

# **TBC BANK GROUP**

**Consolidated Financial Statements**  
For the Year Ended 31 December 2007

# TBC BANK GROUP

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## TBC BANK GROUP

### STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

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The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' report set out on pages 2-3, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the consolidated financial statements of Joint Stock Company TBC Bank (the "Bank") and its subsidiaries (the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group at 31 December 2007, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

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

- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining proper accounting records that 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;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Detecting and preventing fraud, errors and other irregularities.

The consolidated financial statements for the year ended 31 December 2007 were authorized for issue on 23 June 2008 by the management board.

On behalf of the Management Board:

General Director  
Vakhtang Butskhrikidze  
23 June 2008

First Deputy General Director  
Paata Gadzadze  
23 June 2008

## INDEPENDENT AUDITORS' REPORT

To the Shareholders and the Board of Directors of TBC Bank Group:

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of JSC TBC Bank and its subsidiaries (together the "Group"), which comprise the consolidated balance sheet as at 31 December 2007, and the consolidated income statement, consolidated statements of changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards.

This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Auditor's 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 financial statements are free from material misstatement.

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

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### Opinion

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

*Deloitte & Touche*

23 June 2008  
Tbilisi



# TBC BANK GROUP

## CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2007

(in Georgian Lari and in thousands)

	Notes	Year ended 31 December 2007	Year ended 31 December 2006
Interest income	6,29	165,326	94,229
Interest expense	6,29	(81,353)	(39,346)
NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS		83,973	54,883
Provision for impairment losses on interest bearing assets	7	(26,494)	(9,942)
NET INTEREST INCOME		57,479	44,941
Net loss on financial assets and liabilities at fair value through profit or loss	8	(846)	(292)
Net gain on foreign exchange operations	9	15,939	9,735
Fee and commission income	10	25,579	16,272
Fee and commission expense	10	(4,227)	(4,192)
Net loss on subsidiaries		-	(23)
Net gain on investments available-for-sale		191	-
Other income	11	9,657	2,217
NET NON-INTEREST INCOME		46,293	23,717
OPERATING INCOME		103,772	68,658
OPERATING EXPENSES	12	(67,127)	(32,750)
Recovery of provision/(provision) for impairment losses other transactions	7	1,801	(6,008)
PROFIT BEFORE INCOME TAX		38,446	29,900
Income tax expense	13	(9,875)	(7,319)
NET PROFIT		28,571	22,581
Attributable to:			
Equity holders of the parent		28,418	22,471
Minority interest		153	110
		28,571	22,581

On behalf of the Management Board:

General Director  
Vakhtang Butskhrikidze  
23 June 2008  
Tbilisi

First Deputy General Director  
Paata Gadzadze  
23 June 2008  
Tbilisi

The notes on pages 8-56 form an integral part of these consolidated financial statements.

# TBC BANK GROUP

## CONSOLIDATED BALANCE SHEET


AS AT 31 DECEMBER 2007

(in Georgia Lari and in thousands)

	Notes	31 December 2007	31 December 2006
<b>ASSETS:</b>			
Cash and balances with the National Bank of Georgia	14	183,833	197,425
Financial assets at fair value through profit or loss	15	363	1,177
Due from banks	16, 29	80,994	49,630
Loans to customers	17, 29	1,148,278	588,182
Investments available-for-sale	18	5,219	4,590
Investments held to maturity	19	114,596	50,253
Goodwill	20	758	-
Property, plant and equipment purchased for transfer into lease		326	-
Property, plant and equipment	21	118,170	53,233
Current income tax assets		6,808	-
Other assets	22	40,793	9,617
<b>TOTAL ASSETS</b>		<b>1,700,138</b>	<b>954,107</b>
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES:</b>			
Due to banks and financial institutions	23, 29	525,398	238,047
Customer accounts	24, 29	779,541	552,168
Current income tax liabilities		-	1,800
Deferred income tax liabilities	13	13,786	2,289
Other liabilities	25	13,022	14,124
Subordinated debt	26	55,881	25,065
<b>Total liabilities</b>		<b>1,387,628</b>	<b>833,493</b>
<b>EQUITY:</b>			
Equity attributable to equity holders of the parent:			
Share capital	27	11,700	5,385
Share premium	27	136,279	4,715
Property, plant and equipment revaluation reserve		35,385	10,003
Retained earnings		128,574	100,156
<b>Total equity attributable to equity holders of the parent</b>		<b>311,938</b>	<b>120,259</b>
Minority interest		572	355
<b>Total equity</b>		<b>312,510</b>	<b>120,614</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>1,700,138</b>	<b>954,107</b>

On behalf of the Management Board:

  
General Director  
Vakhtang Butskhrikidze  
23 June 2008  
Tbilisi

  
First Deputy General Director  
Paata Gadzadze  
23 June 2008  
Tbilisi

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# TBC BANK GROUP

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2007

(in Georgian Lari and in thousands)

	Share Capital	Share premium	Property , plant and equip- ment revaluati on reserve	Retained earnings	Total equity attri- butable to equity holders of the parent	Minority interest	Total equity
<b>31 December 2005</b>	5,385	4,715	10,003	79,685	99,788	-	99,788
Dividends declared on:							
- ordinary shares	-	-	-	(2,000)	(2,000)	-	(2,000)
Loss on sale of shares	-	-	-	-	-	23	23
Sale of shares	-	-	-	-	-	222	222
Net profit	-	-	-	22,471	22,471	110	22,581
<b>31 December 2006</b>	<u>5,385</u>	<u>4,715</u>	<u>10,003</u>	<u>100,156</u>	<u>120,259</u>	<u>355</u>	<u>120,614</u>
Share capital increase of:							
- ordinary shares	6,145	127,447	-	-	133,592	-	133,592
Gains/(losses) on revaluation of fixed assets, net of income tax effect of GEL 3,744 thousand	-	-	25,382	-	25,382	-	25,382
Loss on sale of shares	-	-	-	-	-	64	64
Share based payments	170	4,117	-	-	4,287	-	4,287
Net profit	-	-	-	28,418	28,418	153	28,571
<b>31 December 2007</b>	<u>11,700</u>	<u>136,279</u>	<u>35,385</u>	<u>128,574</u>	<u>311,938</u>	<u>572</u>	<u>312,510</u>

On behalf of the Management Board:

General Director  
Vakhtang Butskhrikidze  
23 June 2008  
Tbilisi

First Deputy General Director  
Paata Gadzadze  
23 June 2008  
Tbilisi

The notes on pages 8-56 form an integral part of these consolidated financial statements.

# TBC BANK GROUP

## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2007 (in Georgian Lari and in thousands)

	Notes	Year ended 31 December 2007	Year ended 31 December 2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Interest received		160,702	89,501
Interest paid		(73,913)	(33,194)
Fees and commissions received		25,579	18,981
Fees and commissions paid		(4,227)	(5,394)
Realized gains less losses in foreign currencies		16,954	9,694
Other operating income		8,029	2,631
Salaries and benefits		(33,645)	(16,794)
Administrative and operating expenses		(27,077)	(8,579)
Cash flows from operating activities before changes in operating assets and liabilities		72,402	56,846
<b>Changes in operating assets and liabilities</b>			
(Increase)/decrease in operating assets:			
Obligatory reserve with the NBG		(26,083)	(22,477)
Financial assets at fair value through profit or loss		(50)	(12,045)
Due to banks		(59,851)	28,936
Loans to clients		(581,502)	(218,937)
Other assets		(28,559)	(7,681)
Increase/(decrease) in operating liabilities			
Financial liabilities at fair value through profit or loss		67	11,791
Due from banks and financial institutions		278,069	134,316
Customer accounts		226,742	170,033
Other liabilities		(729)	295
Cash inflow from operating activities before taxation		(119,494)	141,077
Income tax paid		(10,730)	(10,933)
Net cash (outflow)/inflow from operating activities		(130,224)	130,144
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of investment held-to-maturity		(61,802)	(42,791)
Purchases of investment available-for-sale		(629)	(5,331)
Proceeds from investments in associates and subsidiaries		-	603
Purchases of property and equipment		(42,129)	(19,956)
Proceeds on sale of property and equipment		26	310
Net cash outflow from investing activities		(104,534)	(67,165)



# TBC BANK GROUP

## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2007 (in Georgian Lari and in thousands)

	Notes	Year ended 31 December 2007	Year ended 31 December 2006
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Share capital		6,315	-
Share premium		131,564	-
Subordinated debt		30,126	17,135
Dividends paid		-	(2,000)
Net cash inflow from financing activities		168,005	15,135
NET INCREASE IN CASH AND CASH EQUIVALENTS		(66,753)	78,114
Effect of changes in foreign exchange rate on cash and cash equivalents		(1,015)	41
CASH AND CASH EQUIVALENTS, beginning of year	14	167,185	89,030
CASH AND CASH EQUIVALENTS, end of year	14	99,417	167,185

On behalf of the Management Board:

General Director  
Vakhtang Butskhrikidze  
23 June 2008  
Tbilisi

First Deputy General Director  
Paata Gadzadze  
23 June 2008  
Tbilisi

The notes on pages 8-56 form an integral part of these consolidated financial statements.

# TBC BANK GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

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### 1. ORGANISATION

Joint Stock Company TBC Bank (the “Bank”) is a joint stock company, which was incorporated in Georgia on 17 December 1992. The Bank is regulated by the National Bank of Georgia (the “NBG”) and conducts its business under the general banking license number 85 granted on 20 January 1993. The Bank’s primary business consists of commercial activities, trading with foreign currencies and originating loans and guarantees.

The registered office of the Bank is located at 121 Rustaveli Street, 383720 Borjomi, Georgia.

As at 31 December 2007 the Bank has 13 branches and 29 service centers operating in Georgia.

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	The Bank ownership interest/voting rights, %		Type of operation
		2007	2006	
JSC TBC Bank (parent)	Georgia			Commercial bank
JSC TBC Leasing	Georgia	90%	90%	Finance leasing
JSC United Financial Corporation	Georgia	90%	45%	Plastic card processing center
TBC Broker LLC	Georgia	100%	100%	Securities market transactions
UFC International Limited	Virgin Islands (UK)	80%	80%	Plastic card transactions’ processing

Joint Stock Company TBC Leasing is a Joint Stock Company, incorporated in Georgia in 2003. The Company’s registered office is located at 11 Chavchavadze Avenue, Tbilisi 0179, Georgia. The principal business activity of the Company is providing finance leases to companies within Georgia.

Joint Stock Company United Financial Corporation is a Joint Stock Company, incorporated in Georgia in 2001. The Company’s registered office is located at 154 Agmashenebeli Avenue, Tbilisi 0112, Georgia. The principal business activity of the Company is providing plastic card processing services to companies within Georgia.

TBC Broker LLC (100%) and UFC International Limited (80%), subsidiaries, are not consolidated into the consolidated financial statements due to the immateriality of their financial statements.

As at 31 December 2007 and 2006, the following shareholders owned the issued shares:

	31 December 2007, %	31 December 2006, %
<b>Shareholder</b>		
Raiki LLC	28.60	-
Mamuka Khazaradze	12.78	0.02
International Finance Corporation	11.94	30.95
TBC Holdings LLC	9.97	21.67
Deutsche Investitions and Entwicklungsgesellschaft mbH.	9.64	13.33
Liquid Crystal International	9.25	20.10
Badri Japaridze	8.38	5.51
David Khazaradze	5.43	6.58
George Kekelidze	1.77	1.84
Vakhtang Butskhrikidze	1.11	-
Others	1.13	-
<b>Total</b>	<u>100.00</u>	<u>100.00</u>

As of 31 December 2007 and 2006, the ultimate shareholders of the Group are:

The ultimate controlling parties of the Bank as at 31 December 2007 and 2006 were Mamuka Khazaradze and Badri Japaridze who achieved control through Raiki LLC, TBC Holding LLC and Liquid Chrystal International.

