Joint Stock Company People’s Bank of Georgia

Independent Auditors’ Report and Financial Statements

Year Ended 31 December 2005

JOINT STOCK COMPANY PEOPLES BANK OF GEORGIA

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' audit report set out on page 2, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the financial statements of Joint Stock Company People's Bank of Georgia (the "Bank").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Bank at 31 December 2005, 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 financial statements, management is responsible for:

- selecting suitable accounting principles and applying them consistently;
- making judgements and estimates that are reasonable and prudent;
- stating whether IFRS have been followed, subject to any material departures disclosed and explained in the financial statements; and
- preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Bank 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 Bank;
- maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Bank, and which enable them to ensure that the financial statements of the Bank comply with IFRS;
- taking such steps as are reasonably available to them to safeguard the assets of the Bank; and
- detecting and preventing fraud and other irregularities.

The financial statements for the year ended 31 December 2005 were authorized for issue on 26 August 2006 by the Management Board.

On behalf of the Management Board

Chairman	**Chief Accountant**
George Goguadze	**Tamar Kasareli**
26 August 2006	**26 August 2006**

Deloitte.

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of the Joint Stock Company People's Bank of Georgia:

We have audited the accompanying balance sheets of the Joint Stock Company People's Bank of Georgia (the "Bank") as at 31 December 2005 and 2004 and the related income statements and statements of cash flows and changes in equity (the "financial statements") for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Notes 2 and 14 to the accompanying financial statements, the Bank did not consolidate the financial statements of Insurance Company PIC LLC (the "subsidiary"), which, in our opinion, is not in accordance with International Accounting Standard 27 "Consolidated and Separate Financial Statements". We were not engaged to audit the financial statements of the Bank's subsidiary as at 31 December 2005 and, accordingly, we are unable to quantify the effects of the departure on the Bank's financial position as at 31 December 2005, or the results of its operations and its cash flows for the year then ended.

We have previously audited the financial statements for the year ended 31 December 2004 and our report dated 31 August 2005 expressed a qualified opinion for the absence of an independent valuation of fixed assets as at 31 December 2004 and not accounting for deferred taxes in accordance with International Accounting Standard 12 "Income Taxes". As discussed in Note 2 to the accompanying financial statements, the Bank has restated its 2004 financial statements and, accordingly, our opinion on the 2004 financial statements expressed in this report is different from the one previously issued.

In our opinion, except for the effects of not consolidating the financial statements of Insurance Company PIC LLC as at 31 December 2005 and for the year then ended, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2005 and 2004, and the results of its operations and its cash flows for the years then ended, in accordance with International Financial Reporting Standards.

Deloitte & Touche

26 August 2006

JOINT STOCK COMPANY PEOPLE'S BANK OF GEORGIA

INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2005
(in Georgian Lari and in thousands)

	Notes	2005	2004 (as restated)
Interest income	4,23	2,232	2,452
Interest expense	4,23	(335)	(338)
NET INTEREST INCOME BEFORE ALLOWANCE FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS		1,897	2,114
Allowance/(recovery of allowance) for impairment losses on interest	5,23	(95)	405
NET INTEREST INCOME		1,802	2,519
Net gain on foreign exchange operations	6	214	128
Fee and commission income	7,23	16,270	8,495
Fee and commission expense	7	(828)	(497)
Other income		483	58
NET NON-INTEREST INCOME		16,139	8,184
OPERATING INCOME		17,941	10,703
OPERATING EXPENSES	8	(14,306)	(8,133)
OPERATING PROFIT		3,635	2,570
Allowance for impairment losses on other transactions	5	(189)	(330)
PROFIT BEFORE INCOME TAX		3,446	2,240
Income tax expense	9	(718)	(369)
NET PROFIT		2,728	1,871

On behalf of the Management Board

Chairman
George Goguadze

Chief Accountant
Tamar Kasareli

The notes on pages 9 to 40 form an integral part of these financial statements. The Independent Auditors' Report is on pages 2-3.

JOINT STOCK COMPANY PEOPLE'S BANK OF GEORGIA

BALANCE SHEET
AS AT 31 DECEMBER 2005
(in Georgian Lari and in thousands)

	Notes	2005	2004 (as restated)
ASSETS			
Cash and balances with the National Bank of Georgia	10	17,070	21,255
Loans and advances to banks, net	11	20,573	12,971
Loans and advances to customers, net	12, 23	24,235	14,009
Investments held to maturity	13	1,019	-
Investments available for sale		40	40
Investment in non consolidated subsidiary	14	1,888	-
Fixed assets, net	15	10,543	7,016
Intangible assets, net	16	573	186
Other assets, net	17	3,424	2,998
TOTAL ASSETS		79,365	58,475
LIABILITIES AND EQUITY			
LIABILITIES:			
Loans and advances from banks and other credit institutions	18	14,111	7,904
Customer accounts	19, 23	50,710	38,251
Income tax liabilities	9	1,136	369
Other liabilities	20	2,919	4,486
Total liabilities		68,876	51,010
EQUITY:			
Share capital	21	10,000	10,000
Revaluation fund	15	654	-
Accumulated deficit		(165)	(2,535)
Total equity		10,489	7,465
TOTAL LIABILITIES AND EQUITY		79,365	58,475

On behalf of the Management Board

Chairman
George Goguadze

Chief Accountant
Tamar Kasareli

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JOINT STOCK COMPANY PEOPLE'S BANK OF GEORGIA

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2005
(in Georgian Lari and in thousands)

	Share capital	Revaluation fund	Accumulated deficit	Total equity
31 December 2003 (as previously reported)	10,000	-	(1,192)	8,808
Restatement (see Note 3)	-	-	(2,823)	(2,823)
1 January 2004 (as restated)	10,000	-	(4,015)	5,985
Dividends announced	-	-	(391)	(391)
Net profit	-	-	1,871	1,871
31 December 2004	10,000	-	(2,535)	7,465
Revaluation, net of taxes	-	654	-	654
Dividends announced	-	-	(358)	(358)
Net profit	-	-	2,728	2,728
31 December 2005	10,000	654	(165)	10,489

