

Georgian Oil and Gas Corporation LLC

**Consolidated Financial Statements
for the year ended 31 December 2009**

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Independent Auditors' Report

To the Board of Directors of
Georgian Oil and Gas Corporation LLC

We have audited the accompanying consolidated financial statements of Georgian Oil and Gas Corporation LLC (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statements of financial position as at 31 December 2009, 31 December 2008 and 1 January 2008, and the consolidated statements of comprehensive income, changes in equity and cash flows for the years ended 31 December 2009 and 31 December 2008, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

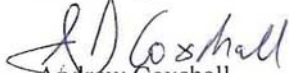
Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain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

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

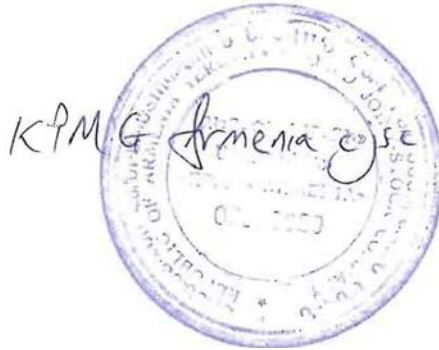
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.


Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2009, 31 December 2008 and 1 January 2008, and its consolidated financial performance and its consolidated cash flows for the years ended 31 December 2009 and 31 December 2008 in accordance with International Financial Reporting Standards.


Andrew Coxshall
Director

KPMG Armenia cjsc
8 December 2010




Tigran Gasparyan
Head of Audit Department

'000 GEL	Note	2009	2008	1 January 2008
ASSETS				
Non-current assets				
Property, plant and equipment	11	196,473	265,733	277,461
Intangible assets	12	852	5,454	5,964
Prepayments for non-current assets		-	9,627	-
Deferred tax assets	13	4,116	3,366	3,525
Other assets		99	1,518	2,422
Total non-current assets		201,540	285,698	289,372
Current assets				
Inventories	14	20,957	12,168	9,880
Value added tax recoverable		29,727	19,985	16,523
Prepayments for current assets and expenses		20,710	13,449	8,469
Trade and other receivables	15	87,130	113,321	57,407
Cash and cash equivalents	16	8,180	16,972	31,913
Total current assets		166,704	175,895	124,192
Total assets		368,244	461,593	413,564
EQUITY AND LIABILITIES				
Equity				
	17			
Charter capital		194,268	166,141	142,684
Additional paid in capital		52,311	25,415	9,355
Fair value adjustment reserve for non-cash owner contributions		(31,168)	(12,261)	-
Retained earnings		(29,937)	12,677	15,018
Total equity		185,474	191,972	167,057
Non-current liabilities				
Government grant	18	9,297	8,300	12,767
Restructured tax liabilities	18	28,201	31,465	30,848
Loans and borrowings	19	86,653	112,414	96,031
Deferred tax liabilities	13	1,785	12,160	17,009
Total non-current liabilities		125,936	164,339	156,655
Current liabilities				
Government grant	18	2,413	4,467	4,022
Restructured tax liabilities	18	7,353	3,405	-
Loans and borrowings	19	28,735	55,448	41,351
Trade and other payables	20	4,694	33,248	33,781
Current tax liabilities		11,913	6,917	8,707
Other taxes payable		1,726	1,797	1,991
Total current liabilities		56,834	105,282	89,852
Total liabilities		182,770	269,621	246,507
Total equity and liabilities		368,244	461,593	413,564

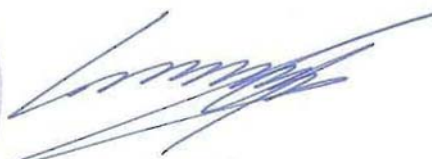
Georgian Oil and Gas Corporation LLC
Consolidated Statement of Comprehensive Income for the year ended 31 December 2009

'000 GEL	Note	2009	2008
Revenue	5	171,365	360,735
Cost of gas and oil	6	(73,250)	(290,063)
Depreciation and amortisation		(24,369)	(24,405)
Personnel costs		(13,249)	(14,691)
Taxes, other than on income		(3,261)	(3,510)
Impairment of property, plant and equipment	11	(75,909)	-
Other expenses	7	(11,800)	(14,286)
Other income	8	26,243	19,212
Results from operating activities		(4,230)	32,992
Impairment loss on trade receivables	21(b)	(17,954)	(14,820)
Net foreign exchange income		955	6,223
Interest income		650	2,290
Interest expense	9	(22,315)	(23,832)
(Loss)/profit before income tax		(42,894)	2,853
Income tax benefit/(expense)	10	5,630	(1,495)
(Loss)/profit and total comprehensive (loss)/income for the year		(37,264)	1,358

These consolidated financial statements were approved by management on 8 December 2010 and were signed on its behalf by:



Zurab Janjgava
General Director

Alexander Sakandelidze
Financial Director

Georgian Oil and Gas Corporation LLC
Consolidated Statement of Changes in Equity for the year ended 31 December 2009

'000 GEL	Charter capital	Fair value adjustment reserve for non-cash owner contributions	Additional paid in capital	Retained earnings	Total
Balance at 1 January 2008	142,684	-	9,355	15,018	167,057
Total comprehensive income for the year					
Profit for the year	-	-	-	1,358	1,358
Contributions by and distributions to owners					
Increase in additional paid in capital, net of tax of GEL 2,834 thousand (see note 23 (c))	-	-	16,060	-	16,060
Distributions of non-cash assets, net of tax of GEL 653 thousand (see note 11)	-	-	-	(3,699)	(3,699)
Increase in charter capital (see note 11)	23,457	-	-	-	23,457
Fair value adjustment of non-cash owner contributions, net of tax of GEL 2,164 thousand (see note 11)	-	(12,261)	-	-	(12,261)
Balance at 31 December 2008	166,141	(12,261)	25,415	12,677	191,972
Balance at 1 January 2009	166,141	(12,261)	25,415	12,677	191,972
Total comprehensive loss for the year					
Loss for the year	-	-	-	(37,264)	(37,264)
Contributions by and distributions to owners					
Increase in additional paid in capital, net of tax of GEL 4,747 thousand (see note 23 (c))	-	-	26,896	-	26,896
Distributions of non-cash assets, net of tax of GEL 180 thousand (see notes 11 and 12)	-	-	-	(5,350)	(5,350)
Increase in charter capital (see note 11)	31,230	-	-	-	31,230
Decrease in charter capital (see note 11)	(3,103)	-	-	-	(3,103)
Fair value adjustment of non-cash owner contributions, net of tax of GEL 3,336 thousand (see note 11)	-	(18,907)	-	-	(18,907)
Balance at 31 December 2009	194,268	(31,168)	52,311	(29,937)	185,474

