CARTU BANK GROUP

Consolidated Financial Statements
For the Year Ended December 31, 2011

CARTU BANK GROUP

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of Closed Joint Stock Company Cartu Bank (the "Bank") and its subsidiaries (the "Group") as at December 31, 2011, the consolidated results of its operations, cash flows and changes in equity for the year then ended, in compliance with International Financial Reporting Standards ("IFRS").

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

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance;
- Making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

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

The consolidated financial statements for the year ended December 31, 2011 were authorized for issue on May 7, 2012 by the Management Board of the Group.

On behalf of the Management Board:

General Director	**Chief Accountant**
Nodar Javakhishvili	**Manana Nadiradze**
May 7, 2012	*May 7, 2012*
Tbilisi, Georgia	*Tbilisi, Georgia*

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and the Board of Directors of Joint Stock Company Cartu Bank:

Report on the financial statements

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

Management's responsibility for the financial statements

Management of the Group 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 auditor's 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 consolidated financial position of the Group as at December 31, 2011, and its consolidated financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

May 7, 2012
Tbilisi, Georgia

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2011
(in thousands of Georgian Lari)

	Notes	Year ended December 31, 2011	Year ended December 31, 2010
Interest income	4, 25	65,165	63,342
Interest expense	4, 25	(25,803)	(27,223)
NET INTEREST INCOME BEFORE (PROVISION)/ RECOVERY OF PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING FINANCIAL ASSETS		39,362	36,119
(Provision)/recovery of provision for impairment losses on interest bearing assets	5, 24, 25	(106,249)	1,572
Recovery of assets previously written off		-	2,695
NET INTEREST (LOSS)/INCOME		(66,887)	40,386
Net gain/(loss) on financial assets at fair value through profit or loss	6	1,543	(42)
Net gain on foreign exchange operations	7	2,897	11,672
Fee and commission income	8, 25	4,496	4,187
Fee and commission expense	8	(2,750)	(2,125)
Recovery of provision/(provision) for guarantees and other operations	5	727	(243)
Other income	9, 25	2,570	4,951
NET NON-INTEREST INCOME		9,483	18,400
OPERATING (LOSS)/INCOME		(57,404)	58,786
OPERATING EXPENSES	10, 25	(17,838)	(17,051)
(LOSS)/PROFIT BEFORE INCOME TAX		(75,242)	41,735
Income tax benefit/(expense)	11	11,441	(6,206)
TOTAL COMPREHENSIVE (LOSS)/INCOME		(63,801)	35,529
Attributable to:			
Owners of the parent		(64,191)	35,355
Non-controlling interest		390	174
		(63,801)	35,529

On behalf of the Management Board:

General Director
Nodar Javakhishvili

May 7, 2012
Tbilisi, Georgia

Chief Accountant
Manana Nadiradze

May 7, 2012
Tbilisi, Georgia

The notes on pages 9-56 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2011
(in thousands of Georgian Lari)

	Notes	December 31, 2011	December 31, 2010
ASSETS:			
Cash and balances with the National Bank of Georgia	12	26,789	22,555
Financial assets at fair value through profit or loss	13	15,479	2,901
Due from banks	14	27,601	89,278
Loans to customers	15, 25	256,152	408,089
Investments available-for-sale		322	245
Investments held to maturity	16	6,414	18,147
Property and equipment	17	12,961	13,541
Current income tax assets	11	620	132
Deferred income tax assets	11	11,767	-
Other assets	18	30,147	16,399
TOTAL ASSETS		388,252	571,287
LIABILITIES AND EQUITY			
LIABILITIES:			
Due to banks	19	25,998	66,646
Customer accounts	20, 25	77,306	84,770
Provisions	5, 25	384	1,184
Deferred income tax liabilities	11	-	2,439
Other liabilities	21	2,130	1,950
Subordinated debt	22, 25	126,970	242,512
Total liabilities		232,788	399,501
EQUITY:			
Equity attributable to owners of the parent:			
Share capital	23	81,196	54,716
Additional paid in capital		24,816	3,817
Retained earnings		48,014	112,205
Total equity attributable to owners of the parent		154,026	170,738
Non-controlling interest		1,438	1,048
Total equity		155,464	171,786
TOTAL LIABILITIES AND EQUITY		388,252	571,287

On behalf of the Management Board:

General Director
Nodar Javakhishvili

May 7, 2012
Tbilisi, Georgia

Chief Accountant
Manana Nadiradze

May 7, 2012
Tbilisi, Georgia

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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED DECEMBER 31, 2011

(in thousands of Georgian Lari)

	Notes	Share capital	Additional paid in capital	Retained earnings	Total equity attributable to owners of the parent	Non-con-trolling interest	Total equity
December 31, 2009		54,716	3,817	76,850	135,383	874	136,257
Total comprehensive income for the year		-	-	35,355	35,355	174	35,529
December 31, 2010		54,716	3,817	112,205	170,738	1,048	171,786
Issue of share	23	26,480	-	-	26,480	-	26,480
Initial recognition effect of subordinated debt issued	22	-	20,999	-	20,999	-	20,999
Total comprehensive loss for the year		-	-	(64,191)	(64,191)	390	(63,801)
December 31, 2011		**81,196**	**24,816**	**48,014**	**154,026**	**1,438**	**155,464**

On behalf of the Management Board:

General Director
Nodar Javakhishvili

May 7, 2012
Tbilisi, Georgia

Chief Accountant
Manana Nadiradze

May 7, 2012
Tbilisi, Georgia

The notes on pages 9-56 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2011

(in thousands of Georgian Lari)

	Notes	Year ended December 31, 2011	Year ended December 31, 2010
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income tax:		(75,242)	41,735
Adjustments for:			
Provision/(recovery of provision) for impairment losses on interest bearing assets		106,249	(1,572)
(Recovery of provision)/provision for guarantees and other operations		(727)	243
Loss/(gain) on foreign exchange operations		2,068	(942)
Depreciation and amortization expense		1,479	1,438
Change in interest accruals, net		(6,268)	(3,351)
Net (gain)/loss on operations with financial assets designed at fair value through profit or loss		(1,543)	42
Cash (outflow)/inflow from operating activities before changes in operating assets and liabilities		26,016	37,593
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposits with the National Bank of Georgia		(6,285)	(1,161)
Due from banks		32	3,633
Loans to customers		51,639	(38,724)
Other assets		(1,760)	(842)
Increase/(decrease) in operating liabilities:			
Due to banks		(40,705)	43,639
Customer accounts		(7,415)	(25,813)
Other liabilities		484	392
Cash inflow from operating activities before taxation		22,006	18,717
Income tax paid		(3,253)	(4,172)
Net cash inflow from operating activities		18,753	14,545
CASH FLOWS FROM INVESTING ACTIVITIES:			
Payments for property and equipment, and intangible assets		(1,424)	(1,263)
Proceeds on disposal of property and equipment and intangible assets		395	83
Proceeds on investments at fair value through profit or loss		26,445	16,841
Payments for investments at fair value through profit or loss		(39,023)	(15,501)
Purchase of repossessed assets		(11,858)	-
Purchase of investments available-for-sale		(77)	-
Purchase of investments held to maturity		-	(12,179)
Proceeds on disposal of investments held to maturity		11,733	-
Net cash outflow from investing activities		(13,809)	(12,019)

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2011 (CONTINUED)
(in thousands of Georgian Lari)

	Notes	Year ended December 31, 2011	Year ended December 31, 2010
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issue of share		26,480	-
Proceeds from subordinated debt		71,828	11,877
Repayment of subordinated debt		(165,995)	-
Net cash (outflow)/inflow from financing activities		(67,687)	11,877
Effect of exchange rate changes on the balance of cash held in foreign currencies		(902)	(3)
NET DECREASE IN CASH AND CASH EQUIVALENTS		(62,743)	14,403
CASH AND CASH EQUIVALENTS, beginning of the year	12	107,155	92,755
CASH AND CASH EQUIVALENTS, end of the year	12	43,510	107,155

Interest paid and received by the Group during the year ended December 31, 2011 amounted to GEL 26,171 thousand and GEL 59,265 thousand, respectively.

Interest paid and received by the Group during the year ended December 31, 2010 amounted to GEL 26,931 thousand and GEL 59,699 thousand, respectively.

On behalf of the Management Board:

General Director
Nodar Javakhishvili

May 7, 2012
Tbilisi, Georgia

Chief Accountant
Manana Nadiradze

May 7, 2012
Tbilisi, Georgia

The notes on pages 9-56 form an integral part of these consolidated financial statements.

(in thousands of Georgian Lari)

1. ORGANISATION

Closed Joint Stock Company Cartu Bank (the "Bank") is a joint-stock bank, which was incorporated in Georgia in 1996. The Bank is regulated by the National Bank of Georgia (the "NBG") and conducts its business under general license number 229. The Bank's primary business consists of commercial activities, originating loans and guarantees, trading with securities, foreign currencies and taking deposits.

The registered office of the Bank is located on 39a Chavchavadze Avenue, Tbilisi, Georgia.

As at December 31, 2011 the Bank has two branches and six service centers operating in Tbilisi, one service center in Gori, one service center in Telavi, one service center in Sachkhere and branches in Kutaisi and Batumi.

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

Name	Country of operation	Ownership interest (%) 2011	2010	Type of operation
Insurance Company Cartu LLC	Georgia	69%	69%	Insurance

Insurance Company Cartu LLC was formed as a limited liability company under the laws of Georgia on September 13, 2001. The company's principal activity is insurance, which is mainly health insurance.

As at December 31, 2011 and 2010 JSC Cartu Group (Georgia) owned 100% of the Bank's shares.

