Bank of Georgia Group
Consolidated Financial Statements

Year ended December 31, 2005
Together with Report of Independent Auditors

CONTENTS

REPORT OF INDEPENDENT AUDITORS

Consolidated Balance sheets 1
Consolidated Statements of income 2
Consolidated Statements of changes in equity 3
Consolidated Statements of cash flows 4

NOTES TO CONSOLIDATED FINANCIAL STATEMENT

1. Principal activities 5
2. Basis of preparation 5
3. Significant accounting policies 6
4. Significant accounting judgments and uncertainties 15
5. Cash and cash equivalents 16
6. Amounts due from credit institutions 16
7. Loans to customers 16
8. Net investment in lease 17
9. Investment securities 18
10. Property and equipment 18
11. Intangible assets 19
12. Taxation 20
13. Allowances for impairment and provisions 22
14. Other assets and liabilities 23
15. Amounts owed to credit institutions 23
16. Amounts owed to customers 24
17. Debt securities issued 25
18. Equity 25
19. Commitments and contingencies 26
20. Net fees and commission income 27
21. Salaries and administrative expenses 28
22. Business combination 28
23. Financial risk management 29
24. Fair values of financial instruments 34
25. Related party transactions 35
26. Capital adequacy 37
27. Subsequent events 37

ERNST & YOUNG

Ernst & Young Audit, LLC
Leselidze Street, 44
Tbilisi 0105 , Georgia
Tel: 995 (32) 75-1064
Fax: 995 (32) 75-1066

REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying consolidated balance sheet of JSC Bank of Georgia (the "Bank") and its subsidiaries (together the "Group") as of December 31, 2005, and the related consolidated statements of income, changes in equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Group's management. 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 plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 2005, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

March 15, 2006

Ernst & Young Audit LLC

CONSOLIDATED BALANCE SHEETS

As of December 31, 2005 and 2004

(Thousands of Georgian Lari)

	Notes	*2005*	*2004*
Assets			
Cash and cash equivalents	5	57,236	102,747
Amounts due from credit institutions	6	33,398	25,585
Loans to customers, net	7	297,376	169,868
Net investment in lease	8	4,314	598
Investment securities:			
- available-for-sale	9	8,327	19,628
- held-to-maturity	9	2,280	–
Property and equipment, net	10	35,815	27,159
Intangible assets, net	11	7,685	6,286
Income tax assets	12	2,570	3,407
Prepayments		455	157
Other assets	14	11,114	7,737
Total assets		**460,570**	**363,172**
Liabilities			
Amounts owed to credit institutions	15	78,873	48,334
Amounts owed to customers	16	269,952	252,129
Debt securities issued	17	1,143	–
Income tax liabilities	12	2,087	203
Provisions	13	975	971
Other liabilities	14	16,078	6,075
Total liabilities		**369,108**	**307,712**
Equity	18		
Share capital		14,729	11,273
Share premium		32,922	13,376
Treasury shares		(81)	(73)
Retained earnings		37,216	23,911
Other reserves		5,369	5,492
Total equity attributable to shareholders		**90,155**	**53,979**
Minority interest		1,307	1,481
Total equity		**91,462**	**55,460**
Total liabilities and equity		**460,570**	**363,172**

Signed and authorized for release on behalf of the Management Board of JSC Bank of Georgia:

Vladimer Gurgenidze **General Director**

Irakli Gilauri **Deputy General Director**

March 15, 2006

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME

For the years ended December 31, 2005 and 2004

(Thousands of Georgian Lari)