'000 GEL	Note	2009	2008
Cash flows from operating activities			
(Loss)/profit before income tax		(42,894)	2,853
<i>Adjustments for:</i>			
Depreciation and amortisation		24,369	24,405
Impairment loss on trade receivables		17,954	14,820
Impairment of property, plant and equipment		75,909	-
Interest expense		22,315	23,832
Amortisation of government grant		(1,239)	(4,022)
Other		1,601	-
Cash flows from operating activities before changes in working capital		98,015	61,888
Change in inventories		(8,789)	(2,288)
Change in trade and other receivables		8,237	(70,734)
Change in prepayments for current assets and expenses		(7,261)	(4,980)
Change in value added tax recoverable		(9,742)	(3,462)
Change in trade and other payables		(28,554)	4,083
Change in restructured tax liabilities and other taxes payable		(3,845)	(194)
Cash flows from/(used in) operations before income taxes and interest paid		48,061	(15,687)
Income tax paid		(1,730)	(7,992)
Interest paid		(10,535)	(4,002)
Net cash from/(used in) operating activities		35,796	(27,681)
Cash flows from investing activities			
Acquisition of property, plant and equipment		(16,435)	(20,807)
Acquisition of intangible assets		-	(20)
Net cash used in investing activities		(16,435)	(20,827)
Cash flows from financing activities			
Proceeds from borrowings		15,000	35,510
Repayment of borrowings		(43,153)	(1,943)
Net cash (used in)/from financing activities		(28,153)	33,567
Net decrease in cash and cash equivalents		(8,792)	(14,941)
Cash and cash equivalents at 1 January		16,972	31,913
Cash and cash equivalents at 31 December	16	8,180	16,972

1 Background

(a) Business environment

Georgian business environment

Georgia has been experiencing political and economic change that has affected, and may continue to affect, the activities of enterprises operating in this environment. The conflict between Georgia and the Russian Federation has created additional uncertainty. The Group's operations and assets could be at risk as a result of negative changes in the political, economic or business environment within Georgia and between Georgia and the Russian Federation. Consequently, operations in Georgia involve risks that typically do not exist in other markets. In addition, the contraction in the capital and credit markets and its impact on the economy of Georgia have further increased the level of economic uncertainty in the environment. These consolidated financial statements reflect management's assessment of the impact of the Georgian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

(b) Organisation and operations

Georgian Oil and Gas Corporation LLC (the "Company") and its subsidiaries (the "Group") comprise Georgian Limited Liability Companies as defined in the the "Law of Georgia on Entrepreneurs". The Company was established as a 100% state-owned enterprise by the order of the Ministry of Economy of Georgia, on 21 March 2006 on the basis of three Georgian state-owned companies: Georgian International Oil Corporation JSC, Georgian Gas International Corporation JSC and Teleti Oil Company JSC.

In 2006 and 2007 respectively Georgian International Oil Corporation JSC and Georgian Gas International Corporation JSC ceased legal existence and the assets and liabilities were transferred to the Company. In November 2007 the shares in Teleti Oil Company JSC were taken over by the Government of Georgia. Related party transactions are detailed in note 23.

The Company's registered office is 21 Kakheti Highway, Tbilisi 0190, Georgia.

The Group's principal activities are the import and sales of gas, the operation of transitory gas pipelines in the territory of Georgia and transit of the gas to the Republic of Armenia and oil and gas exploration and extraction in the territory of Georgia.

The Company has also been granted the status of the "National Oil Company" in December 2006 by Presidential decree number 736 and it acts on behalf of the State of Georgia, receives and disposes of the State's share of extracted oil and gas produced by contractors in the territory of Georgia in accordance with the "Law of Georgia on Oil and Gas" and production sharing agreements signed between the State and the contractors. The Group has not recognised intangible asset for this right as the Group does not control the right.

2 Basis of preparation

(a) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRSs”). These are the Group’s first consolidated financial statements prepared in accordance with IFRSs and IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied.

An explanation of how the transition to IFRSs has affected the reported financial position of the Group is provided in note 26.

(b) Basis of measurement

The consolidated financial statements are prepared on the historical cost basis.

(c) Functional and presentation currency

The national currency of Georgia is the Georgian Lari (“GEL”), which is the Company’s functional currency and the currency in which these consolidated financial statements are presented. All financial information presented in GEL has been rounded to the nearest thousand.

(d) Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements is included in the following notes:

- Note 18 Restructured tax liabilities and government grant – determination of fair value of the restructured debt and accounting of the government grant;
- Note 23(c) Related party loans received – determination of fair value of loans at initial recognition.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year is included in the following notes:

- Note 2(e) Oil and gas reserves;
- Note 11 Property, plant and equipment – determination of deemed cost and impairment;
- Note 21(b) Credit risk – impairment of trade and other receivables;
- Note 22 Contingencies – environmental matters and litigation.

(e) Oil and gas reserves

There are a number of uncertainties in estimating quantities of oil and gas reserves, including many factors beyond the control of the Group. Oil and gas reserve estimates are based upon engineering evaluations of assay values derived from samplings of drill holes and other openings. Additionally, declines in the market price of oil and gas may render certain reserves containing relatively lower contents uneconomic to produce. Further, availability of operating and environmental permits, changes in operating and capital costs, and other factors could materially affect the Group's oil and gas reserve estimates. The Group uses the above estimates in evaluating the impairment of property, plant and equipment and extraction licences and rights.

3 Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and in preparing the opening consolidated IFRS statement of financial position as at 1 January 2008 for the purposes of the transition to IFRSs, unless otherwise indicated. The accounting policies have been applied consistently by Group entities.

In preparing these consolidated financial statements the Group elected to apply the optional exemption to capitalize borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset which relate to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. In 2008 the Group immediately recognised all borrowing costs as an expense.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Group. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

(ii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period. Foreign currency differences arising in retranslation are recognised in profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(c) Financial instruments

Financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to offset the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

(i) Non-derivative financial assets

The Group initially recognises loans and receivables and cash and cash equivalents on the date that they are originated.

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

The Group's financial assets are loans and receivables.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses. Loans and receivables comprise trade and other receivables.

Cash and cash equivalents comprise cash balances and call deposits with original maturities of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

(ii) Non-derivative financial liabilities

Financial liabilities are recognised initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire. A substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are considered substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability.

The Group has the following financial liabilities: loans and borrowings and trade and other payables.

Such financial liabilities are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortised cost using the effective interest method.

(d) Charter capital

Charter capital is classified as equity.

Reduction of charter capital

Charter capital reductions and non-cash distributions are recognised at the carrying amount of the assets distributed.

Increase of charter capital

When charter capital is increased, any difference between the registered amount of charter capital and the fair value of the assets contributed is recognised as a separate component of equity as fair value adjustment reserve for non-cash owner contributions.

(e) Property, plant and equipment

(i) Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Property, plant and equipment contributed by the shareholder are initially measured at fair value. The cost of property, plant and equipment at the date of adopting IFRS, 1 January 2008, was determined by reference to its fair value at that date (“deemed cost”).

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for their intended use, the costs of dismantling and removing the items and restoring the site on which they are located, and borrowing costs on qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and are recognised net within “other income” in profit or loss.

(ii) Subsequent costs

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

(iii) Depreciation

Depreciation is calculated over the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Land is not depreciated.

