

OFFICE COPY

**PEOPLES BANK  
OF GEORGIA GROUP**

**Consolidated Financial Statements**  
for the Years Ended 31 December  
2006 and 2005

**and Independent Auditors' Report**

# PEOPLES BANK OF GEORGIA GROUP

## TABLE OF CONTENTS

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	Page
STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS	1
INDEPENDENT AUDITORS' REPORT	2-3
CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED 31 DECEMBER 2006 AND 2005:	
Consolidated income statement	4
Consolidated balance sheet	5
Consolidated statement of changes in equity	6
Consolidated statement of cash flows	7-8
Notes to the consolidated financial statements	9-41

## **STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006**

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

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group at 31 December 2006, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

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

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

Management is also responsible for:


- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining accounting records in compliance with legislation;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Detecting and preventing fraud and other irregularities.

The consolidated financial statements for the year ended 31 December 2006 were authorised for issue on 15 May 2007 by the Management board.

On behalf of the Management Board:

  
George Gognadze  
Chairman

15 May 2007

  
Tamar Kasareli  
Chief Accountant

15 May 2007

## INDEPENDENT AUDITORS' REPORT

To the Shareholders of Peoples' Bank of Georgia Group:

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Joint Stock Company Peoples' Bank of Georgia (the "Bank") and its subsidiaries (the "Group"), which comprise the consolidated balance sheet as at 31 December 2006, and the consolidated income statement, consolidated statements of changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

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

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

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

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

**Prior year qualification:**

We have previously audited the financial statements for the year ended 31 December 2005 and our report dated 26 August 2005 expressed a qualified opinion for non consolidation of PIC as at 31 December 2005. As discussed in Note 4 to the accompanying consolidated financial statements, the Bank has restated its 2005 financial statements and, accordingly, our opinion on the 2005 financial statements expressed in this report is different from the one previously issued.

**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects the financial position of the Group as at 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

A handwritten signature in blue ink that reads "Deloitte & Touche".

15 May 2007

# PEOPLES BANK OF GEORGIA GROUP

## CONSOLIDATED INCOME STATEMENT FOR THE YEARS ENDED 31 DECEMBER 2006 AND 2005 (in Georgian Lari and in thousands)

	Notes	Year ended 31 December 2006	Year ended 31 December 2005 (restated)
Interest income	5, 24	6,037	2,218
Interest expense	5	(806)	(294)
NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS		5,231	1,924
Provision for impairment losses on interest bearing assets	6	(1,274)	(95)
NET INTEREST INCOME		3,957	1,829
Net gain on foreign exchange operations	7	752	214
Fee and commission income	8, 24	20,685	16,251
Fee and commission expense	8	(839)	(558)
Gain on the purchase of subsidiary	9	391	4,273
Income from architectural works and rent		1,993	914
Other income	10	334	404
OPERATING INCOME		27,273	23,327
OPERATING EXPENSES	11, 24	(24,838)	(16,847)
OPERATING PROFIT		2,435	6,480
Provision for impairment losses on goodwill	6	-	(1,085)
Provision for impairment losses on other transactions	6	(516)	(216)
PROFIT BEFORE INCOME TAX		1,919	5,179
Income tax expense	12	(866)	(566)
NET PROFIT		1,053	4,613
Attributable to:			
Equity holders of the parent		1,070	4,604
Minority interest		(17)	9
		1,053	4,613

On behalf of the Management Board:

  
George Gachadze  
Chairman

15 May 2007

  
Tamar Kasareli  
Chief Accountant

15 May 2007

The notes on pages 9-41 form an integral part of these consolidated financial statements. The Independent Auditors' Report is on pages 2-3.

# PEOPLES BANK OF GEORGIA GROUP

## CONSOLIDATED BALANCE SHEETS AS AT 31 DECEMBER 2006 AND 2005 (in Georgian Lari and in thousands)

	Notes	31 December 2006	31 December 2005 (restated)
<b>ASSETS:</b>			
Cash and balances with the National Bank of Georgia	13	21,505	17,381
Loans and advances to banks	14	14,757	20,573
Loans to customers	15, 24	41,801	20,542
Investments available-for-sale		44	40
Investments held-to-maturity		-	1,019
Property and equipment	16	43,343	20,371
Intangible assets	17	1,851	580
Current income tax assets		653	-
Other assets	18	3,428	3,418
<b>TOTAL ASSETS</b>		<b>127,382</b>	<b>83,924</b>
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES:</b>			
Loans and advances from banks	19	9,295	14,111
Customer accounts	20, 24	80,433	49,491
Provisions	6	-	6
Current income tax liabilities		-	414
Deferred income tax liabilities	12	6,322	2,154
Other liabilities	21	4,235	4,712
<b>Total liabilities</b>		<b>100,285</b>	<b>70,888</b>
<b>EQUITY:</b>			
Equity attributable to equity holders of the parent:			
Share capital	22	12,000	10,000
Revaluation reserve		14,046	654
Retained earnings		559	1,711
		26,605	12,365
Minority interest		492	671
<b>Total equity</b>		<b>27,097</b>	<b>13,036</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>127,382</b>	<b>83,924</b>

On behalf of the Management Board:

  
George Jgundze  
Chairman

15 May 2007

  
Tamar Kasareli  
Chief Accountant

15 May 2007

The notes on pages 9-41 form an integral part of these consolidated financial statements. The Independent Auditors' Report is on pages 2-3.



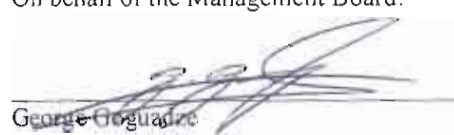
# PEOPLES BANK OF GEORGIA GROUP

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEARS ENDED 31 DECEMBER 2006 AND 2005


(in Georgian Lari and in thousands)

	Share capital	Attributable to the equity holders of the parent Property and equipment revaluation reserve	Retained earnings/ (Accumulated deficit)	Total	Minority interest	Total equity
<b>31 December 2004</b>	10,000	-	(2,535)	7,465	-	7,465
Gains on revaluation of buildings, net of tax GEL 164 thousand	-	654	-	654	-	654
Dividends declared	-	-	(358)	(358)	-	(358)
Purchase of subsidiary	-	-	-	-	662	662
Net profit	-	-	4,604	4,604	9	4,613
<b>31 December 2005 (restated)</b>	<u>10,000</u>	<u>654</u>	<u>1,711</u>	<u>12,365</u>	<u>671</u>	<u>13,036</u>
Share capital increase	2,000	-	-	2,000	-	2,000
Gains on revaluation of buildings, net of tax GEL 3,365 thousand	-	13,392	-	13,392	-	13,392
Dividends declared	-	-	(2,222)	(2,222)	-	(2,222)
Share purchase	-	-	-	-	(162)	(162)
Net profit	-	-	1,070	1,070	(17)	1,053
<b>31 December 2006</b>	<u>12,000</u>	<u>14,046</u>	<u>559</u>	<u>26,605</u>	<u>492</u>	<u>27,097</u>

On behalf of the Management Board:

  
George Goguaia  
Chairman

15 May 2007

  
Tamar Kasareli  
Chief Accountant

15 May 2007

The notes on pages 9-41 form an integral part of these consolidated financial statements. The Independent Auditors' Report is on pages 2-3.