On behalf of the Management Board

Chairman
George Goguadze

Chief Accountant
Tamar Kasareli

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STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2005
(in Georgian Lari and in thousands)

		2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income taxes		3,446	2,240
Adjustments for:			
Provision/(recoveries) for loan losses	5	95	(405)
Provision for losses on other assets	5	196	317
Provision for guarantees and other commitments	5	(7)	13
Losses on fixed assets revaluation		-	26
Depreciation charge of fixed and other intangible assets		824	545
Net unrealized loss arising from changes in foreign currency exchange rates		(230)	(143)
Net change in accruals		808	238
Cash flow from operating activities before changes in operating assets		5,132	2,831
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the National Bank of Georgia		(603)	1,575
Loans and advances to banks		(6,598)	(9,587)
Loans and advances to customers		(10,721)	(6,228)
Investments held to maturity		(1,019)	24
Other assets		(623)	1,107
Increase in operating liabilities:			
Loans and advances from Banks		6,234	7,924
Customer accounts		12,475	13,260
Other liabilities		(1,813)	3,177
Cash inflow from operating activities before income taxes		2,464	14,083
Income tax paid		(158)	(135)
Net cash inflow from operating activities		2,306	13,948
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of fixed and intangible assets		(4,424)	(2,467)
Disposal of fixed assets		504	-
Purchase of investments		(1,888)	-
Sales of securities available for sale		-	103
Net cash outflow from investing activities		(5,808)	(2,364)

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2005 (Continued)
(in Georgian Lari and in thousands)

	Note	2005	2004
CASH FLOWS FROM FINANCING ACTIVITIES:			
Dividends paid		(353)	(349)
Net cash outflow from financing activities		(353)	(349)
Effect of foreign exchange rate changes on cash and cash equivalents		(62)	(39)
NET INCREASE IN CASH AND CASH EQUIVALENTS		(3,917)	11,196
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD		23,598	12,402
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	10	19,681	23,598

Interest paid and received by the Group during the year ended 31 December 2005 amounted to GEL 241 thousand and GEL 2,679 thousand, respectively.

Interest paid and received by the Group during the year ended 31 December 2004 amounted to GEL 347 thousand and GEL 1,005 thousand, respectively.

On behalf of the Management Board

General Director
George Goguadze

Chief Accountant
Tamar Kasareli

The notes on pages 9 to 40 form an integral part of these financial statements. The Independent Auditors' Report is on pages 2-3.

(in Georgian Lari and in thousands)

1. ORGANIZATION

Joint Stock Company People's Bank of Georgia (the "Bank") was incorporated in Georgia. The Bank is the legal successor of State owned bank "Agromrecvbank". By the Decree of the Cabinet of Ministers of Georgia number 288, dated 14 April 1993, and the Ordinance of the President of Georgia number 178, dated 29 May 1994 the organizational forms of state owned banks and enterprises were transformed into Joint Stock Companies. On 3 September 2002 in accordance with the above mentioned Ordinance, based on the decision of a shareholders' meeting of JSC Agromrecvbank, and pursuant to the Resolution number 4/5-1 of the Tbilisi Krtcanisi-Mtacminda's District Court, dated 7 October 2002, the name, legal address, authorized capital, and members of the Board of Directors and Supervisory Board of JSC Agromrecvbank were changed. In terms of the above mentioned Resolution of the Court, the legal name of JSC Agromrecvbank has changed to JSC People's Bank of Georgia.

The Bank's primary business consists of making payments and money transfers, commercial activities, trading with foreign currencies, originating loans and issuing guarantees.

The number of employees of the Bank as at 31 December 2005 and 2004 was 2,689 and 2,361 respectively.

As at 31 December 2005 and 2004 the share capital was distributed among following shareholders:

Shareholder	**2005 Ownership interest, %**	**2004 Ownership interest, %**
Starcode Resources LLC	24%	24%
Kovalenko Elena	24%	24%
Jincharadze Irina	19%	19%
Agureva Anna	9%	9%
Marshania Tamar	7%	7%
Goguadze George	6%	6%
Marshania Gaioz	2%	2%
Other Shareholders (less than 1%)	9%	9%
Total	**100%**	**100%**

These financial statements were authorized for issue by the Management Board on 26 August 2006.

2. BASIS OF PRESENTATION

Accounting basis

These financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards ("IFRS") except for the non consolidation of a wholly owned subsidiary.

These financial statements are presented in thousands of Georgian Lari ("GEL") unless otherwise indicated. These financial statements have been prepared under the historical cost convention except for revaluation of fixed assets.

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates that are particularly susceptible to change relate to the allowances for impairment losses and the fair value of financial instruments.

Functional currency

The functional currency of these financial statements is the Georgian Lari ("GEL").

3. SIGNIFICANT ACCOUNTING POLICIES

Recognition and measurement of financial instruments

The Bank recognizes financial assets and liabilities on its balance sheet when it becomes a party to the contractual obligation of the instrument. Regular way purchases and sales 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 the trade date and the 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 the 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"), except for margin deposits for operations with plastic cards, which may be converted to cash within a short period of time. For the 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 (Note 10).

Loans and advances to banks

In the normal course of business, the Bank maintains advances or deposits for various periods of time with other banks. Loans and advances to 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 accounted for under the effective interest method based on expected maturity. Amounts due from credit institutions are carried net of any allowance for impairment losses.

Originated loans

Loans originated by the Bank are financial assets that are created by the Bank by providing money directly to a borrower or by participating in a loan facility.

All loans originated are initially recognized at fair value plus related transaction costs. Where the fair value of consideration given does not equal the fair value of the loan, for example where the loan is issued at lower than market rates, the difference between the fair value of consideration given and the fair value of the loan is recognized as a loss on initial recognition of the loan and included in the income statement as losses on origination of assets. 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 and advances to customers are carried net of any allowance for impairment losses.

Write off of loans and advances

Loans and advances are written off against the allowance for impairment losses in the case of the uncollectibility of loans and advances, including the repossession of collateral. Loans and advances are written off after management has exercised all possibilities available to collect the amounts due to the Bank and after the Bank has sold all available collateral.

