

**Standard Bank JSC**  
**Financial Statements**

*Year ended December 31, 2006*

*Together with Report of Independent Auditors*

## CONTENTS

### INDEPENDENT AUDITORS' REPORT

Balance sheet .....	1
Statement of income .....	2
Statement of changes in equity .....	3
Statement of cash flows.....	4

### NOTES TO FINANCIAL STATEMENTS

1. Principal activities.....	5
2. Basis of preparation .....	5
3. Summary of accounting policies.....	6
4. Significant accounting judgements and estimates.....	11
5. Cash and cash equivalents.....	12
6. Amounts due from credit institutions.....	12
7. Loans to customers .....	12
8. Investment securities held-to-maturity .....	13
9. Property and equipment.....	13
10. Intangible assets.....	14
11. Taxation.....	15
12. Allowance for impairment and provisions.....	16
13. Other assets and liabilities.....	16
14. Amounts due to credit institutions.....	17
15. Amounts due to customers.....	17
16. Subordinated debt .....	18
17. Equity.....	18
18. Commitments and contingencies .....	18
19. Net fee and commission income .....	19
20. Salaries and other operating expenses.....	20
21. Financial risk management.....	20
22. Fair values of financial instruments.....	25
23. Related party transactions .....	26
24. Capital adequacy .....	27

## INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of Standard Bank JSC –

We have audited the accompanying financial statements of Standard Bank JSC, which comprise the balance sheet as at December 31, 2006, and the statement of income, statement of changes in equity and statement of 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 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 financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

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

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

### *Opinion*

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

February 19, 2007

**BALANCE SHEET****As of December 31, 2006***(Thousands of Georgian Laries)*

	<b>Notes</b>	<b>2006</b>	<b>2005</b>
<b>Assets</b>			
Cash and cash equivalents	5	16,294	2,257
Amounts due from credit institutions	6	7,763	860
Loans to customers	7	57,304	18,978
Investment securities held-to-maturity	8	7,266	-
Property and equipment	9	8,537	831
Intangible assets	10	165	205
Income tax assets	11	87	245
Other assets	13	700	187
<b>Total assets</b>		<b>98,116</b>	<b>23,563</b>
<b>Liabilities</b>			
Amounts due to credit institutions	14	31,729	3,431
Amounts due to customers	15	42,022	7,326
Other liabilities	13	1,983	115
Income tax liability	11	75	-
<b>Total liabilities before subordinated debt</b>		<b>75,809</b>	<b>10,872</b>
<b>Subordinated debt</b>	16	8,611	5,379
<b>Total liabilities</b>		<b>84,420</b>	<b>16,251</b>
<b>Equity</b>			
Share capital	17	12,600	6,900
Retained earnings		1,096	412
<b>Total equity</b>		<b>13,696</b>	<b>7,312</b>
<b>Total liabilities and equity</b>		<b>98,116</b>	<b>23,563</b>

Signed and authorised for release on behalf of the Management Board of the Bank

George Kalandarishvili

General Director

Irina Vorman

Chief Accountant

**February 19, 2007***The accompanying notes on pages 5 to 27 are an integral part of these financial statements.*

**STATEMENT OF INCOME****For the year ended December 31, 2006***(Thousands of Georgian Laries)*

	<i>Notes</i>	<i>2006</i>	<i>2005</i>
<b>Interest income</b>			
Loans to customers		7,439	2,908
Amounts due from credit institutions		1,396	83
Securities		8	1
		<u>8,843</u>	<u>2,992</u>
<b>Interest expense</b>			
Amounts due to customers		1,151	413
Amounts due to credit institutions		2,288	335
		<u>3,439</u>	<u>748</u>
<b>Net interest income</b>		<u>5,404</u>	<u>2,244</u>
Provision for impairment of interest earning assets	12	1,071	223
<b>Net interest income after provision for impairment of interest earning assets</b>		<u>4,333</u>	<u>2,021</u>
Fee and commission income		1,343	165
Fee and commission expense		749	124
<b>Net fee and commission income</b>	19	<u>594</u>	<u>41</u>
Gains less losses from foreign currencies:			
- dealing		675	132
- translation differences		(74)	(80)
Other income		38	227
<b>Other non interest income</b>		<u>639</u>	<u>279</u>
Salaries and benefits	20	2,163	1,044
Administrative expenses	20	1,970	927
Depreciation and amortisation		540	199
Impairment of other assets and provisions/(reversal)	12	(24)	40
<b>Other non interest expense</b>		<u>4,649</u>	<u>2,210</u>
<b>Profit before income tax expense</b>		<u>917</u>	<u>131</u>
Income tax expense /(benefit)	11	233	(84)
<b>Profit for the year</b>		<u>684</u>	<u>215</u>

*The accompanying notes on pages 5 to 27 are an integral part of these financial statements.*

**STATEMENT OF CHANGES IN EQUITY****For the year ended December 31, 2006***(Thousands of Georgian Laries)*

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total</i>
<b>December 31, 2004</b>	<b>6,900</b>	<b>197</b>	<b>7,097</b>
Profit for the year	-	215	215
<b>December 31, 2005</b>	<b>6,900</b>	<b>412</b>	<b>7,312</b>
Issue of share capital (Note 17)	5,700	-	5,700
Profit for the year	-	684	684
<b>December 31, 2006</b>	<b>12,600</b>	<b>1,096</b>	<b>13,696</b>

*The accompanying notes on pages 5 to 27 are an integral part of these financial statements.*

**STATEMENT OF CASH FLOWS****For the year ended December 31, 2006***(Thousands of Georgian Laries)*

	<b>Notes</b>	<b>2006</b>	<b>2005</b>
<b>Cash flows from operating activities</b>			
Interest received		8,466	2,898
Interest paid		(2,421)	(676)
Fees and commissions received		1,343	165
Fees and commissions paid		(749)	(124)
Realised gains less losses from dealing in foreign currencies		601	132
Other income/(expenses) received/(paid)		48	(46)
Salaries and benefits paid		(1,732)	(1,044)
Administrative expenses		(1,970)	(927)
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>		<b>3,586</b>	<b>378</b>
<i>Net (increase)/decrease in operating assets</i>			
Amounts due from credit institutions		(6,832)	(662)
Loans to customers		(38,304)	(13,599)
Other assets		(528)	(71)
<i>Net increase / (decrease) in operating liabilities</i>			
Amounts due to credit institutions		27,089	3,431
Amounts due to customers		34,201	3,951
Other liabilities		1,424	(13)
<b>Net cash flows from operating activities before income tax</b>		<b>20,636</b>	<b>(6,585)</b>
Income tax paid		-	-
<b>Net cash from/(used in) operating activities</b>		<b>20,636</b>	<b>(6,585)</b>
<b>Cash flows from investing activities</b>			
Purchase of investment securities		(7,266)	(14)
Purchase of property and equipment		(8,227)	(604)
Purchase of intangible assets		(73)	(160)
Proceeds from sale of intangible assets		22	-
Proceeds from sale of property and equipment		72	487
<b>Net cash used in investing activities</b>		<b>(15,472)</b>	<b>(291)</b>
<b>Cash flows from financing activities</b>			
Proceeds from issue of share capital		5,700	-
Proceeds from subordinated debt		3,822	5,379
Repayment of subordinated debt		(590)	-
<b>Net cash from financing activities</b>		<b>8,932</b>	<b>5,379</b>
Effect of exchange rates changes on cash and cash equivalents		(59)	(62)
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>14,037</b>	<b>(1,559)</b>
<b>Cash and cash equivalents, beginning</b>		<b>2,257</b>	<b>3,816</b>
<b>Cash and cash equivalents, ending</b>	5	<b>16,294</b>	<b>2,257</b>