The estimated useful lives for the current and comparative periods are as follows:

- gas and oil pipelines 5-34 years
- buildings 6-35 years
- oil wells 4-9 years
- plant and equipment 2-14 years
- other 1-6 years

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

(f) Intangible assets

Intangible assets that are acquired by the Group, which have finite useful lives, are measured at cost less accumulated amortisation and accumulated impairment losses.

(i) Subsequent expenditure

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognised in the profit or loss as incurred.

(ii) Amortisation

Amortisation is calculated over the cost of the asset, or other amount substituted for cost, less its residual value.

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use since this most closely reflects the expected pattern of consumption of future economic benefits embodied in the asset. The estimated useful lives for the current and comparative periods are as follows:

- extraction licence and rights term of the licence
- other 5-7 years

Amortisation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

(g) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the first-in first-out principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(h) Impairment

(i) *Financial assets*

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Group on terms that the Group would not consider otherwise, indications that a debtor or issuer will enter bankruptcy, the disappearance of an active market for a security.

The Group considers evidence of impairment for receivables at both a specific asset and collective level. All individually significant receivables are assessed for specific impairment. All individually significant receivables found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Receivables that are not individually significant are collectively assessed for impairment by grouping together receivables with similar risk characteristics.

In assessing collective impairment the Group uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

(ii) *Non-financial assets*

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, the recoverable amount is estimated each year at the same time.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the “cash-generating unit”).

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated to reduce the carrying amount of the assets in the unit (group of units) on a pro rata basis.

An impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset’s carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(i) Employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

(j) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as finance cost.

(k) Revenue

(i) Sale of gas and oil

Revenue from the sale of gas and oil is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Revenue is recognised when persuasive evidence exists, usually in the form of an executed sales agreement, that the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably. If it is probable that discounts will be granted and the amount can be measured reliably, then the discount is recognised as a reduction of revenue as the sales are recognised.

The timing of the transfers of risks and rewards varies depending on the individual terms of the contract of sale. For sales of gas, the sale is recognised on the basis of metered usage of gas by customers. For sales of oil, transfer occurs upon loading the product onto the relevant carriers, inspection by an independent inspector and sealing of carriers based on FCA (Incoterms 2000) at Vaziani or Supsa stations (Georgia) terms. The seller is responsible for delivery of goods to the named points, uploading goods to the buyer's wagons and customs registration.

(ii) Services

Revenue from services rendered is recognised in profit or loss in proportion to the stage of completion of the transaction at the reporting date. The stage of completion is assessed by reference to surveys of work performed.

Gas and oil transportation fees received in cash are recognised on the basis of the metered gas and oil transferred through the pipelines at the contract rate for cubic meters of gas and barrels of oil. Gas transportation fees received in the form of gas is measured at the sales price of that gas to other parties.

(iii) Government grants

Government grants are recognised initially as deferred income when there is reasonable assurance that they will be received and that the Group will comply with the conditions associated with the grant. Grants that compensate the Group for expenses incurred are recognised in profit or loss as other income on a systematic basis in the same periods in which the expenses are recognised. Grants that compensate the Group for the cost of an asset are recognised in profit or loss on a systematic basis over the useful life of the asset.

Government grants in the form of a significant deferral of tax payments are recognized as the difference between the nominal amount of the tax liabilities and the estimated fair value of the restructured debt. The grants are subsequently amortized over the period of the restructured debt maturity and grant income is recognized using the effective interest method.

(l) Other expenses

(i) Lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the contingency no longer exists and the lease adjustment is known.

(ii) Social expenditure

To the extent that the Group's contributions to social programs benefit the community at large and are not restricted to the Group's employees, they are recognised in profit or loss as incurred.

(m) Finance income and costs

Finance income comprises interest income on funds invested and foreign currency gains. Interest income is recognised as it accrues in profit or loss, using the effective interest method.

Finance costs comprise interest expense on borrowings, unwinding of the discount on provisions, foreign currency losses, and impairment losses recognised on financial assets. Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognised in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis.

(n) Income tax

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets and liabilities, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(o) New Standards and Interpretations not yet adopted

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2009, and have not been applied in preparing these consolidated financial statements. Of these pronouncements, potentially the following will have an impact on the Group's operations. The Group plans to adopt these pronouncements when they become effective.

- Revised IAS 24 *Related Party Disclosures* (2009) introduces an exemption from the basic disclosure requirements in relation to related party disclosures and outstanding balances, including commitments, for government-related entities. Additionally, the standard has been revised to simplify some of the presentation guidance that was previously non-reciprocal. The revised standard is to be applied retrospectively for annual periods beginning on or after 1 January 2011. The Group has not yet determined the potential effect of the amendment.
- IFRS 9 *Financial Instruments* will be effective for annual periods beginning on or after 1 January 2013. The new standard is to be issued in several phases and is intended to replace International Financial Reporting Standard IAS 39 *Financial Instruments: Recognition and Measurement* once the project is completed by the end of 2010. The first phase of IFRS 9 was issued in November 2009 and relates to the recognition and measurement of financial assets. The Group recognises that the new standard introduces many changes to the accounting for financial instruments and is likely to have a significant impact on Group's consolidated financial statements. The impact of these changes will be analysed during the course of the project as further phases of the standard are issued.
- IFRIC 17 *Distributions of Non-cash Assets to Owners* addresses the accounting for non-cash dividend distributions to owners. The interpretation clarifies when and how a non-cash dividend should be recognised and how the difference between the dividend paid and the carrying amount of the net assets distributed should be recognised. IFRIC 17 became effective for annual periods beginning on or after 1 July 2009. The Group has not yet analysed the likely impact of the interpretation on its financial position or performance.
- IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* provides guidance on accounting for debt for equity swaps by the debtor. The interpretation clarifies that an entity's equity instruments qualify as "consideration paid" in accordance with paragraph 41 of International Financial Reporting Standards IAS 39 *Financial Instruments: Recognition and Measurement*. Additionally, the interpretation clarifies how to account for the initial measurement of own equity instruments issued to extinguish a financial liability and how to account for the difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued. IFRIC 19 is applicable for annual periods beginning on or after 1 July 2010. The group has not yet analysed the likely impact of the interpretation on its financial position or performance. The Group has not yet analysed the likely impact of the interpretation on its financial position or performance.
- Various *Improvements to IFRSs* have been dealt with on a standard-by-standard basis. All amendments, which result in accounting changes for presentation, recognition or measurement purposes, will come into effect not earlier than 1 January 2010. The Group has not yet analysed the likely impact of the improvements on its financial position or performance.

4 Determination of fair values

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or for disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(a) Property, plant and equipment

The fair value of property, plant and equipment contributed by the shareholder is based on market values when possible. The market value of property is the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably and willingly. The fair value of items of plant, equipment, fixtures and fittings is based on market approach and cost approaches using quoted market prices for similar items when available.

When no quoted market prices are available, the fair value of property, plant and equipment is primarily determined using depreciated replacement cost. This method considers the cost to reproduce or replace the property, plant and equipment, adjusted for physical, functional or economical depreciation, and obsolescence.

