JSC VTB Bank (Georgia)

Consolidated financial statements

For the year ended 31 December 2011
Together with independent auditors' report

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Independent auditors' report

To the Shareholders and Supervisory Board of JSC VTB Bank (Georgia) -

We have audited the accompanying consolidated financial statements of JSC VTB Bank (Georgia) and its subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2011, and the consolidated statements of comprehensive income, of changes in equity and of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLC

23 March 2012

Consolidated statement of financial position

As of 31 December 2011

(Thousands of Georgian Lari)

	Notes	2011	2010
Assets			
Cash and cash equivalents	6	49,307	37,988
Amounts due from banks and international financial institutions	7	29,879	11,583
Loans and advances to customers	8	267,606	200,458
Investment securities:	9		
- Available-for-sale		3,037	94
- Held-to-maturity		8,486	31,382
Property and equipment	10	37,161	30,250
Investment property	11	18,182	17,897
Current income tax assets		76	286
Deferred income tax assets	12	6,531	7,257
Other assets	13	3,462	3,556
Total assets		423,727	340,751
Liabilities			
Amounts due to banks and international financial institutions	14	40,689	5,644
Amounts due to customers	15	181,868	180,576
Other borrowed funds	16	100,807	63,676
Deferred income tax liabilities	12	7	-
Other liabilities	13	8,614	7,184
Subordinated loan	25	20,295	21,534
Total liabilities		352,280	278,614
Equity			
Share capital	17	148,043	148,043
Land and buildings revaluation reserve		1,572	1,609
Accumulated losses		(78,168)	(87,515)
Total equity		71,447	62,137
Total liabilities and equity		423,727	340,751

Signed and authorised for release on behalf of the Management Board of the Bank on 23 March 2012.

Archil Kontselidze
General Director

Mamuka Jijavadze
Chief Accountant

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December 2011

(Thousands of Georgian Lari)

	Notes	2011	2010
Interest income			
Loans and advancesto customers		39,904	45,903
Investment securities:			
- Available-for-sale		289	-
- Held-to-maturity		2,584	1,393
Cash and cash equivalents		1,122	1,080
Amounts due from banks and international financial institutions		46	21
		43,945	48,397
Interest expense			
Amounts due to customers		(9,153)	(13,492)
Amounts due to banks, international financial institutions and other borrowed funds		(4,334)	(10,898)
Subordinated loan		(1,371)	(1,487)
		(14,858)	(25,877)
Net interest income		29,087	22,520
Net recovery of provision/(net provision charge) for loan impairment	8	2,389	(23,013)
Net interest income/(expense) after recovery of provision/ provision charge for loan impairment		31,476	(493)
Net fee and commission income	19	3,715	2,919
Net gains/(losses) from foreign currencies:			
- dealing		4,116	6,454
- translation differences		236	(151)
Impairment of investment securities		-	(3)
Net gains/(losses) from disposal of investment property		288	(17)
Net (losses)/gains on investment property revaluation	11	(1,091)	70
Other income	20	3,266	3,044
Non-interest income		10,530	12,316
Personnel expenses	21	(20,177)	(17,607)
Depreciation	10	(2,268)	(2,273)
Other operating expenses	21	(8,864)	(7,587)
Other impairment and provisions charge	13	(654)	(499)
Non-interest expenses		(31,963)	(27,966)
Income/(loss) before income tax expense		10,043	(16,143)
Income tax (expense)/benefit	12	(733)	803
Total comprehensive income/(loss) for the year		9,310	(15,340)

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2011

(Thousands of Georgian Lari)

	Note	*Share capital*	*Land and buildings revaluation reserve*	*Accumulated losses*	*Total equity*
As of 31 December 2009 (adjusted)		**104,543**	**1,969**	**(72,535)**	**33,977**
Total comprehensive loss for the year		-	-	(15,340)	(15,340)
Depreciation of revaluation reserve, net of tax		-	(43)	43	-
Transfer of property revaluation reserve upon disposal, net of tax		-	(317)	317	-
Issuance of share capital	17	43,500	-	-	43,500
As of 31 December 2010		**148,043**	**1,609**	**(87,515)**	**62,137**
Total comprehensive income for the year		-	-	9,310	9,310
Depreciation of revaluation reserve, net of tax		-	(37)	37	-
As of 31 December 2011		**148,043**	**1,572**	**(78,168)**	**71,447**

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2011

(Thousands of Georgian Lari)

	Notes	*2011*	*2010*
Cash flows from operating activities			
Interest received		49,680	50,908
Interest paid		(14,561)	(25,679)
Fees and commissions received		4,933	4,161
Fees and commissions paid		(1,206)	(1,271)
Realised net gains from dealing in foreign currencies		4,687	6,507
Other income received		2,569	2,909
Personnel expenses paid		(19,071)	(15,790)
Other operating expenses paid		(9,468)	(7,391)
Cash flows from operating activities before changes in operating assets and liabilities		**17,563**	**14,354**
Net (increase)/decrease in operating assets			
Amounts due from banks and international financial institutions		(23,295)	(6,338)
Loans and advances to customers		(81,688)	22,995
Other assets		97	(281)
Net increase/(decrease) in operating liabilities			
Amounts due to banks and international financial institutions		40,020	(81,149)
Amounts due to customers		6,178	26,824
Other liabilities		(96)	(740)
Net cash flows used in operating activities before income tax		**(41,221)**	**(24,335)**
Income tax paid		-	-
Net cash used in operating activities		**(41,221)**	**(24,335)**
Cash flows from investing activities			
Purchase of investment securities available-for-sale		(8,255)	-
Proceeds from sale and redemption of investment securities available-for-sale		5,369	15
Purchase of investment securities held-to-maturity		(21,071)	(69,044)
Proceeds from redemption of investment securities- Held-to-maturity		43,715	47,781
Purchase of property, equipment and intangible assets		(9,370)	(3,884)
Proceeds from sale of property and equipment		56	317
Proceeds from disposal of investment property		5,029	359
Purchases of investment property		(3,893)	(277)
Net cashfrom/(used in) investing activities		**11,580**	**(24,733)**
Cash flows from financing activities			
Proceeds from issuance of share capital	17	-	43,500
Other borrowed funds received		115,578	17,453
Redemption of other borrowed funds		(74,552)	(34,936)
Net cash from financing activities		**41,026**	**26,017**
Effect of exchange rates changes on cash and cash equivalents		(66)	67
Net increase/(decrease) in cash and cash equivalents		**11,319**	**(22,984)**
Cash and cash equivalents, beginning	6	**37,988**	**60,972**
Cash and cash equivalents, ending	6	**49,307**	**37,988**

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

(Thousands of Georgian Lari)

1. Introduction

These consolidated financial statements have been prepared for JSC VTB Bank (Georgia) (the "Bank" hereafter) and its subsidiaries (together referred to as "the Group").

As of 31 December 2011 and 2010 the Bank's subsidiaries include the following wholly-owned companies, registered in Georgia:

- "Georgian Fund Company" Ltd. Its paid-up share capital amounts to GEL 11. The company operates as a brokerage agent.
- "GT+". Its paid up share capital amounts to GEL 0.2. The company owns and operates tennis courts in Tbilisi.

The Bank was formed as a joint stock company on 7 April 1995 under the laws of Georgia under the name of United Georgian Bank. The Bank changed its name to VTB Bank (Georgia) on 7 December 2006. The Bank operates under a general banking licence issued by the National Bank of Georgia (the "NBG") on 19 May 1995.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its corporate and retail customers. Its main office is in Tbilisi, Georgia. As of 31 December 2011 the Bank has 12 branches (4 of them in Tbilisi) and 1 service centre. As of 31 December 2010 the Bank had 13 branches (5 of them in Tbilisi) and 1 service centre.

The Bank's registered legal address is 14 Chanturia str, Tbilisi, Georgia.

As of 31 December 2011 and 2010, the following shareholders owned more than 1% of the outstanding shares:

Shareholder	*2011* %	*2010* %
VTB Bank OJSC	96.31	96.31
Lacarpa Enterprises Limited	2.08	2.08
Other	1.61	1.61
Total	100.0	100.0

VTB Bank OJSC ("the Parent bank") is the immediate parent of the Bank. The ultimate controlling party for the Group is the State of the Russian Federation ("RF"), acting through the Federal Property Agency, which holds 75.5% of issued and outstanding shares of the Parent bank as of 31 December 2011(2010: 85.5%).

As of 31 December 2011 and 2010 none of the Supervisory Council and Management Board members owned shares of the Bank.

As of 31 December 2011 the Bank had 687 employees (2010: 693).

2. Basis of preparation and significant accounting policies

Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention except for land and buildings, investment property, investment securities available-for-sale and financial instruments at fair value through profit or loss, which are carried at fair value.

