross** | **5,208** | **496** |
| Purchase cost | 13,355 | 5,275 |
| Disposal | (860) | (700) |
| Share of (loss) profit | (713) | 137 |
| **Investments in associates, end of year, gross** | **16,990** | **5,208** |
| Less – Allowance for impairment | (274) | – |
| **Investments in associates, end of year, net** | **16,716** | **5,208** |

Investments in associates at 31 December 2008 include goodwill of GEL 7,354 (2007: GEL 2,413).

The following table summarises certain financial information of the associates:

| **Aggregated assets and liabilities of associates** | *2008* | *2007* |
|---|---|---|
| Assets | 58,171 | 15,611 |
| Liabilities | (32,023) | (5,722) |
| **Net assets** | **26,148** | **9,889** |

| **Aggregated revenue and profit of associates** | *2008* | *2007* |
|---|---|---|
| Revenue | 34,663 | 10,973 |
| (Loss) profit | (1,607) | 1,089 |

Associate company – JSC Teliani Valley is listed on the Georgian Stock Exchange. As of 31 December 2008 the carrying value of the investment in JSC Teliani Valley was GEL 5,042 (2007: GEL 3,810) while the fair value equalled GEL 7,263 (2007: GEL 12,996).

## 13. Investment properties

| | *2008* | *2007* |
|---|---|---|
| **At 1 January** | **35,065** | **1,224** |
| Purchases | 12,613 | 10,499 |
| Net change in fair value through profit and loss | (389) | 16,362 |
| Transfers from property and equipment (Note 14) | – | 5,132 |
| Fair value adjustment through equity | – | 1,848 |
| **At 31 December** | **47,289** | **35,065** |

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

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

| | *2008* | *2007* |
|---|---|---|
| Rental income | 1,211 | 628 |
| Direct operating expenses | (76) | (50) |

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

(Thousands of Georgian Lari)

## 14. Property and Equipment

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

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

The 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 properties | (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** |

(Thousands of Georgian Lari)

## 14. Property and Equipment (continued)

The Group engaged Georgian Valuation Company, an independent appraiser, to determine the fair value of its buildings. Fair value is determined by reference to market-based evidence. According the most recent revaluation report, the latest date of the revaluation was 31 December 2008. If the buildings were measured using the cost model, the carrying amounts of the buildings as of 31 December 2008 and 31 December 2007 would be as follows:

| | *2008* | *2007* |
|---|---|---|
| Cost | 66,917 | 62,605 |
| Accumulated depreciation and impairment | (7,353) | (2,815) |
| **Net carrying amount** | **59,564** | **59,790** |

## 15. Goodwill and Other Intangible Assets

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

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

Computer software and licenses additions in 2008 include GEL 8,625 for the acquisition of a 7-year exclusive license (commencing on the date of launching) of American Express Cards and its related products in Georgia.

(Thousands of Georgian Lari)

## 15. Goodwill and Other Intangible Assets (continued)

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** |

As of 31 December 2008 goodwill acquired through business combinations has been allocated to the following cash-generating units for impairment testing purposes:

- JSC Bank of Georgia
- JSC Belarusky Narodny Bank
- JSC BG Bank (renamed)
- JSC Insurance Company Aldagi – BCI
- JSC Intertour
- United Georgian Registrar LLC
- 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:

| | *WACC appliedfor impairment* | *Carrying amount of goodwill* | |
|---|---|---|---|
| | | *31 December 2008* | *31 December 2007* |
| JSC Bank of Georgia | 7.5% | 22,391 | 21,308 |
| JSC BG Bank | 11.7% | 68,016 | 68,016 |
| JSC Belarusky Narodny Bank | N/A | 23,394 | – |
| JSC Insurance Company Aldagi – BCI | 15.8% | 18,742 | 18,454 |
| JSC My Family Clinic | 15.8% | 220 | 220 |
| JSC Galt & Taggart Bank | N/A | – | 599 |
| Intertour LLC | 12.0% | 698 | 698 |
| United Securities Registrar of Georgia, LLC | 14.0% | 366 | 366 |
| JSC Nova Technology | 14.0% | 411 | 411 |
| **Total** | | **134,238** | **110,072** |

(Thousands of Georgian Lari)

## 15. Goodwill and Other Intangible Assets (continued)

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:

| | *2008* | *2007* |
|---|---|---|
| Retail banking | 78,408 | 55,036 |
| Corporate banking | 35,381 | 34,889 |
| Insurance | 18,962 | 18,673 |
| Asset & wealth management and brokerage | 1,487 | 1,474 |
| | **134,238** | **110,072** |

**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* | |
|---|---|---|---|---|
| | *2008, %* | *2007, %* | *2008, %* | *2007, %* |
| Discount rate | 7.5% | 10% | 7.5% | 10% |
| Projected growth rate | 7.5% | 0% | 7.5% | 0% |

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

| | *Insurance* | | *Asset & wealth management and brokerage* | |
|---|---|---|---|---|
| | *2008, %* | *2007, %* | *2008, %* | *2007, %* |
| Discount rate | 15.8% | 13% | 12%-14% | 12%-14% |
| Projected growth rate | 15.8% | 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.

(Thousands of Georgian Lari)

## 16. Taxation

The corporate income tax expense comprises:

| | 2008 | 2007 |
|---|---|---|
| Current income tax expense | 6,762 | 7,638 |
| Deferred tax (benefit) expense – | | |
| origination and reversal of temporary differences | (10,929) | 17,065 |
| Less: Deferred tax recognised directly in equity | 3,189 | (10,633) |
| **Income tax (benefit) expense** | **(978)** | **14,070** |

The income tax rate applicable to the majority of the Group's income is the income tax rate applicable to subsidiaries income ranges 15% to 26% (2007: from 15% to 25% ). The tax rate for interest income on state securities was Corporate income tax rate in Georgia reduced from to effective 1 January 2009. Reconciliation between the expected and the actual taxation charge is provided below.

The effective income tax rate differs from the statutory income tax rates. As of 31 December 2008 and 2007 a reconciliation of the income tax expense based on statutory rates with actual is as follows:

| | 2008 | 2007 |
|---|---|---|
| **(Loss) profit before income tax benefit (expense)** | **(804)** | **89,712** |
| Statutory tax rate | 15% | 20% |
| **Theoretical income tax (benefit) expense at statutory tax rate** | **(121)** | **17,942** |
| Tax at the domestic rates applicable to profits in the respective country | (837) | 25 |
| Non-deductible share-based compensation expenses | 1,240 | 964 |
| Other operating income | 207 | 62 |
| State securities at lower tax rates | (1,020) | (1,900) |
| Tax effect of intercompany transactions | (783) | – |
| Change in unrecognized deferred tax assets | – | 144 |
| Effect of reduction in tax rate | – | (3,226) |
| Non-deductible expenses: | | |
| - other impairment losses | 171 | (153) |
| - entertainment and business trips | 67 | – |
| - other | 98 | 212 |
| **Income tax (benefit) expense** | **(978)** | **14,070** |

Georgia currently has an updated tax code which has been adopted and put in force in 2006. 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.