# PEOPLES BANK OF GEORGIA GROUP

## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2006 AND 2005 (in Georgian Lari and in thousands)

	Notes	Year ended 31 December 2006	Year ended 31 December 2005 (restated)
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Profit before income taxes		1,919	5,179
Adjustments for:			
Provision for impairment losses on interest bearing assets		1,274	95
Provision for impairment losses on other transactions		516	216
Impairment of goodwill		-	1,085
Depreciation charge of property, equipment and other intangible assets		1,665	923
Net unrealized loss arising from changes in foreign currency exchange rates		23	230
Gain on the purchase of subsidiary		(391)	(4,273)
Net change in accruals		(296)	808
Cash flow from operating activities before changes in operating assets and liabilities		4,710	4,263
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Minimum reserve deposit with the National Bank of Georgia		(4,478)	(603)
Loans and advances to banks		4,588	(6,812)
Loans to customers		(22,137)	(7,564)
Goodwill		-	(1,085)
Other assets		(141)	(59)
Increase/(decrease) in operating liabilities:			
Loans and advances from banks		(4,816)	6,248
Customer accounts		30,802	11,240
Other liabilities		(414)	239
Cash inflow from operating activities before income taxes		8,114	5,867
Income tax paid		(1,130)	(148)
Net cash inflow from operating activities		6,984	5,719
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of property, equipment and intangible assets		(9,240)	(4,431)
Proceeds on sale of property, equipment and intangible assets		26	-
Purchase of investments		-	(4,117)
Investments available-for-sale		(4)	-
Investments held-to-maturity		1,019	(1,019)
Proceeds of share purchase of minority interest		(162)	662
Net cash outflow from investing activities		(8,361)	(8,905)

# PEOPLES BANK OF GEORGIA GROUP

## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEARS ENDED 31 DECEMBER 2006 AND 2005 (CONTINUED)


(in Georgian Lari and in thousands)

	Notes	Year ended 31 December 2006	Year ended 31 December 2005 (restated)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Dividends paid		(2,222)	(358)
Share capital increase		<u>2,000</u>	<u>-</u>
Net cash outflow from financing activities		<u>(222)</u>	<u>(358)</u>
Effect of changes in foreign exchange rate on cash and cash equivalents		<u>(23)</u>	<u>(62)</u>
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		(1,622)	(3,606)
CASH AND CASH EQUIVALENTS, beginning of year	13	<u>19,992</u>	<u>23,598</u>
CASH AND CASH EQUIVALENTS, end of year	13	<u><u>18,370</u></u>	<u><u>19,992</u></u>

On behalf of the Management Board:

  
George Gaguaдзе  
Chairman

15 May 2007

  
Tamar Kasareli  
Chief Accountant

15 May 2007

The notes on pages 9-41 form an integral part of these consolidated financial statements. The Independent Auditors' Report is on pages 2-3.

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED 31 DECEMBER 2006 AND 2005 *(in Georgian Lari and in thousands, unless otherwise stated)*

### 1. ORGANISATION

Joint Stock Company People's Bank of Georgia (the "Bank") was incorporated in Georgia. The Bank is the legal successor of State owned bank "Agromretsvbank". 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 Agromretsvbank, and pursuant to the Resolution number 4/5-1 of the Tbilisi Mtatsminda-Krtsanisi District Court, dated 7 October 2002, the name, legal address, authorized capital, and members of the Board of Directors and Supervisory Board of JSC Agromretsvbank were changed. In terms of the above mentioned Resolution of the Court, the legal name of JSC Agromretsvbank has changed to JSC People's Bank of Georgia.

The registered address of the Bank is 74 Ilia Chavchavadze Avenue, 0162 Tbilisi, 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 2006 and 2005 was 3,687 and 2,987 respectively.

As at 31 December 2006 and 2005 the share capital was distributed among following shareholders:

Shareholder	2006 Ownership interest, %	2005 Ownership interest, %
Starcode Resources LLC	24%	24%
Kovalenko Elena	24%	24%
Jincharadze Irina	19%	19%
Agureva Anna	9%	9%
Marshania Tamar	7%	7%
Gogvadze George	6%	6%
Marshania Gaioz	2%	2%
Other shareholders (individually hold less than 1%)	9%	9%
<b>Total</b>	<b>100%</b>	<b>100%</b>

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

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

Name	Country of incorporation	The Group ownership interest		Type of operation
		2006	2005	
JSC Peoples Insurance Company	Georgia	100%	100%	Insurance
LLC Real Estate Development	Georgia	100%	100%	Real Estate
LLC Peoples Post	Georgia	100%	-	Postal
LLC Public Investment Management	Georgia	100%	-	Brokerage
JSC Sakkalakmshenproekti	Georgia	97%	92%	Architectural design services and renting

JSC People's Insurance Company was established on 4 February 2004. The Company's principal activity is providing insurance services. The company holds insurance licenses N 004/2 dated 13 October 2006 and life insurance license N 002/1 dated 13 October 2006 granted by Insurance Regulatory Department of Georgia. The insurance company was bought by the Bank in 2005.

LLC Real Estate Development was established on 18 November 2005 by the Tax Inspectorate of Tbilisi, Georgia, order number 1422/006. The Company's principal activity is operating on real estate market.

JSC Sakkalakmshenproekti was bought by the Group in 2005. The Company's principal activity is providing architectural design services and renting the buildings.

LLC People's Post was established on 27 September 2005. The Company's principal activity is providing postal services.

LLC Public Investment Management Company was established on 31 July 2006 by the Tax Inspectorate of Tbilisi, Georgia, order number 205168833. The company holds brokerage license number 129 dated 13 September 2006 granted by Securities National Commission of Georgia.