	Notes	*2005*	*2004*
Interest income			
Loans to customers		47,247	31,432
Debt securities owned		2,664	1,654
Amounts due from credit institutions		1,525	672
Net investment in lease		396	–
		51,832	**33,758**
Interest expense			
Amounts owed to customers		9,162	6,819
Amounts owed to credit institutions		3,675	3,100
Debt securities issued		26	–
		12,863	**9,919**
Net interest income		**38,969**	**23,839**
Impairment of interest earning assets	13	6,228	20,511
Net interest income after impairment of interest earning assets		**32,741**	**3,328**
Fees and commissions income		16,753	13,059
Fees and commissions expense		(1,581)	(1,863)
Net fees and commissions income	20	**15,172**	**11,196**
Gains less losses from foreign currencies:			
- dealing		6,604	5,058
- translation differences		(97)	(210)
Net insurance premiums earned		4,028	–
Other operating income		566	152
Other non-interest income		**11,101**	**5,000**
Salaries and other employee benefits	21	23,219	12,896
Administrative expenses	21	10,551	9,363
Depreciation, amortization and impairment	10, 11	4,230	2,609
Net insurance claims incurred		786	–
Impairment of other assets and provisions	13	280	1,559
Other operating expenses		3,213	1,227
Other non-interest expense		**42,279**	**27,654**
Income (loss) before income tax expense		**16,735**	**(8,130)**
Income tax expense (benefit)	12	3,108	(781)
Net income (loss) for the year		**13,627**	**(7,349)**
Attributable to:			
- shareholders of the Group		13,838	(7,349)
- minority interest		(211)	–
		13,627	**(7,349)**
Earnings (loss) per share:	**18**		
- basic		1.138	(0.778)
- diluted		1.138	(0.778)

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

For the years ended December 31, 2005 and 2004

(Thousands of Georgian Lari)

	Attributable to shareholders of the Group							
	Share capital	*Share premium*	*Treasury shares*	*Retained earnings*	*Other reserves*	*Total*	*Minority interest*	*Total equity*
December 31, 2003	**9,856**	**4,530**	**–**	**24,930**	**15,325**	**54,641**	**–**	**54,641**
Depreciation of revaluation reserve, net of tax	–	–	–	112	(112)	–	–	–
Net loss for the year	–	–	–	(7,349)	–	(7,349)	–	(7,349)
Issuance of share capital (Note 18)	1,417	6,763	–	–	–	8,180	–	8,180
Dividends declared (Note 18)	–	–	–	(2,500)	–	(2,500)	–	(2,500)
Purchase of treasury shares (Note 18)	–	(4,530)	(1,366)	(1,003)	–	(6,899)	–	(6,899)
Sale of treasury shares (Note 18)	–	6,830	1,366	–	–	8,196	–	8,196
Minority interest through acquisition	–	–	–	–	–	–	1,481	1,481
Purchase of the treasury shares by subsidiary	–	(217)	(73)	–	–	(290)	–	(290)
Transfers	–	–	–	9,721	(9,721)	–	–	–
December 31, 2004	**11,273**	**13,376**	**(73)**	**23,911**	**5,492**	**53,979**	**1,481**	**55,460**
Portion of the re-valued asset sold	–	–	–	11	(11)	–	–	–
Depreciation of revaluation reserve, net of tax	–	–	–	112	(112)	–	–	–
Net income for the year	–	–	–	13,627	–	13,627	–	13,627
Issuance of share capital (Note 18)	3,456	19,629	–	–	–	23,085	–	23,085
Acquisition of additional interest in existing subsidiaries by minority shareholders	–	–	–	–	–	–	365	365
Acquisition of minority interests in existing subsidiaries	–	–	–	(445)	–	(445)	(539)	(984)
Purchase of the treasury shares by subsidiary	–	(83)	(8)	–	–	(91)	–	(91)
December 31, 2005	**14,729**	**32,922**	**(81)**	**37,216**	**5,369**	**90,155**	**1,307**	**91,462**

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2005 and 2004

(Thousands of Georgian Lari)