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

| | 2008 | 2007 |
|---|---|---|
| Current tax assets | 8,095 | 998 |
| Deferred tax assets | 4,691 | 559 |
| **Tax assets** | **12,786** | **1,557** |
| Current tax liabilities | 779 | 6,500 |
| Deferred tax liabilities | 23,615 | 30,709 |
| **Tax liabilities** | **24,394** | **37,209** |

(Thousands of Georgian Lari)

## 16. Taxation (continued)

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

| | | *Origination and reversal of temporary differences* | | | | *Origination and reversal of temporary differences* | | | |
|---|---|---|---|---|---|---|---|---|---|
| | *2006* | *In the income statement* | *Directly in equity* | *Effect of business combi-nation* | *2007* | *In the income statement* | *Directly in equity* | *Effect of business combi-nation* | *2008* |
| **Tax effect of deductible temporary differences:** | | | | | | | | | |
| Amounts due to credit institutions | 1,457 | (1,422) | – | – | 35 | (35) | – | – | – |
| Investment securities: available-for-sale | – | – | – | – | – | 296 | 1,530 | – | 1,826 |
| Loans to customers | – | 80 | – | | 80 | 390 | – | – | 470 |
| Securities issued | – | | – | 55 | 55 | (55) | – | – | – |
| Reinsurance assets | – | 124 | – | – | 124 | 119 | – | – | 243 |
| Reinsurance premiums receivables | – | – | – | – | – | 2,073 | – | – | 2,073 |
| Allowances for impairment and provisions for other losses | 847 | (622) | – | – | 225 | 240 | – | – | 465 |
| Tax losses carried forward | – | 1,313 | – | – | 1,313 | 16,689 | – | – | 18,002 |
| Finance lease receivables | – | 7 | – | – | 7 | 277 | – | – | 284 |
| Intangible assets | – | 181 | – | – | 181 | 58 | – | – | 239 |
| Property and equipment | – | 2 | – | – | 2 | (175) | 1,659 | 297 | 1,783 |
| Other assets | – | 115 | – | | 115 | 348 | – | – | 463 |
| Other libilities | – | 263 | – | 39 | 302 | 433 | – | – | 735 |
| **Gross deferred tax assets** | **2,304** | **41** | **–** | **94** | **2,439** | **20,658** | **3,189** | **297** | **26,583** |
| Unrecognized deferred tax assets | 63 | (148) | – | (122) | (207) | 207 | – | – | – |
| **Deferred tax assets** | **2,367** | **(107)** | **–** | **(28)** | **2,232** | **20,865** | **3,189** | **297** | **26,583** |
| **Tax effect of taxable temporary differences:** | | | | | | | | | |
| Amounts due to credit institutions | – | – | – | 1,710 | 1,710 | 341 | – | – | 2,051 |
| Amounts due to customers | – | 502 | – | 123 | 625 | (117) | – | – | 508 |
| Securities available-for-sale | – | 150 | – | 32 | 182 | – | – | – | 182 |
| Loans to customers | 2,573 | (305) | – | 2,223 | 4,491 | 2,612 | – | – | 7,103 |
| Reinsurance assets | – | 27 | – | – | 27 | – | – | – | 27 |
| Insurance premium receivables | – | 6 | – | – | 6 | (6) | – | – | – |
| Allowances for impairment and provisions for other losses | – | 38 | – | – | 38 | 1,185 | – | – | 1,223 |
| Property and equipment | 5,774 | 3,149 | 10,173 | 1,060 | 20,156 | 8,324 | – | – | 28,480 |
| Investment properties | – | 2,743 | 460 | – | 3,203 | (342) | – | – | 2,861 |
| Intangible assets | 731 | 277 | – | – | 1,008 | 1,289 | – | – | 2,297 |
| Other assets | – | 414 | – | 522 | 936 | (595) | – | – | 341 |
| Other liabilities | 676 | (676) | – | – | – | 434 | – | – | 434 |
| **Deferred tax liabilities** | **9,754** | **6,325** | **10,633** | **5,670** | **32,382** | **13,125** | **–** | **–** | **45,507** |
| Net deferred tax assets (liabilities) | **(7,387)** | **(6,432)** | **(10,633)** | **(5,698)** | **(30,150)** | **7,740** | **3,189** | **297** | **(18,924)** |

## 17. Other Impairment Allowance and Provisions

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

| | *Impairment allowance for investments in associates* | *Impairment allowance for other assets* | *Provision for guarantees and commitments* | *Total* |
|---|---|---|---|---|
| **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** |
| Charge | 274 | 580 | 3,697 | 4,551 |
| Write-offs | – | (57) | (437) | (494) |
| Recoveries | – | 20 | – | 20 |
| **31 December 2008** | **274** | **549** | **4,263** | **5,086** |

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

(Thousands of Georgian Lari)

## 18. Other Assets and Other Liabilities

**Other assets comprise:**

| | *2008* | *2007* |
|---|---|---|
| Reinsurance assets | 21,493 | 15,987 |
| Insurance premiums receivable | 20,497 | 14,354 |
| Accounts receivable | 7,243 | 3,690 |
| Receivables from money transfers | 5,208 | 997 |
| Receivables from factoring operations | 4,539 | 1,249 |
| Assets held-for-sale | 4,469 | – |
| Foreclosed assets | 3,464 | 3,415 |
| Receivables from sale of assets | 2,317 | – |
| Inventory | 1,966 | – |
| Operating taxes receivables | 1,363 | 3,500 |
| Operating lease receivables | 448 | 1,286 |
| Prepayments for purchase of property and equipment | 245 | 10,725 |
| Trading securities owned | 92 | 6,342 |
| Settlements on operations with securities | 39 | 2,614 |
| Other | 2,287 | 3,505 |
| | **75,670** | **67,664** |
| Less – Allowance for impairment of other assets (Note 17) | (549) | (6) |
| **Other assets** | **75,121** | **67,658** |

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.

Assets held-for-sale comprise 4,469 KGEL of investment in 19.5% share ownership of JSC "GPC", a retail chain of drug stores. Investment was made in June 2008 primarily for the purpose of observing the company's business operations and associated risks in order to decide on acquisition. Based on observations and analysis made, the management of the Group decided in November 2008 to dispose the investment. Negotiations with potential buyers started in December 2008 and are still ongoing. The Group had no gains or losses arising from change in fair value of the asset.