Ultimate shareholder having control over the Groups operations is Bidzina Ivanishvili.

These consolidated financial statements were authorized for issue on May 7, 2012 by the Management Board of the Group.

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

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

Other basis of presentation criteria

These consolidated financial statements have been prepared on the assumption that the Group is a going concern and will continue its operations for the foreseeable future. The management and shareholders have the intention to further develop the business of the Group in Georgia both in corporate and retail segments. The Group's management believes that the going concern assumption is appropriate for the Group due to its sufficient capital adequacy ratio and based on historical experience that short-term obligations will be refinanced in the normal course of business.

These consolidated financial statements are presented in thousands of Georgian Lari ("GEL"), unless otherwise indicated. These consolidated financial statements have been prepared on the historical cost basis, except for the measurement at fair value of certain financial instruments, and the measurement at revalued amounts of repossessed assets as explained in the accounting policies below. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

The Group presents its consolidated statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the consolidated statement of financial position date (current) and more than 12 months after the consolidated statement of financial position date (non–current) is presented in Note 28.

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liability simultaneously. Income and expense are not offset in the consolidated statement of comprehensive income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

The principal accounting policies are set out below.

Basis of consolidation

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

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

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

Non-controlling interests

Non-controlling interests represent the portion of profit or loss and net assets of subsidiaries not owned, directly or indirectly, by the Bank.

Non-controlling interests are presented separately in the consolidated statement of comprehensive income and within equity in the consolidated statement of financial position, separately from parent shareholders' equity.

Recognition of interest income and expense

Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Once a financial asset or a group of similar financial assets has been written down (partly written down) as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Recognition of fee and commission income and expense

Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in profit or loss over the remaining period of the loan commitment. Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in profit or loss on expiry.

All other commissions are recognized when services are provided.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, unrestricted balances on correspondent and time deposit accounts and advances to banks with original maturities within 90 days, except for margin deposits for operations with plastic cards, which may be converted to cash within a short period of time and thus are considered liquid. For purposes of determining cash flows, the minimum reserve deposit required by the National Bank of Georgia is not included as a cash equivalent due to restrictions on its availability.

Financial instruments

The Group recognizes financial assets and liabilities in its consolidated statement of financial position when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognized using settlement date accounting.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Financial assets

Financial assets are classified into the following specified categories: financial assets at fair value through profit or loss (‘FVTPL’), investments ‘held to maturity’, ‘available-for-sale’ (AFS) financial assets and ‘loans and receivables’. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Financial assets at fair value through profit or loss

Financial assets are classified as at fair value through profit or loss when the financial asset is either held for trading or it is designated as at fair value through profit or loss.

A financial asset is classified as held for trading if:

- It has been acquired principally for the purpose of selling it in the near term; or
- On initial recognition it is part of a portfolio of identified financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IAS 39 “Financial Instruments: Recognition and Measurement” permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any dividend or interest earned on the financial asset and is included in the ‘other gains and losses’ line item in the consolidated statement of comprehensive income.

Investments held to maturity

Investments held to maturity are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity. Investments held-to-maturity are measured at amortized cost using the effective interest method less any impairment.

If the Group were to sell or reclassify more than an insignificant amount of investments held-to-maturity before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as available-for-sale. Furthermore, the Group would be prohibited from classifying any financial asset as held to maturity during the following two years.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated as available-for-sale or are not classified as (a) loans and receivables, (2) investments held-to-maturity or (c) financial assets at fair value through profit or loss.

The Group has investment in unlisted shares that are not traded in an active market but that are also classified as AFS financial assets.

AFS equity investment that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is stated at cost less any identified impairment losses at the end of each reporting period. Where the investment is disposed off or is determined to be impaired the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

Loans and receivables

Receivables, loans, and and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the financial asset have been affected.

For unlisted equity investment classified as AFS, a significant or prolonged decline in the fair value of the security below its cost would be considered to be objective evidence of its impairment.

For all other financial assets, objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty; or
- Breach of contract, such as default or delinquency in interest or principal payments; or
- Default or delinquency in interest or principal payments; or
- It becoming probable that the borrower will enter bankruptcy or financial re-organization; or
- Disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial assets such as loans and receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of loans and receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans and receivables, where the carrying amount is reduced through the use of an allowance account. When a loan or a receivable is considered uncollectible, it is written off against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

If an available-for-sale asset is impaired, a total amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in the consolidated statement of comprehensive income is transferred from equity to the consolidated statement of comprehensive income.

Renegotiated loans

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

Write off of loans and receivables

Loans and receivables are written off against the allowance for impairment losses when deemed uncollectible. Loans and receivables are written off after management has exercised all possibilities available to collect amounts due to the Group and after the Group has sold all available collateral. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the consolidated statement of comprehensive income in the period of recovery.

Derecognition of financial assets

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

- Rights to receive cash flows from the asset has 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.

A financial asset is derecognized when it has been transferred and the transfer qualifies for derecognition. A transfer required that the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to receive the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group reassesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been retained, the asset remains on the balance sheet. If substantially all of the risks and rewards have been transferred, the asset is derecognized. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether of not it has retained control of the asset. If it has not retained control, the asset is derecognized. Where the Group retained control of the asset, it continues to recognize the asset to the extent of its continuing involvement.

Financial liabilities and equity instruments issued

Classification as debt or equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Group are recognized at the proceeds received, net of direct issue costs.

Compound instruments

The components parts of compound instruments issued by the Group are classified separately as financial liabilities and equity in accordance with the substance of the contractual agreement. At the date of issue, the fair value of the liability component is estimated using prevailing market interest rate for a similar non-convertible instrument. This amount is recorded as a liability on an amortized cost basis using the effective interest method until extinguished upon conversion or at the instrument's maturity date.

Financial liabilities

Financial liabilities are classified as due to banks, customer accounts, subordinated debt and other financial liabilities.

Financial liabilities, including due to banks and customer accounts, subordinated debt and other liabilities, are initially measured at fair value, net of transaction costs. Financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Derecognition of financial liabilities

The Group derecognizes financial liabilities when, and only when, the Group’s obligations are discharged, cancelled or they expire. 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. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss.

Financial guarantee contracts

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument.

Financial guarantee contracts issued by the Group are initially measured at their fair values and, if not designated as at FVTPL, are subsequently measured at the higher of:

- The amount of the obligation under the contract, as determined in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets"; and
- The amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies.

Property and equipment

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

Depreciation is recognized so as to write off the cost or valuation of assets (other than freehold land and construction in progress) less their residual values over their useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following annual rates:

Buildings and other real estate	2%
Furniture and office fixtures	20%
Computer and office equipment	20%
Other	14%-17%
Intangible assets	10%

Freehold land is not depreciated.

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

The carrying amounts of property and equipment are reviewed at each reporting date to assess whether they are recorded in excess of their recoverable amounts. The recoverable amount is the higher of fair value less costs to sell and value in use. Where carrying values exceed the estimated recoverable amount, assets are written down to their recoverable amount; impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation charge for property and equipment is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

Intangible assets

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives from one to five years. The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss when the asset is derecognized.

Assets classified as held for sale

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

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

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

Impairment of non-financial assets other than goodwill

On an ongoing basis, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognized for taxable temporary differences associated property and equipment, due from banks, loans to customers, provisions, other assets and other liabilities except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with other assets and liabilities are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Current and deferred tax for the year

Current and deferred tax are recognized in profit or loss, except when they relate to items that are recognized in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognized in other comprehensive income or directly in equity, respectively.

Operating taxes

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

Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Contingencies

Contingent liabilities are not recognized 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 recognized in the consolidated statement of financial position but disclosed when an inflow of economic benefits is probable.

Foreign currencies

In preparing the consolidated financial statements of the Group, transactions in currencies other than the Group's functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not translated.

Exchange differences on monetary items are recognized in profit or loss in the period in which they arise except for:

- Exchange differences on foreign currency borrowings relating to construction in progress for future productive use, which are included in the cost of those assets when they are regarded as an adjustment to interest costs on those foreign currency borrowings.

The exchange rates used by the Group in the preparation of the consolidated financial statements as at year-end are as follows:

	December 31, 2011	**December 31, 2010**
GEL/1 US Dollar	1.6703	1.7728
GEL/1 Euro	2.1614	2.3500

Collateral

The Group obtains collateral in respect of customer liabilities where it is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Group a claim on these assets for both existing and future customer liabilities.

Critical accounting judgments and key sources of estimation uncertainty

In the application of the Group's accounting policies, which are described in Note 2, the directors are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Critical judgments in applying accounting policies

The following are the critical judgments, apart from those involving estimations (see below), that the management has made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognized in the consolidated financial statements.

Financial assets held to maturity

The directors have reviewed the Group's held-to-maturity financial assets in the light of its capital maintenance and liquidity requirements and have confirmed the Group's positive intention and ability to hold those assets to maturity. As at December 31, 2011 and 2010 the carrying amounts of the financial assets held to maturity are GEL 6,414 and GEL 18,147 thousand, respectively. Details of these assets are set out in Note 16.

Key sources of estimation uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Impairment of loans and receivables

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

The Group uses management's judgment to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on past performance, past customer behavior, observable data indicating an adverse change in the payment status of borrowers in a group, and national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans. The Group uses management's judgment to adjust observable data for a group of loans to reflect current circumstances not reflected in historical data.

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

As at December 31, 2011 and 2010 the gross loans to customers totaled GEL 388,899 thousand and GEL 445,157 thousand, respectively, and allowance for impairment losses amounted to GEL 132,747 thousand and GEL 37,068 thousand, respectively.