These consolidated financial statements were authorized for issue by the Management Board of the Group on 23 June 2008.

## 2. BASIS OF PRESENTATION

### Accounting basis

These financial statements of the Group 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”).

These financial statements are presented in thousands of Georgian Lari (“GEL”), unless otherwise indicated. These consolidated financial statements have been prepared under the historical cost convention, except for the measurement at fair value of certain financial instruments and measurement of buildings at revalued amounts according to International Accounting Standard (“IAS”) No. 16 “Property, Plant and Equipment” (“IAS 16”).

The Bank and its subsidiaries maintain their accounting records in accordance with IFRS, while its foreign subsidiaries maintain accounting records in accordance with the requirements of the countries where those subsidiaries operate. These consolidated financial statements have been prepared based on accounting records of the Bank and its Georgian subsidiaries, and financial statements of foreign subsidiaries, which have been adjusted to conform to IFRS. These adjustments include certain reclassifications to reflect the economic substance of underlying transactions including reclassifications of certain assets and liabilities, income and expenses to appropriate financial statement captions.

## Key assumptions

The preparation of consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts. Such estimates and assumptions are based on the information available to the Group's management as of the date of the consolidated financial statements. Therefore, actual results could differ from those estimates and assumptions. Estimates that are particularly susceptible to change relate to the provisions for impairment losses and the fair value of financial instruments.

Key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period include:

	31 December 2007	31 December 2006
Allowance for impairment losses on interest bearing assets	26,494	9,942
Allowance for impairment losses for other transactions	1,801	6,008

Loans to customers and due from banks are measured at amortised cost less allowance for impairment losses. The estimation of allowances for impairments involves the exercise of significant judgment.

The Group estimates allowances for impairment with the objective of maintaining balance sheet provisions at a level believed by management to be sufficient to absorb probable losses incurred in the Group's loan portfolio. The calculation of provisions on impaired loans is based on the likelihood of the asset being written off and the estimated loss on such a write-off. These assessments are made using statistical techniques based on historic experience. These determinations are supplemented by various formulaic calculations and the application of management judgment.

The Group considers accounting estimates related to provisions for loans key sources 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 losses relating to impaired loans and advances are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses (as reflected in the provisions) and actual losses will require the Group to take provisions which, if significantly different, could have a material impact on its future income statement and its balance sheet. The Group's assumptions about estimated losses are based on past performance, past customer behavior, the credit quality of recent underwritten business and general economic conditions, which are not necessarily an indication of future losses.

Certain property (buildings) is measured at revalued amounts. The date of the latest appraisal was 31 December 2007. The next revaluation is preliminary scheduled for 31 December 2008.

Investments available-for-sale are measured at fair value less impairment losses. The estimation of impairments involves the exercise of significant management judgment.

The accounting policy for the impairment of financial instruments is discussed in Note 3 below.

Taxation is discussed in Note 13.

## Functional currency

The functional currency of these financial statements is the Georgian Lari.

### **3. SIGNIFICANT ACCOUNTING POLICIES**

#### **Basis of consolidation**

The consolidated financial report incorporates the financial report of the Bank, entities controlled by the Bank (its subsidiaries) and entities under common control made up to the end of each period.. Control is achieved where the Bank has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognized as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to the consolidated income statement in the period of acquisition. The minority interest is stated at the minority's proportion of the fair values of the assets and liabilities recognized. Subsequently, any losses applicable to the minority interest in excess of the minority interest are allocated against the interests of the parent. The equity attributable to equity holders of the parent and net income attributable to minority shareholders' interests are shown separately in the consolidated balance sheet and income statement, respectively.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

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

All intra-group transactions, balances, income and expenses are eliminated on consolidation and combination.

The difference, if any, between the carrying amount of minority interest and the amount received on its purchase is recognized in equity attributable to the equity holders of the parent.

#### **Investments in associates and jointly controlled enterprises**

An associate is an entity over which the Group is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the investee.

Investment in a jointly controlled enterprise is an entity over which the Group executes a joint control, which is when the strategic financial and operating policy decisions relating to the activities of the jointly controlled enterprise require the unanimous consent of the parties sharing control.

The results and assets and liabilities of associates and jointly controlled enterprises are incorporated in these financial statements using the equity method of accounting, which is an alternative treatment allowed by IAS 31 versus the proportionate consolidation.

Investments in associates and jointly controlled enterprises are carried in the consolidated balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets of the associate and jointly controlled enterprise, less any impairment in the value of individual investments. Losses of the associates and jointly controlled enterprises in excess of the Group's interest in those associates and jointly controlled enterprises are not recognized.



Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities of the associate and jointly controlled enterprises at the date of acquisition is recognized as goodwill. The goodwill is included in the carrying amount of the investment and is assessed for impairment as part of the investment. Any deficiency of the cost of acquisition below the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities of the associate at the date of acquisition (i.e. discount on acquisition) is credited in the consolidated income statement in the period of acquisition. The goodwill is included in the carrying amount of the investment and is assessed for impairment as part of the investment.

Where a Group company transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate and jointly controlled enterprise. Losses may provide evidence of an impairment of the asset transferred in which case appropriate provision is made for impairment.

As at 31 December 2007 the Bank did not have any investments in associates. As at 31 December 2006 assets, liabilities and net profit/(loss) for the year then ended of associates are presented as follows:

<b>Name of associate</b>	<b>Total assets of associate</b>	<b>Total liabilities of associate</b>	<b>Revenue of associate</b>	<b>Net profit</b>
JSC GPIH	13,360	11,179	8,705	109

As at 31 December 2007 assets, liabilities and net profit/(loss) for the year then ended of jointly controlled enterprises are presented as follows:

<b>Name of jointly controlled enterprise</b>	<b>Total assets of jointly controlled enterprise</b>	<b>Total liabilities of jointly controlled enterprise</b>	<b>Revenue of jointly controlled enterprise</b>	<b>Net loss</b>
JSC GPI B.V.	25,312	28,096	12,859	(2,344)

## **Goodwill**

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition. The Group's policy for goodwill arising on the acquisition of an associate is described under 'Investments in associates' above.

The Group tests goodwill for impairment at least annually.

If the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the Group:

- Reassesses the identification and measurement of the Group's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and
- Recognizes immediately in profit or loss any excess remaining after that reassessment.

On disposal of an investment, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

## **Recognition and measurement of financial instruments**

The Group recognizes financial assets and liabilities on its consolidated balance sheet when it becomes a party to the contractual obligation of the instrument. Regular way purchase and sale of the financial assets and liabilities are recognized using settlement date accounting. Regular way purchases of financial instruments that will be subsequently measured at fair value between trade date and settlement date are accounted for in the same way as for acquired instruments.

Financial assets and liabilities are initially recognized at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss transaction costs that are directly attributable to acquisition or issue of the financial asset or financial liability. The accounting policies for subsequent re-measurement of these items are disclosed in the respective accounting policies set out below.

### **Cash and cash equivalents**

Cash and cash equivalents include cash on hand, unrestricted balances on correspondent and time deposit accounts with the National Bank of Georgia with original maturity within 90 days, advances to banks in countries included in the Organization for Economic Co-operation and Development ("OECD"). 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.

### **Due from banks**

In the normal course of business, the Group maintains advances and deposits for various periods of time with other banks. Due from banks with a fixed maturity term are subsequently measured at amortized cost using the effective interest method. Those that do not have fixed maturities are carried at amortized cost based on expected maturities. Amounts due from credit institutions are carried net of any allowance for impairment losses.

### **Financial instruments at fair value through profit or loss**

Financial instruments at fair value through profit or loss represent instruments acquired/incurred principally for the purpose of selling/settlement in the near term, or it is a part of portfolio of a identified financial instruments that are managed together and for which there is evidence of a recent and actual pattern of short-term profit-taking, or as a derivative, or financial instruments which upon initial recognition are designated by the Group at fair value through profit or loss. Financial instruments at fair value through profit or loss are initially recorded and subsequently measured at fair value. The Group uses quoted market prices to determine fair value for the Group's financial instruments at fair value through profit or loss. Fair value adjustment on financial instruments at fair value through profit or loss is recognized in the consolidated income statement for the period. The Group does not reclassify financial instruments in or out of this category while they are held. The main Group's aim is using the fair value option is to eliminate or significantly reduce discrepancies in the accounting treatment of certain financial assets and liabilities.

The Group enters into derivative financial instruments to manage currency and liquidity risks. They include forwards on foreign currency and interest rate caps. Derivative financial instruments are entered by the Group are not qualified for hedge accounting.

### **Loans to customers**

Loans to customers are non-derivative assets with fixed or determinable payments that are not quoted in an active market other than those classified in other categories of financial assets.

Loans granted by the Group with fixed maturities are initially recognized at fair value plus related transaction costs. Subsequently, the loan carrying value is measured using the effective interest method. Loans to customers that do not have fixed maturities are accounted for under the effective interest method based on expected maturity. Loans to customers are carried net of any allowance for impairment losses.

## **Write off of loans and advances**

Loans and advances are written off against allowance for impairment losses in case of uncollectibility of loans and advances, including through repossession of collateral. Loans and advances 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.

## **Allowance for impairment losses**

The Group accounts for impairment losses of financial assets when there is objective evidence that a financial asset or group of financial assets is impaired. Impairment losses are measured as the difference between carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted at the financial asset's original effective interest rate, for financial assets which are carried 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. For financial assets carried at cost, the impairment losses are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows, discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

The determination of impairment losses is based on an analysis of the risk assets and reflects the amount which, in the judgment of management, is adequate to provide for losses incurred. Provisions are made as a result of an individual appraisal of risk assets for financial assets that are individually significant, and an individual or collective assessment for financial assets that are not individually significant.

The change in impairment losses is charged to profit either through allowance account (financial assets that are carried at amortized cost) or direct write-off (financial assets carried at cost). The total of the impairment losses is deducted in arriving at assets as shown in consolidated the balance sheet. Factors that the Group considers in determining whether it has objective evidence that an impairment loss has been incurred include information about the debtors' or issuers' liquidity, solvency and business and financial risk exposures, levels of and trends in delinquencies for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees. These and other factors may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred in a financial asset or group of financial assets.

It should be understood that estimates of losses involve an exercise of judgment. While it is possible that in particular periods the Group may sustain losses which are substantial relative for impairment losses, it is the judgment of management that the impairment losses are adequate to absorb losses incurred on risk assets, at the balance sheet date.

## **Finance leases**

Financial leases are leases that transfer substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract.

The Group as a lessor presents finance leases as loans and initially measures them in the amount equal to net investment in the lease. Subsequently the recognition of finance income is based on a pattern reflecting a constant periodic rate of return on the Group's net investment in the finance lease.

Before commencement of the lease property, plant and equipment purchased for future transfer to financial lease is recognized in the consolidated financial statements as property, plant and equipment purchased to transfer to finance lease at cost.

### **Investments held to maturity**

Investments held to maturity are debt securities with determinable or fixed payments. The Group has the positive intent and ability to hold them to maturity. Such securities are carried at amortized cost, less any allowance for impairment. Amortized discounts are recognized in interest income over the period to maturity using the effective interest method.