These consolidated financial statements were authorized for issue by the Management Board on 15 May 2007.

## 2. BASIS OF PRESENTATION

### Accounting basis

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

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

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

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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 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 provisions for impairment losses and the fair value of financial instruments.

### Key assumptions

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

	31 December 2006	31 December 2005
Loans and advances to banks	14,757	20,573
Loans to customers	41,801	20,542

### Functional currency

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

## 3. SIGNIFICANT ACCOUNTING POLICIES

### Basis of consolidation

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

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

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

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

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



## PEOPLES BANK OF GEORGIA GROUP

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

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#### **Goodwill**

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary at the date of acquisition.

The Group tests goodwill for impairment at least annually.

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

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

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

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

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

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

#### **Cash and cash equivalents**

Cash and cash equivalents include cash on hand, unrestricted balances on correspondent and time deposit accounts with the National Bank of Georgia with original maturity within 90 days, advances to banks in countries included in the Organization for Economic Co-operation and Development ("OECD"), except for margin deposits for operations with plastic cards and government securities denominated in Georgian Lari, carried at fair value through profit or loss, which may be converted to cash within a short period of time. For purposes of determining cash flows, the minimum reserve deposit required by the National Bank of Georgia is not included as a cash equivalent due to restrictions on its availability.

#### **Loans and advances to banks**

In the normal course of business, the Group 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 carried at amortized cost based on expected maturities. Amounts due from credit institutions are carried net of any allowance for impairment losses.

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

*(in Georgian Lari and in thousands, unless otherwise stated)*

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### **Originated loans**

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

Loans granted by the Group with fixed maturities 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 according to nature of these losses. Subsequently, the loan carrying value is measured using the effective interest method. Loans to customers that do not have fixed maturities are accounted for under the effective interest method based on expected maturity. Loans to customers are carried net of any allowance for impairment losses.

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

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

### **Allowance for impairment losses**

The Group 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 carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted at the financial asset's original effective interest rate, for financial assets which are carried at amortised 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 recognised, the previously recognised 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. Such impairment losses are not reversed.

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. Provisions are made as a result of an individual appraisal of risk 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 profit and loss and the total of the allowance for impairment losses is deducted in arriving at assets as shown in balance sheet. Factors that the Group considers in determining whether it has objective evidence that an impairment loss has been incurred include information about the debtors' or issuers' liquidity, solvency and business and financial risk exposures, levels of and trends in delinquencies for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees. These and other factors may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred in a financial asset or group of financial assets.



# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

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It should be understood that estimates of losses involve an exercise of judgment. While it is possible that in particular periods the Group may sustain losses, which are substantial relative 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 Group has the positive intent and ability to hold them to maturity. Such securities are carried at amortized cost, less any allowance for impairment. Amortized discounts are recognized in interest income over the period to maturity using the effective interest method.

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

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

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

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

Investments in corporate shares where the Group owns more than 20% of share capital, but does not have ability or intent to control or exercise significant influence over operating and financial policies, as well as investments in corporate shares where the Group owns less than 20% of share capital, are accounted for at fair value or at approximate fair value. If such value cannot be estimated, investments are accounted for at cost. Management periodically assesses realizability of the carrying values of such investments and provides valuation allowances, if necessary.

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

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

## PEOPLES BANK OF GEORGIA GROUP

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

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

Buildings and other real estate	2-3%
Furniture and equipment	15-20%
Computer equipment	20-25%
Vehicles	20-25%
Leasehold improvements	15-25%
Intangible assets	10%

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

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

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

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

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

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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 recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised 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 consolidated income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

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

### **Deposits from banks and customers**

Customer and bank deposits are initially recognized at fair value. Subsequently amounts due are stated at amortized cost and any difference between carrying and redemption value is recognized in the consolidated income statement over the period of the borrowings using the effective interest method.

### **Provisions**

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

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

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

### **Share capital**

Contributions to share capital are recognized at their cost.

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.



## PEOPLES BANK OF GEORGIA GROUP

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

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#### **Retirement and other benefit obligations**

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

#### **Recognition of income and expense**

Interest income and expense are recognized on an accrual basis using effective interest rate method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

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

Interest income also includes income earned on investments in securities. Other income is credited to 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. Commission incomes/expenses are recognized on an accrual basis.

#### **Fee and commission income**

Fee and commission income includes loan origination fees, loan commitment fees and loan servicing fees. Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in profit and loss over the remaining period of the loan commitment. Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in profit and loss on expiry. Loan servicing fees are recognized as revenue as the services are provided. All other commissions are recognized when services are provided.

#### **Provisions for unearned premiums**

The proportion of written premiums, gross of commission payable to intermediaries, attributable to subsequent periods is deferred as unearned premium. The change in the provision for unearned premium is taken to the consolidated income statement in order that revenue is recognized over the period of risk or, for annuities, the amount of expected future benefit payments.

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

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At each balance sheet date, a liability test is performed, to ensure the adequacy of unearned premiums net of related deferred acquisition costs. In performing the test, current best estimates of future contractual cash flows, claims handling and policy administration expenses as well as investment income from assets backing such liabilities are used. Any inadequacy is immediately charged to the consolidated income statement by establishing an unexpired risk provision.

### Foreign currency translation

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

### Rates of exchange

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

	31 December 2006	31 December 2005
GEL/1 US Dollar	1.7135	1.7925
GEL/1 Euro	2.2562	2.1245

### Offset of financial assets and liabilities

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

### Adoption of new and revised International Financial Reporting Standards

In 2006 the following interpretations and amendments applicable to the Group became effective:

- IFRIC 4 “Determining Whether an Arrangement Contains a Lease” (effective 1 January 2006);
- IFRIC 8 “Scope of IFRS 2” (effective 1 May 2006);
- IFRIC 9 “Reassessment of Embedded Derivatives” (effective 1 June 2006);
- Amendment to IAS 39 regarding the financial guarantee contracts (effective 1 January 2006);
- Amendment to IAS 39 regarding the fair value option (effective 1 January 2006).

The effect of these changes on the financial statements of the Group is not significant.

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

At the date of authorisation of these financial statements, the following Standards and Interpretations applicable to the Group were issued but not yet effective:

- IFRS 7 “Financial Instruments: Disclosures” (effective 1 January 2007);
- Amendments to IAS 1 regarding disclosure on the Group’s objectives, policies and processes for managing capital (effective 1 January 2007).

The management is currently assessing the impact of the adoption of these new and revised Standards and Interpretations in future periods.