	Notes	2005	2004
Cash flows from operating activities			
Interest received		48,047	33,600
Interest paid		(11,424)	(10,485)
Fees and commissions received		16,753	13,059
Fees and commissions paid		(1,581)	(1,863)
Recoveries of assets previously written off		2,691	739
Insurance premiums received		4,715	–
Insurance claims paid		(429)	–
Realized gains less losses from dealing in foreign currencies		6,604	5,058
Other operating income received		566	152
Salaries and benefits paid		(23,219)	(13,258)
Administrative and other operating expenses		(13,764)	(10,227)
Cash flows from operating activities before changes in operating assets and liabilities		**28,954**	**16,775**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		(7,793)	(13,457)
Loans to customers		(125,919)	(47,144)
Net investment in lease		(3,714)	–
Other assets		(3,778)	(2,923)
Net increase /(decrease) in operating liabilities			
Amounts owed to credit institutions		26,870	5,144
Amounts owed to customers		12,269	112,562
Other liabilities		8,905	3,038
Net cash flows from operating activities before income tax		**(64,206)**	**73,994**
Income tax paid		(387)	(2,587)
Net cash (used in)/from operating activities		**(64,593)**	**71,407**
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired	22	(735)	7,066
Purchase of (proceeds from sale of) investment securities		9,021	(9,953)
Purchase of investments in associates		(109)	–
Purchase of property and intangible assets		(13,495)	(6,106)
Net cash (used in)/ from investing activities		**(5,318)**	**(8,993)**
Cash flows from financing activities			
Proceeds from issue of share capital		22,576	–
Purchase of treasury shares		(91)	(6,898)
Purchase of additional interest by the minority shareholder, net of cash acquired		365	–
Purchase of additional interest in existing subsidiaries, net of cash acquired		(550)	–
Sale of treasury shares		–	8,196
Proceeds from debt securities issued		1,143	–
Dividends paid to shareholders of the Bank		(9)	(2,376)
Net cash (used in)/ from financing activities		**23,434**	**(1,078)**
Effect of exchange rates changes on cash and cash equivalents		966	(2,215)
Net increase/(decrease) in cash and cash equivalents		**(45,511)**	**59,121**
Cash and cash equivalents, beginning		**102,747**	**43,626**
Cash and cash equivalents, ending	5	**57,236**	**102,747**

The accompanying notes are an integral part of these consolidated financial statements.

(Thousands of Georgian Lari)

1. Principal activities

Bank of Georgia is a joint stock company, formed on the basis of the former State Bank Binsotsbanki on October 21, 1994, under the laws of Georgia. The Bank operates under a general banking license issued by the National Bank of Georgia ("NBG") on December 15, 1994, as well as licenses for foreign currency operations.

The Bank accepts deposits from the public and extends credit, transfers payments in Georgia and abroad, exchanges currencies and provides commercial and investments banking and insurance services to its commercial and retail customers. Its main office is in Tbilisi and it has 19 branches in Tbilisi, Batumi, Kutaisi, Gori, Poti, Rustavi, Gurjaani, and 31 operating outlets. The Bank's registered legal address is Pushkin Street 3, Tbilisi 0105, Georgia.

The consolidated financial statements include Bank of Georgia and its subsidiaries (the "Group"). For the information regarding subsidiaries refer to the disclosure in the Basis of preparation note.

As of December 31, the following shareholders owned more than 5% of the outstanding shares. Other shareholders owned less than 5% individually of the outstanding shares.

Shareholder	***2005, %***	***2004, %***
EBRD	12%	14%
Victor Gelovani	12%	13%
Bank Austria Creditanstalt	10%	–
Firebird Avrora Fund	9%	5%
Firebird Republics Fund	9%	5%
East Capital Holding	6%	–
East Capital Bering Russia Fund	5%	–
Koncentra Limited	5%	–
Firebird Global Master Fund	4%	3%
Other	28%	60%
Total	**100%**	**100%**

2. Basis of preparation

General

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

The Bank and its subsidiaries are required to maintain their records and prepare its financial statements for regulatory purposes in Georgian Lari in accordance with IFRS. These consolidated financial statements are prepared under the historical cost convention modified for the measurement at fair value of financial assets and liabilities held for trading, as well as available-for-sale securities and revaluation of property.

These consolidated financial statements are presented in thousands of Georgian Lari ("GEL"), except per share amounts and unless otherwise indicated. Transactions in currencies other than the Lari are treated as transactions in foreign currencies.

(Thousands of Georgian Lari)

3. Significant accounting policies

Subsidiaries

The consolidated financial statements include the following subsidiaries:

2005

Subsidiary	*Ownership/ Voting, %*	*Country*	*Date of incorporation*	*Industry*	*Date of acquisition*
JSC Euro Pace	100.0%	Georgia	26/07/2004	Insurance	18/10/2005
JSC Georgian Card	55.4%	Georgia	25/11/1996	Card processing	20/10/2004
JSC Galt & Taggart	100.0%	Georgia	19/12/1995	Brokerage and asset management	28/12/2004
Georgian Leasing Company LLC	75.0%	Georgia	29/10/2001	Leasing	31/12/2004
JSC British – Caucasus Insurance Company	100.0%	Georgia	11/08/2001	Insurance	30/12/2004