These consolidated financial statements are presented in thousands of Georgian Lari ("GEL"), unless otherwise indicated. GEL is utilised as the functional currency as the majority of the Group's transactions are denominated or funded in GEL. Transactions in other currencies are treated as transactions in foreign currencies.

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Subsidiaries

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

Financial assets

Initial recognition

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

Date of recognition

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

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.

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 amortized cost. Gains and losses are recognized in the consolidated income statement when the investments are impaired, as well as through the amortization 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 other category. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognised in other comprehensive income until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to the consolidated income statement. However, interest calculated using the effective interest method is recognised in the consolidated income statement.

If the Group has both the intention and ability to hold investment securities available-for-sale to maturity, they may be reclassified as investment securities held-to-maturity. In this case the fair value of securities as of the date of reclassification becomes their new amortised cost. For instruments with a fixed maturity the revaluation reserve as of the date of reclassification is amortised to profit or loss during the period until maturity using the effective interest rate method.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Financial assets (continued)

Determination of fair value

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

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

Cash and cash equivalents

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

Derivative financial instruments

In the normal course of business, the Group enters into certain derivative financial instruments contracts primarily including foreign exchange forwards and swaps. Such financial instruments are recorded at fair value. The fair values are estimated based on 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 net gains/(losses) from foreign currency dealing in consolidated income statement.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to banks and international financial institutions, amounts due to customers, other borrowed funds and subordinated loans. These are initially recognized at fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are 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.

Amounts due to banks and international financial institutions represent funds attracted to manage the Group's liquidity, while other borrowed funds comprises funds received for general capital working purposes and under basic agreements with international credit institutions to finance activities of the Group's customers.

Operating lease – Group as lessee

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

Impairment of financial assets

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

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Impairment of financial assets (continued)

Loans and advances to customers, investment securities held-to-maturity, amounts due from banks and international financial institutions

For assets 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. 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.

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, 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. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Available-for-sale financial investments

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

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

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

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Restructuring of financial assets

The Group from time to time restructures some of its financial assets. This mostly relates to loans and receivables. The accounting treatment of such restructuring is conducted in 3 basic scenarios:

- If the currency of the loan has been changed, the old loan is derecognized and the new loan is recognized, which requires the estimation of a new effective interest rate. If the new effective interest rate is below the market interest rate, the loss on initial recognition is recognized in the reporting period.
- If the loan restructuring is not caused by the financial difficulties of the borrower but the cash flows were renegotiated, the loan is not recognized as impaired. The loan is not derecognised but the new effective interest rate is determined based on the remaining cash flows under the loan agreement till maturity. If the new effective interest rate is below the market rate at the date of restructuring, the new carrying amount is calculated as the fair value of the loan after restructuring, being the present value of the future cash flows discounted using the market rate at the date of restructuring. In this case, the difference between the carrying amount before restructuring and the fair value of the loan after restructuring is recognized as a loss on loans restructuring.
- If the loan is impaired after restructuring, the Group uses the original effective interest rate in respect of new cash flows to estimate the recoverable amount of the loan. The difference between the recalculated present value of the new cash flows taking into account collateral and the carrying amount before restructuring is included in loan impairment charge for the period.

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Non-performing loans

According to the Group's policy, non-performing loans are derecognized as follows:

- individually significant loans are being written off based on respective decision of the Bank's Credit committee;
- other loans are being written off individually when become overdue for 150 days.

In case the Group receives any amounts from the borrower subsequently to the loan write off, respective amounts are recognized within allowance for loan impairment as recoveries.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Derecognition 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 derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the consolidated income statement.

Offsetting

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

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, primarily consisting of letters of credit and guarantees. 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 settling any financial obligation arising as a result of the guarantee.

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

Taxation

The current income tax expense is calculated in accordance with the regulations of Georgia.

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

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

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

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

Property and equipment

Property and equipment, except for land and buildings, are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met. Buildings are measured at fair value less depreciation and impairment charged subsequent to the date of the revaluation. Land is measured at fair value and not depreciated. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Property and equipment (continued)

Any revaluation surplus is credited to the revaluation reserve for land and buildings included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in the consolidated income statement, in which case the increase is recognised in the consolidated income statement. A revaluation deficit is recognised in the consolidated income statement, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

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

Construction in progress is carried at cost, less provision for impairment where required. Upon completion, assets are transferred to office premises or other premises at their carrying amount. Construction in progress is not depreciated until the asset is available for use.

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.

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
Utility systems and relatedfeatures	10-40
Computers and communication equipment	4
Furniture, fixtures and office equipment	6
Motor vehicles	5
Leasehold improvements	Over the term of the underlying lease

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

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

Investment property

Investment property is land or building or a part of a building held to earn rental income or for capital appreciation and which is not used by the Group or held for sale in the ordinary course of business.

Investment property is initially recognized at cost, including transaction costs, and subsequently remeasured at fair value which reflects current market value and represents potential price between knowledgeable, willing parties in an arm's length transaction. Revaluation of investment property is held on each reporting date and recognised in consolidated income statement as gains/losses on investment property revaluation. Earned rental income is recorded in consolidated income statement within other operating income.

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 5 to 20 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.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Provisions

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

Retirement and other employee benefit obligations

The Group does not have any pension arrangements separate from the State pension system of the Republic of Georgia.

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.

Dividends

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

Contingencies

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

Recognition of income and expenses

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

Interest income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as 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

Commission income on settlements and cash operations are recognized when the service is delivered to the customer.

Loan commitment fees for loans that are likely to be drawn down and other credit related fees, including fee on guarantees and letters of credit issued, are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

Dividend income

Revenue is recognised when the Group’s right to receive the payment is established.

(Thousands of Georgian Lari)

2. Basis of preparation and significant accounting policies (continued)

Foreign currency translation

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

Differences between the contractual exchange rate of a transaction in a foreign currency and the National Bank exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official NBG exchange rates at 31 December 2011 and 2010 were 1.6703 GEL and 1.7728 GEL to 1 USD, respectively. The official NBG rate as of 23 March 2012 is 1.6403 GEL to 1 USD.

3. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the amounts recognised in the consolidated financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on Management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the consolidated financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Going concern

The Group's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources and the financial support of the Parent bank to continue in business for the foreseeable future. Furthermore, the Management is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

Allowance for loan impairment

The Group regularly reviews its loans and receivables to assess impairment. The Group uses its judgement 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 judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

Revaluation of property

The Group regularly reviews the value of its property (land, office buildings and investment property) for compliance with fair value and performs revaluation to ensure that the current carrying amount of property does not materially differ from its fair value. The Group performs revaluation using special valuation techniques and information about real estate transactions entered into in the local market. The results received from the application of the above valuation methods, however, may not always correspond to the market value of property.

Land and buildings have been revalued to market value at 31 December 2009. Revalued buildings are depreciated in accordance with their remaining useful life since 1 January 2010. The Group's management believes that carrying value of land and buildings does not differ materially from that which would be determined using fair value as of 31 December 2011.

Investment property is revalued to market value at least at each financial year-end.

(Thousands of Georgian Lari)

3. Critical accounting estimates and judgements in applying accounting policies (continued)

Taxation

Georgian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently, unexpectedly and with retrospective effect. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant tax authorities. Trends within Georgia suggest that the tax authorities are taking a more assertive position in their interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed, the effect of which cannot be practicably estimated, but could be significant to the financial condition of the Group. Fiscal periods remain open to review by the authorities in respect of taxes for six calendar years preceding the year of review.

However, based upon Management's understanding of the tax regulations and Management analysis of the results of inspection conducted by tax authorities, Management believes that its interpretation of the relevant tax legislation is reasonable and will be sustainable. Moreover Management believes that the Group has accrued all applicable taxes.

Deferred tax assets

The recognised deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded in the statement of financial position. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on management expectations that are believed to be reasonable under the circumstances.

Changes in presentation

For the purposes of more detailed presentation of Interest expense in Consolidated statement of comprehensive income, the presentation of comparative figures have been adjusted to conform to the presentation of the current year amounts.

The effect of reclassifications on the consolidated statement of financial position for the year ended 31 December 2010 is as follows:

Interest expense	*As previously reported*	*Reclassification*	*As reclassified*
Amounts due to credit institutions	(12,378)	12,378	-
Amounts due to the National Bank of Georgia and the Government	(1,184)	1,184	-
Amounts due to customers	(12,315)	(1,177)	(13,492)
Amounts due to banks, international financial institutions and other borrowed funds	-	(10,898)	(10,898)
Subordinated loan	-	(1,487)	(1,487)

4. Changes in accounting policies and adoption of new or revised standards and interpretations

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:

IAS 24 Related party disclosures (Revised)

The revised IAS 24, issued in November 2009 and effective for annual periods beginning on or after 1 January 2011, simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. Previously, an entity controlled or significantly influenced by a government was required to disclose information about all transactions with other entities controlled or significantly influenced by the same government. The revised standard requires disclosure about these transactions only if they are individually or collectively significant. The amendment had no significant impact on the Group's consolidated financial statements.