### **Investments available-for-sale**

Investments available-for-sale represent equity investments that are intended to be held for an indefinite period of time. Such securities are initially recorded at fair value. Subsequently the securities are measured at fair value, with such re-measurement recognized directly in equity until sold when gain/loss previously recorded in equity recycles through the consolidated income statement, except for impairment losses, foreign exchange gains or losses and interest income accrued using the effective interest method, which are recognized directly in the consolidated income statement. The Group uses quoted market prices to determine the fair value for the Group's investments available-for-sale. If the market for investments is not active, the Group establishes fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the Group uses that technique. Dividends received are included in dividend income in the consolidated income statement.

Non-marketable equity securities are stated at cost, less impairment losses, if any, unless fair value can be reliably measured.

When there is objective evidence that such securities have been impaired, the cumulative loss previously recognized in equity is removed from equity and recognized in the consolidated income statement for the period. Reversals of such impairment losses on debt instruments, which are objectively related to events occurring after the impairment, are recognized in the consolidated income statement for the period. Reversals of such impairment losses on equity instruments are not recognized in the consolidated income statement.

### **Property, plant and equipment and intangible assets**

Property, plant and equipment and intangible assets are carried at historical cost less accumulated depreciation and any recognized impairment loss. Depreciation on assets under construction and those not placed in service commences from the date the assets are ready for their intended use.

Depreciation is charged on the carrying value of property, plant and equipment and intangible assets and is designed to write off assets over their useful economic lives. It is calculated on a straight line basis at the following annual prescribed rates:

Buildings and other real estate	2%-3%
Furniture and computer equipment	12%-50%
Intangible assets	20%-50%

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, plant and equipment and intangible assets are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts, and where carrying values exceed this estimated recoverable amount, assets are written down to their recoverable amount.

An 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, plant and equipment and intangible assets 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.

Land and buildings held for use in supply of services, or for administrative purposes, are stated in the consolidated balance sheet at their revalued amounts, being the fair value at the date of revaluation, determined from market-based evidence by appraisal undertaken by professional independent appraisers, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.

Any revaluation increase arising on the revaluation of such land and buildings is credited to the property, plant and equipment and intangible assets revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognized as an expense, in which case the increase is credited to the consolidated income statement to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of such land and buildings is charged as an expense to the extent that it exceeds the balance, if any, held in the properties revaluation reserve relating to a previous revaluation of that asset.

Depreciation on revalued buildings is charged to income. On the subsequent sale or retirement of a revalued property, the attributable revaluation surplus remaining in the properties revaluation reserve is transferred directly to retained earnings.

### **Share based payments**

Equity-settled share-based payments to employees and others providing similar services are measured at the fair value of the equity instrument at the grant date. The fair value determined at the grant date is charged to profit. Further details on how the fair value of equity-settled share-based transactions has been determined can be found in Note 34.

### **Taxation**

Income tax expense represents the sum of the current and deferred tax expense.

The current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's current tax expense is calculated using tax rates that have been enacted during the reporting period.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such 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 tax profit nor the accounting profit.



Deferred tax liabilities are recognized for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, 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.

The carrying amount of deferred tax assets is reviewed at each balance sheet date 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 is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the balance sheet if:

- The Group has a legally enforceable right to set off current income tax assets against current income tax liabilities; and
- Deferred income tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

### **Due to banks, customer accounts and subordinated debt**

Due to banks, customer accounts and subordinated debt are initially recognized at fair value. Subsequently, amounts due are stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the consolidated income statement over the period of the borrowings using the effective interest method.

### **Provisions**

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

### **Financial guarantee contracts issued and letters of credit**

Financial guarantee contracts and letters of credit issued by the Group are credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. Such financial guarantee contracts and letters of credit issued are initially recognized at fair value. Subsequently they are measured at the higher of (a) the amount recognized as a provision and (b) the amount initially recognized less, where appropriate, cumulative amortization of initial premium revenue received over the financial guarantee contracts or letter of credit issued.

### **Share capital and share premium**

Contributions to share capital are recognized at their cost. Share premium represents the excess of contributions over the nominal value of the shares issued. Gains and losses on sales of treasury stock are charged or credited to share premium.

External costs directly attributable to the issue of new shares, other than on a business combination, are deducted from equity net of any related income taxes.

Dividends on ordinary shares are recognized in equity as a reduction in the period in which they are declared. Dividends that are declared after the balance sheet date are treated as a subsequent event under International Accounting Standard 10 “Events after the Balance Sheet Date” (“IAS 10”) and disclosed accordingly.

## **Retirement and other benefit obligations**

In accordance with the requirements of the Georgian legislation, the Group withholds amounts of pension contributions from employee salaries and pays them to the state pension fund. In addition such pension system provides for calculation of current payments by the employer as a percentage of current total disbursements to staff. Such expense is charged in the period the related salaries are earned. Upon retirement all retirement benefit payments are made by state pension fund. The Group does not have any pension arrangements separate from the State pension system of Georgia. In addition, the Group has no post-retirement benefits or other significant compensated benefits requiring accrual.

## **Recognition of income and 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 payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

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.

Interests earned on assets at fair value are classified within interest income.

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 the consolidated income statement 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 the consolidated income statement on expiry. Loan servicing fees are recognized as revenue as the services are provided. All other commissions are recognized when services are provided.

## **Foreign currency translation**

Monetary assets and liabilities denominated in foreign currencies are translated into Georgian Lari at the appropriate spot rates of exchange ruling at the balance sheet date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Profits and losses arising from these translations are included in net gain on foreign exchange operations.

## **Rates of exchange**

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

	<b>31 December 2007</b>	<b>31 December 2006</b>
Georgian Lari/1 US Dollar	1.592	1.714
Georgian Lari/1 Euro	2.332	2.256

## **Offset of financial assets and liabilities**

Financial assets and liabilities are offset and reported net on the consolidated balance sheet when the Group has a legally enforceable right to set off the recognized amounts and the Group intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. In accounting for a transfer of a financial asset that does not qualify for derecognition, the Group does not offset the transferred asset and the associated liability.

## **Adoption of new standards**

In the current year, the Group has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the IASB) and the International Financial Reporting Interpretations Committee (the IFRIC) of the IASB that are relevant to its operations and effective for reporting periods beginning on 1 January 2007. The adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Group's accounting policies that have affected the amounts reported for the current or prior years except for the effect of application of IFRS 7 "Financial Instruments: Disclosure" ("IFRS 7").

IFRS 7 is effective for the annual period beginning on or after 1 January 2007. IFRS 7 establishes new requirements and recommendations on financial instrument disclosure. Adoption of IFRS 7 did not affect the classification and measurement of Group's financial instruments in the consolidated financial statements. Additional information was disclosed in the financials statements for the current and comparative reporting periods as required by IFRS 7.

According to IAS 1 Presentation of financial statements – Disclosures (IAS 1), Group shall disclose information that enables users of its financial statements to evaluate the entities objectives, policies and processes for managing capital.

At the date of these financial statements IFRS 8 "Operating Segments" was issued but not yet effective for these financial statements. It is effective from 1 January 2009 and will replace IAS 14 "Operating Segments". The management is currently assessing the impact of the adoption of this Standard in future period.

#### 4. PRIOR PERIOD RECLASSIFICATIONS

Certain reclassifications have been made to the financial statements as at 31 December 2006 and for the year then ended to conform to the presentation as at 31 December 2007 and for the year then ended as current year presentation provides better view of the financial position of the Group.

<b>Nature of reclassification</b>	<b>Amount</b>	<b>Balance sheet/Income statement line as per the previous report</b>	<b>Balance sheet/Income statement line as per current report</b>
Subordinated debt transferred from due to banks and financial institutions to subordinated debt	25,065	Due to banks and financial institutions	Subordinated debt
Net investments in finance lease included in loans to customers	15,079	Net investments in finance lease	Loans to customers
Provisions included in other liabilities	7,010	Provisions	Other liabilities
Provisions for losses on safe deposit boxes and for penalties for the incompliance with the Anti Money Laundering Law reporting requirements transferred from other liabilities to provisions	4,949	Other liabilities	Provisions
Items of property and equipment transferred from inventory to property and equipment	1,979	Other assets	Property and equipment
Loan origination fees transferred from fee and commission income to interest income	1,619	Fee and commission income	Interest income
Prepaid commission expense transferred from other assets to loans from banks and financial institutions	1,154	Other assets	Due to banks and financial institutions
Prepaid commission income transferred from other liabilities to loans to customers	1,090	Other liabilities	Loans to customers
Intangible assets included in other assets	543	Intangible assets	Other assets
Investments in associates and jointly controlled enterprises included in other assets	442	Investments in associates and jointly controlled enterprises	Other assets
Provision for impairment of investment in UFC International Limited transferred from share in losses of associates to provision for impairment losses on other transactions	408	Share in losses of associates	Provision for impairment losses on other transactions
Revaluation of derivative financial instrument (interest rate cap) transferred from fee and commission expense to net loss on financial assets and liabilities at fair value through profit or loss	292	Fee and commission expense	Net loss on financial assets and liabilities at fair value through profit or loss
Interest income on investments held-to-maturity transferred from net gain on investments held to maturity to interest income	117	Net gain on investments held-to-maturity	Interest income
Share in gain of GPIH JSC (associate) transferred from interest income to share in gain of associates	114	Interest income	Share in gain of associates
Investment in TBC Broker LLC (non-consolidated subsidiary) transferred from investment in associates to other assets	20	Investments in associates	Other assets
Investment in non-business foundations transferred from investments available-for-sale to other assets	12	Investments available-for-sale	Other assets

## 5. GROUP REORGANIZATION

In June 2007 the Group acquired 45% share in JSC United Financial Corporation in addition to 45% possessed as at 31 December 2006.

The net assets of JSC United Financial Corporation as at the date of this partial acquisition were as follows:

Cash	11
Property, plant and equipment	571
Accounts receivable and other current assets	120
Other non-current assets	261
Accounts payable and accrued expenses	(415)
Long-term loans	(75)
	<u>473</u>
Share of net assets acquired	45%
Value of net assets acquired	213
Goodwill	<u>1,237</u>
<b>Total consideration, satisfied by cash</b>	<b><u><u>1,450</u></u></b>
Net cash outflow arising on acquisition:	
Cash consideration paid	1,450
Cash and cash equivalents acquired	<u>11</u>
	<b><u><u>1,439</u></u></b>

The Group started to consolidate JSC United Financial Corporation since June 2007.

The amount of the acquiree's profit since the acquisition date included in the acquirer's profit for the period amounted to GEL 359 thousand.