2004

Subsidiary	*Ownership/ Voting, %*	*Country*	*Date of incorporation*	*Industry*	*Date of acquisition*
JSC TbiluniversalBank	100.0%	Georgia	19/02/1994	Banking	31/12/2004
JSC Georgian Card	50.3%	Georgia	25/11/1996	Card processing	20/10/2004
JSC Galt & Taggart	53.0%	Georgia	19/12/1995	Brokerage and asset management	28/12/2004
Georgian Leasing Company LLC	60.0%	Georgia	29/10/2001	Leasing	31/12/2004
JSC British – Caucasus Insurance Company	88.0%	Georgia	11/08/2001	Insurance	30/12/2004

During the year the Group liquidated JSC TbiluniversalBank and merged its operations with the Bank. Also, during the year, the Group increased its interest in all of its existing subsidiaries and acquired another subsidiary – an insurance company JSC Euro Pace (Note 22).

Changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial year except that the Group has adopted those new/revised standards mandatory for financial years beginning on or after January 1, 2005.

The changes in accounting policies result from adoption of the following new or revised standards:

IAS 21 (revised) "The Effects of Changes in Foreign Exchange Rates";
IAS 24 (revised) "Related Party Disclosures";
IAS 32 (revised) "Financial Instruments: Presentation and Disclosure"; and
IAS 39 (revised) "Financial Instruments: Recognition and Measurement".

IAS 39 "Financial Instruments: Recognition and Measurement" (amended 2004)

The gains and losses on the re-measurement of financial assets available-for-sale to fair value are recognized as a separate component of equity. A gain or loss on an available-for-sale financial asset shall be recognised directly in equity (including reversal of impairment losses for equity instruments), through the statement of changes in equity, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognised, at which time the cumulative gain or loss previously recognised in equity shall be recognised in profit or loss. However, interest calculated using the effective interest method is recognised in profit or loss. Dividends on an available-for-sale equity instrument are recognised in profit or loss when the entity's right to receive payment is established.

(Thousands of Georgian Lari)

3. Significant accounting policies (continued)

IFRSs and IFRIC interpretations not yet effective

The Group 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:

IAS 19 (amended 2004) "Employee Benefits";
IAS 21 (amended 2005) "The Effects of Changes in Foreign Exchange Rates";
IAS 39 (amended 2005) "Financial Instruments: Recognition and Measurement";
IFRS 7 "Financial Instruments: Disclosures";
IFRIC 4 "Determining whether an Arrangement contains a Lease";
IFRIC 5 "Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds";

The Group expects that the adoption of the pronouncements listed above will have no significant impact on the Group's financial statements in the period of initial application.

Reclassifications

The following reclassifications were made to 2004 balances to conform to the 2005 presentation requirements:

Caption	*As previously reported*	*As reclassified*	*Comment*
HTM Securities	19,569	–	Reclassification of T-Bills from HTM securities to AFS securities in 2005
AFS Securities	59	19,628	Reclassification of T-Bills from HTM securities to AFS securities in 2005
Other operating income	–	152	Reclassification of Other operating Income from Fee and commission income
Fee and commission income	13,212	13,059	Reclassification of Other operating Income from Fee and commission income
Net investment in lease	–	598	Reclassification of this amount to present finance lease receivable as a separate line this year as the amount was immaterial last year for separate presentation.
Other assets	6,827	7,149	Reclassification of this amount to present finance lease receivable as a separate line this year as the amount was immaterial last year for separate presentation.
Prepayments	1,077	157	Reclassification of advances paid for international money transfers from prepayments to other assets.
Administrative expenses	8,327	9,363	Reclassification of legal and consulting expenses from Fee and commission expense and recruitment expenses from salaries and benefits
Fee and commission expense	2,534	1,863	Reclassification of legal and consulting expenses from Fee and commission expense
Salaries and other employee benefits	13,258	12,896	Reclassification of recruitment expenses from salaries and benefits to administrative expenses

Subsidiaries, which are those entities in which the Group has an interest of more than one half of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All inter company transactions, balances and unrealized gains on transactions between group companies are eliminated; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

(Thousands of Georgian Lari)

3. Significant accounting policies (continued)

Acquisition of subsidiaries

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

The excess of purchase consideration over the fair value of the Group's share of identifiable net assets is recorded as goodwill. If the cost of the acquisition is less than the fair value of the Group's share of identifiable net assets of the subsidiary acquired the difference is recognized directly in the statement of income.