**Other liabilities comprise:**

| | *2008* | *2007* |
|---|---|---|
| Insurance contracts liabilities | 44,340 | 31,813 |
| Accruals for employee compensation | 14,165 | 20,943 |
| Accounts payable | 12,803 | 4,783 |
| Other insurance liabilities | 9,424 | 6,151 |
| Amounts payable for purchase of intangible assets | 5,959 | – |
| Creditors | 5,858 | 10,907 |
| Other taxes payable | 4,783 | 7,384 |
| Pension benefit obligations | 1,642 | 1,262 |
| Dividends payable | 314 | 317 |
| Debt securities issued | 5 | 4,993 |
| Amounts payable for share acquisitions | – | 1,316 |
| Other | 2,262 | 10,268 |
| **Other liabilities** | **101,555** | **100,137** |

(Thousands of Georgian Lari)

## 19. Amounts Due to Credit Institutions

Amounts due to credit institutions comprise:

| | *2008* | *2007* |
|---|---|---|
| Borrowings from international credit institutions | 1,108,014 | 821,667 |
| Time deposits and inter-bank loans | 91,389 | 62,009 |
| Correspondent accounts | 17,319 | 18,119 |
| **Amounts due to credit institutions** | **1,216,722** | **901,795** |

During 2008 the Group received short-term funds from Georgian banks in different currencies. As of 31 December 2008 the Group had an equivalent of GEL 32,795 (2007: GEL 4,744 in foreign currencies received as deposits from Georgian banks. In 2008 the Group paid up to 4.85% interest on these deposits (2007: 5%).

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

**As of 31 December 2008**

| *Credit institution* | *Grant date* | *Contractual maturity* | *Currency* | *Interest rate per annum* | *Facility amount in original currency* | *Outstanding Balance as of 31 December 2008 in GEL (*)* |
|---|---|---|---|---|---|---|
| BG Finance B.V. | 8-Feb-07 | 8-Feb-12 | USD | 9% | 200,000 | 340,864 |
| Rubrika Finance Company Netherlands B.V. | 6-Jun-08 | 6-Jun-10 | USD | LIBOR+9% | 140,000 | 230,740 |
| Merrill Lynch International | 21-Dec-07 | 21-Jan-09 | USD | LIBOR+7.65% | 65,000 | 111,806 |
| Citibank International PLC | 17-Aug-07 | 17-Feb-09 | USD | LIBOR+2.2% | 43,500 | 73,780 |
| Merrill Lynch International | 17-Aug-07 | 17-Aug-17 | USD | LIBOR+5.995% | 35,000 | 59,488 |
| National Bank of Georgia | 30-Sep-08 | 30-Sep-09 | GEL | 13% | 58,900 | 58,900 |
| Netherland Development Finance Company | 30-Jun-08 | 15-Oct-18 | USD | LIBOR+7.25% | 30,000 | 50,351 |
| Overseas Private Investment Corporation | 19-Dec-08 | 19-Dec-18 | USD | 5.75% | 29,000 | 47,605 |
| Citibank International PLC | 20-Aug-07 | 20-Aug-10 | USD | LIBOR+2.75 | 25,000 | 41,875 |
| Semper Augustos B.V. | 31-Oct-07 | 25-Oct-17 | USD | 11.65% | 15,000 | 25,515 |
| Netherlands Development Finance Company | 22-Jan-07 | 15-Mar-14 | USD | LIBOR+3.3% | 12,500 | 20,387 |
| Overseas Private Investment Corporation | 19-Dec-08 | 19-Dec-18 | USD | 7.75% | 10,000 | 16,379 |
| JSC TBC Bank | 31-Dec-08 | 5-Jan-09 | EUR | 5% | 5,000 | 11,824 |
| World Business Capital | 17-Feb-06 | 1-Oct-16 | USD | LIBOR+2.75% | 10,000 | 11,242 |
| Hillside Apex Fund Ltd (subordinated debt) | 14-Aug-06 | 14-Aug-16 | USD | LIBOR+6.20% | 5,000 | 8,630 |
| JSC TBC Bank | 26-Dec-08 | 5-Jan-09 | USD | 4% | 5,000 | 8,340 |
| World Business Capital | 29-Mar-07 | 25-Mar-17 | USD | LIBOR+2.75% | 5,226 | 7,633 |
| JSC HSBC Bank Georgia | 29-Jul-08 | 29-Jan-09 | USD | 9% | 4,000 | 6,926 |
| Commerzbank AG | 16-Dec-05 | 30-Dec-10 | USD | LIBOR+1.3% | 5,000 | 5,408 |
| JSC TBC Bank | 29-Dec-08 | 6-Jan-09 | GEL | 4.5% | 5,000 | 5,001 |
| Balances less than GEL 5,000 | various | various | various | various | various | 56,709 |
| **Total** | | | | | | **1,199,403** |

(Thousands of Georgian Lari)

## 19. Amounts Due to Credit Institutions (continued)

**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 |
| Citibank International PLC | 20-Aug-07 | 20-Aug-10 | USD | LIBOR+2.75% | 25,000 | 45,665 |
| National Bank of Georgia | 31-Dec-07 | 4-Jan-08 | GEL | 14% | 30,000 | 30,000 |
| 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 |
| World Business Capital | 17-Feb-06 | 1-Oct-16 | USD | LIBOR+2.75% | 10,000 | 12,728 |
| European Bank for Reconstruction and Development | 17-Dec-07 | Revolving | USD | LIBOR+1.5% | 5,800 | 9,253 |
| Hillside Apex Fund Ltd (subordinated debt) | 14-Aug-06 | 14-Aug-16 | USD | LIBOR+6.20% | 5,000 | 8,354 |
| World Business Capital | 29-Mar-07 | 25-Mar-17 | USD | LIBOR+2.75% | 4,607 | 7,363 |
| 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** |

*** - includes accrued interest**

Agreements for significant 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 2008 and 2007, the Group complied with all the covenants of the loans received from credit institutions.

(Thousands of Georgian Lari)

## 20. Amounts Due to Customers

The amounts due to customers include the following:

| | *2008* | *2007* |
|---|---|---|
| Current accounts | 612,502 | 737,045 |
| Time deposits | 580,622 | 618,431 |
| **Amounts due to customers** | **1,193,124** | **1,355,476** |
| **Held as security against letters of credit** | **443** | **9,673** |
| **Held as security against guarantees** | **69,998** | **16,701** |

At year-end, amounts due to customers of GEL 323,662 (27%) were due to the 10 largest customers (2007: GEL 302,246 (22%)).