(b) Trade and other receivables

The fair value of trade and other receivables for disclosure purposes is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

(c) Financial liabilities

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

(d) Inventories

The fair value of oil is based on prices established in recognised commodity exchanges published by Platt's Crude Oil Marketwire. The fair value of gas is based on the estimated sales price by the Group less costs to sell.

5 Revenue

'000 GEL	2009	2008
Sales of gas	89,283	263,679
Gas transportation fee – receivable in the form of gas	32,449	57,881
Income from crude oil	22,206	17,980
Gas transportation fee – receivable in cash	14,953	18,386
Oil transportation fee	12,064	2,005
Other revenue	410	804
	171,365	360,735

6 Cost of gas and oil

'000 GEL	2009	2008
Cost of gas	67,798	288,561
Cost of crude oil	5,452	1,502
	73,250	290,063

7 Other expenses

'000 GEL	2009	2008
Banking, consulting and other professional services	2,780	1,295
Fuel, materials and equipment repair	2,290	2,764
Representative and business trip expenses	880	905
Transportation and vehicles maintenance	710	840
Regulation fees	542	1,014
Office and related equipment maintenance	420	559
Communication expenses	354	322
Donations	-	2,669
Other	3,824	3,918
	11,800	14,286

8 Other income

'000 GEL	2009	2008
Customer penalties for late payment	18,171	10,333
Income from provided services	2,644	1,572
Amortisation of government grant	1,239	4,022
Other penalties	1,011	-
Other	3,178	3,285
	26,243	19,212

9 Interest expense

'000 GEL	2009	2008
Interest expense on loans from the Government of Georgia	16,505	17,408
Interest expense on restructured tax liabilities	4,466	4,022
Interest expense on bank loans	1,344	2,402
	22,315	23,832

10 Income tax benefit/(expense)

The Group's applicable tax rate is the income tax rate of 15% for Georgian companies (2008: 15%).

'000 GEL	2009	2008
<i>Current tax expense</i>		
Current year	(6,726)	(6,202)
<i>Deferred tax benefit</i>		
Origination and reversal of temporary differences	12,356	4,707
	5,630	(1,495)

Reconciliation of effective tax rate:

	2009		2008	
	'000 GEL	%	'000 GEL	%
(Loss)/profit before income tax	(42,894)	100	2,853	100
Income tax at applicable tax rate	(6,434)	15	428	15
Non-deductible expenses	804	(2)	1,067	37
	(5,630)	13	1,495	52

11 Property, plant and equipment

'000 GEL	<u>Gas and oil pipelines</u>	<u>Land and buildings</u>	<u>Oil wells</u>	<u>Plant and equipment</u>	<u>Other</u>	<u>Construction in progress and construction materials</u>	<u>Total</u>
<i>Cost/Deemed cost</i>							
Balance at 1 January 2008	177,673	30,263	29,203	4,602	3,279	32,441	277,461
Additions	4,157	4,563	616	1,925	2,890	2,695	16,846
Disposals	(1,234)	(3,631)	-	(35)	(179)	(164)	(5,243)
Balance at 31 December 2008	<u>180,596</u>	<u>31,195</u>	<u>29,819</u>	<u>6,492</u>	<u>5,990</u>	<u>34,972</u>	<u>289,064</u>
Balance at 1 January 2009	180,596	31,195	29,819	6,492	5,990	34,972	289,064
Additions	10,193	933	15	901	2,549	22,221	36,812
Disposals	(1,920)	(1,328)	-	(251)	(190)	(2,908)	(6,597)
Transfers	23,041	-	-	-	-	(23,041)	-
Balance at 31 December 2009	<u>211,910</u>	<u>30,800</u>	<u>29,834</u>	<u>7,142</u>	<u>8,349</u>	<u>31,244</u>	<u>319,279</u>
<i>Depreciation and impairment losses</i>							
Balance at 1 January 2008	-	-	-	-	-	-	-
Depreciation charge	14,608	897	5,001	1,940	1,429	-	23,875
Disposals	(527)	-	-	(17)	-	-	(544)
Balance at 31 December 2008	<u>14,081</u>	<u>897</u>	<u>5,001</u>	<u>1,923</u>	<u>1,429</u>	<u>-</u>	<u>23,331</u>
Balance at 1 January 2009	14,081	897	5,001	1,923	1,429	-	23,331
Depreciation charge	14,796	961	5,093	1,827	1,423	-	24,100
Disposals	(255)	(10)	-	(132)	(137)	-	(534)
Impairment loss	67,192	5,139	-	634	1,698	1,246	75,909
Balance at 31 December 2009	<u>95,814</u>	<u>6,987</u>	<u>10,094</u>	<u>4,252</u>	<u>4,413</u>	<u>1,246</u>	<u>122,806</u>
<i>Carrying amounts</i>							
At 1 January 2008	<u>177,673</u>	<u>30,263</u>	<u>29,203</u>	<u>4,602</u>	<u>3,279</u>	<u>32,441</u>	<u>277,461</u>
At 31 December 2008	<u>166,515</u>	<u>30,298</u>	<u>24,818</u>	<u>4,569</u>	<u>4,561</u>	<u>34,972</u>	<u>265,733</u>
At 31 December 2009	<u>116,096</u>	<u>23,813</u>	<u>19,740</u>	<u>2,890</u>	<u>3,936</u>	<u>29,998</u>	<u>196,473</u>

During 2009 the Government of Georgia contributed certain property, plant and equipment in the form of increase in charter capital. The charter capital has been increased by the nominal amount of these assets of GEL 31,230 thousand (2008: GEL 19,251 thousand). The Group recognised these assets at fair value of GEL 8,987 thousand (2008: GEL 4,826 thousand), which are included in total additions of GEL 36,812 thousand (2008: GEL 16,846 thousand). The difference of GEL 22,243 thousand (2008: GEL 14,425 thousand) between the nominal amount and the fair value has been recognised in equity as fair value adjustment reserve for non-cash owner contributions.

Included in disposals are assets with a carrying amount of GEL 4,300 thousand (2008: 4,352 thousand) which have been withdrawn by the Government of Georgia. The amount consists of a distribution of GEL 1,197 thousand and a decrease in charter capital of GEL 3,103 thousand.

(a) Determination of deemed cost

In 2009 management commissioned Deloitte & Touche LLC to independently appraise property, plant and equipment as at 1 January 2008 in order to determine its deemed cost as part of transition to IFRSs.

The majority of the Group's property, plant and equipment is specialised in nature and is rarely sold on the open market other than as part of a continuing business. The market for similar property, plant and equipment is not active in Georgia and does not provide a sufficient number of sales of comparable property, plant and equipment for using a market-based approach for determining fair value.

Consequently the fair value of property, plant and equipment was primarily determined using depreciated replacement cost. This method considers the cost to reproduce or replace the property, plant and equipment, adjusted for physical, functional or economical depreciation, and obsolescence. The depreciated replacement cost was estimated based on internal sources and analysis of the Georgian and international markets for similar property, plant and equipment. Various market data were collected from published information, catalogues, statistical data etc, and industry experts and suppliers of property, plant and equipment were contacted both in Georgia and abroad.