*The accompanying notes on pages 5 to 27 are an integral part of these financial statements.*

(Thousands of Georgian Laries)

## 1. Principal activities

JSC Standard Bank (the “Bank”) was founded on the basis of JSC Agro-business Bank of Georgia (“ABG”), on June 7, 2005. 100% of ABG shares were purchased by four foreign companies. National Bank of Georgia (“NBG”) granted a full scope banking license to ABG on December 10, 1999, and the Bank commenced its banking operations on February 21, 2000. ABG was founded for the purpose of facilitating the development of Georgian agriculture, by providing relatively cheap, national currency denominated financing to farmers and other companies/individuals employed in this sector of economy.

Presently the Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides other banking services to its commercial and retail customers. Its main office is in Tbilisi and at December 31, 2006 it has 12 branches around the country (2005 – 6). As of December 31, 2006 the Bank had 267 employees (2005 – 71).

The Bank’s registered legal address is Chavchavadze Avenue 43, Tbilisi, Georgia.

As of December 31, 2006 and 2005 shareholders of the Bank were:

<b>Shareholder</b>	<b>2006</b> <b>%</b>	<b>2005</b> <b>%</b>
Standard Capital Georgia Ltd.	75	
Financial Investment Management Company Ltd.	25	
Discovery Investment Holding Ltd.	-	25
Lucente Investments Inc.	-	25
Webster Group Inc.	-	25
Westfor Panally Ltd.	-	25
<b>Total</b>	<b>100</b>	<b>100</b>

The ultimate beneficial owner of the Bank is Mr. Irakli Rukhadze, a USA citizen.

## 2. Basis of preparation

### General

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”).

The Bank is required to maintain its records and prepare its financial statements for regulatory purposes in Georgian Laries in accordance with Georgian accounting and banking legislation and related instructions. These financial statements are based on the Bank’s books and records, as adjusted and reclassified in order to comply with IFRS.

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. These financial statements are presented in thousands of Georgian Laries (“GEL”), unless otherwise indicated.

### Changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial year except for the adoption of the amendment to IAS 39 “Financial Instruments: Recognition and Measurement”: Financial Guarantees, effective for annual periods beginning on or after January 1, 2006. The amendment addresses the treatment of financial guarantee contracts by the issuer. Under the amended IAS 39, financial guarantee contracts are recognized initially at fair value and subsequently re-measured at the higher of the amount determined in accordance with IAS 37 “Provisions, Contingent Liabilities and Contingent Assets” and the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with IAS 18 “Revenue”.

The adoption of the above pronouncement did not have a significant impact on the Bank’s financial statements.

(Thousands of Georgian Laries)

## 2. Basis of preparation (continued)

### IFRSs and IFRIC interpretations not yet effective

The Bank has not applied the following IFRSs and Interpretations of the International Financial Reporting Interpretations Committee (IFRIC) that have been issued but are not yet effective:

IFRS 7 “Financial Instruments: Disclosures”;  
 Amendment to IAS 1 “Presentation of financial Statements” – “Capital Disclosures”;  
 IFRIC 8 “Scope of IFRS 2”;  
 IFRIC 9 “Reassessment of Embedded Derivatives”;  
 IFRIC 10 “Interim Financial Reporting and Impairment”;  
 IFRIC 11 “IFRS 2 – Group and Treasury Share Transactions”;  
 IFRIC 12 “Service Concession Arrangements”

The Bank expects that the adoption of the pronouncements listed above will have no significant impact on the Bank’s financial statements in the period of initial application, except for the inclusion of new disclosures in accordance with IFRS 7 to enable users of the financial statements to evaluate the significance of the Bank’s financial instruments, the nature and extent of risks arising from those financial instruments, and the Bank’s objectives, policies and processes for managing capital.

### Reclassifications

The following reclassifications have been made to 2005 balances to conform to the 2006 presentation:

<i>Amount</i>	<i>Previously reported</i>	<i>As reclassified</i>	<i>Comment</i>
Amounts owed to related parties	7,200	-	To reclassify amounts owed to related parties from Amounts owed to related parties caption to Subordinated debt caption and Amounts owed to credit institutions caption
Subordinated Debt	-	5,379	To reclassify subordinated debt from Owed to related parties caption to Subordinated debt caption
Amounts owed to credit institutions	1,610	3,431	To reclassify other loans owed to related parties from Amounts owed to related parties caption to Subordinated debt caption

## 3. Summary of accounting policies

### Financial assets

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets upon initial recognition.

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Bank commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

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

Financial assets classified as held for trading are included in the category ‘financial assets at fair value through profit or loss’. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognised in the statement of income.

(Thousands of Georgian Laries)

### 3. Summary of accounting policies (continued)

#### Financial assets (continued)

##### *Held-to-maturity investments*

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Bank has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortised cost. This cost is computed as the amount initially recognised minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initially recognised amount and the maturity amount. This calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts. For investments carried at amortised cost, gains and losses are recognised in the statement of income when the investments are impaired, as well as through the amortisation process.

##### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the statement of income when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

##### *Available-for-sale financial assets*

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the statement of income. However, interest calculated using the effective interest method is recognised in the statement of income.

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions, reference to the current market value of another instrument, which is substantially the same and discounted cash flow analysis.

#### Offsetting

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

#### Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from National Bank of Georgia, excluding obligatory reserves, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

#### Derivative financial instruments

In the normal course of business, from time to time, the Bank enters into various derivative financial instruments including swaps in the foreign exchange and capital markets. Such financial instruments are held for trading and are initially recognised in accordance with the policy for initial recognition of financial instruments and are subsequently measured at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of income as gains less losses from trading securities or gains less losses from foreign currencies dealing, depending on the nature of the instrument.

(Thousands of Georgian Laries)

### 3. Summary of accounting policies (continued)

#### **Borrowings**

Borrowings, which include amounts due to the National Bank of Georgia (“NBG”), amounts due to credit institutions, amounts due to customers and debt securities issued, are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the statement of income when the borrowings are derecognised as well as through the amortisation process.