Valuation of financial instruments

As described in Note 26, the Group uses valuation techniques that include inputs that are not based on observable market date to estimate the fair value of certain types of financial instruments. Note 26 provide detailed information about the key assumptions used in the determination of the fair value of financial instruments, as well as the detailed sensitivity analysis for these assumptions. The directors believe that the chosen valuation techniques and assumptions used are appropriate in determining the fair value of financial instruments.

Repossessed assets

Repossessed assets representing land and buildings are measured at revalued amounts. The date of the latest appraisal was December 31, 2011. The carrying value of revalued repossessed assets amounted to GEL 25,166 thousand and GEL 13,308 thousand as at December 31, 2011 and 2010, respectively.

Useful lives of property and equipment

Items of property and equipment are stated at historical cost less accumulated depreciation and less any accumulated impairment losses. The estimation of the useful life of an item of property and equipment is a matter of management judgment based upon experience with similar assets. In determining the useful life of an asset, the management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any one of these conditions or estimates may result in adjustments to future depreciation rates.

Recoverability of deferred tax assets

The management of the Bank is confident that no valuation allowance against deferred tax assets at the reporting date is considered necessary, because it is more likely that the deferred tax asset will be fully realized. The carrying value of deferred tax assets amounted to GEL 11,767 thousand and nil as at December 31, 2011 and 2010, respectively.

3. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSs)

The Group has adopted the following new or revised standards and interpretations issued by International Accounting Standards Board and the International Financial Reporting Interpretations Committee (the IFRIC) which became effective for the Group's annual consolidated financial statement for the year ended 31 December 2011:

- IFRS 3(2008) "Business Combinations" / IAS 27 "Consolidated and Separate Financial Statements" — amendments resulting from May 2010 Annual Improvements to IFRSs: 1) transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS; 2) clarification on measurement of non-controlling interests;
- IFRS 7 "Financial Instruments: Disclosures" — amendments resulting from May 2010 Annual Improvements to IFRSs: clarification of disclosures and release of requirement for disclosure regarding restructured loans;
- IAS 24 "Related Party Disclosures" — (as revised in 2010) modifies the definition of a related party and simplifies disclosures for government-related entities.

The adoption of the new or revised standards did not have any effect on the financial position or performance of the Group, [except as following: *evaluate for each particular case]*, and all have been retrospectively applied in compliance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors", unless otherwise noted below.

Amendments to IAS 24 – The disclosure exemptions introduced in IAS 24 (as revised in 2010) do not affect the Group because the Group is not a government-related entity.

3.1 New and revised IFRSs in issue but not yet effective

At the date of authorization of this financial information, the following new standards and interpretations were in issue, but not yet effective, and which the Group has not early adopted:

- IFRS 7 "Financial Instruments: Disclosures" — amendments enhancing disclosures about transfers of financial assets [1];
- IFRS 9 "Financial Instruments" [2];
- IFRS 10 "Consolidated Financial Statements" [3];
- IFRS 11 "Joint Arrangements" [3];
- IFRS 12 "Disclosure of Interest in Other Entities" [3];
- IFRS 13 "Fair Value Measurement" [2];
- IAS 1 "Presentation of Financial Statements" — amendments to revise the way other comprehensive income is presented [4];
- IAS 12 "Income Taxes" — Limited scope amendment (recovery of underlying assets) [5];
- IAS 27 - reissued as IAS 27 "Separate Financial Statements" (as amended in May 2011) [3];
- IAS 28 - reissued as IAS 28 "Investments in Associates and Joint Ventures" (as amended in May 2011) [3].

[1] Effective for annual periods beginning on or after 1 July 2011, with earlier application permitted.

[2] Effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.

[3] Each of the five standards becomes effective for annual periods beginning on or after 1 January 2013, with earlier application permitted if all the other standards in the 'package of five' are also early applied (except for IFRS 12 that can be applied earlier on its own).

[4] Effective for annual periods beginning on or after 1 July 2012, with early adoption permitted.

[5] Effective for annual periods beginning on or after 1 January 2012, with earlier application permitted.

Amendments to IFRS 7 – The amendments introduce additional disclosures, designed to allow users of financial statements to improve their understanding of transfer transactions of financial assets (for example, securitizations), including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of transfer transactions are undertaken around the end of a reporting period.

Retrospective application is required in accordance with IAS 8 with the exception that in the first year of application, an entity need not provide comparative information for the disclosures required by the amendments for periods beginning before July 1, 2011. The Group does not expect this amendment to have a material effect on its financial position or results of operations.

IFRS 9 – was issued in November 2009 and amended in October 2010 introduces new requirements for the classification and measurement of financial assets and financial liabilities and for derecognition.

- IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* to be subsequently measured at amortized cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods.

- The most significant effect of IFRS 9 regarding the classification and measurement of financial liabilities relates to the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. Specifically, under IFRS 9, for financial liabilities that are designated as at fair value through profit or loss, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognized in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit or loss was recognized in profit or loss.

The Group management anticipate that IFRS 9 that will be adopted in the Group's consolidated financial statements for the annual period beginning 1 January 2013 and that the application of the new Standard will have a significant impact on amounts reported in respect of the Groups' financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

IFRS 10 Consolidated Financial Statements – replaces all of the guidance on control and consolidation in IAS 27 and SIC-12 by introducing a single consolidation model for all entities based on control, irrespective of the nature of the investee (i.e. whether an entity is controlled through voting rights or through other contractual arrangements as is common in special purpose entities). Under IFRS 10, the single definition of control, accompanied by extensive application guidance, is based on whether an investor has:

- power over the investee;
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect the amount of the returns.

IFRS 11 Joint Arrangements – replaces IAS 31 with new accounting requirements for joint arrangements by classifying them as either joint operations or joint ventures (the ‘jointly controlled assets’ classification exists no more).

- In recognizing their rights and obligations arising from the arrangement, the parties should no longer focus on the legal structure of the joint arrangement, but rather on how rights and obligations are shared by them.
- A joint operation gives parties to the arrangement direct rights to the assets and obligations for the liabilities. Thus, a joint operator recognizes its interest based on its involvement in the joint operation (i.e. based on its direct rights and obligations) rather than on the participation interest it has in the joint arrangement. A party to a ‘joint operation’ recognizes assets, liabilities, revenues and expenses arising from the arrangement.
- A joint venture gives the parties rights to the net assets or outcome (profit or loss) of the arrangement. Joint ventures are accounted for using the equity method in accordance with IAS 28 “Investments in Associates”. Entities can no longer account for an interest in a joint venture using the proportionate consolidation method. A party to a ‘joint venture’ recognizes an investment.

IFRS 12 Disclosure of Interests in Other Entities – requires enhanced disclosures about both consolidated and unconsolidated entities in which an entity has involvement, so that financial statement users are able to evaluate the nature, risks and financial effects associated with the entity’s interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. Thus, IFRS 12 sets out the required disclosures for entities reporting under the two new standards, IFRS 10 and IFRS 11 and replaces the disclosure requirements currently found in IAS 28.

IAS 27 (2011) Separate Financial Statements – includes the provisions on separate financial statements that are left almost unchanged after the control provisions of IAS 27 have been replaced with the new IFRS 10.

IAS 28 (2011) Investments in Associates and Joint Ventures – now includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11.

IFRS 13 Fair Value Measurement – aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements to use across IFRSs. The Standard:

- defines fair value;
- sets out in a single IFRS a framework for measuring fair value;
- requires disclosures about fair value measurements.

IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except for share-based payment transactions within the scope of IFRS 2 "Share-based Payment", leasing transactions within the scope of IAS 17 "Leases", and measurements that have some similarities to fair value but that are not fair value, such as net realizable value in IAS 2 "Inventories" or value in use in IAS 36 "Impairment of Assets".

The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

Amendments to IAS 1 Presentation of Financial Statements – revise the way other comprehensive income is presented.

The amendments to IAS 1:

- Preserve the amendments made to IAS 1 in 2007 to require profit or loss and OCI to be presented together, i.e. either as a single 'statement of profit or loss and comprehensive income', or a separate 'statement of profit or loss' and a 'statement of comprehensive income' – rather than requiring a single continuous statement as was proposed in the exposure draft;
- Require entities to group items presented in OCI based on whether they are potentially classifiable to profit or loss subsequently. i.e. those that might be reclassified and those that will not be reclassified;
- Require tax associated with items presented before tax to be shown separately for each of the two groups of OCI items (without changing the option to present items of OCI either before tax or net of tax).

The Group does not expect this amendment to have a material effect on its financial position or results of operations.

Amendment to IAS 12 Income Taxes – provide a presumption that recovery of the carrying amount of an asset measured using the fair value model in IAS 40 Investment Property will, normally, be through sale.

Retrospective application is required in accordance with IAS 8. The Group is considering the impact of the amendment on the consolidated financial statements and the timing of its application.