Non-accrual loans

Once a financial asset or a group of similar financial assets has been 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.

Allowance for impairment losses

The Bank establishes an allowance for impairment losses of financial assets when there is objective evidence that a financial asset or group of financial assets is impaired. The allowance for impairment losses is measured as the difference between the carrying amount 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 by adjusting an allowance account. For financial assets carried at cost the allowance for impairment losses is 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.

The determination of the allowance for 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. Allowances 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 the allowance for impairment losses is charged to the income statement and the total of the allowance for impairment losses is deducted in arriving at assets as shown in the balance sheet. Factors that the Bank 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 Bank may sustain losses, which are substantial relative to the allowance for impairment losses, it is the judgment of management that the allowance for impairment losses is adequate to absorb losses incurred on the risk assets.

Investments held to maturity

Investments held to maturity are debt securities with determinable or fixed payments. The Bank 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. The investments are measured at fair value. Gains or losses on available for sale securities are recognized directly in equity, through the statement of changes in equity, except for impairment losses and foreign exchange gains and losses, until the securities are derecognized, at which time the cumulative gains or losses previously recognized in equity are recognized in the income statement. However, interest calculated using the effective interest method is recognized in the income statement.

The Bank uses quoted market prices to determine the fair value for the Bank's investments available for sale. If such quotes do not exist, management use appropriate valuation techniques.

When a decline in the fair value of available for sale investments has been recognized directly in equity and there is objective evidence that the investments are impaired, the cumulative loss that had been recognized directly in equity is removed from equity and recognized in the income statement even though the securities have not been derecognized. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the income statement, the impairment loss is reversed, with the amount of the reversal recognized in the income statement.

Fixed and intangible assets

Fixed and intangible assets are carried at historical cost less accumulated depreciation and amortization 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 of fixed assets and amortization of intangible assets is charged on their historical cost and is designed to write off assets over their useful lives. It is calculated on a straight line basis at the following annual rates:

Vehicles	20%
Buildings	2%
Computer equipment	25%
Furniture and equipment	17%
Other fixed assets	10%
Intangible assets	10%

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

Buildings are stated in the 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 valuers, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Any revaluation increase arising on the revaluation of fixed assets is credited to the fixed assets revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense, in which case the increase is credited to the profit and loss account 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 fixed assets 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.

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 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 Bank's current tax expense is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

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.

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 realised. Deferred tax is charged or credited in the 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.

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

Deposits from banks and customers

Customer and bank deposits are initially recognized at fair value, which amounts to the issue proceeds less transaction costs incurred. Subsequently amounts due are stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method.

Provisions

Provisions are recognized when the Bank 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.

Share capital

Share capital is recognized at cost. Share capital contributions made in the form of assets other than cash are stated at their fair value at the date of contribution.

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 Bank withholds amounts of pension contributions from employee salaries and pays them to the state pension fund. In addition such pension system provides for the 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 the state pension fund. The Bank does not have any pension arrangements separate from the state pension system of Georgia, which requires current contributions by employer calculated as a percentage of current gross salary payments. In addition, the Bank has no post-retirement benefits or other significant compensated benefits requiring accrual.

Contingencies

Contingent liabilities are not recognized in the financial statements unless it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made. Contingent assets are not recognized in the financial statements but disclosed when an inflow of economic benefits is probable.

Recognition of income and expense

Interest income and expense are recognized on an accrual basis using the effective interest rate method. Interest income also includes income earned on investments. Other income is credited to the income statement when the related transactions are completed. Loan origination fees, if significant, are deferred (together with related direct costs) and recognized as an adjustment to the loan's effective yield. 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/(loss) on foreign exchange operations.

Rates of exchange

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

	31 December 2005	31 December 2004
GEL/1 US Dollar	1,793	1,825
GEL/1 Euro	2,125	2,485

Offset of financial assets and liabilities

Financial assets and liabilities are offset and reported net on the balance sheet when the Bank has a legally enforceable right to set off the recognized amounts and the Bank 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 Bank does not offset the transferred asset and the associated liability.

(in Georgian Lari and in thousands)

Changes in IFRS

The International Accounting Standards Board has amended a number of IAS's and issued certain IFRS's effective for the reporting period beginning 1 January 2005. The effect of these changes was not significant for the financial statements of the Bank for the year ended 31 December 2005.

IAS 39 "Financial Instruments: Recognition and Measurement" was amended in July 2005 and is effective for the reporting period beginning 1 January 2006, and IFRS 7 "Financial Instruments: Disclosures" was introduced in August 2005 and is effective for the reporting period beginning 1 January 2007.

Restatement

The financial statements as at 31 December 2003 and for the year then ended have been restated to reflect the effect of a revaluation of buildings based on an independent expert's appraisal carried out in August 2005. The buildings were revalued as at 31 December 2003. The fair values of revalued items were determined directly by reference to observable prices in an active market and market transactions on arm's length terms for the relevant period. Net assets as at 31 December 2003 were reduced by GEL 2,823 thousand, which is the amount of the decrease of the fair value of buildings relating to periods prior to the year 2004.

	Fixed assets GEL'000	**Accumulated depreciation** GEL'000	**Profit and Loss** GEL'000	**Accumulated reserves** GEL'000
Before restatement				
Balance at 31 December 2003	10,735	2,590	(2,014)	(1,192)
Revaluation loss	(4,781)	(1,958)	(2,823)	(2,823)
Restated				
Balance at 31 December 2003	5,954	632	(4,837)	(4,015)

The financial statements as at 31 December 2004 and for the year then ended have been restated to reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. As at 31 December 2004 net deferred tax asset at statutory tax rate of 20% comprised GEL 111 thousand that was not recognized due to the fact that it is no longer probable that sufficient taxable profit is available to allow all or part of the asset to be recovered.

(in Georgian Lari and in thousands)

Reclassification

Certain reclassifications have been made to the financial statements as at 31 December 2004 and for the year then ended to conform to the presentation as at 31 December 2005 and for the year then ended.