### 4. PRIOR PERIOD ADJUSTMENTS

In 2006 the Group’s management discovered errors in the consolidated balance sheet and income statement for the year ended 31 December 2005. Peoples Insurance Company, Real estate development and Sakkalakmshenproekti was not consolidated in the financial statements. Other liabilities were not properly recorded. In accordance with IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors” correction of the errors was done retrospectively. The effect of adjustments made to the consolidated balance sheet and income statement for the year ended 31 December 2005 is as follows:

Financial statements item	Amount of correction	As previously reported 31 December 2005	As restated 31 December 2005
Cash and balances with the National Bank of Georgia	311	17,070	17,381
Loans to customers	(3,693)	24,235	20,542
Investment in non consolidated subsidiary	(1,888)	1,888	-
Property and equipment	9,828	10,543	20,371
Intangible assets	7	573	580
Other assets	(6)	3,424	3,418
Customer accounts	(1,219)	50,710	49,491
Provisions	6	-	6
Current income tax liabilities	(722)	1,136	414
Deferred income tax liabilities	2,154	-	2,154
Other liabilities	1,793	2,919	4,712
Retained earnings	1,659	(165)	1,494
Minority interest	671	-	671
Interest income	(14)	2,232	2,218
Interest expense	41	(335)	(294)
Fee and commission income	(19)	16,270	16,251
Fee and commission expense	270	(828)	(558)
Gain on the purchase of subsidiary	4,273	-	4,273
Other income	835	483	1,318
Operating expenses	(2,541)	(14,306)	(16,847)
Provision for impairment losses on other transactions	(27)	(189)	(216)
Provision for impairment losses on goodwill	(1,085)	-	(1,085)
Income tax expense	(65)	(718)	(783)
Net income attributable to Minority	(9)	-	(9)

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) (in Georgian Lari and in thousands, unless otherwise stated)

### 5. NET INTEREST INCOME

	Year ended 31 December 2006	Year ended 31 December 2005 (restated)
<b>Interest income</b>		
Interest on loans to customers	5,642	1,729
Interest on loans and advances to banks	271	325
Interest on debt securities	124	164
<b>Total interest income</b>	<b>6,037</b>	<b>2,218</b>
<b>Interest expense</b>		
Interest on customer accounts	(572)	(196)
Interest on loans and advances from banks	(234)	(98)
<b>Total interest expense</b>	<b>(806)</b>	<b>(294)</b>
<b>Net interest income before provision for impairment losses on interest bearing assets</b>	<b>5,231</b>	<b>1,924</b>

### 6. ALLOWANCE FOR IMPAIRMENT LOSSES, OTHER PROVISIONS

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

	Loans and advances to banks	Loans to customers	Total
<b>31 December 2004</b>	<b>71</b>	<b>3,555</b>	<b>3,626</b>
<i>(Recovery)/Provision</i>	(31)	126	95
Write-off of assets	-	(67)	(67)
Recoveries of assets previously written off	-	4	4
<b>31 December 2005</b>	<b>40</b>	<b>3,618</b>	<b>3,658</b>
<i>(Recovery)/Provision</i>	(40)	1,314	1,274
Write-off of assets	-	(943)	(943)
<b>31 December 2006</b>	<b>-</b>	<b>3,989</b>	<b>3,989</b>

The movement in allowance for impairment losses on goodwill was as follows:

	Year ended 31 December 2006	Year ended 31 December 2005
Beginning of the year	-	-
<i>Provision/(Recovery)</i>	-	1,085
Write-off of assets	-	(1,085)
<b>End of the year</b>	<b>-</b>	<b>-</b>



# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) (in Georgian Lari and in thousands, unless otherwise stated)

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

	Other Assets	Guarantees and other commitments	Total
<b>31 December 2004</b>	<b>317</b>	<b>13</b>	<b>330</b>
<i>Provision/(Recovery)</i>	223	(7)	216
Write-off of assets	(276)	-	(276)
<b>31 December 2005</b>	<b>264</b>	<b>6</b>	<b>270</b>
<i>Provision/(Recovery)</i>	522	(6)	516
Write-off of assets	(65)	-	(65)
<b>31 December 2006</b>	<b>721</b>	<b>-</b>	<b>721</b>

### 7. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

	Year ended 31 December 2006	Year ended 31 December 2005 (restated)
Dealing, net	775	444
Translation differences, net	(23)	(230)
<b>Total net gain on foreign exchange operations</b>	<b>752</b>	<b>214</b>

### 8. FEE AND COMMISSION INCOME AND EXPENSE

	Year ended 31 December 2006	Year ended 31 December 2005 (restated)
<b>Fee and commission income:</b>		
Settlements from pension operations	10,563	9,089
Swift money transfers	3,854	1,877
Settlements	3,052	2,717
Cash operations	2,396	2,091
Other	820	477
<b>Total fee and commission income</b>	<b>20,685</b>	<b>16,251</b>
<b>Fee and commission expense:</b>		
Cash operations	413	262
Processing of VISA cards	266	151
Correspondent bank service	160	138
Other	-	7
<b>Total fee and commission expense</b>	<b>839</b>	<b>558</b>

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

### 9. GAIN ON THE PURCHASE OF SUBSIDIARY

	Year ended 31 December 2005, restated	
	JSC "Sakalakmshe nproekti"	JSC "Peoples Insurance Company"
Fair value of net assets of subsidiary	8,320	800
Portion of the group in net assets of shares acquired	7,658	800
Purchase price	3,385	1,885
Gain on the purchase of subsidiary	4,273	-
Goodwill arising on acquisition of subsidiary	-	1,085

	Year ended 31 December 2006 JSC "Sakalakmshe nproekti"
Fair value of net assets of subsidiary	8,438
Portion of the group in net assets of shares acquired	461
Purchase price	70
Gain on the purchase of subsidiary	391

### 10. OTHER INCOME

	Year ended 31 December 2006	Year ended 31 December 2005 (restated)
Insurance income	112	254
Change in reserve for unearned premium	(62)	(37)
Change in reserve on incurred but not reported losses	(5)	(6)
Insurance income, net	45	211
Revenues from employment program	82	61
Revenues from fines	76	13
Revenues from guarantees and letters of credit	63	18
Revenues from servicing documentary stamps	49	49
Dividend income	-	14
Other	19	38
<b>Total other income</b>	<b>334</b>	<b>404</b>

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

### 11. OPERATING EXPENSES

	Year ended 31 December 2006	Year ended 31 December 2005 (restated)
Salary and bonuses	12,421	8,546
Utilities	1,960	1,104
Depreciation of property, equipment and intangible assets	1,665	923
Rent	1,546	978
Representative expenses	1,076	365
Advertising costs	922	554
Property and equipment maintenance	886	509
Security	862	614
Materials	816	1,062
Taxes, other than income tax	635	283
Business trip expenses	344	189
Plastic cards preparation	233	20
Professional services	191	152
Bank forms and documents production	190	312
Other	1,091	1,236
<b>Total operating expenses</b>	<b>24,838</b>	<b>16,847</b>

### 12. INCOME TAXES

The Group provides for taxes based on the tax accounts maintained and prepared in accordance with the Georgian tax regulations that differ from International Financial Reporting Standards.