(Thousands of Georgian Lari)

4. Changes in accounting policies and adoption of new or revised standards and interpretations (continued)

Adoption of new or revised standards and interpretations (continued)

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

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments
IFRIC Interpretation 19 was issued in November 2009 and is effective for annual periods beginning on or after 1 July 2010. The interpretation clarifies the accounting when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor to extinguish all or part of the financial liability. This Interpretation had no impact on the Group's consolidated financial statements.

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

- IFRS 7 *Financial instruments: Disclosures*; introduces the amendments to quantitative and credit risk disclosures. The additional requirements had minor impact as information is readily available.
- Other amendments to IFRS 1, IFRS 3, IAS 1, IAS 27, IAS 34 and IFRIC 13 will have no impact on the accounting policies, financial position or performance of the Group.

The following amendments to standards and interpretations did not have any impact on the accounting policies, financial position or performance of the Group:

- IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Limited Exemption from Comparative IFRS 7 *Disclosures for First-time Adopters*;
- IFRIC 14 *Prepayments of a Minimum Funding Requirement*.

5. New accounting pronouncements

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2012 or later periods and which the Group has not early adopted:

IFRS 9 Financial Instruments
In November 2009 and 2010 the IASB issued the first phase of IFRS 9 *Financial instruments*. This Standard will eventually replace IAS 39 *Financial Instrument: Recognition and Measurement*. IFRS 9 becomes effective for financial years beginning on or after 1 January 2015.The first phase of IFRS 9 introduces new requirements on classification and measurement of financial instruments. In particular, for subsequent measurement all financial assets are to be classified at amortised cost or at fair value through profit or loss with the irrevocable option for equity instruments not held for trading to be measured at fair value through other comprehensive income. For financial liabilities designated at fair value through profit or loss using fair value option IFRS 9 requires the amount of change in fair value attributable to changes in credit risk to be presented in other comprehensive income. The Group now evaluates the impact of the adoption of new Standard and considers the initial application date.

IFRS 10 Consolidated Financial Statements
IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgement to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27.In addition IFRS 10 introduces specific application guidance for agency relationships. IFRS 10 replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also includes the issues raised in SIC-12 *Consolidation – Special Purpose Entities*. It is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. Currently the Group evaluates possible effect of the adoption of IFRS 10 on its financial position and performance.

(Thousands of Georgian Lari)

5. New accounting pronouncements (continued)

IFRS 11 Joint Arrangements

IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. IFRS 11 supersedes IAS 31 Interests in Joint Ventures and SIC-13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers* and is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The Group expects that adoption of IFRS 11 will have no effect on its financial position and performance.

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. IFRS 12 is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. Adoption of the standard will require new disclosures to be made in the financial statements of the Group but will have no impact on its financial position or performance.

IFRS 13 Fair Value Measurement

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. IFRS 13 is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The adoption of the IFRS 13 may have effect on the measurement of the Group's assets and liabilities accounted for at fair value. Currently the Group evaluates possible effect of the adoption of IFRS 13 on its financial position and performance.

IAS 27 Separate Financial Statements (as revised in 2011)

As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The amendment becomes effective for annual periods beginning on or after 1 January 2013. The Group expects that these amendments will have no impact on the Group's financial position.

IAS 28 Investments in Associates and Joint Ventures (as revised in 2011)

As a consequence of the new IFRS 11 and IFRS 12. IAS 28 has been renamed IAS 28 *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after 1 January 2013.The Group expects that these amendments will have no impact on the Group's financial position.

Amendments to IFRS 7 Financial Instruments: Disclosures

The Amendments were issued in October 2010 and are effective for annual periods beginning on or after 1 July 2011. The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Group's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about continuing involvement in derecognised assets to enable the user to evaluate the nature of, and risks associated with, the entity's continuing involvement in those derecognised assets. The amendment affects disclosure only and has no impact on the Group's financial position or performance.

Amendments to IAS 12 Income Taxes – Deferred tax: Recovery of Underlying Assets

In December 2010 the IASB issued amendments to IAS 12 effective for annual periods beginning on or after 1 January 2012. The amendment clarified the determination of deferred tax on investment property measured at fair value. The amendment introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. Furthermore, it introduces the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 always be measured on a sale basis of the asset. The Group now evaluates the impact of the adoption of these amendments.

Amendments to IAS 19 Employee Benefits

The IASB has published amendments to IAS 19 *Employee Benefits*, effective for annual periods beginning on or after 1 January 2013, which proposes major changes to the accounting for employee benefits, including the removal of the option for deferred recognition of changes in pension plan assets and liabilities (known as the "corridor approach"). In addition, these amendments will limit the changes in the net pension asset (liability) recognised in profit or loss to net interest income (expense) and service costs. The Group expects that these amendments will have no impact on the Group's financial position.

(Thousands of Georgian Lari)

5. New accounting pronouncements (continued)

Amendments to IAS 1 Changes to the Presentation of Other Comprehensive Income
The amendments to IAS 1 *Presentation of Financial Statements*, effective for annual periods beginning on or after 1 July 2012, change the grouping of items presented in other comprehensive income. Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. These amendments will change presentation in the statement of comprehensive income but will have no effect on its financial position and performance.

Amendment to IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters
These amendments to IFRS 1, effective for annual periods beginning on or after 1 July 2011, introduce a new deemed cost exemption for entities that have been subject to severe hyperinflation. The Group expects that these amendments will have no impact on the Group's financial position.

Amendments to IAS 32 Financial Instruments: Presentation: guidance on offsetting financial assets and liabilities and amendments to IFRS 7 Financial Instruments: Disclosures: disclosures on offsetting financial assets and liabilities
In December 2011, the IASB issued amendments to its current guidance in IAS 32 on offsetting financial assets and liabilities and has introduced new disclosure requirements in IFRS 7. The amendments to IFRS 7 are to be retrospectively applied for annual periods beginning on or after 1 January 2013 and the amendments to IAS 32 are to be retrospectively applied for annual periods beginning on or after 1 January 2014. Earlier application is permitted. The amendments to IAS 32 now clarify that rights to set-off must not only be legally enforceable in the normal course of business, but must also be enforceable in the event of default, bankruptcy or insolvency of all the counterparties to the contract. The amendments to IAS 32 also clarify that rights of set-off must not be contingent on a future event. The amendments to IAS 32 also clarify the offsetting criteria that the reporting entity is required to intend either to settle on a net basis, or to realize the asset and settle the liability simultaneously. The amendments to IFRS 7 require the reporting entity to disclose information about rights of set-off and related arrangements for all recognized financial instruments that are set off in accordance with IAS 32. The Group now evaluates the impact of the adoption of new amendments and considers the initial application date.

Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards
These amendments issued in March 2012 provide an exception for accounting for government loans at below-market rates of interest. Entities are required to apply the amendments for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The Group expects that these amendments will have no impact on the Group's financial position.

6. Cash and cash equivalents

	2011	*2010*
Cash on hand	15,932	18,348
Overnight deposit with the NBG	11,672	1,800
Current accounts with other credit institutions	10,404	9,864
Current accounts with the NBG	8,007	3,475
Time deposits with credit institutions	3,292	4,501
Cash and cash equivalents	49,307	37,988

As of 31 December 2011, 72% of total current accounts with credit institutions are placed with 2 non-resident credit institutions (2010: 67%).

Non-cash transactions performed by the Group during 2011 are represented by the acquisition of inventory and property and equipment for GEL 243 (2010: GEL 219) and by acquisition of investment property for GEL 2,224 (2010: GEL 3,989).

As of 31 December 2011 overnight deposit with the NBG bears interest rate of 5% (2010: 6%).

As of 31 December 2011 and 2010 the Bank's cash and cash equivalents was of high credit grade, was not either past due, or individually impaired, or renegotiated.

(Thousands of Georgian Lari)

7. Amounts due from banks and international financial institutions

	2011	*2010*
Obligatory reserve with the NBG	27,654	9,472
Time deposits	2,225	2,111
Amounts due from banks and international financial institutions	**29,879**	**11,583**

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

In 2011 and 2010 the obligatory reserve on USD account bears interest at the rate of Federal Reserve System less 0.5 p.a.; on EUR account – the rate of the European Central Bank less 0.5 p.a. In any case the effective rate is not less than zero.

As of 31 December 2011, GEL 2,225(2010: GEL 1,577) included in time deposits was placed on long term deposits and pledged as security for settlement operations to the international financial institutions.