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

| | *2008* | *2007* |
|---|---|---|
| Individuals | 495,747 | 582,991 |
| Private enterprises | 627,049 | 662,808 |
| State and budget organizations | 70,328 | 109,677 |
| **Amounts due to customers** | **1,193,124** | **1,355,476** |

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

| | *2008* | *2007* |
|---|---|---|
| Individuals | 495,747 | 582,991 |
| Trade and services | 296,110 | 354,874 |
| Energy | 134,275 | 78,410 |
| Transport and communication | 70,806 | 61,636 |
| Governmental | 70,328 | 109,677 |
| Construction and development | 40,146 | 62,953 |
| Mining and processing | 16,364 | 68,407 |
| Agriculture | 8,426 | 260 |
| Other | 60,922 | 36,268 |
| **Amounts due to customers** | **1,193,124** | **1,355,476** |

## 21. Equity

**Share capital**

As of 31 December 2008, authorized share capital comprised 39,835,619 common shares, of which 31,253,283 were issued and fully paid (2007: 32,835,619 common shares, of which 27,154,918 were issued and fully paid). Each share has a nominal value of one (1) Georgian Lari. Shares issued and outstanding as of 31 December 2008 are described below:

| | *Number of shares Ordinary* | *Amount of shares Ordinary* |
|---|---|---|
| **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 26) | 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** |
| Increase in share capital | 4,089,000 | 4,089 |
| Increase in share capital arising from share-based payments (Note 26) | 9,365 | 9 |
| **31 December 2008** | **31,253,283** | **31,253** |

(Thousands of Georgian Lari)

## 21. Equity (continued)

### Share capital (continued)

Share capital of the Group was paid by the shareholders in Georgian Lari and they are entitled to dividends in Georgian Lari. For 2008 net income attributable to ordinary shareholders of the Bank was GEL 3,897 (2007: 72,484). As of 31 December 2008 weighted average number of ordinary shares outstanding during the year was 30,160,451 (2007: 24,503,722). At 31 December 2008 the diluted number of ordinary shares was 30,160,451 (2007: 24,598,722). Thus, both, the basic and diluted earnings per share amounted to GEL 0.129 (2007: GEL 2.958 and GEL 2.947, respectively).

In February of 2008 the Bank offered four million new ordinary shares in the form of global depositary receipts ("GDRs"), each GDR representing one ordinary share of the Bank. The Bank sold the four million (4,000,000) new ordinary shares in the form of GDRs at a price of US$25 per GDR. The Offering raised gross proceeds of US$100 million or equivalent of GEL 150,594. Share offering cost from this transaction amounted to GEL 357. An additional 89,000 shares were issued in 2008 arising from the agreement in relation to the 2005 acquisition of Europace.

### Treasury shares

Treasury shares of GEL 890 as of 31 December 2008 comprise the Bank's shares owned by its subsidiaries (2007: GEL 237). Purchases and sales of treasury shares were conducted by the Bank's subsidiaries in the open market: JSC Galt and Taggart Securities, Galt and Taggart Holdings Limited LLC, GC Holdings LLC and JSC Insurance Company Aldagi BCI.

Treasury shares amounting to GEL 1,128 as of 31 December 2008 (2007: GEL 1,500) are kept by the Bank's custodian - Abacus Corporate Trustee Limited.

During the year ended 31 December 2008, 19,933 ordinary shares of GEL 20 par value and additional paid-in capital of GEL 470 have been granted as compensation to top management (2007: GEL 146 at par value and additional paid-in capital of GEL 948).

### Dividends

No dividends were declared nor paid during 2008 and 2007.

### Other reserves

| | *Revaluation reserve for property and equipment and investment properties* | *Unrealised gains (losses) on investment securities available-for-sale* | *Foreign currency translation reserve* | *Total* |
|---|---|---|---|---|
| **At 31 December 2006** | **5,257** | **–** | **–** | **5,257** |
| Revaluation of buildings and Investment properties | 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** |
| Revaluation of buildings | (10,455) | – | – | (10,455) |
| Tax effect of revaluation of buildings | 1,659 | – | – | 1,659 |
| Depreciation of revaluation reserve, net of tax | (1,252) | – | – | (1,252) |
| Net unrealised gains on available-for-sale investments | – | (8,157) | – | (8,157) |
| Transfer of net realized gains on investment securities available-for-sale to the consolidated income statement | – | (513) | – | (513) |
| Currency translation differences | (18) | – | (22,417) | (22,435) |
| **At 31 December 2008** | **54,374** | **(7,811)** | **(20,362)** | **26,201** |

(Thousands of Georgian Lari)

## 21. Equity (continued)

**Nature and purpose of other reserves**

*Revaluation reserve for property and equipment and investment properties*

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

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

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

*Foreign currency translation reserve*

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

## 22. Commitments and Contingencies

**Legal**

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

**Financial commitments and contingencies**

As of 31 December 2008 and 2007 the Group's financial commitments and contingencies comprised the following:

| | *2008* | *2007* |
|---|---|---|
| **Credit-related commitments** | | |
| Undrawn loan facilities | 90,023 | 39,962 |
| Letters of credit | 32,547 | 23,130 |
| Guarantees | 304,906 | 145,627 |
| | **427,476** | **208,719** |
| **Operating lease commitments** | | |
| Not later than 1 year | 5,874 | 6,200 |
| Later than 1 year but not later than 5 years | 12,832 | 12,232 |
| Later than 5 years | 5,993 | 5,902 |
| | **24,699** | **24,334** |
| **Capital expenditure commitments** | **19,851** | **2,623** |
| Less – Provisions (Note 17) | (4,263) | (1,003) |
| Less – Cash held as security against letters of credit and guarantees (Note 20) | (70,441) | (26,374) |
| **Financial commitments and contingencies, net** | **397,322** | **208,299** |

As of 31 December 2008 the capital expenditures represented the commitment for purchase of property GEL 2,132 equipment of GEL 4,721 and software and other intangible assets of GEL 12,998. As of 31 December 2007 the capital expenditures represented the commitment for purchase of property GEL 1,028, equipment of GEL 698 and software and other intangible assets of GEL 897.

(Thousands of Georgian Lari)

## 23. Net Fee and Commission Income

| | 2008 | 2007 |
|---|---|---|
| Settlements operations | 33,659 | 25,488 |
| Guarantees and letters of credit | 8,625 | 7,548 |
| Cash operations | 6,947 | 6,079 |
| Brokerage service fees | 2,626 | 3,448 |
| Advisory | 2,032 | 215 |
| Currency conversion operations | 1,766 | 1,284 |
| Other | 7,848 | 4,296 |
| **Fee and commission income** | **63,503** | **48,358** |
| Insurance brokerage service fees | (5,965) | (2,103) |
| Settlements operations | (3,974) | (2,692) |
| Guarantees and letters of credit | (2,038) | (1,127) |
| Currency conversion operations | (430) | (162) |
| Cash operations | (564) | (253) |
| Other | (563) | (273) |
| **Fee and commission expense** | **(13,534)** | **(6,610)** |
| **Net fee and commission income** | **49,969** | **41,748** |