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

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at 31 December 2006 and 2005 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) (in Georgian Lari and in thousands, unless otherwise stated)

Temporary differences as at 31 December 2006 and 2005 comprise:

	31 December 2006	31 December 2005
<b>Deferred assets:</b>		
Loss carry forward	1,227	-
Loans and advances to banks	76	-
Impairment of goodwill	1,085	1,085
Other liabilities	292	-
<b>Total deferred assets</b>	<b>2,680</b>	<b>1,085</b>
<b>Deferred liabilities:</b>		
Property and equipment	(34,288)	(11,854)
<b>Total deferred liabilities</b>	<b>(34,288)</b>	<b>(11,854)</b>
Net deferred liabilities	(31,608)	(10,769)
<b>Net deferred tax liability</b>	<b>(6,322)</b>	<b>(2,154)</b>

Relationships between tax expenses and accounting profit for the years ended 31 December 2006 and 2005 are explained as follows:

	Year ended 31 December 2006	Year ended 31 December 2005 (restated)
Profit before income tax	1,919	5,179
Tax at the statutory tax rate	384	1,036
Tax effect of permanent differences	482	(470)
<b>Income tax expense</b>	<b>866</b>	<b>566</b>
Current income tax expense	63	357
Deferred income tax expense	803	209
<b>Income tax expense</b>	<b>866</b>	<b>566</b>
<b>Deferred income tax liabilities</b>	<b>2006</b>	<b>2005</b>
<b>1 January</b>	<b>2,154</b>	<b>-</b>
Tax effect of changes in property and equipment revaluation reserve	3,365	164
Deferred income tax liabilities of acquired subsidiaries	-	1,781
Increase in income tax liability for the year through profit and loss account	803	209
<b>31 December</b>	<b>6,322</b>	<b>2,154</b>

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

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

	31 December 2006	31 December 2005
Cash	11,613	15,006
Balances with the National Bank of Georgia	9,892	2,375
<b>Total cash and balances with the National Bank of Georgia</b>	<b>21,505</b>	<b>17,381</b>

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

	31 December 2006	31 December 2005
Cash and balances with the National Bank of Georgia	21,505	17,381
Loans and advances to banks in OECD countries (Note 26)	2,452	3,720
Less minimum reserve deposits and foreign currency deposits with the NBG	(5,587)	(1,109)
<b>Total cash and cash equivalents</b>	<b>18,370</b>	<b>19,992</b>

### 14. LOANS AND ADVANCES TO BANKS

	31 December 2006	31 December 2005
Loans and advances to banks	2,756	5,105
Correspondent accounts with other banks	12,001	15,508
Less allowance for impairment losses	-	(40)
<b>Total loans and advances to banks</b>	<b>14,757</b>	<b>20,573</b>

Movements in allowances for impairment losses and advances to banks for the years ended 31 December 2006 and 2005 are disclosed in Note 6.

As of 31 December 2006 and 2005 included in loans and advances to banks are guarantee deposits placed by the bank for its operations in the amount of GEL 177 thousand and nil, respectively.

### 15. LOANS TO CUSTOMERS

	31 December 2006	31 December 2005
Originated loans	45,790	24,160
Less allowance for impairment losses	(3,989)	(3,618)
<b>Total loans to customers</b>	<b>41,801</b>	<b>20,542</b>

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

As of 31 December 2006 and 2005 accrued interest income included in loans to customers amounted to GEL 1,385 thousand and GEL 989 thousand, respectively.

Movements in allowances for impairment losses for the years ended 31 December 2006 and 2005 are disclosed in Note 6.

	31 December 2006	31 December 2005
Loans collateralized by real estate	11,789	10,883
Loans collateralized by inventories and equipment	6,364	5,592
Loans collateralized by pension funds	4,861	2,144
Loans secured by gold	1,917	1,249
Loans collateralized by securities	1,864	780
Loans collateralized by salary	1,242	234
Loans collateralized by guarantees	183	1
Loans collateralized by cash or Georgian Government guarantees	141	291
Loans collateralized by other collateral	4,286	1,319
Unsecured loans	13,143	1,667
Less allowance for impairment losses	(3,989)	(3,618)
<b>Total loans to customers</b>	<b>41,801</b>	<b>20,542</b>

	31 December 2006	31 December 2005
<b>Analysis by sector:</b>		
Individuals	30,227	12,694
Trade and service	4,158	2,307
Energy	3,080	22
Manufacturing	2,426	3,086
Real estate and construction	2,308	3,086
Agriculture	2,265	2,055
Other	1,326	910
Less allowance for impairment losses	(3,989)	(3,618)
<b>Total loans to customers</b>	<b>41,801</b>	<b>20,542</b>

Loans to individuals consist of:

	31 December 2006	31 December 2005
Consumer loans (including gold pawn loans)	29,042	12,489
Overdrafts	852	142
Other	333	63
<b>Total loans to individuals</b>	<b>30,227</b>	<b>12,694</b>

As at 31 December 2006 and 2005 the Group provided loans to 5 customers, totalling GEL 9,718 thousand and GEL 7,126 thousand, which exceeded 36% and 55% of the Group's equity, respectively.

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

100% of total portfolio is granted to borrowers operating in Georgia, which represents significant geographical concentration in one region.