## 6. NET INTEREST INCOME

	Year ended 31 December 2007	Year ended 31 December 2006
<b>Interest income comprises:</b>		
Interest income on assets recorded at amortized cost:		
- interest income on assets that has been written down as a result of an impairment loss based on collective assessment	129,021	84,427
- interest income on assets that has been written down as a result of an impairment loss based on individual assessment	16,044	4,432
- interest income on unimpaired assets	20,261	5,370
<b>Total interest income</b>	<b>165,326</b>	<b>94,229</b>
Interest income on assets recorded at amortized cost comprises:		
Interest on loans to customers	147,065	85,290
Interest on loans and advances to banks	7,277	5,360
Interest on finance lease	4,239	3,063
Interest on investments held-to-maturity	6,721	491
Other	24	25
Total interest income on financial assets recorded at amortized cost	165,326	94,229
<b>Interest expense comprises:</b>		
Interest on liabilities recorded at amortized cost	(81,353)	(39,346)
<b>Total interest expense</b>	<b>(81,353)</b>	<b>(39,346)</b>
Interest expense on liabilities recorded at amortized cost comprise:		
Interest on customer accounts	(37,318)	(20,397)
Interest on deposits from banks	(44,035)	(18,949)
Total interest expense on financial assets recorded at amortized cost	(81,353)	(39,346)
<b>Net interest income before provision for impairment losses on interest bearing assets</b>	<b>83,973</b>	<b>54,883</b>

## 7. ALLOWANCE FOR IMPAIRMENT LOSSES, OTHER PROVISIONS

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

	Loans to customers
<b>31 December 2005</b>	8,740
Provision	9,942
Write-off of assets	(745)
Recoveries of assets previously written off	398
<b>31 December 2006</b>	18,335
Provision	26,494
Write-off of assets	(7,107)
Recoveries of assets previously written off	2,053
<b>31 December 2007</b>	<b>39,775</b>

The movements in allowances for impairment losses on other transactions were as follows:

	Other assets	Guarantees	Other provisions	Total
<b>31 December 2005</b>	45	1,091	902	2,038
Provision	534	970	4,504	6,008
Write-off of assets and provisions	(34)	-	(457)	(491)
<b>31 December 2006</b>	545	2,061	4,949	7,555
Provision/ (Recovery of provision)	838	(984)	(1,655)	(1,801)
Write-off of assets and provisions	(166)	-	(3,272)	(3,438)
<b>31 December 2007</b>	<u>1,217</u>	<u>1,077</u>	<u>22</u>	<u>2,316</u>

Allowance for impairment losses on assets are deducted from the respective assets. Provision for off-balance sheet transactions are recorded in liabilities.

#### 8. NET LOSS ON FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

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

	Year ended 31 December 2007	Year ended 31 December 2006
Net gain on operations with financial assets held-for-trading	29	-
Net loss on operations with derivative financial instruments	(875)	(292)
<b>Total net loss on financial assets at fair value through profit or loss</b>	<u>(846)</u>	<u>(292)</u>
Net gain on operations with financial assets held-for-trading comprise:		
Unrealized income on revaluation	29	-
<b>Total net gain/(loss) on operations with financial assets held-for- trading</b>	<u>29</u>	<u>-</u>

#### 9. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprises:

	Year ended 31 December 2007	Year ended 31 December 2006
Dealing, net	16,954	9,694
Translation differences, net	(1,015)	41
<b>Total net gain on foreign exchange operations</b>	<u>15,939</u>	<u>9,735</u>

## 10. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	Year ended 31 December 2007	Year ended 31 December 2006
<b>Fee and commission income:</b>		
Documentary operations	8,135	3,549
Plastic cards operations	5,633	3,412
Settlements	4,979	4,266
Cash operations	3,967	3,175
Foreign exchange operations	385	201
Other	2,480	1,669
<b>Total fee and commission income</b>	<b>25,579</b>	<b>16,272</b>
<b>Fee and commission expense:</b>		
Plastic cards services	(2,006)	(1,073)
Settlements	(732)	(1,079)
Documentary operations	(577)	(901)
Communication services	(461)	(176)
Cash operations	(151)	(259)
Foreign currency operations	(51)	(33)
Other	(249)	(671)
<b>Total fee and commission expense</b>	<b>(4,227)</b>	<b>(4,192)</b>

## 11. OTHER INCOME

Other income comprises:

	Year ended 31 December 2007	Year ended 31 December 2006
Revenue from fines	6,346	1,955
Reimbursement from insurer	1,764	42
Reimbursement of interest rate cap	530	47
Loan administration fee	311	91
Share in losses of associates and jointly controlled enterprises	(1,174)	(410)
Impairment of goodwill	(479)	-
Reimbursed social taxes	824	-
Other	1,535	492
	<b>9,657</b>	<b>2,217</b>

## 12. OPERATING EXPENSES

Operating expenses comprise:

	Year ended 31 December 2007	Year ended 31 December 2006
Staff costs	35,697	17,534
Depreciation and amortization	5,956	3,205
Advertising costs	5,233	2,660
Professional services	3,715	1,321
Occupancy and rent	2,412	710
Communications and supplies	2,079	1,148
Transportation and vehicle maintenance	1,040	741
Stationery and other office expenses	1,003	544
Taxes, other than income tax	857	442
Security expenses	575	461
Real estate insurance	574	410
Business trip expenses	529	339
Training	364	214
Other expenses	7,093	3,021
<b>Total operating expenses</b>	<b>67,127</b>	<b>32,750</b>

## 13. INCOME TAXES

The Group provides for taxes based on the tax accounts maintained and prepared in accordance with the tax regulations of Georgia which differs from International Financial Reporting Standards.

The Group is subject to certain permanent tax differences due to 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 31 December 2007 and 2006 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences as at 31 December 2007 and 2006 comprise:

	31 December 2007	31 December 2006
<b>Deductible temporary differences:</b>		
Due from banks and loans to customers	3,861	6,409
Other assets	464	485
Financial assets at fair value through profit or loss	390	67
Other liabilities	14	4,821
<b>Total deductible temporary differences</b>	<b>4,729</b>	<b>11,782</b>
<b>Taxable temporary differences:</b>		
Property, plant and equipment	96,499	22,075
Due to banks	135	1,154
<b>Total taxable temporary differences</b>	<b>96,634</b>	<b>23,229</b>
Net deferred taxable temporary differences	(91,905)	(11,447)
Net deferred tax liability at the statutory tax rate	15%	20%
<b>Net deferred tax liability</b>	<b>(13,786)</b>	<b>(2,289)</b>

Relationships between tax expenses and accounting profit for the years ended 31 December 2007 and 2006 are explained as follows:

	Year ended 31 December 2007	Year ended 31 December 2006
Profit before income tax	38,446	29,900
Tax at the statutory tax rate (20%)	7,689	5,980
Effect of change in tax rate	(4,582)	-
Tax effect of permanent differences	6,768	1,339
<b>Income tax expense</b>	<b>9,875</b>	<b>7,319</b>
Current income tax expense	2,122	7,902
Deferred income tax expense	7,753	(583)
<b>Income tax expense</b>	<b>9,875</b>	<b>7,319</b>
<b>Deferred income tax liabilities</b>	<b>2007</b>	<b>2006</b>
<b>Beginning of the period</b>	<b>2,289</b>	<b>2,872</b>
Tax effect of changes in property, plant and equipment revaluation reserve	3,744	-
Increase/(decrease) in income tax liability for the year charged to profit	7,753	(583)
<b>End of the period</b>	<b>13,786</b>	<b>2,289</b>



#### 14. CASH AND BALANCES WITH THE NATIONAL BANK OF GEORGIA

	31 December 2007	31 December 2006
Cash	71,896	47,939
Balances with the National Bank of Georgia	<u>111,937</u>	<u>149,486</u>
<b>Total cash and balances with the National Bank of Georgia</b>	<b><u>183,833</u></b>	<b><u>197,425</u></b>

The balances with the National Bank of Georgia (“NBG”) as at 31 December 2007 and 2006 include GEL 89,388 thousand and GEL 63,305 thousand, respectively, which represent the obligatory minimum reserve deposits with the NBG. The Bank is required to maintain the reserve balance at the NBG at all times.

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

	31 December 2007	31 December 2006
Cash and balances with the NBG	183,833	197,425
Due from banks in OECD countries	<u>4,972</u>	<u>33,065</u>
Less minimum reserve deposits and foreign currency deposits with the NBG	<u>(89,388)</u>	<u>(63,305)</u>
<b>Total cash and cash equivalents</b>	<b><u>99,417</u></b>	<b><u>167,185</u></b>

#### 15. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial assets at fair value through profit at loss comprise:

	31 December 2007	31 December 2006
Financial assets held-for-trading:		
Shares	<u>135</u>	<u>-</u>
<b>Total financial assets held-for-trading</b>	<b><u>135</u></b>	<b><u>-</u></b>
Hedge instruments:		
Interest rate cap	228	1,177
<b>Total hedge instruments</b>	<u>228</u>	<u>1,177</u>
<b>Total financial assets at fair value through profit or loss</b>	<b><u>363</u></b>	<b><u>1,177</u></b>

Financial assets held-for-trading comprise:

	<b>Ownership interest</b>	<b>31 December 2007</b>
<b>Shares:</b>		
Ordinary shares of JSC “People’s Bank of Georgia”	0.30%	127
Ordinary shares of JSC “Printing Centre”	0.11%	8
<b>Total shares:</b>		<u>135</u>
<b>Total financials assets held-for-trading</b>		<u><b>135</b></u>

Derivative financial instruments and financial assets at fair value through profit at loss comprise:

	<b>31 December 2007</b>		<b>31 December 2006</b>	
	<b>Asset</b>	<b>Liability</b>	<b>Asset</b>	<b>Liability</b>
<b>Foreign exchange contracts</b>				
Forwards	11,657	11,692	3,384	3,383
<b>Hedge Instruments</b>				
Interest rate cap	<u>228</u>	<u>-</u>	<u>1,177</u>	<u>-</u>
	<u><b>11,885</b></u>	<u><b>11,692</b></u>	<u><b>4,561</b></u>	<u><b>3,383</b></u>

In order to manage the risk of floating market interest rates on funds attracted from International Financial Institutions, the Bank has concluded two Interest Rate Cap agreements with AG Commerzbank for a notional amount of US \$ 4,000 thousand, and US \$ 19,000 thousand. The upper interest rates on floating USD-LIBOR-BBA concluded by both parties were 3.5% and 4.25%, respectively. The fixed amount of premium was US \$ 78 thousand and US \$ 65 thousand, respectively. The hedge instrument has been revalued in accordance with the quoted market prices of similar hedge instruments as at the year end.

The fair values of foreign exchange contracts approximated their notional amounts as at 31 December 2006 and 2007. The foreign exchange contracts are accounted on the net basis.

## 16. DUE FROM BANKS

Due from banks comprise:

	<b>31 December 2007</b>	<b>31 December 2006</b>
Time deposits with other banks	27,035	3,840
Correspondent accounts with other banks	52,484	44,007
Other amounts	<u>1,475</u>	<u>1,783</u>
<b>Total due from banks</b>	<u><b>80,994</b></u>	<u><b>49,630</b></u>

As at 31 December 2007 and 2006 the Group had due from 9 and 2 banks, respectively, which individually exceeded 10% of the Group’s equity.

As of 31 December 2007 and 2006 accrued interest expense included in due from banks amounted to GEL 146 thousand and GEL 558 thousand, respectively.

During the years ended 31 December 2007 and 2006 the Group simultaneously placed with and received short-term funds from Georgian banks in different currencies. The Bank did not have such deposits as at 31 December 2007 and 2006.

As at 31 December 2007 and 2006 included in balances due from banks are guarantee deposits placed by the Group for its operations in the amount of GEL 1,460 thousand and GEL 1,760 thousand, respectively.

During the years ended 31 December 2007 and 2006 the Group simultaneously placed with and received short-term funds from foreign banks in different currencies. As at 31 December 2007 and 2006, the Group placed equivalent of GEL 46,647 thousand and GEL 10,212 thousand, respectively, which were received from the same bank.

## 17. LOANS TO CUSTOMERS

Loans to customers comprise:

	<b>31 December 2007</b>	<b>31 December 2006</b>
Loans to customers	1,168,103	591,256
Net investments in finance lease	<u>19,950</u>	<u>15,261</u>
Less allowance for impairment losses	<u>(39,775)</u>	<u>(18,335)</u>
<b>Total loans to customers</b>	<b><u><u>1,148,278</u></u></b>	<b><u><u>588,182</u></u></b>

Movements in allowances for impairment losses for the years ended 31 December 2007 and 2006 are disclosed in Note 7.