Minority interest is the interest in subsidiaries not held by the Group. Minority interest at the balance sheet date represents the minority shareholders' portion of the fair value of the identifiable assets and liabilities of the subsidiary at the acquisition date and the minorities' portion of movements in equity since the date of the combination. Minority interest is presented within equity.

Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiary unless there is a binding obligation of the minority to fund the losses. All such losses are allocated to the Group.

Increases in ownership interests in subsidiaries

The differences between the carrying values of net assets attributable to interests in subsidiaries acquired and the consideration given for such increases are charged or credited to retained earnings.

Investments in associates

Associates are entities in which the Group generally has between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for under the equity method and are initially recognised at cost, including goodwill. Subsequent changes in the carrying value reflect the post-acquisition changes in the Group's share of net assets of the associate. The Group's share of its associates' profits or losses is recognised in the statement of income, and its share of movements in reserves is recognised in equity. However, when the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses, unless the Group is obliged to make further payments to, or on behalf of, the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

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 recognized 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 Group determines the classification of its financial assets after initial recognition.

All regular way purchases and sales of financial assets are recognized on the trade date i.e. the date that the Group 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 recognized in the statement of income.

(Thousands of Georgian Lari)

3. Significant 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 Group has the positive intention and ability to hold 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 amortized cost. This cost is computed as the amount initially recognized minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initially recognized 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 amortized cost, gains and losses are recognized in the consolidated statement of income when the investments are de-recognized or impaired, as well as through the amortization 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 amortized cost using the effective interest method. Gains and losses are recognized in the consolidated statement of income when the loans and receivables are derecognized or impaired, as well as through the amortization 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 recognized as a separate component of equity until the investment is de-recognized 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 consolidated statement of income. However, interest calculated using the effective interest method is recognized in the consolidated statement of income.

Fair value of investments that are actively traded in organized 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 consolidated balance sheet when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the National Bank of Georgia ("NBG"), 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.

Promissory notes

Promissory notes purchased are included in trading securities, or in amounts due from credit institutions or in loans to customers or in available-for-sale securities, depending on their substance and are accounted for in accordance with the accounting policies for these categories of assets.

Borrowings

Borrowings, which include amounts due to NBG and state entities, amounts due to credit institutions, amounts due to customers, debt securities issued, are initially recognized at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in the income statement when the liabilities are de-recognized as well as through the amortization process.

(Thousands of Georgian Lari)

3. Significant accounting policies (continued)

Leases

Finance - Group as lessor
The Group recognizes lease receivables at value equal to the net investment in the lease, starting from the date of commencement of the lease term. Net investment in lease is calculated as the present value of the minimum lease payments. In calculating the present value of the minimum lease payments the discount factor used is the interest rate implicit in the lease. Initial direct costs are included in the initial measurement of the lease receivables. Lease payments received are apportioned between the finance income and the reduction of the outstanding lease receivable. Finance income is based on a pattern reflecting a constant periodic rate of return on the net investment outstanding.

Operating - Group as lessee
Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognized as expenses on a straight-line basis over the lease term and included into other administrative and operating expenses.

Operating - Group as lessor
The Group presents assets subject to operating leases in the consolidated balance sheet according to the nature of the asset. Lease income from operating leases is recognized in the statement of income on a straight-line basis over the lease term as other income. The aggregate cost of incentives provided to lessees is recognized as a reduction of rental income over the lease term on a straight-line basis. Initial direct costs incurred specifically to earn revenues from an operating lease are added to the carrying amount of the leased asset.

Allowances for impairment of financial assets

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

Assets carried at amortized cost
If there is objective evidence that an impairment loss on financial assets carried at amortized 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 shall be reduced through use of an allowance account. The amount of the loss shall be recognized in the consolidated statement of income.

The calculation of the present value of the estimated future cash flows of a collateralized 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 Group 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 recognized 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 recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the consolidated statement of income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

When a loan is uncollectible, is it written off against the related allowance for loan impairment. Such loans 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 amount of allowance for loan impairment in the consolidated statement of income.