(in thousands of Georgian Lari)

4. NET INTEREST INCOME

	Year ended December 31, 2011	Year ended December 31, 2010
Interest income		
Interest income on financial assets recorded at amortized cost:		
Interest income on impaired financial assets	33,117	29,037
Interest income on unimpaired financial assets	32,048	34,305
Total interest income	**65,165**	**63,342**
Interest income on financial assets recorded at amortized cost comprises:		
Interest on loans to customers	61,016	61,073
Interest on balances due from banks	2,825	1,551
Interest on investments held to maturity	1,324	718
Total interest income on financial assets recorded at amortized cost	65,165	63,342
Interest expense		
Interest expense on financial liabilities recorded at amortized cost comprise:		
Interest on subordinated debt	(19,773)	(21,902)
Interest on customer accounts	(3,027)	(3,520)
Interest on due to banks	(3,003)	(1,801)
Total interest expense on financial liabilities recorded at amortized cost	(25,803)	(27,223)
Net interest income before (provision)/ recovery of provision for impairment losses on interest bearing financial assets	**39,362**	**36,119**

5. ALLOWANCE FOR IMPAIRMENT LOSSES AND OTHER PROVISIONS

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

	Loans to customers
December 31, 2009	38,640
Recovery of provisions	(1,572)
December 31, 2010	37,068
Additional provisions recognized	106,249
Write-off of assets	(10,570)
December 31, 2011	**132,747**

(in thousands of Georgian Lari)

The movements in other provisions were as follows:

	Other assets	Guarantees	Total
December 31, 2009	-	962	962
Additional provisions recognized	21	222	243
Write-off of assets	(18)	-	(18)
December 31, 2010	3	1,184	1,187
Additional provisions recognized/(recovery of provisions)/	73	(800)	(727)
Write-off of assets	(76)	-	(76)
December 31, 2011	**-**	**384**	**384**

6. NET GAIN/LOSS ON FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Net gain on financial assets at fair value through profit or loss comprises:

	Year ended December 31, 2011	Year ended December 31, 2010
Net gain/(loss) on operations with financial assets initially recognized at fair value through profit and loss comprise:		
Realized gain on trading operations	23,403	5,542
Realized loss on trading operations	(21,860)	(5,584)
Total net gain/(loss) on operations with financial assets designated at fair value through profit or loss	**1,543**	**(42)**

7. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprises:

	Year ended December 31, 2011	Year ended December 31, 2010
Dealing, net	4,965	10,730
Translation differences, net	(2,068)	942
Total net gain on foreign exchange operations	**2,897**	**11,672**

(in thousands of Georgian Lari)

8. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended December 31, 2011	Year ended December 31, 2010
Fee and commission income:		
Plastic cards operations	1,789	1,375
Settlements	1,095	1,233
Documentary operations	920	841
Cash operations	519	515
Foreign exchange operations	2	10
Other	171	213
Total fee and commission income	**4,496**	**4,187**
Fee and commission expense:		
Plastic cards services	(1,994)	(1,496)
Documentary operations	(365)	(290)
Settlements	(264)	(250)
Cash operations	(14)	(3)
Other	(113)	(86)
Total fee and commission expense	**(2,750)**	**(2,125)**

9. OTHER INCOME

Other income comprises:

	Year ended December 31, 2011	Year ended December 31, 2010
Insurance premiums	1,885	987
Legal income	165	78
Fines and penalties received	11	3,643
Recovery of assets written-off	-	68
Other	509	175
Total other income	**2,570**	**4,951**

(in thousands of Georgian Lari)

10. OPERATING EXPENSES

Operating expenses comprise:

	Year ended December 31, 2011	Year ended December 31, 2010
Staff costs	7,567	8,201
Charity and sponsorship	1,907	1,773
Operating leases	1,713	1,824
Depreciation and amortization	1,479	1,438
Professional services	1,015	317
Communication expenses	746	717
Security expenses	579	514
Postal expenses	361	363
Utilities	217	194
Taxes, other than income tax	171	177
Property and equipment maintenance	157	242
Representative expenses	68	99
Advertising expenses	62	83
Business trip expenses	42	48
Training	19	38
Other expenses	1,735	1,023
Total operating expenses	**17,838**	**17,051**

11. INCOME TAXES

The Group provides for income taxes based on the tax accounts maintained and prepared in accordance with the tax regulations of Georgia, which differs from IFRS.

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

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at December 31, 2011 and 2010 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

The tax rate used for the reconciliations below is the corporate tax rate of 15% payable by corporate entities in Georgia on taxable profits under tax law in that jurisdiction.

Temporary differences as at December 31, 2011 and 2010 comprise:

	December 31, 2011	December 31, 2010
Property and equipment	(5,742)	(3,607)
Other assets	(558)	(581)
Other liabilities	(15)	6
Loans to customers	84,032	(13,435)
Provisions for guarantees and other operations	631	1,358
Subordinated debt	100	-
Net deferred tax (liability)/asset at the statutory tax rate (15%)	11,767	(2,439)
Loss carry forward	-	-
Net deferred tax asset/(liability)	**11,767**	**(2,439)**

(in thousands of Georgian Lari)

Relationships between tax expenses and accounting profit for the years ended December 31, 2011 and 2010 are explained as follows:

	Year ended December 31, 2011	Year ended December 31, 2010
(Loss)/Profit before income tax	(75,242)	41,735
Tax at the statutory tax rate (15%)	(11,286)	6,260
Permanent differences	(155)	(54)
Income tax (benefit)/expense	**(11,441)**	**6,206**
Current income tax expense	2,765	3,175
Deferred tax (benefit)/expense recognized in the current year	(14,206)	3,031
Income tax (benefit)/expense	**(11,441)**	**6,206**

Deferred income tax (liabilities)/asset	**2011**	**2010**
As at January 1 – deferred tax (liabilities)/assets	**(2,439)**	**592**
Change in deferred income tax balances recognized in consolidated profit or loss	14,206	(3,031)
As at December 31- deferred tax assets/(liabilities)	**11,767**	**(2,439)**

12. CASH AND BALANCES WITH THE NATIONAL BANK OF GEORGIA (THE “NBG”)

	December 31, 2011	December 31, 2010
Cash	10,327	11,631
Balances with the NBG	16,462	10,924
Total cash and balances with the NBG	**26,789**	**22,555**

The obligatory minimum reserve deposits with the NBG included in the balances with the NBG are restricted balances of GEL 10,629 thousand and GEL 4,344 thousand, respectively, as at December 31, 2011 and 2010. The Group is required to maintain minimum reserve deposits at the NBG at all times.

Cash and cash equivalents for the purposes of the consolidated statement of cash flows comprise the following:

	December 31, 2011	December 31, 2010
Cash and balances with the NBG	26,789	22,555
Due from banks (Note 28)	27,350	88,944
Less minimum reserve deposits with the NBG	(10,629)	(4,344)
Total cash and cash equivalents	**43,510**	**107,155**

(in thousands of Georgian Lari)

13. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial assets at fair value through profit or loss comprise:

	December 31, 2011	December 31, 2010
Financial assets held for trading:		
Equity securities	15,479	2,901
Total financial assets at fair value through profit or loss	**15,479**	**2,901**

The Group estimates changes in fair value due to credit risk, by estimating the amount of change in the fair value that is not due to changes in market conditions that give rise to market risks.

14. DUE FROM BANKS

Due from banks comprise:

	December 31, 2011	December 31, 2010
Time deposits	9,197	67,631
Correspondent accounts	18,404	21,647
Total due from banks	**27,601**	**89,278**

Included in due from banks is accrued interest in the amount of GEL 3 thousand and GEL 54 thousand as at December 31, 2011 and 2010, respectively.

As at December 31, 2011 and 2010 the Group had balances due from one and two banks, respectively, with individual exposure exceeding 10% of the Group's equity.

As at December 31, 2011 and 2010 included in balances due from banks are guarantee deposits placed by the Group for its operations with plastic cards totaling GEL 251 thousand and GEL 334 thousand, respectively.

As at December 31, 2011 and 2010 the maximum credit risk exposure on due from banks amounted to GEL 27,601 thousand and GEL 89,278 thousand, respectively.

15. LOANS TO CUSTOMERS

Loans to customers comprise:

	December 31, 2011	December 31, 2010
Originated loans to customers	365,951	428,160
Accrued interest	22,948	16,997
	388,899	445,157
Less allowance for impairment losses	(132,747)	(37,068)
Total loans to customers	**256,152**	**408,089**

(in thousands of Georgian Lari)

Movements in the allowance for impairment losses for the years ended December 31, 2011 and 2010 are disclosed in Note 5.

The table below summarizes carrying value of loans to customers analyzed by type of collateral obtained by the Group:

	December 31, 2011	December 31, 2010
Loans collateralized by pledge of real estate, equipment and inventories	240,078	373,064
Loans collateralized by pledge of cash	3,403	22,682
Other collateral	6,836	6,185
Unsecured loans	5,835	6,158
Total loans to customers	**256,152**	**408,089**

	December 31, 2011	December 31, 2010
Analysis by sector:		
Construction	81,564	107,646
Trade and services	97,971	159,632
Manufacturing	33,501	59,937
Individuals	19,690	48,106
Agriculture	7,064	14,128
Transport and communication	527	3,033
Energy	242	2,870
Other	15,593	12,737
Total loans to customers	**256,152**	**408,089**

During the years ended December 31, 2011 and 2010 the Group received financial and non-financial assets by taking possession of collateral it held as security. As at December 31, 2011 and 2010 such assets in amount of GEL 25,166 thousand and GEL 13,308 thousand, respectively, are included in other assets of the Group.

Loans to individuals comprise the following products:

	December 31, 2011	December 31, 2010
Consumer loans	5,163	21,342
Mortgage loans	14,467	9,886
Other	60	16,878
Total loans to individuals	**19,690**	**48,106**

(in thousands of Georgian Lari)

As at December 31, 2011 and 2010 allowance for impairment losses to individuals amounted to GEL 6,957 thousand and GEL 2,367 thousand, respectively.

As at December 31, 2011 and 2010 the Group granted loans to seven and two customers, totaling GEL 117,268 thousand and GEL 35,438 thousand, respectively, which individually exceeded 10% of the Group's equity.

As at December 31, 2011 and 2010 a maximum credit risk exposure on loans to customers amounted to GEL 256,152 thousand and GEL 408,089 thousand, respectively.

As at December 31, 2011 and 2010 all loans were granted to companies operating in Georgia, which represents a significant geographical concentration.