In addition to the determination of the depreciated replacement cost, cash flow testing was conducted in order to assess the reasonableness of those values, which resulted in the depreciated replacement cost values being decreased by GEL 484,469 thousand. The following key assumptions were used in performing the cash flow testing of the gas transportation business:

- Cash flows were projected based on actual operating results and the five-year business plan.
- Total volume of gas transported was projected at 1,711 million cubic meters in the territory of Georgia and 2,134 million cubic meters in the Republic of Armenia through the Georgian territory in the first year of the business plan. The anticipated annual gas transportation volumes growth included in the cash flow projections was 4-6% for the years 2008 to 2012.
- Sales prices of gas were based on the prices regulated by the Government of Georgia.
- Terminal value of expected cash flows after five years (based on forecasted cash flows) was estimated by discounting for perpetuity and extrapolating assuming a growth rate of 2.4% - the long term US inflation rate.
- A discount rate of 17.3% was applied in determining the recoverable amount of the Group's assets in the gas transportation business. The discount rate was estimated based on an industry average weighted average cost of capital, which was based on a possible range of debt leveraging of 26.4% at a market interest rate of 13.5%.

The values assigned to the key assumptions represent management's assessment of future trends in the business and are based on both external sources and internal sources (historical data).

The above estimates are particularly sensitive in the following areas:

- An increase of one percentage point in the discount rate used would have decreased the deemed cost by GEL 11,934 thousand.
- A 5% decrease in future planned gas transportation volumes would have decreased the deemed cost by GEL 23,329 thousand.

Cash flow testing of assets included in the oil business of the Group did not result in a reduction in the depreciated replacement cost values. For the cash flow testing purposes total volumes of oil extracted in different fields were based on assessed volumes of oil reserves. A discount rate of 20.6% was applied in determining the recoverable amount. The discount rate was estimated based on an industry average weighted average cost of capital, which was based on a possible range of debt leveraging of 16.2% at a market interest rate of 13.5%.

(b) Impairment loss

At 31 December 2009, following the decline in gas prices, the economic slowdown in the Republic of Armenia and Georgia and the significant decline in the gas consumption of both countries in 2009, the Group determined that there is an indication of impairment of its property, plant and equipment of the gas transportation business. The Group estimated the recoverable amount of the property, plant and equipment based on its value in use. Based on the assessment, the carrying amount of the property, plant and equipment was determined to be GEL 75,909 thousand higher than its recoverable amount, and an impairment loss of GEL 75,909 thousand was recognised as at 31 December 2009.

The following key assumptions were used in performing the impairment testing of assets in the gas transportation business:

- Cash flows were projected based on actual operating results and the five-year business plan.
- Total volume of gas transported was projected at 1,207 million cubic meters in the territory of Georgia and 1,650 million cubic meters in the Republic of Armenia through the Georgian territory in the first year of the business plan. The anticipated annual gas transportation volumes growth included in the cash flow projections for the years from 2011 to 2014 were based on projections of the Georgian and Armenian gross domestic product growth rates.
- Sales prices of gas were based on the prices set in the sales agreements of the Group.
- Terminal value of expected cash flows after five years (based on forecasted cash flows) was estimated by discounting for perpetuity and extrapolating assuming a growth rate of 3.5% - the long term US inflation rate.
- A discount rate of 17.8% was applied in determining the recoverable amount of the Group's assets in the gas transportation business.

The above estimates are particularly sensitive in the following areas:

- An increase of one percentage point in the discount rate used would have increased the impairment loss by GEL 4,798 thousand.
- A 5% decrease in future planned gas transportation volumes would have increased the impairment loss by GEL 20,013 thousand.

The values assigned to the key assumptions represent management's assessment of future trends in the business and are based on both external sources and internal sources (historical data).

12 Intangible assets

'000 GEL	<u>Extraction licence and rights</u>	<u>Other</u>	<u>Total</u>
<i>Cost</i>			
Balance at 1 January 2008	4,808	1,367	6,175
Addition	-	20	20
Balance at 31 December 2008	<u>4,808</u>	<u>1,387</u>	<u>6,195</u>
Balance at 1 January 2009	4,808	1,387	6,195
Disposal	(4,808)	-	(4,808)
Balance at 31 December 2009	<u>-</u>	<u>1,387</u>	<u>1,387</u>
<i>Amortisation</i>			
Balance at 1 January 2008	-	211	211
Amortisation for the year	355	175	530
Balance at 31 December 2008	<u>355</u>	<u>386</u>	<u>741</u>
Balance at 1 January 2009	355	386	741
Amortisation for the year	120	149	269
Disposal	(475)	-	(475)
Balance at 31 December 2009	<u>-</u>	<u>535</u>	<u>535</u>
<i>Carrying amounts</i>			
At 1 January 2008	<u>4,808</u>	<u>1,156</u>	<u>5,964</u>
At 31 December 2008	<u>4,453</u>	<u>1,001</u>	<u>5,454</u>
At 31 December 2009	<u>-</u>	<u>852</u>	<u>852</u>

The Group became the party as contractor in a production sharing agreement after the purchase of the rights and obligations under the production sharing agreement for license blocks located in the south of Georgia on the basis of a “Licence for Oil and Gas Resources Utilization” granted until 2021 from a former contractor, National Petroleum Limited, a Swiss corporation on 27 April 2007. The purchase price was recognised as an intangible asset. In May 2009 a production sharing agreement was concluded between the Government of Georgia and a private investor and the rights of exploitation of the licence blocks exploited by the Group were transferred from the Group to the private investor. The extraction licence and rights with a carrying amount of GEL 4,333 thousand were recognised as distribution to owners.

13 Deferred tax assets and liabilities

(a) **Recognised deferred tax assets and liabilities**

Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2009	2008	2009	2008	2009	2008
'000 GEL						
Property, plant and equipment	-	-	(1,378)	(12,447)	(1,378)	(12,447)
Inventories	934	638	-	-	934	638
Trade and other receivables	9,284	6,587	-	-	9,284	6,587
Loans and borrowings	-	-	(6,697)	(3,572)	(6,697)	(3,572)
Prepayments for current assets and expenses	188	-	-	-	188	-
Tax assets/(liabilities)	10,406	7,225	(8,075)	(16,019)	2,331	(8,794)
Set off of tax	(6,290)	(3,859)	6,290	3,859	-	-
Net tax assets/(liabilities)	4,116	3,366	(1,785)	(12,160)	2,331	(8,794)

(b) **Movement in temporary differences during the year**

'000 GEL	1 January 2009	Recognised in income	Recognised directly in equity	31 December 2009
Property, plant and equipment	(12,447)	7,553	3,516	(1,378)
Inventories	638	296	-	934
Trade and other receivables	6,587	2,697	-	9,284
Loans and borrowings	(3,572)	1,622	(4,747)	(6,697)
Prepayments for current assets and expenses	-	188	-	188
	(8,794)	12,356	(1,231)	2,331

'000 GEL	1 January 2008	Recognised in income	Recognised directly in equity	31 December 2008
Property, plant and equipment	(15,523)	259	2,817	(12,447)
Inventories	195	443	-	638
Trade and other receivables	4,364	2,223	-	6,587
Loans and borrowings	(2,520)	1,782	(2,834)	(3,572)
	(13,484)	4,707	(17)	(8,794)

14 Inventories

'000 GEL	2009	2008	1 January 2008
Gas receivable	12,689	-	-
Crude oil	2,693	5,497	1,806
Gas	1,702	1,556	3,183
Other	3,873	5,115	4,891
	20,957	12,168	9,880

15 Trade and other receivables

'000 GEL	2009	2008	1 January 2008
Trade receivables	142,612	152,088	81,292
Allowance for impairment	(56,775)	(38,821)	(24,001)
	85,837	113,267	57,291
Other receivables	6,378	5,139	5,201
Allowance for impairment	(5,085)	(5,085)	(5,085)
	1,293	54	116
	87,130	113,321	57,407

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables are disclosed in note 21.