8. Loans and advances to customers

	2011	*2010*
Corporate lending	159,183	132,308
Consumer lending	81,265	53,976
Small business lending	57,761	42,264
Loans to individuals secured by deposits	6,579	5,716
Gross loans and advances to customers	**304,788**	**234,264**
Less – Allowance for impairment	(37,182)	(33,806)
Loans and advances to customers, net	**267,606**	**200,458**

Allowance for impairment of loans and advances to customers

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

	Corporate lending 2011	*Consumer lending 2011*	*Small business lending 2011*	*Total 2011*
At 1 January 2011	**25,948**	**1,747**	**6,111**	**33,806**
Net charge/(reversal) for the year	3,734	(1,566)	(4,557)	**(2,389)**
Recoveries of previously written off loans and advances	3,759	870	1,503	**6,132**
Amounts written off	(166)	(190)	(11)	**(367)**
At 31 December 2011	**33,275**	**861**	**3,046**	**37,182**
Individual impairment	26,924	129	224	**27,277**
Collective impairment	6,351	732	2,822	**9,905**
	33,275	861	3,046	37,182
Gross amount of loans and advances, individually determined to be impaired, before deducting any individually assessed impairment allowance	**39,766**	**259**	**642**	**40,667**

(Thousands of Georgian Lari)

8. Loans and advances customers (continued)

	Corporate lending 2010	*Consumer lending 2010*	*Small business lending 2010*	*Total 2010*
At 1 January 2010	**28,814**	**5,602**	**5,553**	**39,969**
Net charge/(reversal) for the year	21,081	857	1,075	**23,013**
Recoveries of previously written off loans and advances	6,421	2,299	3,262	**11,982**
Amounts written off	(30,368)	(7,011)	(3,779)	**(41,158)**
At 31 December 2010	**25,948**	**1,747**	**6,111**	**33,806**
Individual impairment	23,431	704	360	**24,495**
Collective impairment	2,517	1,043	5,751	**9,311**
	25,948	1,747	6,111	33,806
Gross amount of loans and advances, individually determined to be impaired, before deducting any individually assessed impairment allowance	44,071	1,409	981	46,461

Individually impaired loans

Interest income accrued on loans and advances, for which individual impairment allowances have been recognized, as at 31 December 2011, comprised GEL 2,574 (2010: GEL 4,742).

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, trade receivables and bank guarantees and deposits;
- For retail lending, bank deposits, mortgages over residential properties, inventory, household assets and guarantees of the third persons.

The Group also obtains guarantees from parent companies for loans to their subsidiaries.

The value of collateral is subject to monitoring. The Group may request from the borrower additional collateral in accordance with the loan agreement. For the purposes of providing against impairment losses, realizable value of the received collateral is reviewed and assessed against a number of products with a reference to the liquidity of given collateral and its maturity date.

As of 31 December 2011 the Group held collaterals (land and building) repossessed during the year with cost as of repossession date of GEL 6,117 (2010: GEL 4,266), which were classified as investment property. Refer to Note 11.

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for business use.

Concentration of loans and advances to customers

As of 31 December 2011, the Group had a concentration of loans represented by GEL 90,695 due from the ten largest third party groups of borrowers (29.2% of gross loan portfolio) (2010: GEL 88,069 or 37.5%). An allowance of GEL 22,917 (2010: GEL 21,086) was recognised against these loans.

As of 31 December 2011 included in total loans and advances to customers is an exposure to a single greatest borrower of GEL 8,421 or 2.8% of total loan portfolio (2010: GEL 23,397; 11.67%).

(Thousands of Georgian Lari)

8. Loans and advances customers (continued)

Loans have been extended to the following types of customers:

	2011	*2010*
Commercial legal entities	207,910	165,876
Individuals	96,878	68,388
Gross loans and advances to customers	304,788	234,264

As of 31 December 2011 and 2010 loans and advances to customers are principally issued within Georgia and their distribution by industry sectors is as follows:

	2011	*2010*
Individuals	96,878	68,388
Trading and service enterprises	85,452	76,651
Manufacturing	42,654	11,258
Real estate construction	38,750	31,134
Financial	18,114	9,145
Energy	9,422	31,059
Telecommunication and transportation	7,321	1,660
Agriculture and food processing	543	149
Other	5,654	4,820
Gross loans and advances to customers	304,788	234,264

In 2011 the Group refined its policy of industry classification assignment to the clients, which enabled the Group to obtain more consistent and detailed information on industry concentration. Comparative figures as of 31 December 2010 have been revised accordingly.

9. Investment securities

As of 31 December 2011 investment securities available-for-sale comprised of securities of Ministry of Finance of Georgia with total carrying value of GEL 1,017 (2010: nil), securities of National Bank of Georgia with total carrying value of GEL 1,966 (2010: nil) classified into level 2, and ordinary shares of legal entity GEL 54 (2010: GEL 94) classified into level 3.

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

As of 31 December 2011 securities held-to-maturity comprised securities of the Ministry of Finance of Georgia with total carrying value of GEL 8,486 (2010: GEL 15,534) (2010: securities of National Bank of Georgia with total carrying value of GEL 15,848).

(Thousands of Georgian Lari)

10. Property and equipment

The movements in property and equipment during 2011 and 2010 were as follows:

	Land and buildings	*Computers and communi-cation equipment*	*Furniture, fixtures and office equipment*	*Utility systems and related features*	*Motor vehicles*	*Leasehold improve-ments*	*Construc-tion in progress*	*Total*
Cost or revalued amount								
31 December 2009	**25,414**	**5,297**	**3,209**	**-**	**1,928**	**321**	**3,031**	**39,200**
Additions	-	1,190	516	-	527	-	1,371	**3,604**
Transfers	2,228	-	580	-	-	-	(2,808)	**-**
Disposals	(884)	(294)	(330)	-	(36)	(29)	(230)	**(1,803)**
31 December 2010	**26,758**	**6,193**	**3,975**	**-**	**2,419**	**292**	**1,364**	**41,001**
Additions	180	1,114	1,884	-	145	-	6,318	**9,641**
Transfer	2,766	-	781	1,938	-	347	(5,832)	**-**
Disposals	-	(616)	(167)	-	(1,279)	-	-	**(2,062)**
31 December 2011	**29,704**	**6,691**	**6,473**	**1,938**	**1,285**	**639**	**1,850**	**48,580**
Accumulated depreciation and impairment								
31 December 2009	**(2,276)**	**(3,942)**	**(1,737)**	**-**	**(1,121)**	**(81)**	**-**	**(9,157)**
Depreciation charge	(578)	(766)	(516)	-	(379)	(34)	-	**(2,273)**
Disposals	94	293	244	-	19	29	-	**679**
31 December 2010	**(2,760)**	**(4,415)**	**(2,009)**	**-**	**(1,481)**	**(86)**	**-**	**(10,751)**
Depreciation charge	(493)	(757)	(596)	(24)	(358)	(40)	-	**(2,268)**
Disposals	-	613	132	-	855	-	-	**1,600**
31 December 2011	**(3,253)**	**(4,559)**	**(2,473)**	**(24)**	**(984)**	**(126)**	**-**	**(11,419)**
Net book value:								
31 December 2009	**23,138**	**1,355**	**1,472**	**-**	**807**	**240**	**3,031**	**30,043**
31 December 2010	**23,998**	**1,778**	**1,966**	**-**	**938**	**206**	**1,364**	**30,250**
31 December 2011	**26,451**	**2,132**	**4,000**	**1,914**	**301**	**513**	**1,850**	**37,161**

In 2011 the State security police became a provider of cash collection services in Georgia. In December 2011 the Group outsourced respective services to State security police and disposed of cash-in-transit vehicles in total amount of GEL 1,279.

As of 31 December 2009, an independent appraiser performed the valuation of the fair value of the Group's land and buildings. The market value of the property was determined based on the market data. The market approach was used to determine the fair value, the income approach was used to validate the obtained value estimates, and the cost approach was used to determine the value of real property where no information on recent sales or lease rates for similar properties within the same area was available.

If no revaluation of property and equipment had been performed, the original cost of land and buildings as of 31 December 2011 would have amounted to GEL 26,663 (2010: GEL 23,891) and accumulated depreciation would have amounted to GEL 3,089 (2010: GEL 2,588).

The total value of fully depreciated property and equipment in use as of 31 December 2011 amounted to GEL 4,679 (2010: GEL 3,940).

11. Investment property

	2011	*2010*
Opening balance at 1 January	**17,897**	**13,925**
Additions	6,117	4,266
Reclassified from premises	-	12
Disposals	(4,741)	(376)
Unrealized (loss)/gain on revaluation	(1,091)	70
Closing balance at 31 December	**18,182**	**17,897**

Investment property is a real estate property comprised of land and buildings which was obtained by the Group through repossession of collateral on defaulted loans. Refer to Note 8.