### 16. PROPERTY AND EQUIPMENT

	Buildings and other real estate	Furniture and equipment	Computer equipment	Vehicles	Leasehold improve- ments	Construction in progress	Total
<b>At revalued cost</b>							
31 December 2004	3,676	1,681	1,408	581	584	240	8,170
Acquiring of subsidiary	9,826	94	-	40	-	-	9,960
Additions	638	1,527	630	240	820	159	4,014
Revaluation increase	818	-	-	-	-	-	818
Disposals	(227)	(146)	(80)	(34)	(22)	(152)	(661)
31 December 2005	14,731	3,156	1,958	827	1,382	247	22,301
Additions	550	4,087	1,894	522	780	63	7,896
Revaluation increase	16,757	-	-	-	-	-	16,757
Disposals	(15)	(78)	-	(18)	-	(12)	(123)
31 December 2006	32,023	7,165	3,852	1,331	2,162	298	46,831
<b>Accumulated depreciation</b>							
31 December 2004	119	447	376	191	21	-	1,154
Acquisition of subsidiary	22	9	-	2	-	-	33
Charge for the year	195	265	348	75	17	-	900
Eliminated on disposals	(13)	(111)	(16)	(17)	-	-	(157)
31 December 2005	323	610	708	251	38	-	1,930
Charge for the year	286	510	623	140	33	-	1,592
Eliminated on disposals	(15)	(17)	-	(2)	-	-	(34)
31 December 2006	594	1,103	1,331	389	71	-	3,488
<b>Net book value</b>							
31 December 2006	31,429	6,062	2,521	942	2,091	298	43,343
31 December 2005	14,408	2,546	1,250	576	1,344	247	20,371

The Group's buildings were revalued based on an independent expert's appraisal individual expert Giorgi Lejava and CB Richard Ellis in January-February 2007. 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.

Had the buildings been carried under the cost method the book value would be GEL 4,882 thousand. The total revaluation surplus net of tax recognized in equity amounted to GEL 14,046 thousand.

As at 31 December 2006 property, equipment and intangible assets included fully depreciated and amortized assets in amount of GEL 575 thousands and nil, respectively.



# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

### 17. INTANGIBLE ASSETS

Software and licenses	Year ended 31 December 2006	Year ended 31 December 2005
<b>At cost</b>		
Beginning of the year	623	206
Additions	1,344	417
End of the year	1,967	623
<b>Accumulated amortization</b>		
Beginning of the year	43	20
Charge for the year	73	23
End of the year	116	43
<b>Net book value</b>		
Beginning of the year	580	186
End of the year	1,851	580

### 18. OTHER ASSETS

	31 December 2006	31 December 2005
Prepayments and other debtors	2,468	1,871
Prepayments for property and equipment	591	800
Repossessed assets	468	667
Accrual of commission income	219	4
Prepaid operating taxes	116	80
Other	287	260
Less allowance for impairment losses on other assets	(721)	(264)
<b>Total other assets</b>	<b>3,428</b>	<b>3,418</b>

Movements in allowances for impairment losses on other assets for the years ended 31 December 2006 and 2005 are disclosed in Note 6.

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

### 19. LOANS AND ADVANCES FROM BANKS

	31 December 2006	31 December 2005
Deposits of other banks	5,835	10,779
Loans from other banks and credit institutions	3,431	3,272
Correspondent accounts of other banks	29	60
<b>Total loans and advances from banks</b>	<b>9,295</b>	<b>14,111</b>

As of 31 December 2006 and 2005 accrued interest expenses included in loans and advances from banks amounted to GEL 17 thousand and GEL 27 thousand, respectively.

### 20. CUSTOMER ACCOUNTS

Customer accounts comprise:

	31 December 2006	31 December 2005
Repayable on demand	68,898	45,214
Time deposits	11,535	4,277
<b>Total customer accounts</b>	<b>80,433</b>	<b>49,491</b>

As at 31 December 2006 and 2005 accrued interest expenses included in customers accounts amounted to GEL 225 thousand and GEL 80 thousand, respectively.

	31 December 2006	31 December 2005
Individuals	38,348	25,202
Government	21,096	9,782
State controlled	7,423	4,543
Trade and service	4,546	5,542
Construction	1,022	535
Energy	384	71
Transport and communication	331	441
Mining	117	118
Agriculture	100	64
Other	7,066	3,193
<b>Total customer accounts</b>	<b>80,433</b>	<b>49,491</b>

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) (in Georgian Lari and in thousands, unless otherwise stated)

### 21. OTHER LIABILITIES

	31 December 2006	31 December 2005
Pension funds	3,076	2,565
Sundry creditors	483	145
Prepaid commission expense	158	-
Operating taxes payable	100	106
Suspense amounts	33	12
Dividends payable	27	34
Bonuses payable to members of supervisory board	-	1,695
Other	358	155
<b>Total other liabilities</b>	<b>4,235</b>	<b>4,712</b>

### 22. SHARE CAPITAL

As at 31 December 2006 and 2005 authorized, issued and fully paid share capital comprised of 12,000,000 ordinary shares and 10,000,000 ordinary shares with a par value of GEL 1 each.

### 23. FINANCIAL COMMITMENTS AND CONTINGENCIES

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

The Group's maximum exposure to credit loss under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

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

As of 31 December 2006 and 2005, the nominal or contract amounts and risk-weighted amounts were:

	31 December 2006		31 December 2005	
	Nominal Amount	Risk weighted amount	Nominal amount	Risk weighted amount
<b>Contingent liabilities and credit commitments</b>				
Guarantees issued and similar commitments	3,443	3,443	337	337
<b>Total contingent liabilities and credit commitments</b>	<b>3,443</b>	<b>3,443</b>	<b>337</b>	<b>337</b>

**Capital commitments** – The Group had no material commitments for capital expenditures outstanding as at 31 December 2006 and 2005.

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) (in Georgian Lari and in thousands, unless otherwise stated)

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

**Taxes** – Due to the presence in Georgian commercial legislation, and tax legislation in particular, of provisions allowing more than one interpretation, and also due to the practice developed in a generally unstable environment by the tax authorities of making arbitrary judgment of business activities, if a particular treatment based on Management's judgment of the Group's business activities was to be challenged by the tax authorities, the Group may be assessed additional taxes, penalties and interest. Such uncertainty may relate to valuation of financial instruments, loss and impairment provisions and market level for deals' pricing. The Group believes that it has already made all tax payments, and therefore no allowance has been made in the financial statements.