Reclassification	**Amount of reclassification** GEL '000	**Balance sheet line as per the previous report**	**Balance sheet line as per current report**
Loans and advances to customers, net	245	14,254	14,009
Other liabilities	245	4,731	4,486

4. NET INTEREST INCOME

Net interest income comprises:

	2005	**2004**
Interest income		
Interest on loans and advances to customers	1,743	2,085
Interest on loans and advances to banks	325	309
Interest on debt securities	164	58
Total interest income	**2,232**	**2,452**
Interest expense		
Interest on customer accounts	(237)	(135)
Interest on deposits and loans from banks and other credit institutions	(98)	(203)
Total interest expense	**(335)**	**(338)**
Net interest income before allowance for impairment losses on interest bearing assets	**1,897**	**2,114**

(in Georgian Lari and in thousands)

5. ALLOWANCE FOR IMPAIRMENT LOSSES

The movements in allowance for impairment losses were as follows:

	Loans and advances to banks	Loans and advances to customers	Total
31 December 2003	-	4,516	4,516
Provision/(recovery)	71	(476)	(405)
Write-off of assets	-	(498)	(498)
Recoveries of assets previously written off	-	13	13
31 December 2004	71	3,555	3,626
(Recovery)/provision	(31)	126	95
Write-off of assets	-	(67)	(67)
Recoveries of assets previously written off	-	4	4
31 December 2005	40	3,618	3,658

The movements in provisions for guarantees and other commitments were as follows:

	Other assets	Guarantees and other commitments	Total
31 December 2003	172	-	172
Allowance	317	13	330
Write off of assets	(172)	-	(172)
31 December 2004	317	13	330
Allowance/(recovery of allowance)	196	(7)	189
Write-off of assets	(276)	-	(276)
31 December 2005	237	6	243

6. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprise:

	2005	2004
Dealing differences, net	444	271
Translation differences, net	(230)	(143)
Total net gain on foreign exchange operations	**214**	**128**

(in Georgian Lari and in thousands)

7. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

	2005	2004
Fee and commission income:		
Settlements from pension operations	11,656	5,333
Cash operations	2,091	1,892
Settlements	152	-
Documentary operations	44	43
Other	2,327	1,227
Total fee and commission income	**16,270**	**8,495**
Fee and commission expense:		
Services of processing center	272	158
Cash operations	262	183
Correspondent bank service	138	91
Other	156	65
Total fee and commission expense	**828**	**497**

8. OPERATING EXPENSES

Operating expenses comprise:

	2005	2004
Salary and bonuses	6,251	3,867
Utilities	2,130	868
Depreciation of fixed and intangible assets	824	545
Security	614	296
Advertising costs	553	117
Fixed assets maintenance	509	156
Insurance costs	471	499
Representative expenses	365	117
Taxes, other than income tax	220	253
Business trip expenses	178	131
Bank forms and documents production	27	274
Training	6	25
Other	2,158	985
Total operating expenses	**14,306**	**8,133**

(in Georgian Lari and in thousands)

9. INCOME TAXES

The Bank provides for taxes based on the statutory tax accounts maintained and prepared in accordance with the Georgian statutory tax regulations that differ from International Financial Reporting Standards. The Bank is subject to certain permanent tax differences due to non-tax deductibility of certain expenses.

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 2005 and 2004 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 2005 and 2004 comprise:

	2005	2004 (as restated)
Deferred assets:		
Fixed and intangible assets, net	-	556
Total deferred assets	-	556
Deferred liabilities:		
Fixed and intangible assets, net	(2,131)	-
Revaluation of fixed assets	(818)	-
Total deferred assets (liabilities)	(2,949)	556
Deferred tax assets (liabilities) at the statutory rate of 20%	(590)	111
Less valuation allowance	-	(111)
Total deferred assets (liabilities)	**(590)**	-

Relationships between tax expenses and accounting profit for the years ended 31 December 2005 and 2004 are explained as follows:

	2005	2004 (as restated)
Profit before income taxes	3,446	2,240
Statutory tax rate	20%	20%
Theoretical tax at the statutory tax rate	689	448
Tax effect of permanent differences	82	32
Effect of fixed assets revaluation recorded in equity	(164)	-
Change in valuation allowance	111	(111)
Income tax expense	**718**	**369**
Current income tax expense	292	369
Deferred income tax expense	426	-
Income tax expense	**718**	**369**

(in Georgian Lari and in thousands)

Deferred income tax (liabilities)/assets		
1 January	-	-
Increase in deferred income tax liabilities	590	-
31 December	**590**	**-**

Income tax liabilities consist of the following:

	2005	2004
Current income tax liability	546	369
Deferred income tax liability	590	-
Total income tax liabilities	**1,136**	**369**

10. CASH AND BALANCES WITH THE NATIONAL BANK OF GEORGIA

Cash and balances with the National Bank of Georgia comprise:

	2005	2004
Cash on hand	14,695	9,111
Balances with the National Bank of Georgia	2,375	12,144
Total cash and balances with the National Bank of Georgia	**17,070**	**21,255**

The balances with the NBG as at 31 December 2005 and 2004 include GEL 1,109 thousand and GEL 506 thousand, respectively, which represent the minimum reserve deposits required by 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:

	2005	2004
Cash and balances with the National Bank of Georgia	17,070	21,255
Loans and advances to banks in OECD countries	3,720	2,849
	20,790	24,104
Less minimum reserve deposit with the National Bank of Georgia	(1,109)	(506)
Total cash and cash equivalents	**19,681**	**23,598**

(in Georgian Lari and in thousands)

11. LOANS AND ADVANCES TO BANKS, NET

Loans and advances to banks comprise:

	2005	2004
Loans to banks	2,000	3,000
Advances to banks	18,583	10,036
Accrued interest income on loans and advances to banks	30	6
	20,613	13,042
Less allowance for impairment losses	(40)	(71)
Total loans and advances to banks, net	**20,573**	**12,971**

Movements in allowance for impairment losses for the years ended 31 December 2005 and 2004 are disclosed in Note 5.