16 Cash and cash equivalents

'000 GEL	2009	2008	1 January 2008
Petty cash	17	-	-
Bank balances	8,163	16,972	31,913
Cash and cash equivalents in the consolidated statement of cash flows and in the consolidated statement of financial position	8,180	16,972	31,913

The Group's exposure to interest rate risk and a sensitivity analysis for financial assets and liabilities are disclosed in note 21.

17 Equity

(a) Charter capital

Charter capital represents the nominal amount of capital in the founding documentation of the Company and is subject to state registration.

The owners of charter capital are entitled to receive dividends as declared from time to time and are entitled to the number of votes corresponding to the percentage of shareholding in the Company at meetings of the Company.

(b) Additional paid in capital

Additional paid in capital represents benefits provided by the Government of Georgia to the Group in the form of low interest rate loans representing the difference between the fair value of the loans at initial recognition and the loan amounts and extension of the repayment schedule of loans representing the difference between the carrying value of the loan before extension and the fair value of the loan per the new repayment schedule (see note 23(c)).

(c) Dividends

In accordance with Georgian legislation the Company's distributable reserves are limited to the balance of retained earnings as recorded in the Company's financial statements prepared in accordance with IFRS. As at 31 December 2009 the Company did not have distributable reserves.

18 Restructured tax liabilities and government grant

In April 2007 a tax restructuring agreement was concluded with tax authorities to defer the payment of customs value added taxes, customs fees and accrued fines and penalties payable for periods from 2002 to 2005 with a nominal value of GEL 47,637 thousand. The difference of GEL 19,047 thousand between the fair value of the restructured debt and taxes payable has been recognised as a government grant. The grant is amortized over the period of the restructured debt maturity and grant income is recognized using the effective interest method.

The Group's exposure to liquidity risk related to restructured tax liabilities is disclosed in note 21.

19 Loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 21.

'000 GEL	2009	2008	1 January 2008
<i>Non-current liabilities</i>			
Loans issued by the Government of Georgia	86,653	111,501	92,802
Secured bank loans	-	913	3,229
	86,653	112,414	96,031
<i>Current liabilities</i>			
Current portion of loans issued by the Government of Georgia	20,246	28,621	23,393
Current portion of secured bank loans	-	2,634	2,329
Bank overdraft	8,489	24,193	15,629
	28,735	55,448	41,351

Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

'000 GEL	Currency	Nominal interest rate	Year of maturity	Face value	Carrying amount
1 January 2008					
Loans issued by the Government of Georgia	GEL	0.5-7%	2012	130,073	116,195
Secured bank loans	USD	13.5%	2010	5,290	5,290
Secured bank loans	GEL	13.5%	2010	268	268
Bank overdraft	USD	9.7%	2008	15,629	15,629
				151,260	137,382
31 December 2008					
Loans issued by the Government of Georgia	GEL	0.5-7%	2012	130,073	118,086
Loans issued by the Government of Georgia	GEL	0.5%	2010	27,200	22,036
Secured bank loans	USD	13.5%	2010	3,380	3,380
Secured bank loans	GEL	13.5%	2010	167	167
Bank overdraft	USD	9.7%	2009	24,193	24,193
				185,013	167,862
31 December 2009					
Loans issued by the Government of Georgia	GEL	7%	2011-2012	47,600	46,028
Loans issued by the Government of Georgia	GEL	0.5%	2013-2014	85,273	50,481
Loans issued by the Government of Georgia	GEL	7%	2024	15,000	10,390
Bank overdraft	USD	9.7%	2010	8,489	8,489
				156,362	115,388

20 Trade and other payables

'000 GEL	2009	2008	1 January 2008
Trade payables	4,650	33,163	24,037
Other payables	44	85	3,101
Prepayments received	-	-	6,643
	4,694	33,248	33,781

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 21.

21 Financial instruments and risk management

(a) Overview

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risk

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Executive Directors have overall responsibility for the establishment and oversight of the Group's risk management framework.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities.

(b) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers and cash and cash equivalents.

(i) Trade and other receivables

Credit risk is managed by requesting prepayments from the customers and assessing their creditworthiness. No collateral in respect of trade and other receivables is generally required.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

(ii) **Exposure to credit risk**

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

'000 GEL	Carrying amount		
	2009	2008	1 January 2008
Trade and other receivables	87,130	113,321	57,407
Cash and cash equivalents	8,163	16,972	31,913
	95,293	130,293	89,320

The maximum exposure to credit risk for trade receivables at the reporting date by geographic region was:

'000 GEL	Carrying amount		
	2009	2008	1 January 2008
Domestic	85,837	110,468	52,923
Other CIS countries	-	1,875	-
European countries	-	924	4,368
	85,837	113,267	57,291

The maximum exposure to credit risk for trade receivables at the reporting date by type of customer was:

'000 GEL	Carrying amount		
	2009	2008	1 January 2008
Gas distributors	79,828	89,195	22,808
Thermal power plants	2,570	17,941	28,106
Others	3,439	6,131	6,377
	85,837	113,267	57,291

As at 31 December 2009 the Group had 2 customers whose balances exceeded 10% of total trade receivables (31 December 2008: 3 customers; 1 January 2008: 4 customers). The carrying value of these balances as of 31 December 2009 was GEL 66,031 thousand (31 December 2008: GEL 78,883 thousand; 1 January 2008 GEL 41,044 thousand).

Impairment losses

The aging of trade and other receivables at the reporting date was:

'000 GEL	Gross 2009	Impairment 2009	Gross 2008	Impairment 2008	Gross 1 January 2008	Impairment 1 January 2008
Not past due	31,747	4,558	8,556	-	42,471	-
Past due 0-30 days	6,330	298	59,813	6,763	140	-
Past due 31-90 days	3,430	894	40,478	5,258	6,656	-
Past due 91-365 days	33,919	10,361	19,206	2,711	8,111	-
Past due more than one year	73,564	45,749	29,174	29,174	29,115	29,086
	148,990	61,860	157,227	43,906	86,493	29,086

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

'000 GEL	2009	2008
Balance at beginning of the year	38,821	24,001
Increase during the year	19,108	14,820
Decrease due to reversal	(1,154)	-
Balance at end of the year	56,775	38,821

Impairment allowance of GEL 48,818 thousand as at 31 December 2009 is attributable to 4 customers, gross receivables of which amount GEL 102,165 thousand. GEL 10,102 thousand of this allowance relates to a customer that was declared bankrupt during the year.