## 24. Net Insurance Revenue

Net insurance premiums earned, net insurance claims incurred and respective net insurance revenue for the years ended December 31, 2008 and 2007 comprised:

| | 2008 | 2007 |
|---|---|---|
| Life insurance contracts premium written | 3,456 | 814 |
| General insurance contracts premium written, direct | 53,201 | 35,013 |
| **Total premiums written** | **56,657** | **35,827** |
| Gross change in life provision | 86 | 93 |
| Gross change in unearned premium provision | (6,311) | (10,366) |
| **Total gross premiums earned on insurance contracts** | **50,432** | **25,554** |
| Reinsurers' share of life insurance contracts premium written | (981) | (399) |
| Reinsurers' share of general insurance contracts premium written | (15,271) | (12,326) |
| Reinsurers' share of change in life provision | (4) | (76) |
| Reinsurers' share of change in general insurance contracts uneared premium provision | 1,735 | 1,507 |
| **Total reinsurers' share of gross earned premiums on insurance contracts** | **(14,521)** | **(11,294)** |
| **Net insurance premiums earned** | **35,911** | **14,260** |
| Life insurance claims paid | (455) | (233) |
| General insurance claims paid, direct | (30,175) | (9,825) |
| **Total insurance claims paid** | **(30,630)** | **(10,058)** |
| Reinsurers' share of life claims paid | 351 | 49 |
| Reinsurers' share of general claims paid | 5,443 | 3,076 |
| Gross change in total insurance contracts liabilities | (6,053) | (6,219) |
| Reinsurers' share of change in total insurance contracts liabilities | 3,994 | 4,353 |
| **Net insurance claims incurred** | **(26,895)** | **(8,799)** |
| **Net insurance revenue** | **9,016** | **5,461** |

(Thousands of Georgian Lari)

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

| | *2008* | *2007* |
|---|---|---|
| Salaries and bonuses | (104,039) | (64,388) |
| Social security costs | (4,728) | (11,251) |
| **Salaries and other employee benefits** | **(108,767)** | **(75,639)** |
| | | |
| Occupancy and rent | (12,811) | (6,173) |
| Marketing and advertising | (12,251) | (4,767) |
| Legal and other professional services | (6,391) | (4,132) |
| Communication | (6,117) | (3,132) |
| Repairs and maintenance | (5,441) | (3,033) |
| Security | (4,951) | (2,432) |
| Operating taxes | (3,496) | (1,720) |
| Travel expenses | (2,948) | (1,770) |
| Insurance | (2,886) | (559) |
| Office supplies | (2,813) | (2,446) |
| Banking services | (2,293) | (1,533) |
| Corporate hospitality and entertainment | (1,393) | (681) |
| Penalties | (745) | (900) |
| Personnel training and recruitment | (545) | (342) |
| Other | (3,568) | (2,544) |
| **General and administrative expenses** | **(68,649)** | **(36,164)** |

Salaries and bonuses include GEL 7,820 and GEL 8,992 of the EECP costs in 2008 and 2007, respectively, associated with the existing share-based compensation scheme approved in the Group (Note 26).

## 26. Share-based Payments

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

In February 2007 the Bank's Supervisory Board resolved to recommend to the Trustee to award 267,550 ordinary shares of the Bank 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 shares in the form of restricted GDRs and 16 February 2007 as the grant date for the remaining 77,550 of ordinary shares in the form of restricted GDRs. The Bank estimates that the fair value of the shares on 16 February 2007 was 45.74 Georgian Lari per share.

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

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

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

(Thousands of Georgian Lari)

## 26. Share-based Payments (continued)

Based on the Bank's share price performance calculated by an independent consultant for 2008 and 2007, the Bank estimated the annual expense of share-based compensation related to 2008 annual grant equal to nil.

The Bank estimated the annual expense of share-based compensation related to 2007 top and annual grants equal 300% of the annual base salary of each executive in 2007. Aggregate expense associated with this scheme comprised GEL 3,339 in 2007.

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

The weighted average fair value of share-based awards at the measurement date comprised Georgian Lari 39.5 per share in 2008 (2007: Georgian Lari 28.95.).

The Group's total share-based payment expenses for 2008 comprised GEL 7,820 (2007: 8,992).

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

| **Ordinary shares** | *2008* | *2007* |
|---|---|---|
| Number of shares awarded | 29,298 | 145,502 |
| - Among them, to top management | 9,365 | 145,502 |
| Number of shares vested | 16,010 | 145,502 |
| Weighted average value at grant date, per share (GEL in full amount) | 41.5 | 7.52 |
| **Value at grant date, total (GEL)** | **1,214** | **1,094** |
| **Expense recognized during the year (GEL)** | **(1,017)** | **(1,094)** |

| **GDRs** | *2008* | *2007* |
|---|---|---|
| Number of GDRs awarded | 258,139 | 322,167 |
| - Among them, to top management | 198,139 | 244,617 |
| Number of GDRs vested | 282,606 | - |
| Weighted average value at grant date, per share (GEL in full amount) | 32.5 | 28.95 |
| **Value at grant date, total (GEL)** | **8,391** | **9,328** |
| **Expense recognized during the year (GEL)** | **(6,803)** | **(7,898)** |

| **All instruments** | *2008* | *2007* |
|---|---|---|
| Total number of equity instruments awarded | 287,437 | 467,669 |
| - Among them, to top management | 207,504 | 390,119 |
| Total number of equity instruments vested | 298,615 | 145,502 |
| Weighted average value at grant date, per share (GEL in full amount) | 33.4 | 22.28 |
| **Value at grant date, total (GEL)** | **9,606** | **10,422** |
| **Total expense recognized during the year (GEL)** | **(7,820)** | **(8,992)** |

## 27. Risk Management

**Introduction**

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

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

*Risk management structure*

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

*Supervisory board*

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

*Management board*

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

*Audit committee*

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

*Bank treasury*

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.

## 27. Risk Management (continued)

**Introduction (continued)**

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

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

*Risk mitigation*

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

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

*Excessive risk concentration*

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

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

### Credit risk

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

The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process allows 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)

## 27. 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 2008 | Gross maximum exposure 2007 |
|---|---|---|---|
| Cash and cash equivalents (excluding cash on hand) | 7 | 233,128 | 312,060 |
| Amounts due from credit institutions | 8 | 99,633 | 154,560 |
| Loans to customers | 9 | 2,039,022 | 1,675,681 |
| Finance lease receivables | 10 | 41,605 | 46,674 |
| Investment securities: | | | |
| -Available-for-sale | 11 | 33,737 | 42,387 |
| -Held-to-maturity | 11 | 22,845 | 192,464 |
| | | **2,469,970** | **2,423,826** |
| Financial commitments and contingencies | 22 | 397,322 | 208,299 |
| **Total credit risk exposure** | | **2,867,292** | **2,632,125** |

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 2008 | Standard grade 2008 | Sub-standard grade 2008 | Past due or individually impaired 2008 | Total 2008 |
| Amounts due from credit institutions | 8 | 99,633 | – | – | – | 99,633 |
| Loans to customers: | 9 | | | | | |
| Corporate lending | | 639,988 | 112,558 | 23,428 | 268,985 | 1,044,959 |
| Consumer lending | | 381,299 | 42,126 | 11,576 | 61,196 | 496,197 |
| Residential mortgages | | 337,445 | 13,477 | 1,868 | 38,816 | 391,606 |
| Micro-loans | | 129,666 | 4,894 | 5,182 | 11,571 | 151,313 |
| Gold Pawn Loans | | 46,374 | – | – | – | 46,374 |
| Other | | 713 | 2,514 | 9,414 | 2,533 | 15,174 |
| | | **1,535,485** | **175,569** | **51,468** | **383,101** | **2,145,623** |
| Finance lease receivables | 10 | 12,201 | 2,232 | 204 | 29,131 | 43,768 |
| Investment securities: | | | | | | |
| Available-for-sale | 11 | 33,737 | – | – | – | 33,737 |
| Held-to-maturity | 11 | 22,845 | – | – | – | 22,845 |
| | | **56,582** | **–** | **–** | **–** | **56,582** |
| **Total** | | **1,703,901** | **177,801** | **51,672** | **412,232** | **2,345,606** |