As at December 31, 2011 and 2010 loans to customers included loans totaling GEL 136,340 thousand and GEL 187,704 thousand, respectively, whose terms were renegotiated. Otherwise these loans would be past due or impaired.

16. INVESTMENTS HELD TO MATURITY

	December 31, 2011		December 31, 2010	
	Nominal annual interest rate	Amount	Nominal annual interest rate	Amount
Deposit certificates of the Ministry of Finance of Georgia	7.70%-8.50%	6,500	9.00%-9.80%	18,367
Less discount		(86)		(220)
Total investments held to maturity		**6,414**		**18,147**

(in thousands of Georgian Lari)

17. PROPERTY AND EQUIPMENT

Property and equipment comprise:

	Buildings and other real estate	Furniture and fixtures	Computer and office equipment	Leasehold improvements and other	Construction in progress	Total
At cost						
December 31, 2009	4,945	4,409	2,745	1,734	3,953	17,786
Additions	-	304	272	42	509	1,127
Transfers	1,513	284	7	317	(2,153)	(32)
Disposals	-	(58)	(167)	(18)	-	(243)
December 31, 2010	6,458	4,939	2,857	2,075	2,309	18,638
Additions	-	61	285	19	732	1,097
Transfers	2,558	180	70	31	(2,839)	-
Disposals	(103)	(116)	(260)	(513)	(27)	(1,019)
December 31, 2011	8,913	5,064	2,952	1,612	175	18,716
Accumulated depreciation						
December 31, 2009	430	1,664	1,420	504	-	4,018
Depreciation charge	160	534	346	199	-	1,239
Eliminated on disposals	-	(10)	(138)	(12)	-	(160)
December 31, 2010	590	2,188	1,628	691	-	5,097
Depreciation charge	206	532	343	204	-	1,285
Eliminated on disposals	(103)	(91)	(255)	(178)	-	(627)
December 31, 2011	693	2,629	1,716	717	-	5,755
Net book value						
As at December 31, 2011	**8,220**	**2,435**	**1,236**	**895**	**175**	**12,961**
As at December 31, 2010	**5,868**	**2,751**	**1,229**	**1,384**	**2,309**	**13,541**

As at December 31, 2011 and 2010 included in property and equipment were fully depreciated assets totaling GEL 1,128 thousand and GEL 952 thousand, respectively.

(in thousands of Georgian Lari)

18. OTHER ASSETS

Other assets comprise:

	December 31, 2011	December 31, 2010
Other financial assets:		
Accounts receivable	928	746
Less allowance for impairment of other financial assets	-	(3)
Total other financial assets	928	743
Other non-financial assets:		
Repossessed assets	25,166	13,308
Intangible assets	1,629	1,499
Tax settlements, other than income tax	1,275	77
Advances paid	725	346
Inventory	407	396
Other	17	30
Total other assets	**30,147**	**16,399**

Movements in the allowance for impairment losses on other assets for the years ended December 31, 2011 and 2010 are disclosed in Note 5.

Repossessed assets as at December 31, 2011 and 2010 include land and buildings in the amount of GEL 25,166 thousand and GEL 13,308 thousand, respectively, which are measured lower of its carrying amount and fair value less cost to sell. The repossessed assets have been revalued by independent appraiser as at December 31, 2011 and 2010. The following methods were used for the estimation of their fair value: discounted cash flow method (income approach), direct sales comparison method (comparative approach). For the estimation of the final value, following weights were assigned to the results obtained using different approaches: discounted cash flow method –30-40% and direct sales comparison approach – 60%-70%, depending on the degree to which the estimates met the following characteristics: reliability and completeness of the information, specifics of the estimated property, and other.

(in thousands of Georgian Lari)

	Intangible assets
At cost	
December 31, 2009	2,359
Additions	136
Disposals	(210)
December 31, 2010	2,285
Additions	327
Disposals	(59)
December 31, 2011	2,553
Accumulated amortization	
December 31, 2009	797
Charge for the year	199
Eliminated on disposals	(210)
December 31, 2010	786
Charge for the year	194
Eliminated on disposals	(56)
December 31, 2011	924
Net book value	
December 31, 2011	**1,629**
December 31, 2010	**1,499**

19. DUE TO BANKS

Due to banks comprise:

	December 31, 2011	December 31, 2010
Correspondent accounts of other banks	97	37,184
European Bank of Reconstruction and Development (the “EBRD”)	14,302	20,257
Black Sea Trade and Development Bank (the “BSTDB)	11,599	9,205
Total due to banks	**25,998**	**66,646**

As at December 31, 2011 and 2010 accrued interest expenses included in due to banks amounted to GEL 923 thousand and GEL 866 thousand, respectively.

(in thousands of Georgian Lari)

The Group is obligated to comply with financial covenants in relation to certain due to banks disclosed above. These covenants include stipulated ratios, debt to equity ratios and various other financial performance ratios. During the year ended December 31, 2011 the Group has breached the following ratio set by the EBRD – Ratio of 20 largest Exposure. The Group has obtained a waiver from EBRD for this financial covenant as at February 27, 2012 for the year ending December 31, 2011. As at December 31, 2011 balances due to EBRD amounted to GEL 14,302 thousand.

20. CUSTOMER ACCOUNTS

Customer accounts comprise:

	December 31, 2011	December 31, 2010
Time deposits	19,871	28,656
Repayable on demand	57,435	56,114
Total customer accounts	**77,306**	**84,770**

As at December 31, 2011 and 2010 accrued interest expenses included in customer accounts amounted to GEL 383 thousand and GEL 432 thousand, respectively.

As at December 31, 2011 and 2010 customer accounts totaling GEL 241 thousand and GEL 7,017 thousand, respectively, were held as security against guarantees issued by the Group.

As at December 31, 2011 and 2010 customer accounts totaling GEL 33,306 thousand and GEL 24,013 thousand (43% and 28% of total customer accounts), respectively, were due ten and nine customers, which represents a significant concentration.

	December 31, 2011	December 31, 2010
Analysis by economic sector/customer type:		
Individuals	31,072	34,407
Trade and services	19,343	39,129
Construction	5,950	1,469
Transport and communication	1,835	2,686
Manufacturing	1,733	1,853
Agriculture	351	649
Energy	139	489
Other	16,883	4,088
Total customer accounts	**77,306**	**84,770**

(in thousands of Georgian Lari)

21. OTHER LIABILITIES

Other liabilities comprise:

	December 31, 2011	December 31, 2010
Other financial liabilities:		
Accounts payable	32	432
Other non-financial liabilities:		
Taxes payable, other than income tax	172	23
Insurance reserves	1,045	1,349
Other	881	146
Total other liabilities	**2,130**	**1,950**

22. SUBORDINATED DEBT

Subordinated debt comprises:

	Currency	Maturity date	Interest rate %	December 31, 2011	December 31, 2010
FinService-XXI LTD	USD	28-Dec-21	5%	5,016	-
FinService-XXI LTD	USD	31-Mar-26	2%	34,506	-
FinService-XXI LTD	USD	31-Mar-26	2%	11,381	-
FinService-XXI LTD	USD	9-Feb-12	9%	-	17,824
FinService-XXI LTD	USD	13-Dec-11	9%	-	17,807
FinService-XXI LTD	USD	22-Jun-14	5%	16,721	17,741
FinService-XXI LTD	USD	1-Nov-14	9%	-	8,930
FinService-XXI LTD	USD	11-May-12	9%	-	8,908
FinService-XXI LTD	USD	12-Jul-14	9%	-	8,906
FinService-XXI LTD	USD	17-Jul-14	9%	-	8,895
FinService-XXI LTD	USD	25-Oct-11	9%	-	8,877
FinService-XXI LTD	USD	27-Nov-11	9%	-	8,877
FinService-XXI LTD	USD	26-Jun-15	9%	-	8,875
FinService-XXI LTD	USD	26-Apr-12	9%	-	8,875
FinService-XXI LTD	USD	28-Jun-14	9%	-	8,871
FinService-XXI LTD	USD	2-Oct-14	9%	-	8,871
FinService-XXI LTD	USD	26-Sep-14	9%	-	7,987
FinService-XXI LTD	USD	24-Aug-14	9%	-	7,103
FinService-XXI LTD	USD	31-Jan-15	9%	-	7,091
FinService-XXI LTD	USD	24-Dec-14	9%	-	5,328
FinService-XXI LTD	USD	28-Dec-11	9%	-	5,322
FinService-XXI LTD	USD	20-Sep-14	9%	-	4,444
				67,624	179,532
Inter Consulting Plus LTD	USD	22-Jun-14	5%	16,717	17,741
Inter Consulting Plus LTD	USD	17-Oct-25	5%	11,701	12,419
Inter Consulting Plus LTD	USD	2-Oct-14	5%	8,364	8,871
				36,782	39,031
Georgian Holding LTD	USD	22-Jun-14	5%	16,714	17,741
Christa Enterprises LTD	USD	28-Feb-17	5%	5,850	6,208
				22,564	23,949
Total subordinated debt				**126,970**	**242,512**

(in thousands of Georgian Lari)

As at December 31, 2011 and 2010 accrued interest expense included in subordinated debt amounted to GEL 148 thousand and GEL 524 thousand, respectively.

In the event of bankruptcy or liquidation of the Group, repayment of this debt is subordinate to the repayments of the Group's liabilities to all other creditors.

On 31 March and 13 December 2011 the Group signed subordinated loan agreement with Finservice-XXI LTD both maturing on March 31, 2026. According to the agreement the loan is convertible to equity at maturity. The interest is payable annually in arrears at a nominal annual interest rate of 2 per cent. When the loan was taken, the prevailing market interest rate for similar loan without conversion options was 5 per cent.