During 2009 the Group renegotiated the terms of trade receivables of GEL 25,847 thousand from 3 long-standing customers. If the Group did not make this renegotiation, then the receivables would have been overdue by 1 year. GEL 4,522 thousand impairment allowance was recognized for these receivables as at 31 December 2009 (2008 and 1 January 2008: no instances).

The movement in the allowance for impairment in respect of other receivables during the year was as follows:

'000 GEL	2009	2008
Balance at beginning of the year	5,085	5,085
Increase during the year	-	-
Balance at end of the year	5,085	5,085

The Group has estimated impairment for trade and other receivables based on an analysis of the future cash flows. In determining the impairment allowance, the following key assumptions were used:

- No repayment is projected from customers with overdue balance more than 1 year with a gross value of GEL 34,564 thousand;
- Remaining overdue or renegotiated receivables as of 31 December 2009 are projected to be substantially repaid by 2013;
- Management has estimated future repayment of individually significant overdue balances and has discounted them at an interest rate of 15%.

Changes in these estimates could affect the impairment allowance for trade and other receivables. For example, to the extent that the timing of projected cash receipts is later than one year, the impairment allowance as of 31 December 2009 would be GEL 9,942 thousand higher.

(c) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

Typically the Group ensures that it has sufficient cash on demand to meet expected operational expenses for a period of 60 days, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. In addition, the Group maintains USD 3,401 thousand overdraft facility that is unsecured. Interest would be payable at the rate of 9%.

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements:

2009

'000 GEL	Carrying amount	Contractual cash flows	0-6 mths	6-12 mths	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	Over 5 yrs
Non-derivative financial liabilities									
Loans issued by the Government of Georgia	106,899	166,247	7,674	12,572	24,375	20,900	34,138	50,721	15,867
Bank overdraft	8,489	8,555	8,555	-	-	-	-	-	-
Trade and other payables	4,694	4,694	4,694	-	-	-	-	-	-
Restructured tax liabilities	35,554	58,519	3,711	3,642	7,073	6,793	6,512	6,231	24,557
	155,636	238,015	24,634	16,214	31,448	27,693	40,650	56,952	40,424

2008

'000 GEL	Carrying amount	Contractual cash flows	0-6 mths	6-12 mths	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	Over 5 yrs
Non-derivative financial liabilities									
Loans issued by the Government of Georgia	140,122	173,042	10,983	19,489	77,445	56,915	8,210	-	-
Secured bank loans	3,547	3,883	1,558	1,390	935	-	-	-	-
Bank overdraft	24,193	24,780	24,780	-	-	-	-	-	-
Trade and other payables	33,248	33,248	33,248	-	-	-	-	-	-
Restructured tax liabilities	34,870	62,300	-	3,781	7,353	7,071	6,793	6,512	30,790
	235,980	297,253	70,569	24,660	85,733	63,986	15,003	6,512	30,790

(d) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

(i) Currency risk

The Group is exposed to currency risk on sales, purchases and borrowings that are denominated in a currency other than the respective functional currencies of Group entities. The currency in which these transactions primarily are denominated is USD. The Company generally does not hedge its exposure to foreign currency risk.

Exposure to currency risk

The Group's exposure to foreign currency risk was as follows based on notional amounts:

'000 GEL	USD-denominated 2009	USD-denominated 2008
Current assets		
Trade and other receivables	-	2,851
Cash and cash equivalents	1,638	10,589
Current liabilities		
Trade and other payables	(123)	(26,339)
Loans and borrowings	-	(26,660)
Non-current liabilities		
Loans and borrowings	(8,489)	(913)
Net exposure	(6,974)	(40,472)

The following significant exchange rates applied during the year:

in GEL	Average rate		Reporting date spot rate		
	2009	2008	2009	2008	1 January 2008
USD 1	1.6705	1.4902	1.6858	1.667	1.5916

Sensitivity analysis

A strengthening of the GEL, as indicated below, against USD at 31 December would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis is based on foreign currency exchange rate variances that the Group considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2008.

'000 GEL	Equity	Profit or loss
2009		
USD (10% strengthening)	593	593
2008		
USD (10% strengthening)	3,440	3,440

A weakening of the GEL against USD at 31 December would have had the equal but opposite effect to the amounts shown above, on the basis that all other variables remain constant.

(ii) *Interest rate risk*

Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of raising new loans or borrowings management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity.

Profile

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was:

'000 GEL	Carrying amount	
	2009	2008
Fixed rate instruments		
Loans and borrowings	115,388	167,862
Restructured tax liabilities	35,554	34,870
	150,942	202,732

(e) Fair value sensitivity analysis for fixed rate instruments

The Group does not account for any fixed rate financial assets and liabilities at fair value. Therefore a change in interest rates at the reporting date would not affect profit or loss and equity.

Fair values versus carrying amounts

Management believes that the fair value of the Group's financial assets and liabilities approximates their carrying amounts. The basis for determining fair values is disclosed in note 4.

The interest rates used to discount estimated cash flows, where applicable, are based on the government yield curve at the reporting date plus an adequate credit spread, were as follows:

	31 December 2009	31 December 2008
Loans and borrowings	15%	9%-13%
Restructured tax liabilities	13%	13%

(f) Capital management

The Group does not have a formal policy for capital management but management seeks to maintain a sufficient capital base for meeting the Group's operational and strategic needs and to maintain confidence of market participants. This is achieved with efficient cash management, constant monitoring of Group's revenues and profit, and long-term investment plans mainly financed by the Group's operating cash flows. With these measures the Group aims for steady profits growth.

There were no changes in the Group's approach to capital management during the year.

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

22 Contingencies

(a) Insurance

The insurance industry in Georgia is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group does not have full coverage for its plant facilities, business interruption, or third party liability in respect of property or environmental damage arising from accidents on Group property or relating to Group operations. Until the Group obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Group's operations and financial position.

(b) Taxation contingencies

The taxation system in Georgia is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes unclear, contradictory and subject to varying interpretation. In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by the tax authorities after six years have passed since the end of the year in which the breach occurred.

These circumstances may create tax risks in Georgia that are more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Georgian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these consolidated financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

(c) Environmental matters

The enforcement of environmental regulation in Georgia is evolving and the enforcement posture of government authorities is continually being reconsidered. The Company periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognised immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

(d) Litigation

The Group is defending a claim brought to the court in 2010 by a foreign company which is seeking contract payments of USD 5 million and interests accrued for non-payment and other damages and lost profits from non-performance of a contract concluded in 2003 to 2004 by Georgian International Oil Corporation JSC (see note 1). In 2010 the Group hired a law firm to present the Group in the dispute. The Group denies the validity of the claim. In preparing of these financial statements the management was not able to make a reliable estimate about the outcome of the dispute.

23 Related party transactions

(a) Control relationships

The Company's 100% parent is the state of Georgia represented by the Ministry of Economic Development of Georgia.