(Thousands of Georgian Lari)

12. Taxation

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

	2011	*2010*
Income/(loss) before income tax expense	**10,043**	**(16,143)**
Statutory tax rate	15%	15%
Theoretical income tax (expense)/benefit at the statutory rate	**(1,506)**	**2,421**
Change in unrecognized deferred tax assets	1,181	(1,747)
Non-deductible expenses	(393)	(28)
Tax exempt income less income recognized for tax purposes only	(15)	157
Income tax (expense)/benefit	**(733)**	**803**

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

	Origination and reversal of temporary differences				
	2009 (adjusted)	*In the income statement*	*2010*	*In the income statement*	*2011*
Tax effect of deductible temporary differences:					
Allowance for loan impairment	1,157	(651)	506	(206)	300
Tax losses carried forward	10,129	3,383	13,512	(2,429)	11,083
Financial instruments adjustment for effective interest rates	-	19	19	571	590
Accrued expenses	648	(57)	591	115	706
Securities available-for-sale	161	1	162	-	162
Investment property	76	(22)	54	153	207
Other	12	19	31	278	309
Gross deferred tax assets	**12,183**	**2,692**	**14,875**	**(1,518)**	**13,357**
Unrecognized deferred tax asset	(5,113)	(1,747)	(6,860)	1,181	(5,679)
Deferred tax assets	**7,070**	**945**	**8,015**	**(337)**	**7,678**
Tax effect of taxable temporary differences:					
Property and equipment	(175)	(143)	(318)	(262)	(580)
Property revaluation	(396)	-	(396)	-	(396)
Allowances for impairment and provision for other losses	-	(44)	(44)	(134)	(178)
Financial instruments adjustment for effective interest rate	(45)	45	-	-	-
Deferred tax liabilities	**(616)**	**(142)**	**(758)**	**(396)**	**(1,154)**
Net deferred tax assets	**6,454**	**803**	**7,257**	**(733)**	**6,524**

Georgian legal entities must file individual tax declarations. The tax rate for banks for profits was 15% for 2011 and 2010. The tax rate for companies other than banks was also 15%. According to the Georgian legislation, revenue from state securities are exempted from taxation.

Deferred income tax liabilities of GEL 7 (2010: GEL 5) presented at consolidated statement of position represents respective liability of "GT+".

The Bank and its subsidiaries have available GEL 3,485 of tax losses carried forward which begins to expire in 2012, GEL 39,604 of tax losses carried forward which will expire in 2013, GEL 9,213 of tax losses carried forward which will expire in 2014, GEL 21,137 of tax losses carried forward which will expire in 2015 and GEL 446 of tax losses carried forward which will expire in 2016 if not utilised.

In 2011 and 2010 the Group incurred no current income tax expense.

(Thousands of Georgian Lari)

13. Other assets and liabilities

Other assets comprise:

	2011	*2010*
Financial assets		
Unsettled transactions on money transfers	784	854
Accrued commission receivable on guarantees and letters of credit	31	15
Derivative financial assets	-	15
Total financial assets	**815**	**884**
Non financial assets		
Prepaid expenses	1,268	277
Intangible assets	1,073	794
Repossessed collateral (equipment)	196	181
Advances paid	42	320
Inventories in stock	32	388
Prepaid operational taxes	6	87
Assets held for sale	-	595
Other	30	30
Total non-financial assets	**2,647**	**2,672**
Other assets	**3,462**	**3,556**

Other liabilities comprise:

	2011	*2010*
Financial liabilities		
Accrued bonuses	3,926	2,896
Unsettled transactions on money transfers	1,821	1,073
Derivative financial liabilities	661	66
Payables for unused vacations	616	542
Accrued expenses	494	628
Settlements on plastic cards	424	308
Settlements on acquisition of property and equipment and inventory	246	219
Total financial liabilities	**8,188**	**5,732**
Non financial liabilities		
Dividends payable to shareholders of the Bank	232	233
Operational taxes payable	152	14
Advances received	42	875
Provision for legal claims	-	330
Total non-financial liabilities	**426**	**1,452**
Other liabilities	**8,614**	**7,184**

As of 31 December 2011 and 2010 the Group's derivative financial instruments comprised of foreign exchange forwards and depo swaps and were attributable to the Level 2 of fair value hierarchy.

Derivatives are valued using a valuation technique with market observable inputs. The applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

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

	Allowance for impairment of other assets	*Provision for legal claim*	*Total*
31 December 2009	**-**	**2,687**	**2,687**
Charge	38	461	**499**
Assets written off	(38)	-	**(38)**
Utilization of provision	-	(2,818)	**(2,818)**
31 December 2010	**-**	**330**	**330**
Charge/(reversal)	831	(177)	**654**
Assets written off	(831)	-	**(831)**
Utilization of provision	-	(153)	**(153)**
31 December 2011	**-**	**-**	**-**

(Thousands of Georgian Lari)

13. Other assets and liabilities (continued)

In November 2009 a legal case was filed in the Georgian court of arbitration by the Georgian telecommunication company Caucasus Online against the Group. Related provision totalling GEL 330 was recognized by the Group. In October 2011, according to decision of the Supreme Court "Caucasus On-line" was completely refused to satisfy the claim. As a result, provision of GEL 177 was released, and GEL 153 utilized to cover legal costs.

In January 2010 the Bank utilized previously recognized provision to settle the legal claim of Harwisk Ltd in the amount of GEL 2,818 based on the final award issued by the London Court of International Arbitration on 30 December 2009.

14. Amounts due to banks and international financial institutions

	2011	*2010*
Loans received from the Parent bank	40,382	5,323
Current accounts	307	321
Amounts due to banks and international financial institutions	**40,689**	**5,644**

As of 31 December 2011 loans received from the Parent bank had maturities ranging from January 2012 till March 2012 (2010: till June 2011) and bear annual interest rates from 0.9% to 3.72% (2010: 4.18%).

Current accounts include facility from the Parent bank of GEL 185 (2010: GEL 186).

15. Amounts due to customers

	2011	*2010*
Individuals:		
- Current/demand accounts	24,154	27,922
- Term deposits	50,270	53,357
Total due to individuals	**74,424**	**81,279**
State and budgetary organisations:		
- Current/settlement accounts	15,417	15,436
- Term deposits	-	242
Total due to state and budgetary organisations	**15,417**	**15,678**
Commercial legal entities:		
- Current/settlement accounts	76,897	66,389
- Term deposits	15,130	17,230
Total due to commercial legal entities	**92,027**	**83,619**
Total due to legal entities	**107,444**	**99,297**
Total amounts due to customers	**181,868**	**180,576**
Held as security against guarantees issued	**1,224**	**472**
Held as security against letters of credit issued	**648**	**378**
Held as security against settlement operations	**2**	**6**

At 31 December 2011 the Group had ten largest customers with aggregate balance due of GEL 51,863 or 29% of total amounts due to customers (2010: GEL 53,078 or 29%).

In accordance with the internal rules, the Bank is obliged to repay term deposits upon demand of a customer. In case a term deposit is repaid upon demand of the customer prior to maturity, interest on it is paid based on the interest rate for demand deposits, unless a different interest rate is specified in the agreement.

(Thousands of Georgian Lari)

15. Amounts due to customers (continued)

An analysis of customer accounts by industry follows:

	2011	*2010*
Individuals	74,424	81,279
Trade and service	24,280	21,729
Transport and communication	24,183	25,578
Government	15,417	14,589
Energy	14,687	9,476
Finance	11,526	12,335
Real estate constructions	6,201	7,250
Education	5,132	1,783
Manufacturing	3,971	3,885
Agriculture	158	376
Other	1,889	2,296
Amounts due to customers	181,868	180,576

In 2011 the Group refined its policy of industry classification assignment to the clients, which enabled the Group to obtain more consistent and detailed information on industry concentration. Comparative figures as of 31 December 2010 have been revised accordingly.

16. Other borrowed funds

	2011	*2010*
Borrowings from theParent bank	58,823	35,878
Borrowings from international financial institutions	39,354	21,579
Borrowings from commercial banks	2,630	6,219
Other borrowed funds	100,807	63,676

As of 31 December 2011 maturities of borrowings from the Parent bank were ranging from January 2012 till October 2014 (2010: from July 2011 till September 2012), interest rates from 3.29% to 7.96% (2010: from 5.81% to 10.95%). Refer to Note 25.

Borrowings from international financial institutions as of 31 December 2011 contained facilities in U.S. dollars and Euro with maturities ranging from January 2012 to December 2032 (2010: from April 2011 to December 2032) and interest rates from Libor+3% to Libor+5.5% and one loan bearing annual interest at 0.75% (2010: from Libor+3% to Libor+6.5%; 0.75%).

Borrowings from commercial banks as of 31 December 2011 contained facility in U.S. dollars with maturities ranging from January 2012 till October 2014 (2010: from July 2011 till September 2012) and interest rate from 3.29% to 7.96% and one loan issued at Libor+2% (2010: 15.18% till 10.945%; Libor+2%).