23. SHARE CAPITAL

As at December 31, 2011 and 2010 share capital consisted of 81,196 and 54,716 ordinary shares with par value of GEL 1 each.

The Group's share capital comprises of the following number of shares:

	Share capital Pcs'000
Ordinary shares	
December 31, 2009	54,716
December 31, 2010	54,716
Issue of shares	26,480
December 31, 2010	**81,196**

24. COMMITMENTS AND CONTINGENCIES

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

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

Provision for losses on contingent liabilities totaled GEL 384 thousand and GEL 1,184 thousand as at December 31, 2011 and 2010, respectively.

As at December 31, 2011 and 2010 contingent liabilities comprise:

	December 31, 2011	**December 31, 2010**
Contingent liabilities and credit commitments		
Guarantees issued and similar commitments	20,174	66,449
Letters of credit and other transaction related contingent obligations	8,241	988
Commitments on loans and unused credit lines	2,950	26,597
Total contingent liabilities and credit commitments	**31,365**	**94,034**

Extension of loans to customers within credit line limits is approved by the Group on a case-by-case basis and depends on borrowers' financial performance, debt service and other conditions. As at December 31, 2011 and 2010 such unused credit lines come to GEL 2,950 thousand and GEL 26,597 thousand, respectively.

Capital commitments – The Group had no material commitments for capital expenditures outstanding as at December 31, 2011 and 2010.

Operating lease commitments – No material rental commitments were outstanding as at December 31, 2011 and 2010.

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

Taxation – Commercial legislation of Georgia, including tax legislation, may allow more than one interpretation. In addition, there is a risk of tax authorities making arbitrary judgments of business activities. If a particular treatment, based on management's judgment of the Group's business activities, was to be challenged by the tax authorities, the Group may be assessed additional taxes, penalties and interest.

Such uncertainty may relate to the valuation of financial instruments, valuation of provision for impairment losses and the market pricing of deals. Additionally such uncertainty may relate to the valuation of temporary differences on the provision and recovery of the provision for impairment losses on loans to customers and receivables, as an underestimation of the taxable profit. The management of the Group believes that it has accrued all tax amounts due and therefore no allowance has been made in the consolidated financial statements.

On October 28, 2011 Georgian Parliament adopted amendments to Article 239 of the Tax Code and Article 82 of the Law on Enforcement Proceedings of Georgia. Pursuant to these amendments tax authorities have received priority over secured claims of financial institution regarding any borrower in case the grounds of origin of the tax claim secured by a tax pledge or mortgage belong to the period prior to the registration date of the pledge/mortgage of such financial institution.

In the beginning of 2012 the amendment to the Georgian law, mentioned above, was cancelled and the priority of mortgages was returned to the financial institutions. By the time of issuance of these financial statements Tax Code determines the priority of mortgages/pledges according to the time of their creation. The rights of creditors of prior rank are protected by ensuring that in case of enforcement of a tax pledge/mortgage their claims are satisfied before those of the state.

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

Pensions and retirement plans – Employees receive pension benefits from the Government of Georgia in accordance with the laws and regulations of the country. As at December 31, 2011 and 2010, the Group was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

Operating Environment – Emerging markets such as Georgia are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks.

(in thousands of Georgian Lari)

As has happened in the past, actual or perceived financial problems or an increase in the perceived risks associated with investing in emerging economies could adversely affect the investment climate in Georgia and the Georgia's economy in general.

Laws and regulations affecting businesses in Georgia continue to change rapidly. Tax, currency and customs legislation within Georgia are subject to varying interpretations, and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in Georgia. The future economic direction of Georgia is largely dependent upon economic, fiscal and monetary measures undertaken by the government, together with legal, regulatory, and political developments.

The global financial turmoil that has negatively affected Georgia's financial and capital markets in 2009 and 2010 has receded and Georgia's economy returned to growth in 2011. However significant economic uncertainties remain. Adverse changes arising from systemic risks in global financial systems, including any tightening of the credit environment could slow or disrupt Georgia's economy, adversely affect the Group's access to capital and cost of capital for the Group and, more generally, its business, results of operations, financial condition and prospects.

25. TRANSACTIONS WITH RELATED PARTIES

Transactions between the Bank and its subsidiaries, which are related parties of the Bank, have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Group and other related parties are disclosed below:

	December 31, 2011		December 31, 2010	
	Related party balances	Total category as per the consolidated financial statements caption	Related party balances	Total category as per the consolidated financial statements caption
Loans to customers	16,414	388,899	37,623	445,157
- other related parties	16,414		37,623	
Allowance for impairment losses on loans to customers	(502)	(132,747)	(854)	(37,068)
- other related parties	(502)		(854)	
Customer accounts	30,582	77,306	6,873	84,770
- shareholders	11,891		842	
- key management personnel	-		62	
- other related parties	18,691		5,969	
Subordinated debt	126,970	126,970	242,512	242,512
- shareholders	126,970		242,512	
Provisions	4	384	12	1,184
- other related parties	4		12	
Letters of credit and other transaction related contingent obligations	-	8,241	889	988
- other related parties			889	
Guarantees issued and similar commitments	-	20,174	552	66,449
- other related parties			552	

(in thousands of Georgian Lari)

The remuneration of directors and other members of key management was as follows:

	December 31, 2011		December 31, 2010	
	Related party transactions	**Total category as per the consolidated financial statements caption**	**Related party transactions**	**Total category as per the consolidated financial statements caption**
Key management personnel compensation:				
- short-term employee benefits	774	7,567	722	8,201

Included in the consolidated statement of comprehensive income for the years ended December 31, 2011 and 2010 are the following amounts which were recognized in transactions with related parties:

	Year ended December 31, 2011		Year ended December 31, 2010	
	Related party transactions	**Total category as per the consolidated financial statements caption**	**Related party transactions**	**Total category as per the consolidated financial statements caption**
Interest income	5,614	65,165	4,865	63,342
- other related parties	5,614		4,865	
Interest expense	(19,318)	(25,803)	(21,972)	(27,223)
- shareholders	-		-	
- other related parties	(19,318)		(21,972)	
Provision for impairment losses on interest bearing assets	(301)	(106,249)	(256)	1,572
- other related parties			(256)	
Fee and commission income	196	4,496	297	4,187
- shareholders	7		3	
- key management	1		1	
- other related parties	188		293	

26. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale.

Assets for which fair value approximates carrying value

For financial assets and liabilities that have a short term maturity (less than 3 months), it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without a maturity.

(in thousands of Georgian Lari)

Loans and advances to banks

The fair value of loans and advances to banks has been estimated using the same valuation technique for financial instruments accounted for at fair value as described in the valuation techniques below.

Loans and advances to customers

Loans and advances to personal customers are made both at variable and at fixed rates. As there is no active secondary market in Georgia for such loans and advances, there is no reliable market value available for this portfolio.

(a) Variable rate – Management believes that carrying rate may be assumed to be fair value.

(b) Fixed rate – Certain of the loans secured are at a fixed rate. Fair value has been estimated by reference to the market rates available at the balance sheet date for similar loans of maturity equal to the remaining fixed period.

Financial investments – available for sale

Available-for-sale financial assets valued using valuation techniques or pricing models primarily consist of unquoted equities and debt securities.

These assets are valued using models that use both observable and unobservable 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.

Except as detailed below, management of the Group considers that the fair value of financial assets and liabilities approximates their carrying value:

	December 31, 2011		December 31, 2010	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
Cash and balances with the NBG	26,789	26,789	22,555	22,555
Due from banks	27,601	27,595	89,278	88,916
Loans to customers	256,152	255,100	408,089	407,212
Investments available-for-sale	322	322	245	245
Investments held to maturity	6,414	6,414	18,147	18,147
Other financial assets	928	928	743	743
Due to banks	25,998	25,738	66,646	66,429
Customer accounts	77,306	77,249	84,770	84,091
Other financial liabilities	32	32	432	432
Subordinated debt	126,970	126,970	242,512	240,777

The fair values of financial assets and financial liabilities are determined as follows.

- The fair values of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices (includes listed redeemable notes, bills of exchange, debentures and perpetual notes).
- The fair values of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and dealer quotes for similar instruments.

(in thousands of Georgian Lari)

27. CAPITAL RISK MANAGEMENT

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance.

The adequacy of the Group's capital is monitored using, among other measures, the ratios established by the Basel Capital Accord 1988 and the ratios established by the NBG in supervising the Group.

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

The capital structure of the Group consists of debt, which includes subordinated debt disclosed in Note 22, and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in consolidated statement of changes in equity.

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

The Group's overall capital risk management policy remains unchanged from 2010.

The following table analyzes the Group's regulatory capital resources for capital adequacy purposes in accordance with the principles employed by the Basel Committee:

	Year ended December 31, 2011	Year ended December 31, 2010
Movement in tier 1 capital:		
At January 1	171,786	136,257
Net profit	(64,191)	35,355
Issue of share	26,480	-
Additional paid in capital	20,999	-
Non-controlling interest	390	174
At December 31	**155,464**	**171,786**

	Year ended December 31, 2011	Year ended December 31, 2010
Composition of regulatory capital:		
Tier 1 capital:		
Share capital	81,196	54,716
Additional paid in capital	24,816	3,817
Retained earnings	48,014	112,205
Non-controlling interest	1,438	1,048
Total qualifying tier 1 capital	155,464	171,786
Subordinated debt (restricted to 50% of Tier 1 capital)	77,732	85,893
Less investments to companies engaged in financial activities	(250)	(216)
Total regulatory capital	**232,946**	**257,463**
Capital ratios:		
Tier 1 capital	37.14%	32.84%
Total capital	55.64%	49.22%

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

As at December 31, 2011 and 2010, the Group included in the computation of Total Capital for capital adequacy purposes the subordinated debt received, limited to 50% of Tier 1 capital. In the event of bankruptcy or liquidation of the Group, repayment of this debt is subordinate to the repayments of the Group's liabilities to all other creditors.