12. LOANS AND ADVANCES TO CUSTOMERS, NET

Loans and advances to customers comprise:

	2005	2004
Originated loans	26,851	16,115
Accrued interest income on loans and advances to customers	1,002	1, 449
	27,853	17,564
Less allowance for impairment losses	(3,618)	(3,555)
Total loans and advances to customers, net	**24,235**	**14,009**

Movements in allowances for impairment losses for the years ended 31 December 2005 and 2004 are disclosed in Note 5.

(in Georgian Lari and in thousands)

As at 31 December 2005 and 2004 the Bank had 5 and 1 loan totaling GEL 7,967 thousand and GEL 1,600 thousand, respectively, which individually exceeded 10% of the Bank's equity.

	2005	2004
Analysis by industry		
Individuals	11,715	7,131
Construction	5,614	113
Trade and service	2,370	2,074
Agriculture	1,664	1,135
Gold pawn	1,295	1,152
Mining	88	388
Energy sector	23	117
Other	4,082	4,005
Accrued interest income on loans and advances to customers	1,002	1,449
	27,853	17,564
Less allowance for impairment losses	(3,618)	(3,555)
Total loans and advances to customers, net	**24,235**	**14,009**

13. INVESTMENTS HELD TO MATURITY

Investments held to maturity comprise:

	Interest to nominal	2005
Investments held to maturity		
Promissory notes of JSC Procreditbank	14%	1,000
Accrued interest income		19
Investments held to maturity		1,019

14. INVESTMENT IN NON CONSOLIDATED SUBSIDIARY

Investment in non consolidated subsidiary represents a 100% investment in the Insurance Company PIC LLC. The investment is stated at cost and is not consolidated with the Bank's financial statements as at 31 December 2005.

(in Georgian Lari and in thousands)

15. FIXED ASSETS, NET

	Computers	Furniture and equipment	Vehicles	Leasehold improve-ments	Construction in progress	Buildings	Total
At cost							
31 December 2004 (as previously reported)	1,408	1,681	581	584	240	8,457	12,951
Restatement (see Note 3)	-	-	-	-	-	(4,781)	(4,781)
At cost							
31 December 2004 (as restated)	1,408	1,681	581	584	240	3,676	8,170
Additions	630	1,527	240	820	159	638	4,014
Revaluation	-	-	-	-	-	818	818
Disposals	(80)	(146)	(34)	(22)	(152)	(227)	(661)
31 December 2005	1,958	3,062	787	1,382	247	4,905	12,341
Accumulated depreciation							
31 December 2004 (as previously reported)	376	447	191	21	-	2,077	3,112
Restatement (see Note 3)	-	-	-	-	-	(1,958)	(1,958)
31 December 2004 (as restated)	376	447	191	21	-	119	1,154
Charge for the year	348	254	73	17	-	109	801
Elimination on disposal	(16)	(111)	(17)	-	-	(13)	(157)
31 December 2005	708	590	247	38	-	215	1,798
Net book value							
31 December 2005	**1,250**	**2,472**	**540**	**1,344**	**247**	**4,690**	**10,543**
Net book value							
31 December 2004	**1,032**	**1,234**	**390**	**563**	**240**	**3,557**	**7,016**

The Bank's buildings were revalued at 31 December 2003 based on an independent expert's appraisal carried out in August 2005. The fair values of revalued items were determined directly by reference to observable prices in an active market and recent market transactions on arm's length terms. The total revaluation loss recognized in 2003 amounted to GEL 2,823 thousand.

Had the buildings been carried under the cost method the book value would be GEL 12,548 thousand. The total revaluation gain recognized in equity in 2005 amounted to GEL 654 thousand. The gross carrying value of fully depreciated fixture and equipment still in use comprises GEL 489 thousand.

(in Georgian Lari and in thousands)

16. INTANGIBLE ASSETS, NET

	2005	2004
At cost		
1 January	206	68
Additions	410	138
31 December	616	206
Accumulated amortization		
1 January	20	7
Charge for the year	23	13
31 December	43	20
Net book value		
31 December	**573**	**186**

17. OTHER ASSETS, NET

Other assets comprise:

	2005	2004
Prepayments and other debtors	2,593	1,918
Repossessed assets	667	468
Accrual of commission income	4	443
Receivable from the State United Insurance fund of Georgia	-	157
Other	397	329
	3,661	3,315
Less allowance for impairment on other assets	(237)	(317)
Total other assets, net	**3,424**	**2,998**

(in Georgian Lari and in thousands)

18. LOANS AND ADVANCES FROM BANKS AND OTHER CREDIT INSTITUTIONS

Loans and advances from banks and other credit institutions comprise:

	2005	2004
Correspondent accounts of other banks	61	604
Loans from banks and other credit institutions	14,023	7,298
Accrued interest expense	27	2
Total loans and advances from banks and other credit institutions	**14,111**	**7,904**

19. CUSTOMER ACCOUNTS

Customer accounts comprise:

	2005	2004
Repayable on demand	45,593	36,705
Time deposits	4,997	1,520
Accrued interest expense on customer accounts	120	26
Total customer accounts	**50,710**	**38,251**

Analysis of customer accounts by sector:

	2005	2004
Individuals	25,214	14,282
Government	9,783	11,126
Trade	6,937	7,204
Transport and communication	1,227	713
Construction	928	1,163
Energy	435	279
Mining	121	152
Agriculture	78	83
Other	5,867	3,223
Accrued interest expense on customer accounts	120	26
Total customer accounts	**50,710**	**38,251**

(in Georgian Lari and in thousands)

20. OTHER LIABILITIES

Other liabilities comprise:

	2005	2004
Pension funds	2,565	4,360
Guarantee provision	6	13
Other	348	113
Total other liabilities	**2,919**	**4,486**

The movement in provisions for the years ended 31 December 2005 and 2004 is disclosed in Note 5.

21. SHARE CAPITAL

As at 31 December 2005 and 2004 authorized, issued and fully paid share capital comprised of 10,000,000 ordinary shares with a par value of GEL 1 Gel each.

22. FINANCIAL COMMITMENTS AND CONTINGENCIES

In the normal course of business the Bank 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 balance sheet. The risk-weighted amount is obtained by applying credit conversion factors and counterparty risk weightings according to the principles employed by the Basel Committee on Banking Supervision.