(b) Transactions with management and close family members

Management remuneration

Key management received the following remuneration during the year, which is included in personnel costs:

'000 GEL	2009	2008
Salaries and bonuses	<u>836</u>	<u>737</u>

(c) Transactions with other related parties

The Group's other related party transactions are disclosed below.

(i) **Revenue**

'000 GEL	Transaction value		Outstanding balance					
	2009	2008	2009		2008		1 January 2008	
			Gross	Impairment	Gross	Impairment	Gross	Impairment
Sale of gas and gas transportation:								
State controlled entities	1,516	53,135	10,982	10,102	30,673	10,123	25,455	8,688

All outstanding balances with related parties are to be settled in cash within six months of the reporting date. None of the balances are secured.

(ii) **Loans**

'000 GEL	Interest expense		Outstanding balance		
	2009	2008	2009	2008	1 January 2008
Loans received:					
Government bodies	16,505	17,408	106,899	140,122	116,195

Upon initial recognition low interest loan with a nominal amount of GEL 15,000 thousand received in 2009 from the Government of Georgia was discounted using a market rate of interest of 15%. The resulting difference upon discounting of GEL 5,860 thousand was recognised in additional paid in capital.

In 2009 amendments were concluded for two loan agreements of the Group with the Government of Georgia. According to the amendments the repayments of the loans were extended from 2010 and 2011 to 2013 and 2014. These transactions have been accounted for as extinguishment of the old debts and recognition of new financial liabilities at fair value. The difference between carrying values of the loans before amendments and the fair value of the loans after amendments of GEL 25,783 thousand (2008: 18,894 thousand) were recognised in additional paid in capital.

24 Significant subsidiaries

Subsidiary	Country of incorporation	Ownership interest		
		2009	2008	1 January 2008
Georgian Gas Transportation Company LLC	Georgia	100%	100%	100%
Ioris Valley Oil and Gas LLC	Georgia	100%	100%	100%

25 Events subsequent to the reporting date

In June-July 2010 agreements were concluded with the Government of Georgia according to which part of loans issued by the Government of Georgia with a face value of GEL 115,865 thousand as at 31 December 2009 were repaid by transferring to the Government the receivables of the Group with a gross value of GEL 115,865 thousand at the transfer date which had a gross value of GEL 98,714 thousand as at 31 December 2009 (GEL 9,996 thousand was a written off receivable as at 31 December 2009 and the remaining balance of receivables of GEL 7,155 thousand was accrued in 2010). The Carrying amount of the transferred receivables was GEL 68,320 thousand as at 31 December 2009.

In September 2010 the Government of Georgia forgave the Group the remaining part of loans issued by the Government of Georgia with a face value of GEL 25,131 thousand as at 31 December 2009 after GEL 6,877 thousand was repaid by the Group in 2010.

In June-July 2010 the Government of Georgia contributed in the charter capital of the Group part of the Baku-Supsa pipeline and Supsa oil terminal with a nominal registration value of GEL 269 million. The management has not yet completed its analysis of how the contribution may impact the Group's financial position or performance.

In September 2010 GEL 9.1 million dividends were declared by the Company.

26 Explanation of transition to IFRSs

As stated in note 2(a), these are the Group's first consolidated financial statements prepared in accordance with IFRSs.

The accounting policies set out in note 3 have been applied in preparing the consolidated financial statements for the year ended in 31 December 2009, the comparative information presented in these consolidated financial statements for the year ended in 31 December 2008 and in the preparation of an opening consolidated IFRS statement of financial position at 1 January 2008 (the Group's date of transition). In preparing its opening consolidated IFRS statement of financial position, the Group has adjusted amounts reported previously in financial statements prepared in accordance with its old basis of accounting which was based on IFRSs with certain departures. The Group did not prepare financial statements in 2008 in accordance with its old basis of accounting. An explanation of how the transition from previous basis of accounting to IFRSs has affected the Group's financial position is set out in the following table and the notes that accompany the table:

'000 GEL	<u>Previous GAAP</u>		<u>Effect of transition to IFRSs and correction of errors</u>	<u>Consolidation of Ioris Valley Oil and Gas LLC</u>	<u>IFRSs</u>
ASSETS					
Non-current assets					
Property, plant and equipment	174,933	(a)	102,528	-	277,461
Intangible assets	9,343	(b)	(3,379)	-	5,964
Deferred tax assets	-	(c)	3,525	-	3,525
Equity investments available for sale	11,182	(d)	(2,422)	(8,760)	-
Other assets	-	(d)	2,422	-	2,422
Total non-current assets	195,458		102,674	(8,760)	289,372
Current assets					
Inventories	9,977	(e)	(683)	586	9,880
Value added tax recoverable	16,523		-	-	16,523
Prepayments for current assets and expenses	8,143		-	326	8,469
Trade and other receivables	58,371	(e)	(967)	3	57,407
Cash and cash equivalents	31,882		-	31	31,913
Total current assets	124,896		(1,650)	946	124,192
Total assets	320,354		101,024	(7,814)	413,564
EQUITY AND LIABILITIES					
Equity					
Charter capital	142,684		-	-	142,684
Additional paid in capital	9,355		-	-	9,355
Retained earnings	(61,205)		84,015	(7,792)	15,018
Total equity	90,834		84,015	(7,792)	167,057
Non-current liabilities					
Government grant	16,789	(f)	(4,022)	-	12,767
Restructured tax liabilities	-	(f)	30,848	-	30,848
Loans and borrowings	96,031		-	-	96,031
Deferred tax liabilities	-	(c)	17,009	-	17,009
Total non-current liabilities	112,820		43,835	-	156,655
Current liabilities					
Government grant	-	(f)	4,022	-	4,022
Loans and borrowings	41,351		-	-	41,351
Trade and other payables	33,811		-	(30)	33,781
Current tax liabilities	8,707		-	-	8,707
Other taxes payable	32,831	(f)	(30,848)	8	1,991
Total current liabilities	116,700		(26,826)	(22)	89,852
Total liabilities	229,520		17,009	(22)	246,507
Total equity and liabilities	320,354		101,024	(7,814)	413,564

- (a) The Group has adopted IFRS 1 as of 1 January 2008 and determined deemed cost of the property, plant and equipment. The effect is to increase property, plant and equipment by GEL 102,528 thousand to GEL 277,461 thousand as of 1 January 2008.
- (b) The Group has corrected an error in the purchase price of an intangible asset. The correction has resulted in an increase in the carrying value of the property, plant and equipment.
- (c) The Group did not account for deferred taxation in accordance with IAS 12 before adoption of IFRSs. The Group has recognised a deferred tax asset of GEL 3,525 thousand and a deferred tax liability of GEL 17,009 thousand as of 1 January 2008.
- (d) The Group has consolidated a 100% subsidiary, investment in which was previously presented as equity investment available for sale. Other equity investments in an immaterial unconsolidated subsidiary and an associate are reclassified to other assets.
- (e) The Group has corrected an error relating to inventories and trade and other receivables. The correction has resulted in a decrease of the retained earnings.
- (f) The Group has reclassified restructured tax liabilities out from other taxes payable for the separate presentation purposes and has reclassified the current portion of the government grant as current liabilities.