(Thousands of Georgian Lari)

## 27. Risk Management (continued)

### Credit risk (continued)

| | | *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 | 8 | 154,560 | – | – | – | 154,560 |
| Loans to customers: | 9 | | | | | |
| 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 |
| | | **1,499,293** | **121,854** | **3,305** | **80,158** | **1,704,610** |
| Finance lease receivables | 10 | 6,430 | 2,865 | 234 | 37,961 | 47,490 |
| Investment securities: | 11 | | | | | |
| Available-for-sale | | 42,387 | – | – | – | 42,387 |
| Held-to-maturity | | 192,464 | – | – | – | 192,464 |
| | | **234,851** | **–** | **–** | **–** | **234,851** |
| **Total** | | **1,895,134** | **124,719** | **3,539** | **118,119** | **2,141,511** |

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

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

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

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

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

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

(Thousands of Georgian Lari)

## 27. Risk Management (continued)

**Credit risk (continued)**

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

| | Less than 30 days 2008 | 31 to 60 days 2008 | 61 to 90 days 2008 | More than 90 days 2008 | Total 2008 |
|---|---|---|---|---|---|
| Loans to customers: | | | | | |
| Corporate lending | 12,107 | 4,937 | 6,990 | 15,118 | 39,152 |
| Micro-loans | 2,751 | 270 | 67 | 196 | 3,284 |
| Consumer lending | 21,375 | 764 | 336 | 2,469 | 24,944 |
| Residential mortgages | 6,887 | 6 | – | 86 | 6,979 |
| Other | 256 | 712 | 2,160 | 3,128 | 6,256 |
| Finance lease receivables | – | 46 | – | 24,380 | 24,426 |
| **Total** | **43,376** | **6,735** | **9,553** | **45,377** | **105,041** |

| | 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: | | | | | |
| Commercial 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 |
| Finance lease receivables | 720 | 34,599 | 17 | 867 | 36,203 |
| **Total** | **38,659** | **37,094** | **579** | **6,982** | **83,314** |

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

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

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

| | 2008 | 2007 |
|---|---|---|
| Loans to customers: | | |
| Commercial lending | 384,404 | 10,651 |
| Micro loans | 5,952 | 638 |
| Consumer lending | 19,384 | 3,221 |
| Residential mortgages | 6,193 | 5,625 |
| Other | 8,194 | 762 |
| Financial lease receivables | 3,173 | – |
| **Total** | **427,300** | **20,897** |

(Thousands of Georgian Lari)

## 27. Risk Management (continued)

### Credit risk (continued)

*Impairment assessment*

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

*Individually assessed allowances*

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

*Collectively assessed allowances*

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

The collective assessment takes 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:

| | 2008 | | | | 2007 | | | |
|---|---|---|---|---|---|---|---|---|
| | Georgia | OECD | CIS and other foreign countries | Total | Georgia | OECD | CIS and other foreign countries | Total |
| **Assets:** | | | | | | | | |
| Cash and cash equivalents | 153,236 | 208,997 | 35,358 | 397,591 | 105,393 | 207,049 | 93,328 | 405,770 |
| Amounts due from credit institutions | 64,081 | 3,414 | 32,138 | 99,633 | 140,852 | 609 | 13,099 | 154,560 |
| Loans to customers | 2,008,652 | – | 30,370 | 2,039,022 | 1,452,649 | – | 223,032 | 1,675,681 |
| Finance lease receivables | 37,405 | – | 4,200 | 41,605 | 46,674 | – | – | 46,674 |
| Investment securities | | | | | | | | |
| - available-for-sale | 33,420 | 201 | 116 | 33,737 | 6,234 | 231 | 35,922 | 42,387 |
| - held-to-maturity | 22,845 | – | – | 22,845 | 184,201 | – | 8,263 | 192,464 |
| All other assets | 586,214 | 1,210 | 37,050 | 624,474 | 396,938 | 17,281 | 21,856 | 436,075 |
| | **2,905,853** | **213,822** | **139,232** | **3,258,907** | **2,332,941** | **225,170** | **395,500** | **2,953,611** |
| **Liabilities:** | | | | | | | | |
| Amounts due to credit institutions | 129,091 | 1,080,179 | 7,452 | 1,216,722 | 104,731 | 791,054 | 6,010 | 901,795 |
| Amounts due to customers | 1,152,244 | 2,477 | 38,403 | 1,193,124 | 1,085,505 | – | 269,971 | 1,355,476 |
| All other liabilities | 118,978 | 7,216 | 4,018 | 130,212 | 116,455 | 6,673 | 15,221 | 138,349 |
| | **1,400,313** | **1,089,872** | **49,873** | **2,540,058** | **1,306,691** | **797,727** | **291,202** | **2,395,620** |
| **Net balance sheet position** | **1,505,540** | **(876,050)** | **89,359** | **718,849** | **1,026,250** | **(572,557)** | **104,298** | **557,991** |

(Thousands of Georgian Lari)

## 27. Risk Management (continued)

**Liquidity risk and funding management**

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a 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:

| | *2008* | *2007, %* |
|---|---|---|
| Average liquidity  ratio for the year | 31.4% | 47.5% |
| Maximum Liquidity ratio | 48.6% | 92.7% |
| Minimum Liquidity ratio | 20.8% | 19.5% |

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 2008 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**<br>As at 31 December 2008 | *Less than 3 months* | *3 to 12 months* | *1 to 5 years* | *Over 5 years* | *Total* |
|---|---|---|---|---|---|
| Amounts due to credit institutions | 291,471 | 131,625 | 922,928 | 259,148 | 1,605,172 |
| Amounts due to customers | 869,050 | 266,412 | 74,947 | 4,712 | 1,215,121 |
| Debt securities issued and other liabilities | 1,373 | 90 | 5 | – | 1,468 |
| **Total undiscounted financial liabilities** | **1,161,894** | **398,127** | **997,880** | **263,860** | **2,821,761** |

| **Financial liabilities**<br>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** |

(Thousands of Georgian Lari)

## 27. Risk Management (continued)

**Liquidity risk and funding management (continued)**

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

| | *Less than 3 months* | *3 to 12 months* | *1 to 5 years* | *Over 5 years* | *Total* |
|---|---|---|---|---|---|
| 2008 | 187,311 | 94,245 | 166,843 | 23,627 | 472,026 |
| 2007 | 85,305 | 76,578 | 55,364 | 18,429 | 235,676 |

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

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

Included in due to customers are term deposits of individuals. In accordance with the Georgian legislation, the Bank Group is obliged to repay such deposits upon demand of a depositor. Refer to Note 20.