As of 31 December 2007 and 2006 accrued interest expense included in loans to customers amounted to GEL 11,022 thousand and GEL 5,986 thousand, respectively.

The below table summarized the amount of loans secured by collateral, rather than the fair value of the collateral itself:

	<b>31 December 2007</b>	<b>31 December 2006</b>
Loans collateralized by pledge of real estate or rights thereon	604,127	156,982
Loans collateralized by pledge of inventories and equipment	252,284	175,784
Loans collateralized by pledge of corporate shares	45,700	37,134
Loans collateralized by cash	24,878	18,345
Loans secured by gold	13,409	11,669
Loans collateralized by pledge of guarantees	-	26,284
Other collateral	131,539	130,557
Unsecured loans	96,166	34,501
	<hr/>	<hr/>
Less allowance for impairment losses	(39,403)	(18,153)
	<hr/>	<hr/>
<b>Total loans to customers</b>	<b>1,128,700</b>	<b>573,103</b>
	<hr/>	<hr/>
	<b>31 December 2007</b>	<b>31 December 2006</b>
<b>Analysis by sector:</b>		
Trade and service	463,628	279,970
Individuals	300,349	147,303
Real estate and construction	141,521	46,661
Manufacturing	127,787	66,758
Communication	43,565	30,432
Agriculture	25,082	1,060
Energy	18,162	4,524
Pawn loans	13,409	11,669
Other	34,600	2,879
	<hr/>	<hr/>
Less allowance for impairment losses	(39,403)	(18,153)
	<hr/>	<hr/>
<b>Total loans to customers</b>	<b>1,128,700</b>	<b>573,103</b>
	<hr/>	<hr/>

During the years ended 31 December 2007 and 2006 the Group received non-financial assets by taking possession of collateral it held as security. As at 31 December 2007 and 2006 such assets in amount of GEL 2,349 thousand and GEL 439 thousand, respectively, are included in other assets.

Loans to individuals comprise the following products:

	<b>31 December 2007</b>	<b>31 December 2006</b>
Mortgage loans	137,598	76,005
Consumer loans	82,442	29,115
Car loans	24,308	6,473
Instalments	22,409	2,140
Business loans	11,947	15,999
Other	21,645	17,571
	<hr/>	<hr/>
Less allowance for impairment losses	(10,704)	(745)
	<hr/>	<hr/>
<b>Total loans to individuals</b>	<b>289,645</b>	<b>146,558</b>
	<hr/>	<hr/>

As at 31 December 2007 and 2006 the Group granted loans to 21 and 10 customers, totaling GEL 292,937 thousand and GEL 114,638 thousand, respectively, which exceeded 90% of the Group's equity.

As at 31 December 2007 and 2006 a significant amount of loans (100% of total portfolio) is granted Georgian companies and individuals, which represents a significant geographical concentration in one region.

As at 31 December 2007 and 2006 loans to customers included loans in amount of GEL 40,577 thousand and GEL 8,511 thousand, respectively, whose terms have been renegotiated. Otherwise these loans would be past due or impaired.

As at 31 December 2007 and 2006 loans to customers included loans in amount of GEL 126,186 thousand and GEL 36,226 thousand, respectively, that were individually determined to be impaired.

The components of net investment in finance lease as of 31 December 2007 and 2006 are as follows:

	<b>31 December 2007</b>	<b>31 December 2006</b>
Not later than one year	14,693	8,987
From one year to five years	12,708	11,721
	<hr/>	<hr/>
Minimum lease payments	27,401	20,708
Less unearned finance lease income	(7,451)	(5,447)
	<hr/>	<hr/>
Net investment in finance leases	19,950	15,261
Less allowance for impairment	(372)	(182)
	<hr/>	<hr/>
<b>Net investment in finance leases</b>	<b>19,578</b>	<b>15,079</b>
	<hr/>	<hr/>

The present value of future minimum lease payments due from customer under finance lease as at 31 December 2007 and 2006 are as follows:

	<b>31 December 2007</b>	<b>31 December 2006</b>
Current portion	10,585	6,651
Long-term portion	8,993	8,428
	<hr/>	<hr/>
<b>Total present value of future minimum lease payments</b>	<b>19,578</b>	<b>15,079</b>
	<hr/>	<hr/>

## 18. INVESTMENTS AVAILABLE-FOR-SALE

Investments available-for-sale comprise:

	31 December 2007	31 December 2006
Equity securities	5,219	4,590
<b>Total investments available-for-sale</b>	<b>5,219</b>	<b>4,590</b>

	Ownership interest	31 December 2007	Ownership interest	31 December 2006
<b>Equity securities</b>				
Nikora LLC	10.00%	1,902	4.00%	960
GRDC JSC	1.63%	1,772	1.63%	1,772
Caucasus Online LLC	9.94%	1,332	4.90%	568
Creditinfo Georgia JSC	16.63%	95	15.30%	92
Interbank Exchange Market JSC	8.33%	50	8.33%	50
American Academy in Tbilisi JSC	5.38%	50	5.38%	50
Tbilisi Free University LLC	20%	7	-	-
Georgian Card LLC	0.15%	5	0.17%	5
SWIFT	0.00%	3	0.00%	3
Central Depositor of Georgian Securities JSC	0.30%	3	0.30%	3
Mukhranis Valley LLC	-	-	17.00%	1,087
<b>Total investments available- for-sale</b>		<b>5,219</b>		<b>4,590</b>

## 19. INVESTMENTS HELD TO MATURITY

	Interest to nominal %	31 December 2007	Interest to nominal %	31 December 2006
NBG Deposit certificates	10%	114,596	11%	50,209
Ministry of Finance Treasury bills	-	-	13%	44
<b>Total investments held to maturity</b>		<b>114,596</b>		<b>50,253</b>

## 20. GOODWILL

	2007
<b>At the beginning of the period</b>	-
Recognized on acquisition of a subsidiary (JSC United Financial Corporation)	1,237
Impairment loss	(479)
<b>At the end of the period</b>	<b>758</b>

## 21. PROPERTY, PLANT AND EQUIPMENT

	Buildings and other real estate	Furniture and equipment	Construction in progress	Total
<b>At initial/revalued cost</b>				
31 December 2005	29,102	12,154	1,987	43,243
Additions	96	5,997	12,267	18,360
Transfers	1,997	-	(1,997)	-
Disposals	(6)	(186)	-	(192)
31 December 2006	31,189	17,965	12,257	61,411
Additions	501	18,692	23,046	42,239
Revaluation	20,284	-	6,466	26,750
Acquisition of subsidiaries	-	1,278	-	1,278
Transfers	8,507	(628)	(7,879)	-
Disposals	(1,104)	(1,377)	(48)	(2,529)
31 December 2007	59,377	35,930	33,842	129,149
<b>Accumulated depreciation</b>				
31 December 2005	1,382	3,881	-	5,263
Charge for the year	748	2,328	-	3,076
Eliminated on disposals	-	(161)	-	(161)
Transfers	-	-	-	-
31 December 2006	2,130	6,048	-	8,178
Charge for the year	1,058	4,471	-	5,529
Acquisition of subsidiaries	-	710	-	710
Eliminated on revaluation	(2,374)	-	-	(2,374)
Eliminated on disposals	(235)	(829)	-	(1,064)
31 December 2007	579	10,400	-	10,979
<b>Net book value</b>				
<b>31 December 2007</b>	<b>58,798</b>	<b>25,530</b>	<b>33,842</b>	<b>118,170</b>
<b>31 December 2006</b>	<b>29,059</b>	<b>11,917</b>	<b>12,257</b>	<b>53,233</b>

As at 31 December 2007 and 2006 included in property, plant and equipment were fully depreciated assets of GEL 4,204 thousands and GEL 3,549 thousands, respectively.

As at 31 December 2007 the buildings and other real estate and construction in progress owned by the Group were revalued to market prices according to the opinion of the independent appraiser. As a result, carrying value of these building amounted to GEL 82,970 thousand. If the buildings were accounted at historical cost less accumulated depreciation and impairment losses, its carrying value would be GEL 53,845 thousand as at 31 December 2007.

Buildings owned by the Group were revalued by independent appraisers as at 31 December 2007. The following methods were used for the estimation of their fair value: discounted cash flow method (income approach), integrated cost estimation method (cost based method), method of sales comparison (comparative approach). For the estimation of the final value, certain weights were assigned to the results obtained using different approaches, depending on the degree to which the estimates met the following characteristics: reliability and completeness of the information, specifies the estimated property and other.



## 22. OTHER ASSETS

Other assets comprise:

	31 December 2007	31 December 2006
Prepayments for acquisition of subsidiary	13,371	-
Prepayments for purchase of leasing assets	9,446	1,816
Prepayments for fixed assets	5,642	2,284
Repossessed assets	2,349	439
Prepaid expenses	2,112	1,268
Intangible assets	2,199	543
Receivable from selling of investment	1,277	-
Tax settlements, other than income tax	970	155
Trade debtors	923	2,311
Inventories	575	291
Investments in non-consolidated subsidiaries	428	428
Investments in associates and jointly controlled enterprises	-	442
Other	2,718	185
	<hr/>	<hr/>
Less allowance for impairment losses	(1,217)	(545)
	<hr/>	<hr/>
<b>Total other assets</b>	<b>40,793</b>	<b>9,617</b>

Prepayments for acquisition of subsidiary represent money prepaid for the acquisition of 75% share in Soa Kredit, Azerbaijan based microfinance organization. The acquisition was executed subsequent to the year end. Please refer to Note 32.

	Intangible assets
<b>At cost</b>	
31 December 2005	1,209
Additions	<hr/> 326
31 December 2006	1,535
Additions	1,826
Acquisition of subsidiaries	<hr/> 401
31 December 2007	<hr/> 3,762
<b>Accumulated amortization</b>	
31 December 2005	863
Charge for the year	<hr/> 129
31 December 2006	992
Charge for the year	427
Acquisition of subsidiaries	<hr/> 144
31 December 2007	<hr/> 1,563
<b>Net book value</b>	
<b>31 December 2007</b>	<hr/> <b>2,199</b> <hr/>
<b>31 December 2006</b>	<hr/> <b>543</b> <hr/>

Intangible assets include software and licenses.

The following investments in associates were recorded in the consolidated financial statements using the equity method as at 31 December 2006:

	<b>31 December 2006</b>	
	<b>Ownership interest</b>	<b>Carrying value</b>
JSC GPIH	20%	442
United Financial Corporation	45%	-
		<u><b>442</b></u>

The movements of investments in associates comprise:

	<b>31 December 2007</b>	<b>31 December 2006</b>
<b>At the beginning of the period</b>	442	823
Purchase cost	23	29
Contribution to equity of joint venture	(465)	-
Share in results of associates transferred to subsidiary	(196)	-
Share in results of associates	<u>196</u>	<u>(410)</u>
<b>At the end of the period</b>	<u><b>-</b></u>	<u><b>442</b></u>

As more fully describe in Note 5, the investment in the United Financial Corporation increased in 2007 and the Bank obtained full control over this subsidiary, thus making United Financial Corporation a consolidated subsidiary.

In 2007, as per Agreement about Incorporation of Private Company with Limited Liability, the Bank and TBIH Financial Service Group N.V. incorporated new jointly ventured company with limited liability GPI B.V with 50%-50% of ownership. The Bank has transferred all shares of GPIH to the newly established GPI B.V. GPI B.V. is treated as a jointly controlled enterprise.