17. Equity

Share capital

Movements in ordinary shares authorized and fully paid were as follows:

	Number of shares authorized	*Number of shares fully paid*	*Nominal amount, GEL*
31 December 2009	104,575,002	104,542,701	104,543
Increase in share capital	43,500,000	43,500,000	43,500
31 December 2010	148,075,002	148,042,701	148,043
Cancellation	(32,301)	-	-
31 December 2011	148,042,701	148,042,701	148,043

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

On 11 February 2011 the Bank's registrar recorded the cancellation of 32,301 unpaid common shares of the Bank, following the respective decision of the Parent bank.

(Thousands of Georgian Lari)

17. Equity (continued)

Share capital (continued)

On 2 June 2010 the Annual Shareholders Meeting made a decision to increase the number of authorized shares by 43,500,000. Based on that decision and in accordance with the Bank's charter on 2 June 2010 the Supervisory Board made a decision to issue 43,500,000 ordinary shares. Relates share issue prospectus was approved by the National Bank of Georgia on 18 June 2010 under the order #537. The additional issue was placed in full.

Dividends

In accordance with the Georgian legislation, dividends may only be declared to the shareholders of the Bank from the net income as shown in the Bank's separate financial statements prepared in accordance with the NBG requirements. National Bank shall be authorized to suspend or restrict payment of dividends, if a commercial bank has violated regulatory requirements of the National Bank.

No dividends were declared by the Bank for 2011 through the date of these consolidated financial statements.

18. Commitments and contingencies

Operating environment

Georgia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy, improvement of institutional policies and market structures. 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.

The Georgian economy is vulnerable to global economic slowdowns. International economic crisis, which had negative impact on Georgian economy in 2008-2010, has been gradually overcome. In 2011 gradual economic recovery was accompanied by financial stabilization, however, there continues to be uncertainty regarding further economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects.

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

Legal

From time to time and in the normal course of business, claims against the Group are received. At the reporting date the Group had several unresolved legal claims. Management is of the opinion that there would be no material outflow of resources and accordingly no material provision has been made in these consolidated financial statements.

Financial commitments and contingencies

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

	2011	*2010*
Credit related commitments		
Undrawn loan facilities	27,096	18,941
Guarantees issued	23,252	14,715
Letters of credit	3,653	1,441
Financial commitments and contingencies (before deducting collateral)	**54,001**	**35,097**
Less – cash held as security against letters of credit and guarantees issued (Note 15)	(1,872)	(850)
Financial commitments and contingencies	**52,129**	**34,247**
Operating lease commitments		
Not later than 1 year	111	78
Later than 1 year but not later than 5 years	70	76
	181	**154**

Insurance

The Group has arrangement for employee's medical insurance with insurance company "IC Group". According to the agreement, the Group makes monthly payments of insurance premium to the insurer.

(Thousands of Georgian Lari)

19. Net fee and commission income

	2011	*2010*
Commission on settlements operations	3,200	2,777
Commission on guarantees and letters of credit issued	874	632
Commission on cash operations	753	617
Other	128	149
Fee and commission income	4,955	4,175
Commission on settlements operations	(1,068)	(1,166)
Commission on cash operations	(83)	(63)
Commission on guarantees and letters of credit issued	(78)	(18)
Other	(11)	(9)
Fee and commission expense	(1,240)	(1,256)
Net fee and commission income	3,715	2,919

20. Other income

	2011	*2010*
Penalties received from lending operations	1,801	2,362
Reimbursement of legal fees	418	260
Penalties received for deposit redemption before maturity	382	-
Income from disposal of property	230	133
Income from operation lease	69	40
Dividends received on equity investments	54	-
Other	312	249
Other income	3,266	3,044

21. Personnel and other operating expenses

	2011	*2010*
Salaries	15,429	13,998
Bonuses and premiums	4,748	3,609
Personnel expenses	20,177	17,607
Marketing and advertising	1,429	944
Legal and consultancy	862	1,196
Office supplies	854	806
Repairs and maintenance of property and equipment	766	723
Occupancy and rent	631	446
Computer software maintenance	614	116
Communications	543	585
Utilities	468	457
Business travel and related expenses	366	273
Security	349	143
Representation expenses	340	278
Operating taxes	333	520
Insurance	242	231
Amortisation of intangible assets	198	124
Loss on disposal of property and equipment	144	103
Charity	66	28
Penalties incurred	9	2
Other	650	612
Other operating expenses	8,864	7,587

(Thousands of Georgian Lari)

22. Risk management

The Group is required to manage financial risks that arise as a consequence of its operations to deliver its policy objectives as well as in the course of managing the Group's statement of financial position. These risks primarily include credit risk, liquidity risk, interest rate risk, foreign exchange risk and operational risk.

Risk is inherent to 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 profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities.

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

Risk management structure

The Bank's Board of Directors is ultimately responsible for identifying and controlling risks of the Group; however, there are separate independent bodies responsible for managing and monitoring risks.

Supervisory Council

The Supervisory Council 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. The Asset – liability and Risk management Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Risk Management Unit

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

Risk Controlling Unit

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

Bank Treasury

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

Internal Audit

Risk management processes throughout the Group are audited annually by the internal audit function 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 Supervisory Council through the Audit Committee.

Risk measurement and reporting systems

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

(Thousands of Georgian Lari)

22. Risk management (continued)

Risk measurement and reporting systems (continued)

Information compiled from all the business divisions is examined and processed to analyse, control and identify risks timely. This information is provided to the Management Board, the Asset - liability and Risk management Committee, and the head of each business division. The report includes aggregate credit exposure, credit metric forecasts, hold limit exceptions, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Risk management department assesses the appropriateness of the allowance for credit losses on a monthly basis.

A daily summary on liquidity utilisation is provided to the Management Board and all other relevant employees of the Group.

Risk mitigation

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

Credit risk

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

Credit-related commitments risks

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

The maximum exposure to credit risk for the components of the consolidated statement of financial position, including derivatives, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

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

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group internal credit ratings.

For the purpose of these consolidated financial statements all not past due collectively assessed loans to legal entities (Corporate lending and small business lending) are classified in three quality groups presented in the tables below.

- The high grade group includes borrowers with sound level of liquidity and profitability. The probability of default is assessed as low.
- The standard grade includes borrowers with average level of liquidity and profitability. The probability of default is assessed as moderate.
- Sub-standard grade group includes borrowers with satisfactory level of liquidity and profitability. The probability of breach of default is assessed as above moderate.

For the purpose of these consolidated financial statements all not past due collectively assessed loans to individuals are classified in three quality groups presented in the tables below.

- The high grade group includes borrowers with good debt servicing and excellent financial position of the borrower, loans secured with deposits, loans secured with gold.
- The standard grade group includes borrowers with good/average debt servicing and excellent/moderate financial position of the borrower.
- The sub-standard grade group is represented by loans with average debt servicing and moderate financial position of the borrower.

(Thousands of Georgian Lari)

22. Risk management (continued)

Credit risk (continued)

The table below shows the credit quality by class of credit risk bearing assets:

	Notes	*Neither past due nor impaired* High grade 2011	Standard grade 2011	Sub-standard grade 2011	*Past due or individually impaired 2011*	*Total 2011*
Amounts due from banks and international financial institutions	7	29,879	-	-	-	29,879
Investment securities:	9					
Available-for-sale		2,983	-	-	-	2,983
Held-to-maturity		8,486	-	-	-	8,486
Loans and advances to customers	8					
Corporate lending		27,321	73,979	11,175	13,433	125,908
Small business lending		13,904	25,316	14,368	1,127	54,715
Consumer lending		78,753	-	737	914	80,404
Loans to individuals secured with deposits		6,579	-	-	-	6,579
		126,557	99,295	26,280	15,474	267,606
Total		167,905	99,295	26,280	15,474	308,954

	Notes	*Neither past due nor impaired(adjusted)* High grade 2010	Standard grade 2010	Sub-standard grade 2010	*Past due or individually impaired 2010*	*Total 2010*
Amounts due from banks and international financial institutions	7	11,583	-	-	-	11,583
Investment securities held-to-maturity	9	31,382	-	-	-	31,382
Loans and advances to customers	8					
Corporate lending		34,273	49,728	542	21,816	106,359
Small business lending		192	27,138	5,635	3,189	36,154
Consumer lending		49,359	-	1,705	1,165	52,229
Loans to individuals secured with deposits		5,716	-	-	-	5,716
		89,540	76,866	7,882	26,170	200,458
Total		132,505	76,866	7,882	26,170	243,423

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

Overdue but not impaired loans and advances include solely loans and advances that are not individually significant. The tables below show aging analysis of overdue loans.

(Thousands of Georgian Lari)

22. Risk management (continued)

Credit risk (continued)

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

As of 31 December 2011	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans and advances to customers					
Corporate lending	155	281	155	-	591
Consumer lending	577	156	29	22	784
Small business lending	99	411	199	-	709
Total	831	848	383	22	2,084

As of 31 December 2010	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans and advances to customers					
Corporate lending	-	-	-	1,176	1,176
Consumer lending	302	17	6	135	460
Small business lending	617	119	127	1,705	2,568
Total	919	136	133	3,016	4,204

In 2011, the Group applied revised approach to allocation of collective impairment over past due loans. As a result, loans overdue for more than 90 days are provided in full. That change had no effect on the Group's financial position.