(in Georgian Lari and in thousands)

As at 31 December 2005 and 2004, the nominal or contract amounts and the risk amounts were:

	2005		2004	
	Nominal Amount	Risk Weighted Amount	Nominal Amount	Risk Weighted Amount
Guarantees issued and similar commitments	337	337	667	667
Total contingent liabilities and credit commitments	**337**	**337**	**667**	**667**

Legal proceedings - From time to time and in the normal course of business, claims against the Bank 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.

Capital commitments - The Bank had no material commitments for capital expenditures outstanding as at 31 December 2005 and 2004.

Taxes - Georgian tax authorities are increasingly directing their attention to the business community as a result of the overall economic Georgian environment. In respect of this, the local and national tax environment in Georgia is constantly changing and subject to inconsistent application, interpretation and enforcement. Non-compliance with Georgian laws and regulations can lead to the imposition of severe penalties and interest. Future tax examinations could include taxes, penalties and interest, and these amounts could be material.

On 14 April 2004 the Regional Tax Inspectorate of Kutaisi, Georgia issued a tax examination act in respect of the Bagdadi Branch of the Bank. The examination covered the period from 1 January 1999 to 1 March 2004. As a result of the examination, taxes and related penalties of GEL 365 thousand were assessed. The management of the Bank do not agree with the examination results and have submitted an appeal application to the Tax Department. The Appeal Division of the Tax Department considered the appeal of the Bank and responded on 2 July 2004. In the response, the Tax Department instructed the Regional Tax Inspectorate of Kutaisi to perform a more accurate tax examination of the Branch to verify the facts detailed in the appeal of the Bank. The Tax Department ordered the regional tax inspectorate to provide them with a revised tax examination act to enable them to make a final decision. However, no revision of the tax examination act was conducted by the Regional Tax Inspectorate of Kutaisi.

Non compliance with Georgian laws and regulation may lead to the imposition of severe penalties and interest. Future tax examinations could include taxes, penalties and interest, and these amounts could be material. While the Bank believes it had complied with local tax legislation, there have been many new tax and foreign currency laws and related regulations introduced in recent years, which are not always clearly written.

Pensions and retirement plans - Employees receive pension benefits from the Georgian Government in accordance with the laws and regulations of the country. As at 31 December 2005 and 2004 the Bank was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

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

Other - In accordance with the agreement on State procurement between the Georgian Social Insurance State Fund and the Bank, the Bank's exclusive right to distribute pensions to Georgian pensioners, expires on 31 December 2006.

23. TRANSACTIONS WITH RELATED PARTIES

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

(a) Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the Bank (this includes holding companies, subsidiaries and fellow subsidiaries);

(b) Associates – enterprises in which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;

(c) Individuals owning, directly or indirectly, an interest in the voting power of the Bank that gives them significant influence over the Bank;

(d) Key management personnel, that is, those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, including directors and officers of the Bank (also non-executive directors and close members of the families of such individuals);

(e) Enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the Bank and enterprises that have a member of key management in common with the Bank;

(f) Parties with joint control over the Bank;

(g) Joint ventures in which the Bank is a venture.

(in Georgian Lari and in thousands)

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Bank had the following transactions outstanding with related parties:

	2005		2004	
	Related party transactions	**Total category as per financial statements caption**	**Related party transactions**	**Total category as per financial statements caption**
Loans to customers, gross	9,501	26,851	938	16,115
Accrued interest on loans to customers	219	1,002	105	1, 449
Allowance for impairment losses	(299)	(3,618)	(314)	(3,555)
Loans to customers, net	9,421	24,235	729	14,009
Customer accounts	894	50,590	4	38,225
Accrued interest on customer accounts	40	120	-	26
Total customer accounts	**934**	**50,710**	**4**	**38,251**

During the year ended 31 December 2005 the Bank received repayments on loans to related party customers of GEL 4,436 thousand and originated loans of GEL 12,999 thousand. During the year ended 31 December 2004 the Bank received repayments on loans to related party customers of GEL 1,422 thousand and originated loans of GEL 1,989 thousand.

During the year ended 31 December 2005 the Bank received deposits from related party customers of GEL 22,029 thousand and repaid deposits totaling GEL 21,095 thousand. During the year ended 31 December 2004 the Bank received deposits from customers who were related parties totaling GEL10,993 thousand and repaid deposits of GEL 14,792 thousand.

(in Georgian Lari and in thousands)

Included in the income statement for the years ended 31 December 2005 and 2004 are the following amounts, which arose due to transactions with related parties:

	2005		2004	
	Related party transactions	**Total category as per financial statements caption**	**Related party transactions**	**Total category as per financial statements caption**
Interest income	444	2,232	31	2,452
- related companies	437		31	
- key management personnel	7			
Interest expense	-	335	22	338
- key management personnel			22	
Recovery of allowance / (allowance) for impairment losses	(186)	(95)	-	405
Fees and commission income	18	16,270	26	8,495
- related companies	16		26	
- key management personnel	2		-	

	2005		2004	
	Related party transactions	**Total category as per financial statements caption**	**Related party transactions**	**Total category as per financial statements caption**
Key management personnel compensation:				
short-term employee benefits	717	6,251	51	3,867

Transactions with related parties entered into by the Bank during the years ended 31 December 2005 and 2004 and outstanding as at 31 December 2005 and 2004 were made in the normal course of business and mostly under arms length conditions.

(in Georgian Lari and in thousands)

24. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments is made in accordance with the requirements of IAS 32 "Financial Instruments: Disclosure and Presentation" 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. As no readily available published price quotations in an active market exist for a large part of the Bank's financial instruments, judgment is necessary in arriving at fair value using a valuation technique, based on current economic conditions and specific risks attributable to the instrument.

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

	31 December 2005		31 December 2004 (as restated)	
	Carrying value	Fair value	Carrying value	Fair value
Cash and balances with the NBG	17,070	17,070	21,255	21,255
Loans and advances to banks, net	20,573	20,573	12,971	12,971
Loans and advances to customers, net	24,235	24,235	14,009	14,009
Investments held-to-maturity	1,019	1,019	-	-
Investments available for sale	40	40	40	40
Other assets	3,424	3,424	2,998	2,998
Loans and advances from banks and other institutions	14,111	14,111	7,904	7,904
Customer accounts	50,710	50,710	38,251	38,251
Other liabilities	2,919	2,919	4,486	4,486

(in Georgian Lari and in thousands)

25. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (as set forth in the table below) of total (8%) and tier 1 capital (4%) to risk weighted assets.