**Pensions and retirement plans** – Employees receive pension benefits from Government of Georgia in accordance with the laws and regulations of the country. As at 31 December 2006 and 2005, the Group was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

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

### 24. TRANSACTIONS WITH RELATED PARTIES

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

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

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

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

	31 December 2006		31 December 2005	
	Related party balances	Total category as per financial statements caption	Related party balances	Total category as per financial statements caption
Loans to customers	3,937	41,801	1,598	20,542
- key management personnel	106		54	
- members of supervisory board	3,831		1,544	
Customer accounts	257	80,433	94	49,491
- key management personnel	210		37	
- members of supervisory board	47		57	

	31 December 2006		31 December 2005	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
<b>Key management personnel compensation:</b>				
Short-term employee benefits	715	12,421	717	8,546

Included in the income statement for the years ended 31 December 2006 and 2005 are the following amounts which arose due to transactions with related parties:

	Year ended 31 December 2006		Year ended 31 December 2005	
	Related party transactions	Total category as per financial statements caption	Related party transactions	Total category as per financial statements caption
Interest income	65	6,037	7	2,218
- key management personnel	2		1	
- members of supervisory board	63		6	
Fees and commission income	7	20,685	18	16,251
- key management personnel	3		2	
- members of supervisory board	4		16	
Operating expense	1,533	24,838	2,917	16,847
- key management personnel	715		717	
- members of supervisory board	818		2,200	

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

### 25. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments are made in accordance with the requirements of IAS 32 "Financial Instruments: Presentation and Disclosure" and IAS 39 "Financial Instruments: Recognition and Measurement". Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. The estimates presented herein are not necessarily indicative of the amounts the Group could realize in a market exchange from the sale of its full holdings of a particular instrument.

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

	31 December 2006		31 December 2005	
	Current amount	Fair value	Current amount	Fair value
Cash and balances with the National Bank of Georgia	21,505	21,505	17,381	17,381
Loans and advances to banks	14,757	14,757	20,573	20,573
Investments available-for-sale	44	44	40	40
Investments held-to-maturity	-	-	1,019	1,019
Loans and advances from banks	9,295	9,295	14,111	14,111
Customer accounts	80,433	80,433	49,491	49,491

The fair value of loans to customers and investments available-for-sale can not be measured reliably as it is not practicable to obtain market information or apply any other valuation techniques on such instruments.

### 26. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Group 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 Basle 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 to customers
100%	Guarantees
50%	Obligations and commitments on unused loans with the initial maturity of over 1 year
100%	Other assets

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

Capital amounts and ratios	Actual Amount	For Capital Adequacy purposes	Ratio For Capital Adequacy purposes	Minimum Required Ratio
<b>As at 31 December 2006</b>				
Total capital	25,668	26,880	28%	12%
Tier I capital	12,834	12,834	13%	8%
<b>As at 31 December 2005</b>				
Total capital	14,384	12,819	25%	12%
Tier I capital	13,473	12,165	24%	8%

## 27. RISK MANAGEMENT POLICIES

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

The Group 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 Group 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 inter-bank 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 is the risk that the future cash flow of a financial instrument will fluctuate because of changes in market interest rates.

The ALMC also manages interest rate and market risks by matching the Group's interest rate position, which provides the Group with a positive interest margin.

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



# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) (in Georgian Lari and in thousands, unless otherwise stated)

The following table presents an analysis of interest rate risk and thus the potential of the Group 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 Group.

	GEL	2006 USD	GEL	2005 USD
<b>ASSETS</b>				
Loans and advances to banks	6.9%	-	5%	2.5%
Loans to customers	20.9%	24%	18.5%	25.2%
<b>LIABILITIES</b>				
Loans and advances from banks	12%	5.3%	4.7%	4.2%
Customer accounts	11.4%	9.5%	9%	9%

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 month to 1 year	1 year to 5 years	Maturity undefined	31 December 2006 Total
<b>ASSETS</b>						
Loans and advances to banks	1,510	1,000	-	246	-	2,756
Loans to customers	8,565	2,783	21,268	9,185	-	41,801
Total interest bearing assets	10,075	3,783	21,268	9,431	-	44,557
Cash and balances with the NBG	15,918	-	-	-	5,587	21,505
Loans and advances to banks	11,824	-	-	-	177	12,001
Property and equipment	-	-	-	-	43,343	43,343
Intangible assets	-	-	-	-	1,851	1,851
Investments available-for-sale	-	-	-	-	44	44
Current income tax assets	-	-	653	-	-	653
Other assets	3,428	-	-	-	-	3,428
<b>TOTAL ASSETS</b>	<b>41,245</b>	<b>3,783</b>	<b>21,921</b>	<b>9,431</b>	<b>51,002</b>	<b>127,382</b>
<b>LIABILITIES</b>						
Loans and advances from banks	4,838	997	-	3,431	-	9,266
Customer accounts	3,202	2,316	5,691	326	-	11,535
Total interest bearing liabilities	8,040	3,313	5,691	3,757	-	20,801
Loans and advances from banks	29	-	-	-	-	29
Customer accounts	68,898	-	-	-	-	68,898
Deferred income tax liabilities	-	-	-	-	6,322	6,322
Other liabilities	4,235	-	-	-	-	4,235
<b>TOTAL LIABILITIES</b>	<b>81,202</b>	<b>3,313</b>	<b>5,691</b>	<b>3,757</b>	<b>6,322</b>	<b>100,285</b>
Liquidity gap	(39,957)	470	16,230	5,674		
Interest sensitivity gap	2,035	470	15,577	5,674		
Cumulative interest sensitivity gap	2,035	2,505	18,082	23,756		
Cumulative interest sensitivity gap as a percentage of total assets	1.6%	2.0%	14.2%	18.6%		

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

(in Georgian Lari and in thousands, unless otherwise stated)

	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	Maturity undefined	31 December 2005 Total
<b>ASSETS</b>						
Loans and advances to banks	2,030	1,000	2,075	-	-	5,105
Loans to customers	10,197	4,134	5,441	770	-	20,542
Investments held-to-maturity	-	-	1,019	-	-	1,019
Total interest bearing assets	12,227	5,134	8,535	770	-	26,666
Cash and balances with the NBG	16,272	-	-	-	1,109	17,381
Loans and advances to banks	15,468	-	-	-	-	15,468
Property and equipment	-	-	-	-	20,371	20,371
Intangible assets	-	-	-	-	580	580
Investments available-for-sale	-	-	-	-	40	40
Other assets	3,418	-	-	-	-	3,418
<b>TOTAL ASSETS</b>	<b>47,385</b>	<b>5,134</b>	<b>8,535</b>	<b>770</b>	<b>22,100</b>	<b>83,924</b>
<b>LIABILITIES</b>						
Loans and advances from banks	1,819	10,439	1,793	-	-	14,051
Customer accounts	708	741	2,724	104	-	4,277
Total interest bearing liabilities	2,527	11,180	4,517	104	-	18,328
Loans and advances from banks	60	-	-	-	-	60
Customer accounts	45,214	-	-	-	-	45,214
Current income tax liabilities	-	-	414	-	-	414
Deferred income tax liabilities	-	-	-	-	2,154	2,154
Provisions	-	-	-	-	6	6
Other liabilities	4,712	-	-	-	-	4,712
<b>TOTAL LIABILITIES</b>	<b>52,513</b>	<b>11,180</b>	<b>4,931</b>	<b>104</b>	<b>2,160</b>	<b>70,888</b>
Liquidity gap	(5,128)	(6,046)	3,604	666		
Interest sensitivity gap	9,700	(6,046)	4,018	666		
Cumulative interest sensitivity gap	9,700	3,654	7,672	8,338		
Cumulative interest sensitivity gap as a percentage of total assets	11.6%	4.4%	9.1%	9.9%		