#### **Allowances for impairment of financial assets**

The Bank assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

##### *Assets carried at amortised cost*

If there is objective evidence that an impairment loss on financial assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the impairment loss is recognised in the statement of income.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not the foreclosure is probable.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

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. Any subsequent reversal of an impairment loss is recognised in the statement of income, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

When an asset is uncollectible, it is written off against the related allowance for impairment. Such assets are written off after all necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the charge for impairment of financial assets in the statement of income.

##### *Available-for-sale financial assets*

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the statement of income, is transferred from equity to the statement of income. Reversals in respect of equity instruments classified as available-for-sale are not recognised in the statement of income. Reversals of impairment losses on debt instruments are reversed through the statement of income if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

#### **Derecognition of financial assets and liabilities**

##### *Financial assets*

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

- the rights to receive cash flows from the asset have expired;
- the Bank has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a ‘pass-through’ arrangement; and
- the Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

(Thousands of Georgian Laries)

### 3. Summary of accounting policies (continued)

#### Derecognition of financial assets and liabilities (continued)

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

#### Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the statement of income.

#### Taxation

The current income tax expense is calculated in accordance with the regulations of the Georgian Tax Code.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Georgia also has various operating taxes that are assessed on the Bank activities. These taxes are included as a component of other operating expenses.

#### Property and equipment

Property and equipment is carried at cost less accumulated depreciation and any accumulated impairment in value. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met. Buildings are measured at fair value less depreciation and impairment charged subsequent to the date of the revaluation.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	<u>Years</u>
Buildings	25
Furniture and fixtures	5
Computers and office equipment	5
Motor vehicles	5

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

Costs related to repairs and renewals are charged when incurred and included in other operating expenses, unless they qualify for capitalization.

*(Thousands of Georgian Laries)*

### 3. Summary of accounting policies (continued)

#### **Intangible assets**

Intangible assets include computer software and licences.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic lives of 3 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end.

Intangible assets with indefinite useful lives are not amortised, but tested for impairment annually either individually or at the cash-generating unit level. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable.

#### **Foreclosed assets**

Foreclosed assets comprise assets that ownership title for which was transferred to the Bank as a result of the failure by the Bank's borrowers to repay loans. Practically, these are the assets foreclosed by the Bank from its defaulted borrowers and they have been initially placed as a security against loans obtained by these borrowers from the Bank.

Foreclosed assets are recognized by the Bank when respective ownership title to an asset is approved by the legitimate court. Foreclosed assets are initially recognized and further carried at cost.

When foreclosed assets are further realized by the Bank, any difference between the carrying value of the asset and the fair value of consideration received for such assets is granted back to the default borrower.

#### **Provisions**

Provisions are recognised 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 amount of obligation can be made.

#### **Segment reporting**

The Bank's operations are highly integrated and constitute a single industry segment, banking, which accounts for 100% of the Bank's business. Accordingly, for the purposes of IAS 14 "Segment Reporting", the Bank is treated as one business segment. The Bank's assets are concentrated in Georgia, and the majority of the Bank's revenues and net income is derived from operations in, and connected with, Georgia.

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

The Bank does not have any pension arrangements separate from the State pension system of the Georgia, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such expense is charged in the period the related salaries are earned. In addition, the Bank has no post-retirement benefits or significant other compensated benefits requiring accrual.

#### **Share capital**

##### *Share capital*

Share capital is recognized at cost. Any excess of the fair value of consideration received over the par value of shares issued is recognised as additional paid-in capital.

##### *Dividends*

Dividends are recognised as a liability and deducted from equity at the balance sheet date only if they are declared before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the financial statements are authorised for issue.

(Thousands of Georgian Laries)

### 3. Summary of accounting policies (continued)

#### Contingencies

Contingent liabilities are not recognised in the balance sheet but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognised in the balance sheet but disclosed when an inflow of economic benefits is probable.

#### Income and expense recognition

Interest income and expense are recognised on an accrual basis calculated using the effective interest method. Loan origination fees for loans issued to customers are deferred (together with related direct costs) and recognised as an adjustment to the effective yield of the loans. Fees, commissions and other income and expense items are generally recorded on an accrual basis when the service has been provided.

#### Foreign currency translation

The financial statements are presented in Georgian Laries, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the statement of income as gains less losses from foreign currencies - translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the National Bank of Georgia ("NBG") exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official NBG exchange rates at December 31, 2006 and 2005 were GEL 1.7135 and GEL 1.7925 to 1 USD, respectively.

### 4. Significant accounting judgements and estimates

#### Judgements

In the process of applying the Bank's accounting policies, management has made the following judgements, apart from those involving estimates, which have the most significant effect on the amounts recognised in the financial statements:

- *Classification of investment securities as held to maturity;*
- *Useful life periods for the tangible and intangible assets*
- *Tax accruals*

#### Estimation uncertainty

The 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 year are discussed below:

##### *Allowance for impairment of loans and receivables*

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its experienced judgement to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its experienced judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

*(Thousands of Georgian Laries)***5. Cash and cash equivalents**

As of December 31, cash and cash equivalents comprise:

	<u>2006</u>	<u>2005</u>
Cash on hand	3,733	734
Current accounts with the National Bank of Georgia	45	392
Current accounts with other credit institutions	12,516	1,131
<b>Cash and cash equivalents</b>	<b><u>16,294</u></b>	<b><u>2,257</u></b>

As of December 31, 2006 current accounts with two Georgian banks accounted for 97% of the total balance of current accounts with other credit institutions.

**6. Amounts due from credit institutions**

As of December 31, amounts due from credit institutions comprise:

	<u>2006</u>	<u>2005</u>
Obligatory reserve with the National Bank of Georgia	5,345	782
Time deposits for more than 90 days or overdue	2,385	-
Other amounts	33	78
<b>Amounts due from credit institutions</b>	<b><u>7,763</u></b>	<b><u>860</u></b>

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the National Bank of Georgia, the amount of which depends on the level of funds attracted by the credit institution. The Bank's ability to withdraw such deposit is significantly restricted by the statutory legislation.

As of December 31, 2006, there were no inter-bank loans placed with Georgian Banks.

During 2006, the Bank placed with and received short-term funds from Georgian Banks in Georgian Laries and US Dollars. As of December 31, 2006, the Bank placed an equivalent of GEL 45 (2005 - GEL 0) as deposits in USD in two Georgian banks with average interest rate of 1.5%, GEL 338 (2005 - 0) as deposit in EUR in one Georgian bank bearing 8% interest rate and GEL 2,001 (2005 - GEL 0) as deposit in Georgian Laries in one Georgian Bank bearing interest rate of 9%.