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

Estimate	Description of position
0%	Cash and balances with the National Bank of Georgia
0%	State debt securities
20%	Loans and advances to banks for up to 1 year
100%	Loans and advances to customers
100%	Other assets
100%	Guarantees
50%	Obligations and commitments on unused loans with the initial maturity of over 1 year

The Bank's actual capital amounts and ratios are presented in the following table:

Capital amounts and ratios	Actual Amount in GEL thousand	For Capital Adequacy purposes Amount in GEL thousand	Ratio For Capital Adequacy purposes	Minimum Required Ratio
As at 31 December 2005				
Total capital	10,489	10,489	18%	8%
Tier 1 capital	9,835	9,835	17%	4%
As at 31 December 2004				
Total capital	7,465	7,465	20%	8%
Tier 1 capital	7,465	7,465	20%	4%

26. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the banking business and is an essential element of the Bank's operations. The main risks inherent to the Bank's operations are those related to credit exposures, liquidity and market movements in interest rates and foreign exchange rates. A description of the Bank's risk management policies in relation to those risks follows.

(in Georgian Lari and in thousands)

The Bank manages the following risks:

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. In order to manage liquidity risk, the Bank performs daily monitoring of expected future cash flows on clients' and banking operations, which is a part of the assets/liabilities management process.

The Assets and Liabilities Management Committee sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

Cash flow interest rate risk

Cash flow interest rate risk arises from the possibility that changes in interest rates will affect the value of the financial instruments. The following table presents an analysis of interest rate risk and thus the potential of the Bank for gain or loss. Effective 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 Bank.

	2005		2004	
	GEL	**USD**	**GEL**	**USD**
ASSETS				
Loans and advances to banks, net	5%	2,5%	-	-
Loans and advances to customers, net	12%-16%	15%	18%-20%	18%-36%
Investments available for sale	14%	-	13%	49%
LIABILITIES				
Loans and advances from banks and other institutions	4,7%	2,3%	-	-
Customer accounts	9%	9%	7%	5%-7%

(in Georgian Lari and in thousands)

The analysis of interest rate and liquidity risk on balance sheet transactions is presented in the following table:

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Overdue	Maturity undefined	2005 Total
ASSETS							
Loans and advances to banks, net	2,030	1,000	2,075	-	-	-	5,105
Loans and advances to customers,	3,775	4,134	9,134	770	6,422	-	24,235
Investments held-to-maturity	-	-	1,019	-	-	-	1,019
Total interest bearing assets	5,805	5,134	12,228	770	6,422	-	30,359
Cash and balances with the NBG	15,961	-	-	-	-	1,109	17,070
Loans and advances to banks, net	15,468	-	-	-	-	-	15,468
Fixed and intangible assets, net	-	-	-	-	-	11,116	11,116
Investments available for sale	-	-	-	-	-	40	40
Investment in non consolidated subsidiary	-	-	-	-	-	1,888	1,888
Other assets	3,424	-	-	-	-	-	3,424
TOTAL ASSETS	**40,658**	**5,134**	**12,228**	**770**	**6,422**	**14,153**	**79,365**
LIABILITIES							
Loans and advances from banks and other credit institutions	1,819	10,439	1,793	-	-	-	14,051
Customer accounts	708	741	3,564	104	-	-	5,117
Total interest bearing liabilities	2,527	11,180	5,357	104	-	-	19,168
Loans and advances from banks and other credit institutions	60	-	-	-	-	-	60
Customer accounts	45,593	-	-	-	-	-	45,593
Income tax liabilities	-	-	1,136	-	-	-	1,136
Other liabilities	2,913	-	-	-	-	6	2,919
TOTAL LIABILITIES	**51,093**	**11,180**	**6,493**	**104**	**-**	**6**	**68,876**
Liquidity gap	(10,435)	(6,046)	5,735	666			
Interest sensitivity gap	3,278	(6,046)	6,871	666			
Cumulative interest sensitivity gap	3,278	(2,768)	4,103	4,769			
Cumulative interest sensitivity gap as a percentage of total assets	4%	(3%)	5%	6%			

(in Georgian Lari and in thousands)

	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Overdue	Maturity undefined	2004 (restated) Total
ASSETS								
Loans and advances to banks,	3,446	-	-	-	-	-	-	3,446
Loans and advances to customers, net	2,580	2,257	3,767	1,700	-	3,705	-	14,009
Total interest bearing assets	6,026	2,257	3,767	1,700	-	3,705	-	17,455
Cash and balances with the	20,749	-	-	-	-	-	506	21,255
Loans and advances to banks,	9,525	-	-	-	-	-	-	9,525
Investments available for sale	-	-	-	-	-	-	40	40
Fixed and intangible assets, net	-	-	-	-	-	-	7,202	7,202
Other assets	2,847	-	-	151	-	-	-	2,998
TOTAL ASSETS	**39,147**	**2,257**	**3,767**	**1,851**	**-**	**3,705**	**7,748**	**58,475**
LIABILITIES								
Customer accounts	166	263	391	700	-	-	-	1,520
Total interest bearing	166	263	391	700	-	-	-	1,520
Loans and advances from banks and other credit	7,904	-	-	-	-	-	-	7,904
Customer accounts	36,731	-	-	-	-	-	-	36,731
Income tax liabilities	369	-	-	-	-	-	-	369
Other liabilities	4,473	-	-	-	-	-	13	4,486
TOTAL LIABILITIES	**49,643**	**263**	**391**	**700**	**-**	**-**	**13**	**51,010**
Liquidity gap	(10,496)	1,994	3,376	1,151	-			
Interest sensitivity gap	5,860	1,994	3,376	1,000	-			
Cumulative interest sensitivity	5,860	7,854	11,230	12,230	12,230			
Cumulative interest sensitivity gap as a percentage of total	10%	13%	19%	21%	21%			

(in Georgian Lari and in thousands)

The majority of the Bank's interest earning assets and interest bearing liabilities are at fixed rates of interest.