28. RISK MANAGEMENT POLICIES

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

- Credit risk
- Liquidity risk
- Market risk

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

Credit risk

The Group is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

Risk management and monitoring is performed within set limits of authority. These processed are performed by the Credit Committees and the Group's Management Board. Before any application is made by the Credit Committee, all recommendations on credit processes (borrower's limits approved, or amendments made to loan agreements, etc.) are reviewed and approved by the branch risk-manager or the Risk Management Department. Daily risk management is performed by the Heads of Credit Departments and Branch Credit Divisions.

The Group structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Limits on the level of credit risk by a borrower, industry sector are approved quarterly by the Management Board. The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Credit Committee. Actual exposures against limits are monitored on a regular basis.

Where appropriate, and in the case of most loans, the Group obtains collateral and corporate and personal guarantees. However, some portion of loans is personal lending, where no such facilities can be obtained. Such risks are monitored on a continuous basis and subject to annual or more frequent reviews.

Commitments to extend credit represent unused portions of credit in the form of loans, guarantees or letters of credit. The credit risk on off-balance sheet financial instruments is defined as a probability of losses due to the inability of counterparty to comply with the contractual terms and conditions.

(in thousands of Georgian Lari)

With respect to credit risk on commitments to extend credit, the Group is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of the loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group applies the same credit policy to the contingent liabilities as it does to the balance sheet financial instruments, i.e. the one based on the procedures for approving the grant of loans, using limits to mitigate the risk, and current monitoring. The Group monitors the term to maturity of off balance sheet contingencies because longer term commitments generally have a greater degree of credit risk than short-term commitments.

Maximum exposure of credit risk

The Group's maximum exposure to credit risk varies significantly and is dependent on both individual risks and general market economy risks.

The following table presents the maximum exposure to credit risk of balance sheet and off balance sheet financial assets. For financial assets in the balance sheet, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. The Group's maximum exposure to credit risk under contingent liabilities and commitments to extend credit, in the event of non performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

	Maximum exposure	
	December 31, 2011	**December 31, 2010**
Financial assets at fair value through profit or loss	15,479	2,901
Due from banks	27,601	89,278
Loans to customers	256,152	408,089
Investments available-for-sale	322	245
Investments held to maturity	6,414	18,147
Other financial assets	928	743
Guarantees issued and similar commitments	20,174	66,449
Commitments on loans and unused credit lines	2,950	26,597

Off – balance sheet risk

The Group applies fundamentally the same risk management policies for off-balance sheet risks as it does for its on-balance sheet risks. In the case of commitments to lend, customers and counterparties will be subject to the same credit management policies as for loans and advances. Collateral may be sought depending on the strength of the counterparty and the nature of the transaction.

Credit quality by classes of financial assets

As at December 31, 2011:

	Neither past due nor individually impaired	**Past due but not individually impaired**	**Individually impaired**	**Collectively impaired**	**(Impairment allowance)**	**Total**
Balances with the NBG	16,462	-	-	-	-	16,462
Due from banks	27,601	-	-	-	-	27,601
Loans to customers	132,759	8,298	233,189	14,653	(132,747)	256,152
Investments available-for-sale	322	-	-	-	-	322
Investments held to maturity	6,414	-	-	-	-	6,414
Other financial assets	928	-	-	-	-	928

(in thousands of Georgian Lari)

As at December 31, 2010:

	Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Collectively impaired	(Impairment allowance)	Total
Balances with the NBG	10,924	-	-	-	-	10,924
Due from banks	89,278	-	-	-	-	89,278
Loans to customers	180,318	8,747	166,474	89,618	(37,068)	408,089
Investments available-for-sale	245	-	-	-	-	245
Investments held to maturity	18,147	-	-	-	-	18,147
Other financial assets	743	-	-	-	-	743

Financial assets are graded according to the current credit rating they have been issued by an internationally regarded agency such as Fitch. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

As at December 31, 2011 and 2010 the balances with the NBG amounted to GEL 16,462 thousand and GEL 10,924 thousand, respectively. The credit rating of Georgia according to the international rating agencies corresponded to investment level <BBB.

The following table details credit ratings of financial assets held by the Group as at December 31, 2011:

	AAA	AA	A	BBB	<BBB	Not rated	Total at December 31, 2010
Balances with the NBG	-	-	-	-	16,462	-	16,462
Financial assets at fair value through profit or loss	-	-	862	-	-	14,617	15,479
Due from banks	-	1,141	13,472	-	9,848	3,140	27,601
Loans to customers	-	-	-	-	-	256,152	256,152
Investments available-for-sale	-	-	-	-	-	322	322
Investments held to maturity	-	-	-	-	6,414	-	6,414
Other financial assets	-	-	-	-	-	928	928

As at December 31, 2010:

	AAA	AA	A	BBB	<BBB	Not Rated	Total at December 31, 2009
Balances with the NBG	-	-	-	10,924	-	-	10,924
Financial assets at fair value through profit or loss	-	-	820	90	-	1,991	2,901
Due from banks	-	16,527	6,301	460	65,990	-	89,278
Loans to customers	-	-	-	-	-	408,089	408,089
Investments available-for-sale	-	-	-	-	-	245	245
Investments held to maturity	-	-	-	18,147	-	-	18,147
Other financial assets	-	-	-	-	-	743	743

The banking industry is generally exposed to credit risk through its loans to customers and inter bank deposits. With regard to the loans to customers this risk exposure is concentrated within Georgia.

(in thousands of Georgian Lari)

The exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the Group's risk management policy are not breached.

Geographical concentration

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

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

	Georgia	Other non-OECD countries	OECD countries	December 31, 2011 Total
FINANCIAL ASSETS				
Cash and balances with the NBG	26,789	-	-	26,789
Financial assets at fair value through profit or loss	-	106	15,373	15,479
Due from banks	11,909	14,192	1,500	27,601
Loans to customers	256,152	-	-	256,152
Investments available-for-sale	322	-	-	322
Investments held to maturity	6,414	-	-	6,414
Other financial assets	928	-	-	928
TOTAL FINANCIAL ASSETS	302,514	14,298	16,873	333,685
FINANCIAL LIABILITIES				
Due to banks	95	-	25,903	25,998
Customer accounts	74,911	1,525	870	77,306
Other financial liabilities	32	-	-	32
Subordinated debt	121,106	5,864	-	126,970
TOTAL FINANCIAL LIABILITIES	196,144	7,389	26,773	230,306
NET POSITION	**106,370**	**6,909**	**(9,900)**	

	Georgia	Other non-OECD countries	OECD countries	December 31, 2010 Total
FINANCIAL ASSETS				
Cash and balances with the NBG	22,555	-	-	22,555
Financial assets at fair value through profit or loss	-	265	2,636	2,901
Due from banks	65,986	891	22,401	89,278
Loans to customers	407,612	-	477	408,089
Investments available-for-sale	245	-	-	245
Investments held to maturity	18,147	-	-	18,147
Other financial assets	743	-	-	743
TOTAL FINANCIAL ASSETS	515,288	1,156	25,514	541,958
FINANCIAL LIABILITIES				
Due to banks	37,183	1	29,462	66,646
Customer accounts	84,046	185	539	84,770
Other financial liabilities	432	-	-	432
Subordinated debt	236,303	6,209	-	242,512
TOTAL FINANCIAL LIABILITIES	357,964	6,395	30,001	394,360
NET POSITION	**157,324**	**(5,239)**	**(4,487)**	

Liquidity risk

Liquidity risk management

Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due.

The ALCO controls these types of risks by means of maturity analysis, determining the Group's strategy for the next financial period. Current liquidity is managed by the Treasury Department, which deals in the money markets for current liquidity support and cash flow optimization.

In order to manage liquidity risk, the Group performs daily monitoring of future expected cash flows on clients' and banking operations, which is a part of assets/liabilities management process.
The Management Board sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level on interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

Further is analysis of liquidity and interest rate risks:

(a) term to maturity of financial liabilities, that are not derivatives, calculated for non-discounted cash flows on financial liabilities (main debt and interests) on the earliest date, when the Group will be liable to redeem the liability;

(b) term to maturity of financial liabilities, that are derivatives, calculated for non-discounted cash flows on financial liabilities on the earliest date, when the Group will be liable to redeem the liability; and

(c) estimated term till maturity of financial assets, that are not derivatives, calculated for non-discounted cash flows on financial assets (including interests), which will be received on these assets based on contractual terms of maturity, except the cases when the Group expects that cash flows will be received in the different time.

An analysis of the liquidity by classes of financial assets and financial liabilities, and interest rate risks is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the Group.