**7. Loans to customers**

As of December 31, loans to customers comprise:

	<u>2006</u>	<u>2005</u>
Loans to customers	56,488	18,722
Overdrafts	2,220	703
	<b><u>58,708</u></b>	<b><u>19,425</u></b>
Less – Allowance for loan impairment (Note 12)	(1,404)	(447)
<b>Loans to customers</b>	<b><u>57,304</u></b>	<b><u>18,978</u></b>

As of December 31, 2006, the Bank had a concentration of loans represented by GEL 19,638 due from the ten largest third party entities (33% of gross loan portfolio) (2005 – GEL 7,821 or 40%). An allowance of GEL 391 (2005 – GEL 157) was established against these loans.

As of December 31, loans have been extended to the following types of customers:

	<u>2006</u>	<u>2005</u>
Private companies	50,562	10,073
Individuals	8,146	9,352
	<b><u>58,708</u></b>	<b><u>19,425</u></b>
Less – Allowance for loan impairment (Note 12)	(1,404)	(447)
<b>Loan to customers</b>	<b><u>57,304</u></b>	<b><u>18,978</u></b>

(Thousands of Georgian Laries)

**7. Loans to customers (continued)**

As of December 31 loans, are made principally within Georgia in the following industry sectors:

	<u>2006</u>	<u>2005</u>
Trading and service enterprises	17,023	6,925
Individuals	10,365	3,243
Energy	6,983	-
Agriculture and food processing	4,883	3,232
Gold Pawn	17,215	-
Real estate construction	1,150	4,333
Transport & telecommunication	939	512
Metallurgy	17	-
Other	133	1,180
	<u>58,708</u>	<u>19,425</u>
Less – Allowance for loan impairment (Note 12)	(1,404)	(447)
<b>Loans to customers</b>	<u><u>57,304</u></u>	<u><u>18,978</u></u>

**8. Investment securities held-to-maturity**

As of December 31, investment securities held-to-maturity comprise:

	<u>2006</u>		<u>2005</u>	
	<u>Carrying value</u>	<u>Nominal value</u>	<u>Carrying value</u>	<u>Nominal value</u>
Treasury bills of the NBG	7,266	7,274	-	-
<b>Held-to-maturity securities</b>	<u>7,266</u>	<u>7,274</u>	<u>-</u>	<u>-</u>

Nominal interest rates and maturities of these securities are as follows:

	<u>2006</u>		<u>2005</u>	
	<u>%</u>	<u>Maturity</u>	<u>%</u>	<u>Maturity</u>
Treasury bills of the NBG	10%	January 2007	-	-

**9. Property and equipment**

The movements in property and equipment for the years 2006 and 2005 were as follows:

	<u>Buildings</u>	<u>Furniture and fixtures</u>	<u>Motor vehicles</u>	<u>Leasehold Improvements</u>	<u>Assets under construction</u>	<u>Total</u>
<b>Cost</b>						
<b>December 31, 2005</b>	98	621	284	153	-	1,156
Additions	4,333	2,214	202	1,397	22	8,168
Disposals	-	(40)	(32)	-	-	(72)
<b>December 31, 2006</b>	<u>4,431</u>	<u>2,795</u>	<u>454</u>	<u>1,550</u>	<u>22</u>	<u>9,252</u>
<b>Accumulated depreciation</b>						
<b>December 31, 2005</b>	58	141	84	42	-	325
Depreciation charge	101	235	67	47	-	450
Disposals	-	(40)	(20)	-	-	(60)
<b>December 31, 2006</b>	<u>159</u>	<u>336</u>	<u>131</u>	<u>89</u>	<u>-</u>	<u>715</u>
<b>Net book value:</b>						
<b>December 31, 2005</b>	<u>40</u>	<u>480</u>	<u>200</u>	<u>111</u>	<u>-</u>	<u>831</u>
<b>December 31, 2006</b>	<u>4,272</u>	<u>2,459</u>	<u>323</u>	<u>1,461</u>	<u>22</u>	<u>8,537</u>

(Thousands of Georgian Laries)

**9. Property and equipment (continued)**

	<i>Buildings</i>	<i>Furniture, fixtures and equipment</i>	<i>Vehicles</i>	<i>Leasehold improvements</i>	<i>Total</i>
<b>Cost</b>					
December 31, 2004	374	448	101	82	1,005
Additions	–	339	211	88	638
Disposals	(276)	(166)	(28)	(17)	(487)
<b>December 31, 2005</b>	<b>98</b>	<b>621</b>	<b>284</b>	<b>153</b>	<b>1,156</b>
<b>Accumulated depreciation</b>					
December 31, 2004	61	251	37	17	366
Charge for the year	7	60	60	25	152
Disposals	(10)	(170)	(13)	–	(193)
<b>December 31, 2005</b>	<b>58</b>	<b>141</b>	<b>84</b>	<b>42</b>	<b>325</b>
<b>Net book value</b>					
December 31, 2004	313	197	64	65	639
<b>December 31, 2005</b>	<b>40</b>	<b>480</b>	<b>200</b>	<b>111</b>	<b>831</b>

**10. Intangible assets**

The movements in intangible assets for the years 2006 and 2005 were as follows:

	<i>Licences</i>	<i>Computer software</i>	<i>Total</i>
<b>Cost</b>			
December 31, 2005	231	29	260
Additions	42	9	51
Disposals	–	(22)	(22)
<b>December 31, 2006</b>	<b>273</b>	<b>16</b>	<b>289</b>
<b>Accumulated amortization and impairment</b>			
December 31, 2005	39	16	55
Amortisation charge	84	7	91
Disposals	–	(22)	(22)
<b>December 31, 2006</b>	<b>123</b>	<b>1</b>	<b>124</b>
<b>Net book value:</b>			
December 31, 2005	192	13	205
<b>December 31, 2006</b>	<b>150</b>	<b>15</b>	<b>165</b>
<b>Cost</b>			
December 31, 2004	–	22	22
Additions	231	7	238
<b>December 31, 2005</b>	<b>231</b>	<b>29</b>	<b>260</b>
<b>Accumulated amortization and impairment</b>			
December 31, 2004	–	8	8
Amortisation charge	39	8	47
<b>December 31, 2005</b>	<b>39</b>	<b>16</b>	<b>55</b>
<b>Net book value:</b>			
December 31, 2004	–	14	14
<b>December 31, 2005</b>	<b>192</b>	<b>13</b>	<b>205</b>

(Thousands of Georgian Laries)

## 11. Taxation

The corporate income tax expense comprises:

	<u>2006</u>	<u>2005</u>
Current tax charge	-	-
Deferred tax charge/(benefit) – origination of temporary differences	233	(84)
<b>Income tax expense</b>	<b><u>233</u></b>	<b><u>(84)</u></b>

Georgian legal entities must individually report taxable income and remit profit taxes thereon to the appropriate authorities. The tax rate for banks for profits other than on state securities was 20% in 2006 and 2005. The tax rate for interest income on state securities was 10%.