The movements of investments in jointly controlled enterprise comprise:

	<b>31 December 2007</b>
<b>At the beginning of the period</b>	-
Purchase cost	1,370
Share in results of jointly controlled enterprise	<u>(1,370)</u>
<b>At the end of the period</b>	<u><b>-</b></u>

Purchase cost of GEL 1,370 comprises of contributions of cash in the amount of GEL 905 and investment in GPIH in the amount of GEL 465 thousand.

## 23. DUE TO BANKS AND FINANCIAL INSTITUTIONS

Due to banks and financial institutions comprise:

	31 December 2007	31 December 2006
Correspondent accounts of other banks	6,465	20,733
Loans from banks and financial institutions	433,041	206,873
Deposits of banks	85,892	10,441
<b>Total due to banks</b>	<b>525,398</b>	<b>238,047</b>

As at 31 December 2007 and 2006 the due to banks in the amounts of GEL 295,799 thousand (62%) and GEL 195,681 thousand (86%), respectively, were due to 4 banks, which represents significant concentration.

As of 31 December 2007 and 2006 accrued interest expense included in due to banks amounted to GEL 11,139 thousand and GEL 5,020 thousand, respectively.

During 2007 and 2006 the Group simultaneously placed with and received short-term funds from foreign banks in different currencies.

## 24. CUSTOMER ACCOUNTS

Customer accounts comprise:

	31 December 2007	31 December 2006
Time deposits	327,729	232,388
Repayable on demand	451,812	319,780
<b>Total customer accounts</b>	<b>779,541</b>	<b>552,168</b>

As at 31 December 2007 and 2006 customer accounts amounted to GEL 33,356 thousand and GEL 9,322 thousand, respectively, were held as security against letters of credit issued and other transaction related contingent obligations. As at 31 December 2007 and 2006 customer accounts amounted to GEL 46,270 thousand and GEL 25,804 thousand, respectively, were held as security against guarantees issued.

As of 31 December 2007 and 2006 accrued interest expense included in customer accounts amounted to GEL 6,352 thousand and GEL 5,721 thousand, respectively.

The Bank had no significant concentration within customer accounts as at 31 December 2007 and 2006.

	<b>31 December 2007</b>	<b>31 December 2006</b>
<b>Analysis by sector:</b>		
Individuals	436,675	308,196
Trade and service	209,145	122,420
Transport and communication	21,990	22,724
Construction	23,072	5,274
Energy	7,358	4,465
Mining and natural resource processing	2,419	2,740
Agriculture	174	152
Government	551	1,934
Other	78,157	84,263
<b>Total customer accounts</b>	<b>779,541</b>	<b>552,168</b>

## 25. OTHER LIABILITIES

Other liabilities comprise:

	<b>31 December 2007</b>	<b>31 December 2006</b>
Accrued expenses	7,157	4,999
Security deposits for finance lease	2,575	487
Provisions	1,099	7,010
Sundry creditors	726	952
Taxes payable, other than income tax	749	269
Suspense amounts	-	187
Other	716	220
<b>Total other liabilities</b>	<b>13,022</b>	<b>14,124</b>

Movements on provisions for the years ended 31 December 2007 and 2006 are disclosed in Note 7.

## 26. SUBORDINATED DEBT

	<b>Currency</b>	<b>Maturity date year</b>	<b>Interest rate %</b>	<b>31 December 2007</b>	<b>31 December 2006</b>
Subordinated debt from related parties (Deutsche Investitions and Entwicklungsgesellschaft mbH.)	USD	2012	6.3%+LIBOR	16,766	18,040
Subordinated debt from related parties (International Financial Corporation)	USD	2011	4.5%+LIBOR	6,502	7,025
Subordinated debt from other banks	USD	2014	6.25%+LIBOR	32,613	-
				<b>55,881</b>	<b>25,065</b>

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.

As of 31 December 2007 and 2006 accrued interest expense included in subordinated debt amounted to GEL 1,766 thousand and GEL 1,076 thousand, respectively.

## 27. SHARE CAPITAL AND SHARE PREMIUM

As of 31 December 2007 and 2006 authorized, issued and paid-in share capital consisted of 117,000 and 53,851 ordinary shares, respectively, with par value of GEL 100 each.

As at 31 December 2007 the Group's share capital comprised of the following number of shares of GEL 100 each:

	<b>Authorized share capital</b>	<b>Unpaid share capital</b>	<b>Total share capital</b>
Ordinary shares	118,133	(1,133)	117,000

As at 31 December 2006 the Group's share capital comprised of the following number of shares of GEL 100 each:

	<b>Authorized share capital</b>	<b>Unpaid share capital</b>	<b>Total share capital</b>
Ordinary shares	56,681	(2,830)	53,851

The below table provides a reconciliation of the number of shares outstanding as of 31 December 2007 and 2006:

	<b>Preference shares</b>	<b>Ordinary shares</b>
31 December 2005	6,409	47,442
Convert of shares	<u>(6,409)</u>	<u>6,409</u>
31 December 2006	-	53,851
Issue of shares	<u>-</u>	<u>63,149</u>
31 December 2007	<u><u>-</u></u>	<u><u>117,000</u></u>

Share premium represents an excess of contributions received over the nominal value of shares issued.

The amount of dividends declared subsequently to 31 December 2006 amounted to GEL 2,000 thousand.

## 28. 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 balance sheet.

The Group's maximum exposure to credit loss 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.

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 amounted to GEL 1,069 thousand and GEL 2,061 thousand as at 31 December 2007 and 2006, respectively.

As at 31 December 2007 and 2006 the nominal or contract amounts were:

	31 December 2007 Nominal amount	31 December 2006 Nominal amount
<b>Contingent liabilities and credit commitments</b>		
Guarantees issued and similar commitments, secured by cash	4,092	4,654
Guarantees issued and similar commitments, not secured by cash	197,317	124,453
Letters of Credit collateralised by the underlying shipments	40,857	22,601
Commitments on loans and unused credit lines up to one year	50,734	40,666
Commitments on loans and unused credit lines over one year	84,416	141
Other commitments	-	847
<b>Total contingent liabilities and credit commitments</b>	<b>377,416</b>	<b>193,362</b>

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 31 December 2007 and 2006 such unused credit lines amounted to GEL 135,150 thousand and GEL 40,807 thousand, respectively.

**Capital commitments** – The Group had no material commitments for capital expenditures outstanding as at 31 December 2007 and 2006.

**Operating lease commitments** – Where the Group is the lessee, the future minimum lease payments under non cancelable operating leases are as follows:

	31 December 2007	31 December 2006
Not later than 1 year	56	53
Later than 1 year and not later than 5 years	519	928
Later than 5 years	354	636
<b>Total operating lease commitments</b>	<b>929</b>	<b>1,617</b>

**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 financial statements.

**Taxation** – Due to the presence in Georgian commercial legislation, and tax legislation in particular, of provisions allowing more than one interpretation, and also due to the practice developed in a generally unstable environment by the tax authorities of making arbitrary judgment 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 valuation of financial instruments, loss and impairment provisions and market level for deals’ pricing. The Group believes that it has already made all tax payments, and therefore no allowance has been made in the financial statements.

**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.

## **29. SUBSEQUENT EVENTS**

On 30 June 2007 the Bank has entered into the subscription and member’s agreements with the Shorebank International Ltd. on the potential acquisition of SOA Kredit - Azerbaijan based microfinance organization.

In December 2007 the Bank has transferred the share purchase payment of USD equivalent of GEL 13,371 (please refer to note 25). The payment was done for the share participation of 75% in SOA Kredit. However, as at 31 December 2007 this participation was subject to the approval of the Ministry of Taxes of the Republic of Azerbaijan. No charter registration, participation in the shareholder’s meetings and decision making could happen from the Bank’s side until the above approval.

On 14 February 2008 Ministry of Taxes of the Republic of Azerbaijan approved the acquisition of SOA Kredit shares by the Bank.

## **30. TRANSACTIONS WITH RELATED PARTIES**

Related parties or transactions with related parties, as defined by IAS 24 “Related party disclosures”, represent:

- (a) Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Group (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Group that gives them significant influence over the Bank; and that have joint control over the Group;
- (b) Associates – enterprises on which the Group has significant influence and which is neither a subsidiary nor a joint venture of the investor;
- (c) Joint ventures in which the Group is a venturer;
- (d) Members of key management personnel of the Group or its parent;
- (e) Close members of the family of any individuals referred to in (a) or (d);
- (f) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e).

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Group had the following transactions outstanding as at 31 December 2007 and 2006 with related parties:

	<b>31 December 2007</b>		<b>31 December 2006</b>	
	<b>Related party balances</b>	<b>Total category as per financial statements caption</b>	<b>Related party balances</b>	<b>Total category as per financial statements caption</b>
Loans to customers	19,573	1,148,278	21,270	588,182
Other assets	3,378	40,793	648	9,617
Due to banks	1,343	525,398	8,482	238,047
Customer accounts	12,645	779,541	12,336	552,168
Other liabilities	1,658	13,022	2,147	14,124
Subordinated debt	23,268	55,881	25,065	25,065
Commitments and contingencies	3,150	377,416	15,912	193,362

	<b>31 December 2007</b>		<b>31 December 2006</b>	
	<b>Related party transactions</b>	<b>Total category as per financial statements caption</b>	<b>Related party transactions</b>	<b>Total category as per financial statements caption</b>
<b>Key management personnel compensation:</b>				
- short-term employee benefits	4,759	35,697	2,644	17,534

Included in the consolidated income statement for the years ended 31 December 2007 and 2006 are the following amounts which arose due to transactions with related parties:

	<b>Year ended 31 December 2007</b>		<b>Year ended 31 December 2006</b>	
	<b>Related party transactions</b>	<b>Total category as per financial statements caption</b>	<b>Related party transactions</b>	<b>Total category as per financial statements caption</b>
Interest income	1,806	165,326	1,955	94,229
Interest expense	(658)	(81,353)	(4,405)	(39,346)

### 31. SHARE BASED PAYMENTS

The Group has an ownership-based compensation scheme for executives of the Group. As approved by shareholders at meeting held on 4 November 2005, General Director and a First Deputy General Director are granted options to purchase ordinary shares at a fixed price of GEL 100 per ordinary share.

Each employee share option converts into one ordinary share of JSC TBC Bank on exercise at the nominal value of GEL 100 each. The options carry neither rights to dividends nor voting rights. Options may be exercised within five years.



In accordance with the terms of the share-based arrangement, options vest upon relevant decision of the Shareholders, which is based on the Management performance in terms of meeting the strategic goals of the Bank. These goals are not defined in any qualitative or quantitative terms.

The fair value of the share options as at the grant date is GEL 2,520 per share.

The following reconciles the outstanding share options granted at the beginning and end of the financial year:

	<b>31 December 2007</b>
	<b>Number of options</b>
Balance at beginning of the financial year	2,834
Granted during the financial year	-
Exercised during the financial year	(1,701)
Balance at end of the financial year	<u>1,133</u>

The options exercised during the financial year are accounted in operating expenses within staff costs.

## 32. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments are made in accordance with the requirements of IAS 32 “Financial Instruments: Presentation and Disclosure” and IAS 39 “Financial Instruments: Recognition and Measurement”. 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. The estimates presented herein are not necessarily indicative of the amounts the Group could realize in a market exchange from the sale of its full holdings of a particular instrument.