**Market risk**

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

*Interest rate risk*

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

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2008. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2008 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve. During 2008 and 2007 sensitivity analysis did not reveal significant potential effect on Group Equity.

| *Currency* | *Increase in basis points 2008* | *Sensitivity of net interest income 2008* | *Sensitivity of equity 2008* |
|---|---|---|---|
| UAH | 0.75% | – | 72 |
| EUR | 1.50% | 79 | – |
| USD | 0.55% | 3,434 | – |

| *Currency* | *Decrease in basis points 2008* | *Sensitivity of net interest income 2008* | *Sensitivity of equity 2008* |
|---|---|---|---|
| UAH | -1.25% | – | (121) |
| EUR | -1.50% | (79) | – |
| USD | -0.55% | (3,434) | – |

(Thousands of Georgian Lari)

## 27. Risk Management (continued)

**Market risk (continued)**

| *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 | – |

*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 2008 on its trading and non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Georgian Lari, with all other variables held constant on the income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase. During 2008 and 2007 sensitivity analysis did not reveal significant potential effect on Group Equity.

| *Currency* | *Change in currency rate in % 2008* | *Effect on profit before tax 2008* | *Effect on equity 2008* | *Change in currency rate in % 2007* | *Effect on profit before tax 2007* | *Effect on equity 2007* |
|---|---|---|---|---|---|---|
| EUR | 14.9% | (832) | – | 4.6% | 104 | – |
| GBP | 24.9% | 17 | – | 5.0% | (137) | – |
| RUR | 0.3% | (6) | – | 0.1% | 24 | – |
| UAH | 2.8% | 8 | – | 0.7% | (38) | – |
| USD | 9.2% | (1,216) | – | 3.5% | (2,450) | – |

*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 (loss) profit before tax for one year and on equity, is as follows:

| | *Effect on net interest income* | *Effect on equity* |
|---|---|---|
| 2008 | (34,546) | |
| 2007 | (36,527) | – |

## 27. Risk Management (continued)

### Operational risk

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

### Operating environment

As an emerging market, Georgia does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature market economy. Operations in Georgia may involve risks that are not typically associated with those in developed markets (including the risk that the Georgian Lari is not freely convertible outside of the country, and undeveloped debt and equity markets). However over the last few years the Georgian government has made a number of developments that positively affect the overall investment climate of the country, specifically implementing the reforms necessary to create banking, judicial, taxation and regulatory systems. This includes the adoption of a new body of legislation (including new Tax Code and procedural laws). In management's view, these steps contribute to mitigate the risks of doing business in Georgia.

The existing tendency aimed at the overall improvement of the business environment is expected to persist. The future stability of the Georgian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Government. However, the Georgian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. During the year there have been major events that have an effect on the Bank's operations – the military conflict in August 2008 involving Georgia, the Russian Federation and South Ossetia, and the financial crisis which significantly affected global economies from last quarter of 2008. Though no direct damage has been sustained by the Bank during the military conflict, it had caused significant damage to the Georgian economy and the Fitch and S&P country ratings were downgraded. The ongoing global financial crisis and the military conflict have resulted in capital markets instability, deterioration of liquidity in the banking sector, and tighter credit conditions within Georgia. The Georgian Government has introduced a range of stabilization measures aimed at ensuring solvency and providing liquidity and supporting refinancing of foreign debt for Georgian banks and companies.

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

(Thousands of Georgian Lari)

## 28. 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 2008 | Fair value 2008 | Unrecognised loss 2008 | Carrying value 2007 | Fair value 2007 | Unrecognised loss 2007 |
|---|---|---|---|---|---|---|
| *Financial assets* | | | | | | |
| Cash and cash equivalents | 397,591 | 397,591 | – | 405,770 | 405,770 | – |
| Amounts due from credit institutions | 99,633 | 99,633 | – | 154,560 | 154,560 | – |
| Loans to customers | 2,039,022 | 1,991,449 | (47,573) | 1,675,681 | 1,675,681 | – |
| Finance lease receivables | 41,605 | 41,605 | – | 46,674 | 46,674 | – |
| Investment securities: | | | | | | |
| - available-for-sale | 33,737 | 33,737 | – | 42,387 | 42,387 | – |
| - held-to-maturity | 22,845 | 22,845 | – | 192,464 | 191,572 | (892) |
| *Financial liabilities* | | | | | | |
| Amounts due to credit institutions | 1,216,722 | 1,216,722 | – | 901,795 | 901,795 | – |
| Amounts due to credit institutions | 1,193,124 | 1,201,746 | (8,622) | 1,355,476 | 1,355,476 | – |
| Debt securities issued | 5 | 5 | – | 4,993 | 4,993 | – |
| **Total unrecognised change in unrealised fair value** | | | **(56,195)** | | | **(892)** |

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)

## 28. 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 2008* | *Valuation techniques – market observable inputs 2008* | *Valuation techniques – non-market observable inputs 2008* | *Total 2008* |
|---|---|---|---|---|
| *Financial assets* | | | | |
| Investment securities – available-for-sale | 17,644 | 16,093 | – | 33,737 |
| Other assets – trading securities owned | 92 | – | – | 92 |
| | **17,736** | **16,093** | **–** | **33,829** |

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

(Thousands of Georgian Lari)

## 29. Maturity Analysis of Financial Assets and Liabilities

The table below shows an analysis of financial assets and liabilities according to when they are expected to be recovered or settled. See Note 27 "Risk management" for the Group's contractual undiscounted repayment obligations.

| | 2008 | | | 2007 | | |
|---|---|---|---|---|---|---|
| | Within one year | More than one year | Total | Within one year | More than one year | Total |
| *Financial assets* | | | | | | |
| Cash and cash equivalents | 397,591 | – | 397,591 | 405,770 | – | 405,770 |
| Amounts due from credit institutions | 87,205 | 12,428 | 99,633 | 153,893 | 667 | 154,560 |
| Loans to customers | 897,167 | 1,141,855 | 2,039,022 | 929,246 | 746,435 | 1,675,681 |
| Finance lease receivables | 33,375 | 8,230 | 41,605 | 31,225 | 15,449 | 46,674 |
| Investment securities: | | | | | | |
| – available–for–sale | 33,737 | – | 33,737 | 7,787 | 34,600 | 42,387 |
| – held–to–maturity | 22,845 | – | 22,845 | 176,466 | 15,998 | 192,464 |
| **Total** | **1,471,920** | **1,162,513** | **2,634,433** | **1,704,387** | **813,149** | **2,517,536** |
| *Financial liabilities* | | | | | | |
| Amounts due to credit institutions | 402,094 | 814,628 | 1,216,722 | 146,815 | 754,980 | 901,795 |
| Amounts due to customers | 1,124,598 | 68,526 | 1,193,124 | 1,280,911 | 74,565 | 1,355,476 |
| Debt securities issued and other liabilities | 1,463 | 5 | 1,468 | 9,283 | 4,369 | 13,652 |
| **Total** | **1,528,155** | **883,159** | **2,411,314** | **1,437,009** | **833,914** | **2,270,923** |
| **Net** | **(56,235)** | **279,354** | **223,119** | **267,378** | **(20,765)** | **246,613** |

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 2008 deposits amounted to GEL 1,193,124 (2007: GEL 1,355,476) and represented 47% (2007: 57%) of Group's total liabilities. These borrowings continue to provide a majority of the Group's funding and represent a diversified and stable source of funds. As of 31 December 2008 amounts owed to other credit institutions amounted to GEL 1,216,722 (2006: GEL 901,795) and represented 48% (2007: 38%) of total liabilities.