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	<u>2006</u>	<u>2005</u>
<b>Profit/(loss) before tax</b>	<b>917</b>	<b>131</b>
Statutory tax rate	20%	20%
<b>Theoretical income tax expense at the statutory rate</b>	<b>183</b>	<b>26</b>
Tax exempt income	-	(110)
Non-deductible expenditures	50	-
<b>Income tax expense/(benefit)</b>	<b><u>233</u></b>	<b><u>(84)</u></b>

Georgia currently has a number of laws related to various taxes imposed by state authorities. Applicable taxes include value added tax, corporate income tax (profit tax), and payroll (social), together with other. Laws related to these taxes have not been in force for significant periods, in contrast to the more developed market economies. Therefore, regulations are often unclear or nonexistent and few precedents have been established. This creates tax risks in Georgia substantially more significant than typically found in countries with more developed tax systems. Management believes that the Bank is in substantial compliance with the tax laws affecting its operations. However, the risk remains that relevant authorities could take differing positions with regard interpretive issues.

Deferred tax assets and liabilities comprise:

	<u>2006</u>	<u>2005</u>
<b>Tax effect of deductible temporary differences</b>		
Tax loss carried forward	25	134
Loans to customers	-	24
<b>Total tax effect of deductible temporary differences</b>	<b>25</b>	<b>158</b>
Unrecognized deferred tax assets	-	-
<b>Deferred tax asset</b>	<b>25</b>	<b>158</b>
<b>Tax effect of taxable temporary differences</b>		
Accumulated depreciation	(10)	-
Other assets	(45)	-
Allowance for impairment of other assets	(22)	-
Other liabilities	(24)	-
<b>Deferred tax liability</b>	<b><u>(101)</u></b>	<b><u>-</u></b>
<b>Deferred tax liability</b>	<b>(76)</b>	<b>-</b>

Tax loss carried forward was not utilized in 2006. As of December 31, 2006 the Bank had the amount of tax loss carried forward equal to KGEL 123.

(Thousands of Georgian Laries)

Tax assets and liabilities consist of the following:

	<u>2006</u>	<u>2005</u>
Current tax asset	87	87
Deferred tax asset	-	158
	<u>87</u>	<u>245</u>
Current tax liability	-	-
Deferred tax liability	75	-
	<u>75</u>	<u>-</u>

## 12. Allowance for impairment and provisions

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

	<u>Loans to customers</u>
<b>December 31, 2004</b>	<b>285</b>
Charge	223
Write-offs	(118)
Recoveries	57
<b>December 31, 2005</b>	<b>447</b>
Charge	1,071
Write-offs	(147)
Recoveries	33
<b>December 31, 2006</b>	<b>1,404</b>

The movements in allowances for other assets and provisions were as follows:

	<u>Other assets</u>	<u>Legal claims</u>	<u>Total</u>
<b>December 31, 2004</b>	<b>56</b>	<b>-</b>	<b>56</b>
Charge	15	25	40
Write-offs	(3)	-	(3)
<b>December 31, 2005</b>	<b>68</b>	<b>25</b>	<b>93</b>
Charge (reversal)	1	(25)	(24)
Write-offs	(2)	-	(2)
<b>December 31, 2006</b>	<b>67</b>	<b>-</b>	<b>67</b>

Allowances for impairment of assets are deducted from the carrying amounts of the related assets. In accordance with the Georgian legislation, loans may only be written off with the approval of the Board of Directors and, in certain cases, with the respective decision of the Court.

## 13. Other assets and liabilities

As of December 31, other assets comprise:

	<u>2006</u>	<u>2005</u>
Prepayments	580	-
Foreclosed assets	82	133
Fixed asset prepayments	38	99
Net positive replacement value of SWAP agreement	48	-
Investment securities	-	14
Prepaid operating taxes	5	4
Other debtors	14	5
	<u>767</u>	<u>255</u>
Less – Allowance for impairment of other assets (Note 12)	(67)	(68)
<b>Other assets</b>	<b>700</b>	<b>187</b>

(Thousands of Georgian Laries)

As of December 31, other liabilities comprise:

	<u>2006</u>	<u>2005</u>
Sundry creditors	1,931	86
Other taxes payable	40	-
Provisions for contingent liabilities	-	25
Other	12	4
<b>Other liabilities</b>	<b><u>1,983</u></b>	<b><u>115</u></b>

#### 14. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	<u>2006</u>	<u>2005</u>
Time deposits	24,162	1,001
Loans from credit institutions	7,567	2,430
<b>Amounts due to credit institutions</b>	<b><u>31,729</u></b>	<b><u>3,431</u></b>

During 2006, the Bank placed with and received short-term funds from Georgian banks in different currencies. As of December 31, 2006, the Bank received equivalent of GEL 20,103 (2005 – GEL 1,001) as deposits in Georgian Laries and GEL 4,059 (2005 – GEL 0) as deposit in US Dollars in Georgian Banks.

#### 15. Amounts due to customers

As of December 31, the amounts owed to customers include the following:

	<u>2006</u>	<u>2005</u>
Current accounts	24,403	2,640
Time deposits	17,619	4,686
<b>Amounts due to customers</b>	<b><u>42,022</u></b>	<b><u>7,326</u></b>
<b>Held as security against letters of credit</b>	<b>-</b>	<b>23</b>
<b>Held as security against guarantees</b>	<b>2,075</b>	<b>60</b>

As of December 31, 2006, the ten largest customers represented 44% of total amount due to customers (2005 – 61%) . Current accounts of the Bank's customers are non-interest bearing. Time deposit accounts bear 2% – 16% annual interest (2.75% – 11% in 2005).

Included in time deposits are deposits of individuals in the amount of GEL 26,301 (2005 – GEL 3,605). In accordance with the Georgian Civil Code, the Bank is obliged to repay such deposits upon demand of a depositor. In case a term deposit is repaid upon demand of the depositor prior to maturity, interest on it is paid based on the interest rate for demand deposits, unless a different interest rate is specified in the agreement.

Amounts due to customers include accounts with the following types of customers:

	<u>2006</u>	<u>2005</u>
Individuals	25,562	3,561
Private enterprises	4,497	869
Employees	739	44
State and budgetary organisations	16	-
Other	11,208	2,852
<b>Amounts due to customers</b>	<b><u>42,022</u></b>	<b><u>7,326</u></b>

(Thousands of Georgian Laries)

An analysis of customer accounts by economic sector follows:

	<u>2006</u>	<u>2005</u>
Individuals including employees	26,301	3,605
Energy	1,985	-
Trade	1,972	632
Real estate constructions	387	-
Transport and communication	150	-
Agriculture	3	58
Insurance	-	179
Other	11,224	2,852
<b>Amounts due to customers</b>	<b><u>42,022</u></b>	<b><u>7,326</u></b>

## 16. Subordinated debt

As of December 31, 2006 the balance of the subordinated loan comprised the following:

	<u>2006</u>	<u>2005</u>
Standard Capital Georgia Ltd (US dollar denominated, granted September 29, 2005; 10 equal annual payments with annual interest rate of 11%, maturing September 29, 2015)	5,167	5,379
Standard Capital Georgia Ltd (US dollar denominated, granted December 15, 2006; 10 equal annual payments, with annual interest rate of 11%, maturing December 15, 2015)	3,444	-
<b>Subordinated Debt</b>	<b><u>8,611</u></b>	<b><u>5,379</u></b>

In the event of bankruptcy or liquidation of the Bank, repayment of these loans is subordinate to the repayment of the Bank's liabilities to all other creditors.