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) (in Georgian Lari and in thousands, unless otherwise stated)

### Currency risk

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

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

The Group's exposure to foreign currency exchange rate risk is presented in the following table:

	GEL	USD USD 1 = GEL 1.7135	EUR EUR 1 = GEL 2.2562	Other currency	31 December 2006 Total
<b>ASSETS</b>					
Cash and balances with the NBG	18,180	2,229	1,031	65	21,505
Loans and advances to banks	2,764	11,411	483	99	14,757
Loans to customers	36,223	5,565	13	-	41,801
Investments available-for-sale	44	-	-	-	44
Property and equipment	43,343	-	-	-	43,343
Intangible assets	1,851	-	-	-	1,851
Current income tax assets	653	-	-	-	653
Other assets	3,428	-	-	-	3,428
<b>TOTAL ASSETS</b>	<b>106,486</b>	<b>19,205</b>	<b>1,527</b>	<b>164</b>	<b>127,382</b>
<b>LIABILITIES</b>					
Loans and advances from banks	2,031	7,264	-	-	9,295
Customer accounts	64,055	14,881	1,427	70	80,433
Deferred income tax liabilities	6,322	-	-	-	6,322
Other liabilities	4,210	25	-	-	4,235
<b>TOTAL LIABILITIES</b>	<b>76,618</b>	<b>22,170</b>	<b>1,427</b>	<b>70</b>	<b>100,285</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>29,868</b>	<b>(2,965)</b>	<b>100</b>	<b>94</b>	

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

	GEL	USD USD 1 = GEL 1.7925	EUR EUR 1 = GEL 2.1245	Other currency	31 December 2005 Total
<b>ASSETS</b>					
Cash and balances with the NBG	12,029	4,448	804	100	17,381
Loans and advances to banks	5,191	14,572	755	55	20,573
Loans to customers	15,864	4,675	3	-	20,542
Investments available-for-sale	40	-	-	-	40
Investments held-to-maturity	1,019	-	-	-	1,019
Property and equipment	20,371	-	-	-	20,371
Intangible assets	580	-	-	-	580
Other assets	2,963	455	-	-	3,418
<b>TOTAL ASSETS</b>	<b>58,057</b>	<b>24,150</b>	<b>1,562</b>	<b>155</b>	<b>83,924</b>
<b>LIABILITIES</b>					
Loans and advances from banks	665	13,446	-	-	14,111
Customer accounts	39,255	9,983	237	16	49,491
Provisions	6	-	-	-	6
Current income tax liabilities	414	-	-	-	414
Deferred income tax liabilities	2,154	-	-	-	2,154
Other liabilities	4,682	30	-	-	4,712
<b>TOTAL LIABILITIES</b>	<b>47,176</b>	<b>23,459</b>	<b>237</b>	<b>16</b>	<b>70,888</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>10,881</b>	<b>691</b>	<b>1,325</b>	<b>139</b>	

### Price risk

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

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

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

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

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### Credit risk

The Group is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Group 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 Group 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 Group 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 Group applies the same credit policy to the contingent liabilities as it does to the balance sheet financial instruments, i.e. the one based on the procedures for approving the grant of loans, using limits to mitigate the risk, and current monitoring. The Group monitors the term to maturity of credit commitments because longer term commitments generally have a greater degree of credit risk than shorter term commitments.

# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

### 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 Group's activities. This approach allows the Group to minimize potential losses from investment climate fluctuations in Georgia.

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

	Georgia	OECD countries	Non-OECD countries	31 December 2006 Total
<b>ASSETS</b>				
Cash and balances with the NBG	21,505	-	-	21,505
Loans and advances to banks	5,977	3,034	5,746	14,757
Loans to customers	41,801	-	-	41,801
Investments available-for-sale	44	-	-	44
Property and equipment	43,343	-	-	43,343
Intangible assets	1,851	-	-	1,851
Current income tax assets	653	-	-	653
Other assets	3,428	-	-	3,428
<b>TOTAL ASSETS</b>	<b>118,602</b>	<b>3,034</b>	<b>5,746</b>	<b>127,382</b>
<b>LIABILITIES</b>				
Loans and advances from banks	5,868	-	3,427	9,295
Customer accounts	80,433	-	-	80,433
Deferred income tax liability	6,322	-	-	6,322
Other liabilities	4,235	-	-	4,235
<b>TOTAL LIABILITIES</b>	<b>96,858</b>	<b>-</b>	<b>3,427</b>	<b>100,285</b>
<b>NET POSITION</b>	<b>21,744</b>	<b>3,034</b>	<b>2,319</b>	



# PEOPLES BANK OF GEORGIA GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED) *(in Georgian Lari and in thousands, unless otherwise stated)*

	Georgia	OECD countries	Non-OECD countries	31 December 2005 Total
<b>ASSETS</b>				
Cash and balances with the NBG	17,381	-	-	17,381
Loans and advances to banks	7,000	3,720	9,853	20,573
Loans to customers	20,542	-	-	20,542
Investments available-for-sale	40	-	-	40
Investments held-to-maturity	1,019	-	-	1,019
Property and equipment	20,371	-	-	20,371
Intangible assets	580	-	-	580
Other assets	3,418	-	-	3,418
<b>TOTAL ASSETS</b>	<b>70,351</b>	<b>3,720</b>	<b>9,853</b>	<b>83,924</b>
<b>LIABILITIES</b>				
Loans and advances from banks	5,148	-	8,963	14,111
Customer accounts	49,491	-	-	49,491
Provisions	6	-	-	6
Current income tax liability	414	-	-	414
Deferred income tax liability	2,154	-	-	2,154
Other liabilities	4,712	-	-	4,712
<b>TOTAL LIABILITIES</b>	<b>61,925</b>	<b>-</b>	<b>8,963</b>	<b>70,888</b>
<b>NET POSITION</b>	<b>8,426</b>	<b>3,720</b>	<b>890</b>	