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

(Thousands of Georgian Lari)

## 30. Related Party Disclosures

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

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

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

| | *2008* | | | *2007* | | |
|---|---|---|---|---|---|---|
| | *Parent* | *Asso-ciates* | *Key management personnel* | *Parent* | *Asso-ciates* | *Key management personnel* |
| **Loans outstanding at 1 January, gross** | **–** | **13,274** | **510** | **–** | **6,010** | **312** |
| Loans issued during the year | 1,339 | 12,085 | 8,229 | – | 14,237 | 507 |
| Loan repayments during the year | (1,074) | (9,709) | (3,375) | – | (6,649) | (299) |
| Other movements | – | 5,994 | 208 | – | – | – |
| **Loans outstanding at 31 December, gross** | **265** | **21,644** | **5,572** | **–** | **13,598** | **520** |
| Less: allowance for impairment at 31 December | | (3,181) | (1,064) | – | (324) | (10) |
| **Loans outstanding at 31 December, net** | **265** | **18,463** | **4,508** | **–** | **13,274** | **510** |
| Interest income on loans | – | 2,125 | 468 | – | 1,102 | 58 |
| Loan impairment charge | – | 3,099 | 120 | – | 139 | 4 |
| **Deposits at 1 January** | **12,733** | **4,485** | **626** | **11,281** | **2,944** | **7,252** |
| Deposits received during the year | – | 79,356 | 53,081 | 1,452 | 95,488 | 12,038 |
| Deposits repaid during the year | – | (83,638) | (35,450) | – | (93,947) | (18,664) |
| Other movements | – | (26) | 67 | – | – | – |
| **Deposits at 31 December** | **12,733** | **177** | **18,324** | **12,733** | **4,485** | **626** |
| **Current accounts at 31 December** | | | | | | |
| Interest expense on deposits | – | 2 | 14 | 746 | 178 | 97 |
| Other income | 767 | _ | 32 | – | – | 852 |

Compensation of key management personnel was comprised of the following:

| | **2008** | **2007** |
|---|---|---|
| Salaries and other benefits | 9,975 | 16,104 |
| - Among them, termination benefits | 10 | 4,876 |
| Share-based payments compensation | 7,820 | 8,992 |
| - Among them, termination benefits | – | 1,944 |
| Social security costs | 94 | 4,124 |
| Recruitment costs | 28 | 20 |
| **Total key management compensation** | **17,917** | **29,240** |

The number of key management personnel as 31 December 2008 was 105 (2007: 70).

(Thousands of Georgian Lari)

## 31. Capital Adequacy

The Group maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the ratios established by the 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 the special purpose financial statements prepared in accordance with NBG regulations and pronouncements. As of 31 December 2008 and 2007, the Bank's capital adequacy ratio on this basis was as follows:

| | *2008* | *2007* |
|---|---|---|
| Core capital | 573,146 | 368,959 |
| Supplementary capital | 162,902 | 162,867 |
| Less: Deductions from capital | (269,427) | (166,230) |
| **Total regulatory capital** | **466,621** | **365,596** |
| **Risk-weighted assets** | **3,458,133** | **2,796,443** |
| **Total capital adequacy ratio** | **13.5%** | **13.1%** |

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

**Capital adequacy ratio under Basel Capital Accord 1988**

The Bank's capital adequacy ratio, computed in accordance with the Basel Capital Accord 1988, with subsequent amendments including the amendment to incorporate market risks, as of 31 December 2008 and 2007, follows:

| | *2008* | *2007* |
|---|---|---|
| Tier 1 capital | 651,826 | 464,516 |
| Tier 2 capital | 232,840 | 159,914 |
| Less: Deductions from capital | (249,373) | (214,615) |
| **Total regulatory capital** | **635,293** | **409,815** |
| **Risk-weighted assets** | **2,560,696** | **1,859,330** |
| Total capital ratio | 24.8% | 22.0% |
| Tier 1 capital ratio | 25.5% | 25.0% |
| **Minimum capital adequacy ratio** | **8%** | **8%** |

## 32. Events Subsequent to Balance Sheet Date

During the 1st quarter of 2009 the Bank obtained long-term unsecured funding from the European Bank for Reconstruction and Development ("EBRD") and International Financial Corporation ("IFC"), with a total combined nominal value of USD 200 million, comprising of the following facilities:

**IFC funded**

- USD 50 million senior loan at LIBOR + 5.5% annual interest rate and maturity of 55 months;
- USD 24 million subordinated debt at LIBOR + 10% annual interest rate and maturity of 120 months; and
- USD 26 million subordinated, convertible loan at LIBOR + 8% annual interest rate and maturity of 120 months;

**EBRD funded**

- USD 50 million senior loan at LIBOR + 5.5% annual interest rate and maturity of 61 months;
- USD 24 million subordinated debt at LIBOR + 10% annual interest rate and maturity of 120 months; and
- USD 26 million subordinated, convertible loan at LIBOR + 8% annual interest rate and maturity of 120 months;

# Shareholder Information

**Joint Stock Company Bank of Georgia**

Registered Address
3 Pushkin Street
Tbilisi, Georgia 0105
www.bog.ge

Registered under number 06/5-07 by Krtsanisi District Court
Tbilisi, Georgia
Registration date: 29 November 1995

**Stock Listing**

London Stock Exchange (LSE)
Ticker symbol for Bank of Georgia GDR is BGEO
Bloomberg: BGEO LI

Georgian Stock Exchange (GSE)
Ticker symbol for Bank of Georgia share is GEB

**Contact Information**

Bank of Georgia Investor Relations
TEL:+995 32 444 571
Fax: + 995 32 444 241
E-mail: ir@bog.ge
www.bog.ge/ir

**Depositary**

The Bank of New York Mellon
101 Barclay Street
New York, NY 10286

**Auditors**

Ernst & Young Audit LLC
44 Kote Abkhazi Street
Tbilisi, Georgia 0105

**Registrar**

Kavkazreestri
74a Chavchavadze Avenue
Tbilisi, Georgia 0162