## 17. Equity

The number of authorised ordinary shares is 252 (2005 - 138), with a nominal value per share of GEL 50. All authorised shares have been issued and fully paid. During 2006 the Bank issued additional 114,000 shares with a nominal value per share of GEL 50. All shares were issued at par value.

The share capital of the Bank was contributed by the shareholders in Georgian Laries and they are entitled to dividends and any capital distribution in Georgian Laries. The Bank has not thus far declared any dividends for both of the years 2006 and 2005.

## 18. Commitments and contingencies

### Operating environment

The Georgian economy while deemed to be of market status continues to display certain characteristics consistent with that of a market in transition. These characteristics include, but are not limited to, relatively high inflation and the existence of currency controls which cause the national currency to be illiquid outside of Georgia. The stability of the Georgian economy will be significantly impacted by the government's policies and actions with regards to supervisory, legal, and economic reforms.

### Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

(Thousands of Georgian Laries)

### Taxation

Georgian tax, currency and customs legislation are subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant regional and central authorities. Recent events within Georgia suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at December 31 2006 management believes that its interpretation of the relevant legislation is appropriate and that the Bank's tax, currency and customs positions will be sustained.

### Financial commitments and contingencies

As of December 31, the Bank's financial commitments and contingencies comprised the following:

	<u>2006</u>	<u>2005</u>
<b>Credit related commitments</b>		
Undrawn loan commitments	5,397	214
Guarantees and letters of credit	5,521	906
	<u>10,918</u>	<u>1,120</u>
<b>Operating lease commitments</b>		
Not later than 1 year	693	71
Later than 1 year but not later than 5 years	2,345	252
Later than 5 years	1,567	106
	<u>4,605</u>	<u>429</u>
Less – Provisions	-	(4)
Less – Cash held as security against letters of credit and guarantees	(2,075)	(23)
<b>Financial commitments and contingencies</b>	<u>13,448</u>	<u>1,522</u>

## 19. Net fee and commission income

Net fee and commission income comprises:

	<u>2006</u>	<u>2005</u>
Cash collection	603	60
Currency conversion operations	102	6
Settlement operations	32	1
Other	606	98
<b>Fee and commission income</b>	<u>1,343</u>	<u>165</u>
Cash operations	284	28
Settlements operations	209	26
Advisory services	172	50
Currency conversion operations	6	2
Other	78	18
<b>Fee and commission expense</b>	<u>749</u>	<u>124</u>
<b>Net fee and commission income</b>	<u>594</u>	<u>41</u>

(Thousands of Georgian Laries)

## 20. Salaries and other operating expenses

Salaries and benefits, and other operating expenses comprise:

	<b>2006</b>	<b>2005</b>
Salaries and bonuses	1,709	773
Social security costs	454	271
<b>Salaries and other employee benefits</b>	<b>2,163</b>	<b>1,044</b>
Business development	628	195
Communication and supplies	255	120
Fines and penalties incurred	10	121
Occupancy and rent	385	118
Professional services	-	82
Operating taxes	188	15
Other	504	276
<b>Administrative expenses</b>	<b>1,970</b>	<b>927</b>

## 21. Financial risk management

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

### Credit risk

The Bank is exposed to credit risk which is the risk that a counter party will be unable to pay amounts in full when due. 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, and to industry segments. Limits on the level of credit risk by borrower and product are approved monthly by the Management Board. Where appropriate, and in the case of most loans, the Bank obtains collateral. Such risks are monitored on a continuous basis and subject to annual or more frequent reviews.

### Credit risk (continued)

The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Credit Committee. The maximum credit risk exposure, ignoring the fair value of any collateral, in the event other parties fail to meet their obligations under financial instruments is equal to the carrying value of financial assets as presented in the accompanying financial statements and the disclosed financial commitments.

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.

### Geographical concentration

As of December 31, 2006 and 2005 substantially all assets and liabilities are concentrated in Georgia.

### Market risk

The Bank takes on exposure to market risks. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The Bank manages market 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.

*(Thousands of Georgian Laries)***21. Financial risk management (continued)****Currency risk**

The Bank is exposed to effects of fluctuation 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 (primarily USD), by branches and in total. These limits also comply with the minimum requirements of the National Bank of Georgia. The Bank's exposure to foreign currency exchange rate risk is as follows:

	<b>2006</b>				
	<b>GEL</b>	<b>USD</b>	<b>EUR</b>	<b>Other currencies</b>	<b>Total</b>
<b>Assets:</b>					
Cash and cash equivalents	10,641	4,011	1,637	5	16,294
Due from credit institutions	7,347	78	338	-	7,763
Loans to customers	7,553	49,495	256	-	57,304
Investment securities held-to-maturity	7,266	-	-	-	7,266
All other assets	9,480	7	2	-	9,489
	<b>42,287</b>	<b>53,591</b>	<b>2,233</b>	<b>5</b>	<b>98,116</b>
<b>Liabilities:</b>					
Due to credit institutions	20,104	11,625	-	-	31,729
Due to customers	7,129	32,665	2,206	6	42,006
Due to state institutions	16	-	-	-	16
Subordinated debt	-	8,611	-	-	8,611
All other liabilities	440	1,526	92	-	2,058
	<b>27,689</b>	<b>54,427</b>	<b>2,298</b>	<b>6</b>	<b>84,420</b>
<b>Net balance sheet position</b>	<b>14,598</b>	<b>(836)</b>	<b>(65)</b>	<b>(1)</b>	<b>13,696</b>
	<b>2005</b>				
	<b>GEL</b>	<b>USD</b>	<b>EUR</b>	<b>Other currencies</b>	<b>Total</b>
<b>Assets:</b>					
Cash and cash equivalents	1,590	417	248	2	2,257
Amounts due from credit institutions	782	49	29	-	860
Loans to customers	4,648	14,330	-	-	18,978
Investment securities held-to-maturity	-	-	-	-	-
All other assets	1,464	3	1	-	1,468
	<b>8,484</b>	<b>14,799</b>	<b>278</b>	<b>2</b>	<b>23,563</b>
<b>Liabilities:</b>					
Amounts due to credit institutions	1,001	2,430	-	-	3,431
Amounts due to customers	1,270	5,864	191	1	7,326
Subordinated debt	-	5,379	-	-	5,379
All other liabilities	115	-	-	-	115
	<b>2,386</b>	<b>13,673</b>	<b>191</b>	<b>1</b>	<b>16,251</b>
<b>Net balance sheet position</b>	<b>6,098</b>	<b>1,126</b>	<b>87</b>	<b>1</b>	<b>7,312</b>

The Bank's principal cash flows (revenues, operating expenses) are largely generated in Georgian Laries. As a result, future movements in the exchange rate between the Georgian Laries and USD will affect the carrying value of the Bank's USD denominated monetary assets and liabilities.