For the purpose of these consolidated financial statements a loan is considered overdue when the borrower fails to make any payment due under the loan agreement at the reporting date. In this case the aggregate amount of all amounts due from borrower under the respective loan agreement including accrued interest and commissions is recognised as overdue.

Loans and advances to customers have been assessed for impairment on the collective basis. Details of loan loss allowance of loan portfolio are disclosed in Note 8.

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

The table below shows the carrying amount for renegotiated (prolonged or refinanced) financial assets, by class.

	2011	*2010*
Loans and advances to customers		
Corporate lending	4,846	12,934
Small business lending	2,484	5,856
Consumer lending	589	1,320
Loans secured by deposits	835	-
Total	8,754	20,110

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days for individuals and 60 days for legal entities or there are any known difficulties in the cash flows of counterparties, 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 occurred, 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.

(Thousands of Georgian Lari)

22. Risk management (continued)

Credit risk (continued)

Collectively assessed allowances

Allowances are assessed collectively for losses on loans and advances to customers that are not individually significant (including consumer lending and small business lending) and for individually significant loans where there is not yet any evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

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

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

	2011				*2010*			
	Georgia	*OECD*	*CIS and other foreign countries*	*Total*	*Georgia*	*OECD*	*CIS and other foreign countries*	*Total*
Assets:								
Cash and cash equivalents	36,340	12,068	899	**49,307**	29,749	7,868	371	**37,988**
Amounts due from banks and international financial institutions	28,585	1,294	-	**29,879**	10,965	618	-	**11,583**
Loans and advances to customers	267,606	-	-	**267,606**	200,458	-	-	**200,458**
Investment securities								
- available-for-sale	3,037	-	-	**3,037**	94	-	-	**94**
- held-to-maturity	8,486	-	-	**8,486**	31,382	-	-	**31,382**
Other assets	815	-	-	**815**	869	-	15	**884**
	344,869	**13,362**	**899**	**359,130**	**273,517**	**8,486**	**386**	**282,389**
Liabilities:								
Amounts due to banks and international financial institutions	56	63	40,570	**40,689**	103	31	5,510	**5,644**
Amounts due to customers	164,839	11,753	5,276	**181,868**	165,702	10,537	4,337	**180,576**
Other borrowed funds	-	42,284	58,523	**100,807**	-	27,798	35,878	**63,676**
Subordinated loan	-	-	20,295	**20,295**	-	-	21,534	**21,534**
Other liabilities	7,496	68	624	**8,188**	5,594	72	66	**5,732**
	172,391	**54,168**	**125,288**	**351,847**	**171,399**	**38,438**	**67,325**	**277,162**
Net assets/(liabilities)	**172,478**	**(40,806)**	**(124,389)**	**7,283**	**102,955**	**29,952**	**66,939**	**6,064**
Net financial commitments	**45,265**	**6,949**	**1,787**	**54,001**	**34,689**	**355**	**53**	**35,097**

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, the Group's 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 state securities that can be pledged to the NBG to obtain financing in the event of demand. The Group also has committed lines of credit that it can assess to meet liquidity needs.

(Thousands of Georgian Lari)

22. Risk management (continued)

Liquidity risk and funding management (continued)

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratio established by National Bank of Georgia. As of 31 December 2011 and 2010 the ratio was as follows:

	2011	*2010*
LK "Average Liquidity Ratio" (Average monthly volume of liquid assets / Average monthly volume of liabilities)	32%	42%

In 2011 minimum limit of average liquidity ratio is 30% (2010: 30%).

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2011 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 Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

Financial liabilities As of 31 December 2011	*On demand and less or equal 1 month*	*More 1 month and less or equal 3 months*	*More 3 month and less or equal 6 months*	*More 6 months and less or equal 1 year*	*More than 1 year*	*Total*
Amounts due to banks and international financial institutions	24,035	17,061	-	-	-	41,096
Amounts due to customers	120,234	17,199	15,575	24,983	7,734	185,725
Other borrowed funds	11,494	9,256	18,014	24,749	45,440	108,953
Subordinated loan	350	247	346	700	25,344	26,987
Other liabilities	3,205	2,070	154	2,759	-	8,188
Total undiscounted financial liabilities	159,318	45,833	34,089	53,191	78,518	370,949

Financial liabilities As of 31 December 2010	*On demand and less or equal 1 month*	*More 1 month and less or equal 3 months*	*More 3 month and less or equal 6 months*	*More 6 months and less or equal 1 year*	*More than 1 year*	*Total*
Amounts due to banks and international financial institutions	321	55	5,372	-	-	5,748
Amounts due to customers	109,747	25,793	14,306	16,537	18,860	185,243
Other borrowed funds	2,190	2,704	5,009	38,490	19,015	67,408
Subordinated loan	363	-	363	725	28,529	29,980
Other liabilities	2,239	2,731	152	589	21	5,732
Total undiscounted financial liabilities	114,860	31,283	25,202	56,341	66,425	294,111

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

	On demand and less or equal 1 month	*More 1 month and less or equal 3 months*	*More 3 month and less or equal 6 months*	*More 6 months and less or equal 1 year*	*More than 1 year*	*Total*
2011	9,127	5,221	9,605	10,245	19,803	54,001
2010	5,751	3,659	3,476	12,604	9,607	35,097

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

Management believes that this level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Group would be given sufficient notice so as to realise its liquid assets to enable repayment.

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 on demand and in less or equal one month in the tables above.

(Thousands of Georgian Lari)

22. Risk management (continued)

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. Except for the concentrations within foreign currency and interest rate risks, the Group has no significant concentration of market risk.

Market risk – Trading

The Management Board has set limits on the level of risk that may be accepted. The Group's activity in market risks area is limited by NBG Deposit certificates, Ministry of Finance of Georgia Treasury Bills, CDs operations, also interbank loans and deposits, and exchange operations. The Group does not perform derivative trading.

Market risk – Non - trading

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 consolidated income statement.

The sensitivity of the consolidated income statement includes the effect of the reasonably possible changes in interest rates on the net interest income for one year based on the assumption that there are parallel shifts in the yield curve.

Currency	*Increase in basis points 2011*	*Sensitivity of pre-tax income 2011*
USD	0.06%	(36)
USD	(0.06%)	36

Currency	*Increase in basis points 2010*	*Sensitivity of pre-tax income 2010*
USD	0.66%	(281)
USD	(0.66%)	281

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 National Bank of Georgia (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 2011 and 2010 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Lari, with all other variables held constant on the consolidated income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on consolidated statement of comprehensive income does not differ from the effect on the consolidated income statement. A negative amount in the table reflects a potential net reduction in consolidated income statement or consolidated statement of comprehensive income, while a positive amount reflects a net potential increase.

Currency	*Increase in currency rate in % 2011*	*Effect on profit before tax 2011*	*Increase in currency rate in % 2010*	*Effect on profit before tax 2010*
USD	(5.8%)	(167)	5.17%	38
EUR	(7.56%)	6	(2.07%)	-

Currency	*Decrease in currency rate in % 2011*	*Effect on profit before tax 2011*	*Decrease in currency rate in % 2010*	*Effect on profit before tax 2010*
USD	5.8%	167	(5.17%)	(38)
EUR	7.56%	(6)	2.07%	-

(Thousands of Georgian Lari)

22. Risk management (continued)

Market risk (continued)

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 effect on profit before tax for one year and on equity, assuming 10% of repayable financial instruments were to prepay at the beginning of the year, with all other variables held constant, is as follows:

	Effect on net interest income
2011	4,910
2010	4,200

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.

As of 31 December 2011 the Group obtained Banker's Blanket Bond and Computer Crime insurance withinsurance premium of GEL 835 (2010: GEL 886) from Lloyd's insurance company.

23. Fair value of financial instruments

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

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

Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments that are not carried at fair value in the consolidated statement of financial position, except for assets for which fair value approximates carrying value – those assets that are liquid or have a short term maturity (less than three months or bear floating interest rate).

	Carrying value 2011	*Fair value 2011*	*Unrecognised gain/(loss) 2011*	*Carrying value 2010*	*Fair value 2010*	*Unrecognised gain/(loss) 2010*
Financial assets						
Loans and advances to customers	267,606	273,075	5,469	200,458	204,453	3,995
Investment securities held-to-maturity	8,486	8,585	99	31,382	31,382	-
Financial liabilities						
Amounts due to customers	181,868	182,208	(340)	180,576	181,529	(953)
Other borrowed funds	100,807	98,006	2,801	63,676	60,542	3,134
Total unrecognised change in unrealised fair value			8,029			6,176

(Thousands of Georgian Lari)

23. Fair value of financial instruments (continued)

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 three months) or bear floating interest rate, it is assumed that the carrying amounts approximate to their fair value.