(in thousands of Georgian Lari)

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	December 31, 2011 Total
FINANCIAL ASSETS						
Due from banks	9,197	-	-	-	-	9,197
Loans to customers	27,828	1,008	28,653	95,996	102,667	256,152
Investments held to maturity	1,000	4,000	1,414	-	-	6,414
Total interest bearing financial assets	38,025	5,008	30,067	95,996	102,667	271,763
Cash and balances with the NBG	26,789	-	-	-	-	26,789
Financial assets at fair value through profit or loss	15,479	-	-	-	-	15,479
Due from banks	18,404	-	-	-	-	18,404
Investments available-for-sale	-	-	-	322	-	322
Other financial assets	928	-	-	-	-	928
Total financial assets	99,625	5,008	30,067	96,318	102,667	333,685
FINANCIAL LIABILITIES						
Due to banks	-	-	10,893	13,648	1,361	25,902
Customer accounts	7,597	4,902	10,488	2,142	12	25,141
Subordinated debt	147	-	-	41,758	85,065	126,970
Total interest bearing financial liabilities	7,744	4,902	21,381	57,548	86,438	178,013
Due to banks	96	-	-	-	-	96
Customer accounts	52,165	-	-	-	-	52,165
Other financial liabilities	32	-	-	-	-	32
Total financial liabilities	60,037	4,902	21,381	57,548	86,438	230,306
Interest sensitivity gap	30,281	106	8,686	38,448	16,229	
Cumulative interest sensitivity gap	**30,281**	**30,387**	**39,073**	**77,521**	**93,750**	
Liquidity gap	39,588	106	8,686	38,770	16,229	
Cumulative liquidity gap	**39,588**	**39,694**	**48,380**	**87,150**	**103,379**	

(in thousands of Georgian Lari)

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	December 31, 2010 Total
FINANCIAL ASSETS						
Due from banks	64,541	2,352	266	-	-	67,159
Loans to customers	17,263	11,395	22,243	65,214	291,974	408,089
Investments held to maturity	6,343	10,338	1,466	-	-	18,147
Total interest bearing financial assets	88,147	24,085	23,975	65,214	291,974	493,395
Cash and balances with the NBG	22,555	-	-	-	-	22,555
Financial assets at fair value through profit or loss	2,901	-	-	-	-	2,901
Due from banks	22,119	-	-	-	-	22,119
Investments available-for-sale	-	-	-	245	-	245
Other financial assets	743	-	-	-	-	743
Total financial assets	136,465	24,085	23,975	65,459	291,974	541,958
FINANCIAL LIABILITIES						
Due to banks	57,317	-	9,205	-	-	66,522
Customer accounts	23,086	4,047	17,933	2,984	283	48,333
Subordinated debt	-	-	40,884	183,000	18,628	242,512
Total interest bearing financial liabilities	80,403	4,047	68,022	185,984	18,911	357,367
Due to banks	124	-	-	-	-	124
Customer accounts	35,268	151	693	325	-	36,437
Other financial liabilities	432	-	-	-	-	432
Total financial liabilities	116,227	4,198	68,715	186,309	18,911	394,360
Interest sensitivity gap	7,744	20,038	(44,047)	(120,770)	273,063	
Cumulative interest sensitivity gap	**7,744**	**27,782**	**(16,265)**	**(137,035)**	**136,028**	
Liquidity gap	20,238	19,887	(44,740)	(120,850)	273,063	
Cumulative liquidity gap	**20,238**	**40,125**	**(4,615)**	**(125,465)**	**147,598**	

An analysis of liquidity and interest rate risk is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the Group. The amounts disclosed in these tables do not correspond to the amounts recorded in the consolidated statement of financial position as the presentation below includes a maturity analysis for financial liabilities that indicates the total remaining contractual payments (including interest payments), which are not recognized in the consolidated statement of financial position under the effective interest rate method.

(in thousands of Georgian Lari)

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	December 31, 2011 Total
FINANCIAL LIABILITIES							
Due to banks	2.35%	1,089	2,171	9,772	14,271	725	28,028
Customer accounts	7.70%	8,746	4,867	10,129	3,115	12	26,869
Subordinated Debt	5.00%	242	439	1,953	55,517	68,819	126,970
Total interest bearing financial liabilities		10,007	7,477	21,854	72,903	69,556	181,867
Due to banks		96	-	-	-	-	96
Customer accounts		53,824	35	630	389	28	54,906
Other financial liabilities		32	-	-	-	-	32
TOTAL FINANCIAL LIABILITIES		**63,959**	**7,512**	**22,484**	**73,292**	**69,584**	**263,901**

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	December 31, 2010 Total
FINANCIAL LIABILITIES							
Due to banks	1.34%	58,203	98	9,500	-	-	67,801
Customer accounts	9.10%	23,452	4,621	19,379	3,875	412	51,739
Subordinated debt	9.00%	1,667	5,001	55,886	231,970	27,011	321,535
Total interest bearing financial liabilities		83,322	9,720	84,765	235,845	27,423	441,075
Due to banks		124	-	-	-	-	124
Customer accounts		35,268	151	693	325	-	36,437
Other financial liabilities		432	-	-	-	-	432
TOTAL FINANCIAL LIABILITIES		**119,146**	**9,871**	**85,458**	**236,170**	**27,423**	**478,068**

Market risk

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

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

(in thousands of Georgian Lari)

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

The majority of the Group's loan contracts and other financial assets and liabilities that bear interest are either variable or contain clauses enabling the interest rate to be changed at the option of the lender. The Group monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

Interest rate sensitivity

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

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

Impact on profit before tax based on asset values as at December 31, 2011 and 2010:

	December 31, 2011		**December 31, 2010**	
	Interest rate +2%	**Interest rate -2%**	**Interest rate +2%**	**Interest rate -2%**
Financial assets:				
Due from banks	184	(184)	1,417	(1,417)
Loans to customers	5,123	(5,123)	8,450	(8,450)
Investments held to maturity	128	(128)	204	(204)
Financial liabilities:				
Due to banks	(518)	518	(704)	704
Customer accounts	(503)	503	(1,788)	1,788
Subordinated debt	(2,539)	2,539	(4,869)	4,869
Net impact on profit before tax	**1,875**	**(1,875)**	**2,745**	**(2,745)**

Impact on equity:

	December 31, 2011		**December 31, 2010**	
	Interest rate +2%	**Interest rate -2%**	**Interest rate +2%**	**Interest rate -2%**
Financial assets:				
Due from banks	156	(156)	1,205	(1,205)
Loans to customers	4,355	(4,355)	7,183	(7,183)
Investments held to maturity	109	(109)	173	(173)
Financial liabilities:				
Due to banks	(440)	440	(599)	599
Customer accounts	(428)	428	(1,520)	1,520
Subordinated debt	(2,158)	2,158	(4,139)	4,139
Net impact on equity	**1,594**	**(1,594)**	**2,303**	**(2,303)**

(in thousands of Georgian Lari)

Currency risk

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

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

The Group's open positions by the major currencies in which it holds the assets and liabilities are presented below:

	GEL	**USD** USD 1 = GEL1.6703	**EUR** EUR 1 = GEL 2.1614	**Other currency**	**December 31, 2011 Total**
FINANCIAL ASSETS					
Cash and balances with the NBG	12,228	12,099	2,348	114	26,789
Financial assets at fair value through profit or loss	-	15,312	-	167	15,479
Due from banks	11,616	15,514	342	129	27,601
Loans to customers	114,383	134,369	7,400	-	256,152
Investments available-for-sale	322	-	-	-	322
Investments held to maturity	6,414	-	-	-	6,414
Other financial assets	393	354	103	78	928
TOTAL FINANCIAL ASSETS	146,356	177,648	10,193	488	333,685
FINANCIAL LIABILITIES					
Due to banks	55	25,942	1	-	25,998
Customer accounts	17,414	53,748	6,094	50	77,306
Other financial liabilities	18	14	-	-	32
Subordinated debt	-	126,970	-	-	126,970
TOTAL FINANCIAL LIABILITIES	17,487	206,674	6,095	50	230,306
OPEN BALANCE SHEET POSITION	**127,869**	**(29,026)**	**4,098**	**438**	

	GEL	**USD** USD 1 = GEL1.7728	**EUR** EUR 1 = GEL 2.3500	**Other currency**	**December 31, 2010 Total**
FINANCIAL ASSETS					
Cash and balances with the NBG	13,347	7,703	1,418	87	22,555
Financial assets at fair value through profit or loss	-	2,696	-	205	2,901
Due from banks	65,792	11,084	12,243	159	89,278
Loans to customers	81,561	316,951	9,577	-	408,089
Investments available-for-sale	245	-	-	-	245
Investments held to maturity	18,147	-	-	-	18,147
Other financial assets	743	-	-	-	743

(in thousands of Georgian Lari)

	GEL	**USD** USD 1 = GEL1.7728	**EUR** EUR 1 = GEL 2.3500	**Other currency**	**December 31, 2010 Total**
TOTAL FINANCIAL ASSETS	179,835	338,434	23,238	451	541,958
FINANCIAL LIABILITIES					
Due to banks	55	52,470	14,121	-	66,646
Customer accounts	26,831	47,786	9,842	311	84,770
Subordinated debt	-	242,512	-	-	242,512
Other financial liabilities	432	-	-	-	432
TOTAL FINANCIAL LIABILITIES	27,318	342,768	23,963	311	394,360
OPEN BALANCE SHEET POSITION	**152,517**	**(4,334)**	**(725)**	**140**	

Currency risk sensitivity

The following table details the Group’s sensitivity to a 5% increase and decrease in the USD against the GEL. 5% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management’s assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 5% change in foreign currency rates.

Impact on net profit and equity based on asset values as at December 31, 2011 and 2010:

	December 31, 2011		**December 31, 2010**	
	GEL/USD +5%	**GEL/USD -5%**	**GEL/USD +5%**	**GEL/USD -5%**
Impact on profit or loss before tax	1,410	(1,410)	216	(216)
Impact on equity	1,199	(1,199)	184	(184)

Limitations of sensitivity analysis

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

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

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

Price risk

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

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

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 it endeavors to manage these risks through a control framework and by monitoring and responding to potential risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes.

29. SUBSEQUENT EVENTS

Subsequent to the year end, the group converted subordinated loan from related party, FinService-XXI LTD, in the amount of GEL 11,701 thousand to share capital.