*(Thousands of Georgian Laries)***21. Financial risk management (continued)****Interest rate risk**

Interest rate risk arises from the possibility that changes in interest rates will affect the fair value of the financial instruments or the future cash flows on financial instruments. The Bank's interest rate policy is reviewed and approved by the Bank's Assets and Liabilities Management Committee. The Bank sets limits on the level of mismatch of interest rate re-pricing that may be undertaken.

The table below summarises the Bank exposure to interest rate risk as at December 31, 2006. Included in the table are the Bank's monetary assets and liabilities at carrying amounts, classified by the earlier of contractual re-pricing or maturity dates.

	2006							Total
	On demand	Less than 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Past due	
<b>Assets:</b>								
Cash and cash equivalents	16,294	-	-	-	-	-	-	16,294
Amounts due from credit institutions	5,346	2,339	-	-	-	78	-	7,763
Loans to customers	-	549	9,451	22,000	22,599	2,597	108	57,304
Investment securities held-to-maturity	-	7,266	-	-	-	-	-	7,266
	<b>21,640</b>	<b>10,154</b>	<b>9,451</b>	<b>22,000</b>	<b>22,599</b>	<b>2,675</b>	<b>108</b>	<b>88,627</b>
<b>Liabilities:</b>								
Amounts due to state institutions	16	-	-	-	-	-	-	16
Amounts due to credit institutions	-	23,255	-	4,579	3,895	-	-	31,729
Amounts due to customers	28,022	3,115	534	3,622	4,997	1,716	-	42,006
Subordinated debt	-	-	-	-	-	8,611	-	8,611
	<b>28,038</b>	<b>26,370</b>	<b>534</b>	<b>8,201</b>	<b>8,892</b>	<b>10,327</b>	<b>-</b>	<b>82,362</b>
<b>Net position</b>	<b>(6,398)</b>	<b>(16,216)</b>	<b>8,917</b>	<b>13,799</b>	<b>13,707</b>	<b>(7,652)</b>	<b>108</b>	<b>6,265</b>
<b>Accumulated gap</b>	<b>(6,398)</b>	<b>(22,614)</b>	<b>(13,697)</b>	<b>102</b>	<b>13,809</b>	<b>6,157</b>	<b>6,265</b>	

(Thousands of Georgian Laries)

**21. Financial risk management (continued)****Interest rate risk (continued)**

	2005							Total
	On demand	Less than 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Past due	
<b>Assets:</b>								
Cash and cash equivalents	2,257	-	-	-	-	-	-	2,257
Amounts due from credit institutions	782	78	-	-	-	-	-	860
Loans to customers	-	156	671	8,553	8,630	952	16	18,978
	<b>3,039</b>	<b>234</b>	<b>671</b>	<b>8,553</b>	<b>8,630</b>	<b>952</b>	<b>16</b>	<b>22,095</b>
<b>Liabilities:</b>								
Amounts due to credit institutions	-	1,610	-	1,821	-	-	-	3,431
Amounts due to customers	6,275	49	9	519	474	-	-	7,326
Subordinated debt	-	-	-	-	-	5,379	-	5,379
	<b>6,275</b>	<b>1,659</b>	<b>9</b>	<b>2,340</b>	<b>474</b>	<b>5,379</b>	<b>-</b>	<b>16,136</b>
<b>Net position</b>	<b>(3,236)</b>	<b>(1,425)</b>	<b>662</b>	<b>6,213</b>	<b>8,156</b>	<b>(4,427)</b>	<b>16</b>	<b>5,959</b>
<b>Accumulated gap</b>	<b>(3,236)</b>	<b>(4,661)</b>	<b>(3,999)</b>	<b>2,214</b>	<b>10,370</b>	<b>5,943</b>	<b>5,959</b>	

As at December 31, the effective average interest rates by currencies for interest generating/ bearing monetary financial instruments were as follows:

	2006			2005		
	GEL	USD	Other foreign currencies	GEL	USD	Other foreign currencies
Cash and cash equivalents	7%	8%	3%	4%	3%	2%
Amounts due from credit institutions	12%	2%	8%	6.7%	8.8%	2%
Debt investment securities held to maturity	10%	-	-	-	-	-
Loans to customers	23%	27%	27%	18%	22%	-
Amounts due to credit institutions	10%	11%	-	-	-	-
Customer deposits	12%	11%	9%	7%	10%	-
Subordinated debt	-	11%	-	-	11%	-

(Thousands of Georgian Laries)

**21. Financial risk management (continued)****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 future expected cash flows on clients' and banking operations, which is a part of 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 on inter-bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

The following tables provide an analysis of monetary assets and liabilities grouped on the basis of the remaining period from the balance sheet date to the contractual maturity date.

	2006							Total
	On demand	Less than 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Past due	
<b>Assets:</b>								
Cash and cash equivalents	16,294	-	-	-	-	-	-	16,294
Amounts due from credit institutions	5,346	2,339	-	-	-	78	-	7,763
Loans to customers	-	549	9,451	22,000	22,599	2,597	108	57,304
Investment securities held-to-maturity	-	7,266	-	-	-	-	-	7,266
	<b>21,640</b>	<b>10,154</b>	<b>9,451</b>	<b>22,000</b>	<b>22,599</b>	<b>2,675</b>	<b>108</b>	<b>88,627</b>
<b>Liabilities:</b>								
Due to state institutions	16	-	-	-	-	-	-	16
Due to credit institutions	-	23,255	-	4,579	3,895	-	-	31,729
Due to customers	28,022	3,115	534	3,622	4,997	1,716	-	42,006
Subordinated debt	-	-	-	-	-	8,611	-	8,611
	<b>28,038</b>	<b>26,370</b>	<b>534</b>	<b>8,201</b>	<b>8,892</b>	<b>10,327</b>	<b>-</b>	<b>82,362</b>
<b>Net position</b>	<b>(6,398)</b>	<b>(16,216)</b>	<b>8,917</b>	<b>13,799</b>	<b>13,707</b>	<b>(7,652)</b>	<b>108</b>	<b>6,265</b>
<b>Accumulated gap</b>	<b>(6,398)</b>	<b>(22,614)</b>	<b>(13,697)</b>	<b>102</b>	<b>13,809</b>	<b>6,157</b>	<b>6,265</b>	