The fair value of financial assets and liabilities compared with the corresponding carrying amount in the consolidated balance sheet of the Group is presented below:

	<b>31 December 2007</b>		<b>31 December 2006</b>	
	<b>Carrying value</b>	<b>Fair value</b>	<b>Carrying value</b>	<b>Fair value</b>
Cash and balances with the National Bank of Georgia	183,833	183,833	197,425	197,425
Financial assets at fair value through profit or loss	363	363	1,177	1,177
Due from banks	80,994	80,994	49,630	49,630
Loans to customers	1,148,278	1,148,278	588,182	588,182
Investments available-for-sale	5,219	5,219	4,590	4,590
Investments held to maturity	114,596	114,596	50,253	50,253
Due to banks	525,398	525,398	238,047	238,047
Customer accounts	779,541	779,541	552,168	552,168
Subordinated debt	55,881	55,881	25,065	25,065

### **33. REGULATORY MATTERS**

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.

The ratio was calculated according to the principles employed by the Basle Committee by applying the following risk estimates to the assets and off-balance sheet commitments net of allowances for impairment losses.

As at 31 December 2007 the Group's total capital amount for Capital Adequacy purposes was GEL 344,934 thousand and tier 1 capital amount was GEL 276,391 thousand with ratios of 19% and 15%, respectively.

As at 31 December 2006 the Group's total capital amount for Capital Adequacy purposes was GEL 143,812 thousand and tier 1 capital amount was GEL 110,611 thousand with ratios of 21% and 16%, respectively.

As at 31 December 2007 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.

### **34. CAPITAL MANAGEMENT**

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

The capital structure of the Group consists of debt, which includes subordinated debt disclosed in Note 29, 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 the 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 2006.

### **35. 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 exposures
- Liquidity risk
- Market risk

The Group recognises 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, 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 Head of Credit Departments and Branch Management.

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 and a product are approved semi annually by the Supervisory 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 daily.

Where appropriate, and in the case of most loans, the Group obtains collateral and corporate and personal guarantees but a significant portion 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 a counterparty to comply with the contractual terms and conditions. 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

The Groups maximum exposure to credit risk varies significantly and is dependant 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. For financial guarantees and other off balance sheet assets, the maximum exposure to credit risk is the maximum amount the Group would have to pay if the guarantee was called on or in the case of commitments, if the loan amount was called on.

	Maximum exposure	
	31 December 2007	31 December 2006
Financial assets at fair value through profit or loss	363	1,177
Due from banks	80,994	49,630
Loans to customers	1,148,278	588,182
Investments available-for-sale	5,219	4,590
Investments held to maturity	114,596	50,253

Financial assets are graded according to the internal rating systems and the current credit rating that has been issued by internationally regarded agencies - Standard and Poor's, Fitch and Moody. Loans to customers, investments available-for-sale and investments held to maturity are rated based on the internal rating system. Due from and to banks are rated by the international rating agencies. The highest possible rating is AAA. Investment grade financial assets have ratings from AA to BB. Financial assets which have ratings lower than BB are classed as speculative grade. The following table details the credit ratings of financial assets held by the Group as at 31 December 2007:

	AA+	AA	AA-	A+	A
Financial assets at fair value through profit or loss	-	-	-	-	-
Due from banks	231	1,394	1,044	11,102	48,191
Loans to customers	-	-	-	-	-
Investments available-for-sale	-	-	-	-	-
Investments held to maturity	-	-	-	-	-

	BBB	BB-	B	B-
Financial assets at fair value through profit or loss	-	-	-	-
Due from banks	607	-	-	-
Loans to customers	-	22,056	143,378	211,227
Investments available-for-sale	-	1,902	-	1,332
Investments held to maturity	-	114,596	-	-

	CCC+	CCC	CC	Not rated	Total at 31 December 2007
Financial assets at fair value through profit or loss	-	-	-	363	363
Due from banks	-	-	-	18,425	80,994
Loans to customers	266,156	93,008	88,453	324,000	1,148,278
Investments available-for-sale	1,772	-	-	213	5,219
Investments held to maturity	-	-	-	-	114,596

As at 31 December 2006:

	AA+	AA	AA-	A+	A
Financial assets at fair value through profit or loss	-	-	-	-	-
Due from banks	4,487	5,886	11,972	1,061	10,451
Loans to customers	-	-	-	-	-
Investments available-for-sale	-	-	-	-	-
Investments held to maturity	-	-	-	-	-

	BB+	BB-	B	B-
Financial assets at fair value through profit or loss	-	-	-	-
Due from banks	6,787	-	1,425	-
Loans to customers	-	3,386	79,789	97,235
Investments available-for-sale	-	412	-	569
Investments held to maturity	-	50,253	-	-

	CCC+	CCC	CC	Not rated	Total at 31 December 2006
Financial assets at fair value through profit or loss	-	-	-	1,177	1,177
Due from banks	-	-	-	7,561	49,630
Loans to customers	86,151	40,784	35,612	245,225	588,182
Investments available-for-sale	1,772	-	-	1,837	4,590
Investments held to maturity	-	-	-	-	50,253

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. 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.

The following table details the ageing of those financial assets that are past due but not impaired:

As at 31 December 2007:

	Financial assets past due but not impaired				Total
	0-3 months	3-6 months	6 months to 1 year	Greater than one year	
Loans to customers	9,560	1,145	454	338	11,497

As at 31 December 2006:

	Financial assets past due but not impaired				Total
	0-3 months	3-6 months	6 months to 1 year	Greater than one year	
Loans to customers	5,318	572	230	151	6,271

### *Geographical concentration*

The Assets and Liabilities Management Committee (“ALMC”) 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 Group’s Management Board sets up country limits, which mainly applies to banks of the Commonwealth of Independent States and Baltic countries.

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

	<b>Georgia</b>	<b>OECD countries</b>	<b>Non-OECD countries</b>	<b>31 December 2007 Total</b>
<b>ASSETS</b>				
Cash and balances with the National Bank of Georgia	183,833	-	-	183,833
Financial assets at fair value through profit or loss	135	228	-	363
Due from banks	12,571	62,746	5,677	80,994
Loans to customers	1,148,278	-	-	1,148,278
Investments available-for-sale	5,219	-	-	5,219
Investments held to maturity	114,596	-	-	114,596
Goodwill	758	-	-	758
Property, plant and equipment purchased for transfer into lease	326	-	-	326
Property, plant and equipment	118,170	-	-	118,170
Current income tax assets	6,808	-	-	6,808
Other assets	40,793	-	-	40,793
<b>TOTAL ASSETS</b>	<b><u>1,631,487</u></b>	<b><u>62,974</u></b>	<b><u>5,677</u></b>	<b><u>1,700,138</u></b>
<b>LIABILITIES</b>				
Due to banks	29,585	476,905	18,908	525,398
Customer accounts	779,541	-	-	779,541
Deferred income tax liabilities	13,786	-	-	13,786
Other liabilities	12,987	35	-	13,022
Subordinated debt	-	55,881	-	55,881
<b>TOTAL LIABILITIES</b>	<b><u>835,899</u></b>	<b><u>532,821</u></b>	<b><u>18,908</u></b>	<b><u>1,387,628</u></b>
<b>NET POSITION</b>	<b><u>795,588</u></b>	<b><u>(469,847)</u></b>	<b><u>(13,231)</u></b>	

	Georgia	OECD countries	Non-OECD countries	31 December 2006 Total
<b>ASSETS</b>				
Cash and balances with the National Bank of Georgia	196,307	1,118	-	197,425
Financial assets at fair value through profit or loss	-	1,177	-	1,177
Due from banks	7,983	34,483	7,164	49,630
Loans to customers	588,182	-	-	588,182
Investments available-for-sale	4,590	-	-	4,590
Investments held to maturity	50,253	-	-	50,253
Property, plant and equipment	53,233	-	-	53,233
Other assets	9,617	-	-	9,617
<b>TOTAL ASSETS</b>	<b>910,164</b>	<b>36,778</b>	<b>7,164</b>	<b>954,107</b>
<b>LIABILITIES</b>				
Due to banks	35,043	196,357	6,647	238,047
Customer accounts	552,168	-	-	552,168
Current income tax liabilities	1,800	-	-	1,800
Deferred income tax liabilities	2,289	-	-	2,289
Other liabilities	14,124	-	-	14,124
Subordinated debt	-	25,065	-	25,065
<b>TOTAL LIABILITIES</b>	<b>605,425</b>	<b>221,422</b>	<b>6,647</b>	<b>833,493</b>
<b>NET POSITION</b>	<b>304,741</b>	<b>(184,644)</b>	<b>517</b>	

## Liquidity risk

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 ALMC 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 optimisation.

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.

An analysis of the liquidity risk on balance sheet transactions is presented in the following table:

As at 31 December 2007:

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2007 Total
<b>ASSETS</b>							
Due from banks	75,140	-	4,846	1,008	-	-	80,994
Loans to customers	60,889	72,856	269,416	567,124	177,993	-	1,148,278
Investments held to maturity	62,872	19,671	32,053	-	-	-	114,596
Total interest bearing assets	198,901	92,527	306,315	568,132	177,993	-	1,343,868
Cash and balances with the National Bank of Georgia	94,445	-	-	-	-	89,388	183,833
Financial assets at fair value through profit or loss	-	-	-	228	-	135	363
Investments available-for-sale	-	-	-	-	-	5,219	5,219
Goodwill	-	-	-	-	-	758	758
Property, plant and equipment purchased for transfer into lease	-	-	-	-	-	326	326
Property, plant and equipment	-	-	-	-	-	118,170	118,170
Current income tax assets	-	-	6,808	-	-	-	6,808
Other assets	12	38,363	189	-	-	2,229	40,793
<b>TOTAL ASSETS</b>	<b>293,358</b>	<b>130,890</b>	<b>313,312</b>	<b>568,360</b>	<b>177,993</b>	<b>216,225</b>	<b>1,700,138</b>
<b>LIABILITIES</b>							
Due to banks	107,883	24,593	132,359	260,563	-	-	525,398
Customer accounts	223,486	65,578	185,421	39,748	1,392	-	515,625
Subordinated debt	-	-	-	23,268	32,613	-	55,881
Total interest bearing liabilities	331,369	90,171	317,780	323,579	34,005	-	1,096,904
Customer accounts	263,916	-	-	-	-	-	263,916
Deferred income tax liabilities	-	-	-	-	-	13,786	13,786
Other liabilities	11,734	-	189	-	-	1,099	13,022
<b>TOTAL LIABILITIES</b>	<b>607,019</b>	<b>90,171</b>	<b>317,969</b>	<b>323,579</b>	<b>34,005</b>	<b>14,885</b>	<b>1,387,628</b>
Liquidity gap	(313,661)	40,719	(4,657)	244,781	143,988		
Interest sensitivity gap	(132,468)	2,356	(11,465)	244,553	143,988		
<b>Cumulative interest sensitivity gap</b>	<b>(132,468)</b>	<b>(130,112)</b>	<b>(141,577)</b>	<b>102,976</b>	<b>246,964</b>		
<b>Cumulative interest sensitivity gap as a percentage of total assets</b>	<b>(7.8%)</b>	<b>(7.7%)</b>	<b>(8.3%)</b>	<b>6.1%</b>	<b>14.5%</b>		



As at 31 December 2006:

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2006 Total
<b>ASSETS</b>							
Due from banks	44,934	-	3,602	1,094	-	-	49,630
Loans to customers	69,146	73,563	177,050	238,222	28,544	1,657	588,182
Investments held to maturity	50,209	-	44	-	-	-	50,253
Total interest bearing assets	164,289	73,563	180,696	239,316	28,544	1,657	688,065
Cash and balances with the National Bank of Georgia	134,120	-	-	-	-	63,305	197,425
Financial assets at fair value through profit or loss	-	-	14	1,163	-	-	1,177
Investments available-for-sale	-	-	-	-	-	4,590	4,590
Property, plant and equipment	-	-	-	-	-	53,233	53,233
Other assets	-	8,600	-	-	-	1,017	9,617
<b>TOTAL ASSETS</b>	<b>298,409</b>	<b>82,163</b>	<b>180,710</b>	<b>240,479</b>	<b>28,544</b>	<b>123,802</b>	<b>954,107</b>
<b>LIABILITIES</b>							
Due to banks	63,303	671	80,168	79,247	14,658	-	238,047
Customer accounts	150,313	37,355	119,719	39,453	1,296	-	348,136
Subordinated debt	-	-	-	25,065	-	-	25,065
Total interest bearing liabilities	213,616	38,026	199,887	143,765	15,954	-	611,248
Customer accounts	204,032	-	-	-	-	-	204,032
Current income tax liabilities	-	1,800	-	-	-	-	1,800
Deferred income tax liabilities	-	-	-	-	-	2,289	2,289
Other liabilities	7,114	-	-	-	-	7,010	14,124
<b>TOTAL LIABILITIES</b>	<b>424,762</b>	<b>39,826</b>	<b>199,887</b>	<b>143,765</b>	<b>15,954</b>	<b>9,299</b>	<b>833,493</b>
Liquidity gap	(126,353)	42,337	(19,177)	96,714	12,590		
Interest sensitivity gap	(49,327)	35,537	(19,191)	95,551	12,590		
<b>Cumulative interest sensitivity gap</b>	<b>(49,327)</b>	<b>(13,790)</b>	<b>(32,981)</b>	<b>62,570</b>	<b>75,160</b>		
<b>Cumulative interest sensitivity gap as a percentage of total assets</b>	<b>(5.2%)</b>	<b>(1.4%)</b>	<b>(3.5%)</b>	<b>6.6%</b>	<b>7.9%</b>		

Substantially all of the Group's interest earning assets and interest bearing liabilities are at fixed rates of assets.

Asset and liability maturity periods and the ability to replace interest bearing liabilities at an acceptance cost when they mature are crucial in determining the Group's liquidity and its fluctuation of interest and exchange rates.

The maturity of time deposits of individuals is based on contractual terms. However, time deposits can be withdrawn by individuals on demand.

Currently, a considerable part of customer deposits are repayable on demand. However, the fact that these deposits are diversified by the number and type of customers and the Group's previous experience indicate that deposits are a stable and long-term source of financing for the Group. Moreover, the Group's liquidity risk management includes estimation of actual estimated maturities for its current deposits. The estimation is based on statistical methods applied to historic information on fluctuations of customer accounts balances.

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2007 Total
Customer accounts analyzed based on expected withdrawal dates	<u>161,918</u>	<u>76,611</u>	<u>235,071</u>	<u>304,549</u>	<u>1,392</u>	<u>-</u>	<u>779,541</u>
Liquidity gap (based on expected withdrawal dates for customer accounts)	<u>11,823</u>	<u>29,686</u>	<u>(54,307)</u>	<u>(20,020)</u>	<u>143,988</u>	<u>-</u>	
	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	31 December 2006 Total
Customer accounts analyzed based on expected withdrawal dates	<u>123,646</u>	<u>45,175</u>	<u>154,910</u>	<u>227, 140</u>	<u>1,296</u>	<u>-</u>	<u>552,168</u>
Liquidity gap (based on expected withdrawal dates for customer accounts)	<u>104,346</u>	<u>34,517</u>	<u>(54,368)</u>	<u>(90,973)</u>	<u>12,590</u>		

## 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 entities in the Group borrow funds at both fixed and floating rates. The risk is managed by the Group maintaining an appropriate mix between fixed and floating rate borrowings.

The ALMC 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 Control 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.

## Cash flow interest rate risk

Cash flow interest rate risk is the risk that the future cash flow of a financial instrument will fluctuate because of changes in market interest rates.

Interest rate risk is managed within the limit framework as established in accordance with the standards set by the Group. Interest rate risks are controlled via regular interest rate gap reporting. The Group does not perform hedging activities, thus no risk management policy for hedging transactions has been developed.

The following table presents an analysis of interest rate risk and thus the potential of the Group for gain or loss. Effective average interest rates are presented by categories of financial assets and liabilities to determine interest rate exposure and effectiveness of the interest rate policy used by the Group.

	31 December 2007			31 December 2006		
	GEL	USD	Other currencies	GEL	USD	Other currencies
<b>ASSETS</b>						
Due from Banks	3,7%	2,5%	3,6%	1,3%	0,9%	2,1%
Loans to customers	18,9%	16,0%	14,8%	16,2%	16,4%	14,4%
Investments held to maturity	6,2%	-	-	11,2%	-	-
<b>LIABILITIES</b>						
Due to Banks	13,4%	8,8%	7,5%	12,7%	9,5%	8,6%
Customer accounts	6,8%	7,9%	5,6%	9,8%	7,2%	6,2%

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 net profit and equity:

	As at 31 December 2007		As at 31 December 2006	
	Interest rate +2%	Interest rate -2%	Interest rate +2%	Interest rate -2%
<b>Assets:</b>				
Due from banks and financial assets at fair value through profit or loss	1,321	(1,321)	831	(831)
Loans to customers	6,849	(6,849)	3,933	(3,933)
Investments held to maturity	2,007	(2,007)	964	(964)
<b>Liabilities:</b>				
Due to banks and financial liabilities at fair value through profit or loss	(6,631)	6,878	(2,355)	2,355
Customer accounts	(5,613)	5,613	(4,136)	4,136
Subordinated debt	(398)	429	-	-
<b>Net impact on profit before tax</b>	<b>(2,465)</b>	<b>2,743</b>	<b>(763)</b>	<b>763</b>

Impact on shareholders equity:

	As at 31 December 2007		As at 31 December 2006	
	Interest rate +2%	Interest rate -2%	Interest rate +2%	Interest rate -2%
<b>Assets:</b>				
Due from banks and financial assets at fair value through profit or loss	(87)	87	(60)	60
Loans to customers	(43,070)	43,070	(19,026)	19,026
Investments held to maturity	(351)	351	(40)	40
<b>Liabilities:</b>				
Due to banks and financial liabilities at fair value through profit or loss	4,834	(4,015)	3,118	(3,118)
Customer accounts	2,574	(2,574)	2,697	(2,697)
Subordinated debt	1,947	(1,477)	2,896	(2,896)
<b>Net impact on shareholders equity</b>	<b>(35,056)</b>	<b>36,345</b>	<b>(10,415)</b>	<b>10,415</b>

## 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 ALMC 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 exposure to foreign currency exchange rate risk is presented in the table below:

As at 31 December 2007:

	<b>GEL</b>	<b>USD</b> USD 1 = GEL 1.592	<b>EUR</b> EUR 1 = GEL 2.332	<b>Other currency</b>	<b>31 December 2007 Total</b>
<b>ASSETS</b>					
Cash and balances with the National Bank of Georgia	63,511	113,124	6,560	638	183,833
Financial assets at fair value through profit or loss	135	228	-	-	363
Due from banks	10,056	10,067	59,501	1,370	80,994
Loans to customers	285,252	850,620	12,406	-	1,148,278
Investments available-for-sale	5,219	-	-	-	5,219
Investments held to maturity	114,596	-	-	-	114,596
Goodwill	758	-	-	-	758
Property, plant and equipment purchased for transfer into lease	326	-	-	-	326
Property, plant and equipment	118,170	-	-	-	118,170
Current income tax assets	6,808	-	-	-	6,808
Other assets	25,232	15,206	355	-	40,793
<b>TOTAL ASSETS</b>	<b>630,063</b>	<b>989,245</b>	<b>78,822</b>	<b>2,008</b>	<b>1,700,138</b>
<b>LIABILITIES</b>					
Due to banks	18,195	487,502	19,701	-	525,398
Customer accounts	233,882	441,566	102,398	1,695	779,541
Deferred income tax liabilities	13,786	-	-	-	13,786
Other liabilities	10,699	2,247	76	-	13,022
Subordinated debt	-	55,881	-	-	55,881
<b>TOTAL LIABILITIES</b>	<b>276,562</b>	<b>987,196</b>	<b>122,175</b>	<b>1,695</b>	<b>1,387,628</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>353,501</b>	<b>2,049</b>	<b>(43,353)</b>	<b>313</b>	

## Derivative financial instruments and spot contracts

Fair value of derivative financial instruments and spot contracts are included in the currency analysis presented above and the following table presents further analysis of currency risk by types of derivative financial instruments and spot contracts as at 31 December 2007:

	USD USD 1 = GEL 1.592	31 December 2007 Total
Accounts receivable on spot and derivative contracts	<u>228</u>	<u>228</u>
<b>NET SPOT AND DERIVATIVE FINANCIAL INSTRUMENTS POSITION</b>	<u><u>228</u></u>	
<b>TOTAL OPEN POSITION</b>	<u><u>228</u></u>	

As at 31 December 2006:

	GEL	USD USD 1 = GEL 1.714	EUR EUR 1 = GEL 2.256	Other currency	31 December 2006 Total
<b>ASSETS</b>					
Cash and balances with the National Bank of Georgia	98,042	94,672	4,340	371	197,425
Financial assets at fair value through profit or loss	-	1,177	-	-	1,177
Due from banks	127	30,992	18,138	373	49,630
Loans to customers	110,278	463,349	14,555	-	588,182
Investments available-for-sale	4,590	-	-	-	4,590
Investments held to maturity	50,253	-	-	-	50,253
Property, plant and equipment	53,233	-	-	-	53,233
Other assets	5,645	3,701	271	-	9,617
<b>TOTAL ASSETS</b>	<u><u>322,168</u></u>	<u><u>593,891</u></u>	<u><u>37,304</u></u>	<u><u>744</u></u>	<u><u>954,107</u></u>
<b>LIABILITIES</b>					
Due to banks	31,044	204,353	2,650	-	238,047
Customer accounts	148,961	363,290	38,794	1,123	552,168
Current income tax liabilities	1,800	-	-	-	1,800
Deferred income tax liabilities	2,289	-	-	-	2,289
Other liabilities	8,107	5,039	932	46	14,124
Subordinated debt	-	25,065	-	-	25,065
<b>TOTAL LIABILITIES</b>	<u><u>192,201</u></u>	<u><u>597,747</u></u>	<u><u>42,376</u></u>	<u><u>1,169</u></u>	<u><u>833,493</u></u>
<b>OPEN BALANCE SHEET POSITION</b>	<u><u>129,967</u></u>	<u><u>(3,856)</u></u>	<u><u>(5,072)</u></u>	<u><u>(425)</u></u>	

As at 31 December 2006:

	USD USD 1 = GEL 1.714	31 December 2006 Total
Accounts receivable on spot and derivative contracts	<u>1,177</u>	<u>1,177</u>
<b>NET SPOT AND DERIVATIVE FINANCIAL INSTRUMENTS POSITION</b>	<u><u>1,177</u></u>	
<b>TOTAL OPEN POSITION</b>	<u><u>1,177</u></u>	

## Currency risk Sensitivity

The following table details the Group's Sensitivity to a 10% increase and decrease in the USD against the GEL. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Group where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

	As at 31 December 2007		As at 31 December 2006	
	GEL/USD +10%	GEL/USD -10%	GEL/USD +10%	GEL/USD -10%
Impact on profit or loss	1,860	(1,860)	(745)	745
Impact on equity	1,488	(1,488)	(596)	596

### 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 on the balance sheet. 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 margin 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.