Asset and liability maturity periods and the ability to replace interest liabilities at an acceptable cost when they mature are crucial in determining the Bank's liquidity and its susceptibility to fluctuations in interest rates and exchange rates.

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 Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The Management Board sets limits on the level of exposure by currencies. These limits also comply with the minimum requirements of the NBG. The Bank's exposure to foreign currency exchange rate risk is presented in the table below:

	GEL	**USD** 1 USD= GEL 1,793	**EUR** 1 EUR= GEL 2,125	**Other currencies**	**2005 Total**
ASSETS					
Cash and balances with the NBG	11,718	4,448	804	100	17,070
Loans and advances to banks, net	5,191	14,572	755	55	20,573
Loans and advances to customers, net	19,557	4,675	3	-	24,235
Investments available for sale	40	-	-	-	40
Investments held-to-maturity	1,019	-	-	-	1,019
Investment in non consolidated subsidiary	1,888	-	-	-	1,888
Fixed and intangible assets, net	11,116	-	-	-	11,116
Other assets, net	2,969	455	-	-	3,424
TOTAL ASSETS	**53,498**	**24,150**	**1,562**	**155**	**79,365**
LIABILITIES					
Loans and advances from banks and other institutions	665	13,446	-	-	14,111
Customer accounts	40,474	9,983	237	16	50,710
Income tax liabilities	1,136	-	-	-	1,136
Other liabilities	2,889	30	-	-	2,919
TOTAL LIABILITIES	**45,164**	**23,459**	**237**	**16**	**68,876**
OPEN POSITION	8,334	691	1,325	139	

(in Georgian Lari and in thousands)

	GEL	USD 1 USD= GEL 1,825	EUR 1 EUR= GEL 2,485	Other currencies	2004 (restated) Total
ASSETS					
Cash and balances with the NBG	18,463	2,555	193	44	21,255
Loans and advances to banks, net	3,494	9,188	251	38	12,971
Loans and advances to customers, net	8,321	5,675	13	-	14,009
Investments available for sale	40	-	-	-	40
Fixed and intangible assets, net	7,202	-	-	-	7,202
Other assets	2,331	665	2	-	2,998
TOTAL ASSETS	**39,851**	**18,083**	**459**	**82**	**58,475**
LIABILITIES					
Loans and advances from banks and other institutions	604	7,300	-	-	7,904
Customer accounts	32,638	5,438	175	-	38,251
Income tax liabilities	369	-	-	-	369
Other liabilities	4,450	14	-	22	4,486
TOTAL LIABILITIES	**38,061**	**12,752**	**175**	**22**	**51,010**
OPEN POSITION	**1,790**	**5,331**	**284**	**60**	

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 Bank is exposed to price risks of its products which are subject to general and specific market fluctuations.

The Bank manages price risk through periodic estimations 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 Bank is potentially exposed to loss in an amount equal to the total amount of such commitments. However, the likely amount of loss is less than that, since most commitments are contingent upon certain conditions set out in the loan agreements.

Fair value interest rate risk

Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.

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

Credit risk

The Bank 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. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers.

Limits on the level of credit risk by borrower are reviewed and approved by the Supervisory Board twice a year. Actual exposure per borrower against limits is monitored on new loans granted. The Credit Committee may initiate a change in the limits, however this must be approved by the Supervisory Board.

Where appropriate, and in the case of most loans, the Bank obtains collateral and corporate guarantees. The credit risks are monitored on a continuous basis and are subject to annual or more frequent reviews, especially where no such security can be obtained.

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 the counterparty to comply with the contractual terms and conditions. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank 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 Bank monitors the term to maturity of credit commitments because longer term commitments generally have a greater degree of credit risk than shorter term commitments.

(in Georgian Lari and in thousands)

Geographical concentration

The Assets and Liabilities Management Committee exercises control over the risk in the legislation and regulatory arena and assess its influence on the Bank's activities. This approach allows the Bank to minimize potential losses from investment climate fluctuations in Georgia.

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

	Georgia	Other CIS countries	OECD countries	2005 Total
ASSETS				
Cash and balances with the NBG	17,070	-	-	17,070
Loans and advances to banks, net	7,000	9,853	3,720	20,573
Loans and advances to customers, net	24,235	-	-	24,235
Investments available for sale	40	-	-	40
Investments held-to-maturity	1,019	-	-	1,019
Investment in non consolidated subsidiary	1,888	-	-	1,888
Fixed assets and intangible assets, net	11,116	-	-	11,116
Other assets, net	3,424	-	-	3,424
TOTAL ASSETS	**65,792**	**9,853**	**3,720**	**79,365**
LIABILITIES				
Loans and advances from banks and other institutions	5,148	8,963	-	14,111
Customer accounts	50,710	-	-	50,710
Income tax liabilities	1,136	-	-	1,136
Other liabilities	2,919	-	-	2,919
TOTAL LIABILITIES	**59,913**	**8,963**	**-**	**68,876**
NET POSITION	**5,879**	**890**	**3,720**	

(in Georgian Lari and in thousands)

	Georgia	Other CIS countries	OECD countries	2004 (restated) Total
ASSETS				
Cash and balances with the NBG	21,255	-	-	21,255
Loans and advances to banks, net	3,512	6,610	2,849	12,971
Loans and advances to customers, net	14,009	-	-	14,009
Investments available for sale	40	-	-	40
Fixed and intangible assets, net	7,202	-	-	7,202
Other assets	2,998	-	-	2,998
TOTAL ASSETS	**49,016**	**6,610**	**2,849**	**58,475**
LIABILITIES				
Deposits from banks and other credit institutions	2,429	5,475	-	7,904
Customer accounts	38,251	-	-	38,251
Income tax liabilities	369	-	-	369
Other liabilities	4,486	-	-	4,486
TOTAL LIABILITIES	**45,535**	**5,475**	**-**	**51,010**
NET POSITION	**3,481**	**1,135**	**2,849**	