	2005							Total
	On demand	Less than 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Past due	
<b>Assets:</b>								
Cash and cash equivalents	2,257	-	-	-	-	-	-	2,257
Amounts due from credit institutions	782	78	-	-	-	-	-	860
Loans to customers	-	156	671	8,553	8,630	952	16	18,978
	<b>3,039</b>	<b>234</b>	<b>671</b>	<b>8,553</b>	<b>8,630</b>	<b>952</b>	<b>16</b>	<b>22,095</b>
<b>Liabilities:</b>								
Due to credit institutions	-	1,610	-	1,821	-	-	-	3,431
Due to customers	6,275	49	9	519	474	-	-	7,326
Subordinated debt	-	-	-	-	-	5,379	-	5,379
	<b>6,275</b>	<b>1,659</b>	<b>9</b>	<b>2,340</b>	<b>474</b>	<b>5,379</b>	<b>-</b>	<b>16,136</b>
<b>Net position</b>	<b>(3,236)</b>	<b>(1,425)</b>	<b>662</b>	<b>6,213</b>	<b>8,156</b>	<b>(4,427)</b>	<b>16</b>	<b>5,959</b>
<b>Accumulated gap</b>	<b>(3,236)</b>	<b>(4,661)</b>	<b>(3,999)</b>	<b>2,214</b>	<b>10,370</b>	<b>5,943</b>	<b>5,959</b>	

The Bank capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant deficit in the period less than one year, resulting from a significant concentration of deposits from customers of the short-term nature.

(Thousands of Georgian Laries)

## 21. Financial risk management (continued)

### Liquidity risk (continued)

The Bank has received significant funds from customers and credit institutions during the year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

Long-term loans are generally not available in Georgia, except for programs set up by international financial institutions. However, in the Georgian marketplace, many short-term credits are granted with the expectation of renewing the loans at maturity. As such, the ultimate maturity of assets may be different from the analysis presented above. In addition, the maturity gap analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due on demand in the tables above.

## 22. Fair values of financial instruments

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of IAS 32 "Financial Instruments: Disclosure and Presentation". Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties on arm's length conditions, other than in forced sale or liquidation.

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Bank's balance sheet at fair value.

	2006		2005	
	Carrying amount	Fair value	Carrying amount	Fair value
<i>Financial assets</i>				
Amounts due from credit institutions	7,763	7,763	860	860
Loans to customers	57,304	57,304	18,978	18,978
Investment securities held-to-maturity	7,266	7,266	-	-
<i>Financial liabilities</i>				
Due to credit institutions	31,729	31,729	3,431	3,431
Due to customers	42,022	42,022	7,326	7,326
Subordinated Debt	8,611	8,611	5,379	5,379

The following methods and assumptions are used by the Bank to estimate the fair value of these financial instruments:

### Amounts due from and to credit institutions and customers

For assets and liabilities maturing within one month, the carrying amount approximates fair value due to the relatively short-term maturity of these financial instruments. For the assets and liabilities maturing in over one month, the fair value was estimated as the present value of estimated future cash flows discounted at the appropriate year-end market rates.

### Subordinated loan

The Bank believes that the carrying amount of the borrowed funds approximates their fair value as of December 31, 2006 based on the regular revision of the current market conditions.

*(Thousands of Georgian Laries)***23. Related party transactions**

In accordance with IAS 24 “Related Party Disclosures”, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

	2006				2005			
	Share-holders	Entities under common control	Key management personnel	Other related entities	Share-holders	Entities under common control	Key management personnel	Other related entities
<b>Loans outstanding as of January 1, gross</b>	59	1,454	44	4,037	-	-	47	-
Loans issued during the year	451	8,465	168	857	2,178	4,947	334	4,100
Loan repayments during the year	(458)	(9,756)	(191)	(4,037)	(2,119)	(3,493)	(337)	(63)
<b>Loans outstanding as of December 31, gross</b>	<b>52</b>	<b>163</b>	<b>21</b>	<b>857</b>	<b>59</b>	<b>1,454</b>	<b>44</b>	<b>4,037</b>
Less: allowance for impairment as of December 31	(1)	(3)	-	(17)	(1)	(29)	(1)	(80)
<b>Loans outstanding as of December 31, net</b>	<b>51</b>	<b>160</b>	<b>21</b>	<b>840</b>	<b>58</b>	<b>1,425</b>	<b>43</b>	<b>3,957</b>
<b>Deposits as of January 1</b>	-	-	92	-	-	-	2	-
Deposits received during the year	5,415	-	193	-	-	-	199	-
Deposits repaid during the year	(5,402)	-	(204)	-	-	-	(109)	-
<b>Deposits as of December 31</b>	<b>13</b>	<b>-</b>	<b>81</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>92</b>	<b>-</b>
Loans as of January 1	-	-	-	-	-	-	-	-
Loans received during the year	-	35,865	-	-	-	2,868	-	-
Loans repaid during the year	-	(31,971)	-	-	-	(1,047)	-	-
<b>Loans as of December 31</b>	<b>-</b>	<b>3,894</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,821</b>	<b>-</b>	<b>-</b>
<b>Subordinated loans as of January 1</b>	-	5,379	-	-	-	-	-	-
Loans received during the year	-	3,822	-	-	-	5,379	-	-
Loans repaid during the year	-	(590)	-	-	-	-	-	-
<b>Subordinated loans as of December 31</b>	<b>-</b>	<b>8,611</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5,379</b>	<b>-</b>	<b>-</b>
Interest income on loans	16	97	8	76	165	176	8	8
Impairment expense on loans	-	(26)	-	(64)	-	(29)	(1)	(81)
Interest expense on deposits	-	-	(9)	(2)	-	-	(1)	-
Interest expense on loans	-	(469)	-	-	-	(201)	-	-
Interest expense on subordinated debt	-	(565)	-	-	-	(592)	-	-

(Thousands of Georgian Laries)

### 23. Related party transactions (continued)

Compensation of key management personnel was comprised of the following:

	<u>2006</u>	<u>2005</u>
Salaries and other short-term benefits	378	253
Social security costs	76	51
<b>Total key management compensation</b>	<b><u>454</u></b>	<b><u>304</u></b>

### 24. Capital adequacy

The NBG requires banks to maintain a capital adequacy ratio of 8% of risk-weighted assets, computed based on respective requirements. As of December 31, 2006 and 2005, the Bank's capital adequacy ratio on this basis exceeded the statutory minimum.

The Bank's risk based capital adequacy ratio, computed in accordance with the Basle Accord guidelines issued in 1988, as of December 31, 2006 and 2005, was 17% and 33%, respectively. These ratios exceeded the minimum ratio of 8% recommended by the Basle Accord.