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.

24. Maturity analysis of financial assets and liabilities

The table below shows assets and liabilities at 31 December 2011 by their remaining expected maturity.Refer to Note 22 for the Bank's contractual undiscounted repayment obligations.

Following principles underlying gap analysis presentation and the Group liquidity risk management are based on the mix of National Bank of Georgia approach and the Bank's practice:

- Cash and cash equivalents represent highly liquid assets and are classified as "On demand and less or equal 1 month"
- Investment securities held-to-maturity are classified based on the remaining maturities
- Loans and advances to customers, amounts due from banks and international financial institutions, other assets, amounts due to banks and international financial institutions, other borrowed funds and other liabilities are included into gap analysis table based on remaining contractual maturities
- Diversification of customer deposits of the bank by number and type of depositors and the past experience of the Group indicate that such accounts and deposits provide a long-term and stable source of funding, and as a result they are allocated per expected time of funds outflow in the gap analysis table on the basis of statistical data accumulated by the Group during the previous periods and assumptions regarding the "stable part" of current account balances. Respective approach was adopted in 2011; comparative figures as of 31 December 2010 have been revised accordingly.

	2011							
	On demand and less or equal 1 month	*More 1 month and less or equal 3 months*	*More 3 month and less or equal 6 months*	*More 6 months and less or equal 1 year*	*More than 1 year*	*Overdue*	*No stated maturity*	*Total*
Financial assets								
Cash and cash equivalents	49,307	-	-	-	-	-	-	**49,307**
Amounts due from banks and international financial institutions	6,557	5,536	4,236	6,860	6,690	-	-	**29,879**
Loans and advances to customers	26,916	45,312	32,444	51,185	110,473	1,276	-	**267,606**
Investment securities								
- available-for-sale	-	1,966	-	-	1,017	-	54	**3,037**
- held-to-maturity	1,993	2,460	-	4,033	-	-	-	**8,486**
Other assets	792	7	7	4	5	-	-	**815**
Total	85,565	55,281	36,687	62,082	118,185	1,276	54	359,130
Financial liabilities								
Amounts due to banks and international financial institutions	23,850	16,839	-	-	-	-	-	**40,689**
Amounts due to customers	41,596	20,352	20,103	23,904	75,913	-	-	**181,868**
Other borrowed funds	10,896	8,051	16,963	23,363	41,534	-	-	**100,807**
Subordinated debt	251	-	-	-	20,044	-	-	**20,295**
Other liabilities	3,205	2,070	154	2,759	-	-	-	**8,188**
Total	79,798	47,312	37,220	50,026	137,491	-	-	351,847
Net	5,767	7,969	(533)	12,056	(19,306)	1,276	54	7,283
Cumulative gap	5,767	13,736	13,203	25,259	5,953	7,229	7,283	-

(Thousands of Georgian Lari)

24. Maturity analysis of financial assets and liabilities (continued)

	2010							
	On demand and less or equal 1 month	*More 1 month and less or equal 3 months*	*More 3 month and less or equal 6 months*	*More 6 months and less or equal 1 year*	*More than 1 year*	*Overdue*	*No stated maturity*	*Total*
Financial assets								
Cash and cash equivalents	37,988	-	-	-	-	-	-	**37,988**
Amounts due from banks and international financial institutions	5,282	712	822	2,989	1,778	-	-	**11,583**
Loans and advances to customers	13,477	20,830	18,901	18,511	126,483	2,256	-	**200,458**
Investment securities								
- available-for-sale	-	-	-	-	-	-	94	**94**
- held-to-maturity	4,992	10,856	2,363	9,128	4,043	-	-	**31,382**
Other assets	858	15	3	-	8	-	-	**884**
Total	62,596	32,413	22,089	30,629	132,312	2,256	94	282,389
Financial liabilities								
Amounts due to banks and international financial institutions	321	5	5,318	-	-	-	-	**5,644**
Amounts due to customers	46,924	16,432	18,650	15,737	82,833	-	-	**180,576**
Other borrowed funds	2,190	1,821	3,628	37,927	18,110	-	-	**63,676**
Subordinated debt	260	-	-	-	21,274	-	-	**21,534**
Other liabilities	2,239	2,731	152	589	21	-	-	**5,732**
Total	51,934	20,989	27,748	54,253	122,238	-	-	277,162
Net	10,662	11,424	(5,659)	(23,624)	10,074	2,256	94	5,227
Cumulative gap	10,662	22,086	16,427	(7,197)	2,877	5,133	5,227	-

As of 31 December 2011 total amount of funding obtained from the Parent bank amounted to GEL 119,385 (2010: GEL 62,921). Management believes that this level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

Long-term loans are generally not available in Georgia. However, in the Georgian marketplace, many short-term credits are granted with the expectation of renewing the loans at maturity. As such, the ultimate maturity of assets may be different from the analysis presented above.

25. Related party disclosures

As of 31 December 2011 and 2010 outstanding balances on related party transactions are as follows:

	2011			2010		
	The Parent bank	*Entities under common control*	*Key management personnel*	*The Parent bank*	*Entities under common control*	*Key management personnel*
Cash and cash equivalents	700	3,828	-	69	3,480	-
Loans and advances to customers, gross	-	-	26	-	23,397	13
Other assets	-	-	-	15	-	2
Amounts due to banks and international financial institutions (Note 14)	40,567	2	-	5,509	-	-
Amounts due to customers	-	7,067	302	-	6,245	381
Other borrowed funds (Note 16)	58,823	-	-	35,878	-	-
Subordinated loan	20,295	-	-	21,534	-	-
Other liabilities	624	-	1,514	66	-	945

Entities under common control are companies that directly or indirectly through one or more intermediaries control or are controlled by or are under common control with the Bank (this includes holding companies subsidiaries and fellow subsidiaries). In these consolidated financial statements included into entities under common control are the members of VTB Group and other legal entities controlled by the Russian Federation.

(Thousands of Georgian Lari)

25. Related party disclosures (continued)

On 25 October 2005, the Group entered into a subordinated loan agreement with the Parent bank for the total amount of USD 12,000 thousand, with interest rate of Libor+6% payable quarterly and maturity on 26 October 2016. In the case of a liquidation of the Group, this loan is only repayable after all the obligations to the Group senior creditors have been met.

As of 31 December 2011 other liabilities to key management personnel comprised of accrued bonuses totaling GEL 1,451 (2010: GEL 900) and unpaid vacation of GEL 63 (2010: GEL45).

Profit and loss on related party transactions are presented in the table below:

	2011			*2010*		
	The Parent bank	*Entities under common control*	*Key management personnel*	*The Parent bank*	*Entities under common control*	*Key management personnel*
Interest income	-	404	4	-	3,033	5
Interest expense	(4,496)	(319)	(48)	(11,060)	(383)	(13)
Fee and commission income	-	34	-	-	18	-
Fee and commission expense	(1)	(49)	-	(1)	(52)	-
Net (losses)/gains from foreign currencies dealing	(565)	127	5	2,479	143	5

Key management personnel as of 31 December 2011 and 2010 comprise 5 members of the Supervisory Board and 5 members of the Management Board of the Bank.

The Group had no significant transactions with members of the Supervisory Board in 2011 and 2010.

For the year ended 31 December 2011, remuneration of the members of the key management personnel comprised salaries, bonuses and other staff related expenses totalling GEL 3,231 (2010: GEL 2,157).

26. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by the National Bank of Georgia (the "NBG") in supervising the Bank.

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

The Bank 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 Bank may return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Capital adequacy ratio

Regulatory capital consists of Tier 1 capital, which comprises common shares, reserve fund and retained earnings excluding current year profit or loss less amount of property revaluation reserve transferred to authorised capital, and intangible assets. The other component of regulatory capital is Tier 2 capital, which includes profit or loss of current year, general reserves (not more than 1.25% of risk weighted assets) and subordinated long-term debt.

The NBG requires banks to maintain a minimum capital adequacy ratio of 12% of risk-weighted assets, computed based on the NBG guidelines. As of 31 December 2011 the Bank's statutory capital adequacy ratio as calculated in accordance with the NBG requirements was 16.19% (2010: 22.88%).

The Bank was in compliance with the capital adequacy ratio calculated based on the NBG requirement as of 31 December 2011 and 2010.

(Thousands of Georgian Lari)

26. Capital adequacy (continued)

Capital adequacy ratio of the Bank in accordance with Basel I as modified by the NBG requirements is as follows:

	2011	*2010*
Tier 1 capital	59,492	75,074
Tier 2 capital	26,392	6,624
Total regulatory capital for ratio calculation	**85,884**	**81,698**
Risk weighted assets	**510,738**	**338,068**
Capital adequacy ratio	**16.82%**	**24.17%**