(Thousands of Georgian Lari)

3. Significant accounting policies (continued)

Allowances for impairment of financial assets (continued)

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 amortization) and its current fair value, less any impairment loss previously recognized in the consolidated statement on income, is transferred from equity to the consolidated statement of income. Reversals in respect of equity instruments classified as available-for-sale are not recognized in the consolidated statement of income. Reversals of impairment losses on debt instruments are reversed through the consolidated 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 recognized in profit or loss.

De-recognition 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 de-recognized where:

- the rights to receive cash flows from the asset have expired;
- the Group 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 Group 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.

Where the Group 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 recognized to the extent of the Group'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 Group 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 Group's continuing involvement is the amount of the transferred asset that the Group 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 Group's 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 de-recognized 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 de-recognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the consolidated statement of income.

Taxation

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

(Thousands of Georgian Lari)

3. Significant accounting policies (continued)

Taxation (continued)

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 utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Georgia also has various operating taxes that are assessed on the Group's 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 plant and 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.

Following initial recognition at cost, buildings are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation on buildings and subsequent accumulated impairment losses. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Any revaluation surplus is credited to the asset revaluation reserve included in the equity section of the balance sheet, except to the extent that it reverses a revaluation decrease of the same asset previously recognized in the statement of income, in which case the increase is recognized in the statement of income. A revaluation deficit is recognized in the statement of income, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the asset revaluation reserve.

An annual transfer from the asset revaluation reserve to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Additionally, accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Depreciation of assets under construction and those not placed in service commences from the date the assets are placed into service. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	50
Furniture and fixtures	10
Computers and office equipment	5
Motor vehicles	5

Leasehold improvements are amortized over the life of the related leased asset. 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 Lari)

3. Significant accounting policies (continued)

Goodwill

Goodwill acquired in a business combination represents the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of acquisition. Goodwill on an acquisition of a subsidiary is included in intangible assets. Goodwill on an acquisition of an associate is included in the investments in associates. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- is not larger than a segment based on either the Group's primary or the Group's secondary reporting format determined in accordance with IAS 14 "Segment Reporting".

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Other intangible assets

The Group's other intangible assets comprise computer software. Computer software is recognized at cost and amortized using the straight-line method over its useful life, but not exceeding a period of ten years.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization 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 amortized over the useful economic lives of 4 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortization 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 amortized, 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.

Costs associated with maintaining computer software programs are recorded as an expense as incurred. Software development costs (relating to the design and testing of new or substantially improved software) are recognized as intangible assets only when the Group can demonstrate the technical feasibility of completing the software so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete and the ability to measure reliably the expenditure during the development. Other software development costs are recognized as an expense as incurred.

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 amount of obligation can be made.

(Thousands of Georgian Lari)

3. Significant accounting policies (continued)

Retirement and other employee benefit obligations

The Group does not have any pension arrangements separate from the State pension system of 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 Group has no post-retirement benefits or significant other compensated benefits requiring accrual.

Share-based payment transactions

Employees (including senior executives) of the Group receive share-based remuneration, whereby employees render services as consideration for the equity instruments ('equity settled transactions').

Equity-settled transactions
The cost of equity settled transactions with employees is measured by reference to the fair value at the date on which they are granted.

The cost of equity settled transactions is recognized together with the corresponding increase in equity, over the period in which the performance /and or service conditions are fulfilled, ending on the date until the relevant employee is fully entitled to the award ('the vesting date'). The cumulative expense recognized for equity settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The income statement charge or credit for the period represents the movement in cumulative expense recognized as at the begging and end of that period.

No expense is recognized for the awards until they ultimately vest, except for the awards where vesting is conditional upon market conditions which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity settled award are modified, as the minimum an expense is recognized as if the terms had not been modified. In addition an expense is recognized for any modification which increases the total fair value of the share based payment arrangement, or is otherwise beneficial to the employee as measured at the date of the modification.

Where an equity-settled award is cancelled, it is treated as if it has vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. However if a new award is substituted for the cancelled award, and designated as the replacement award on the date that it is granted the cancelled and the new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

Segment reporting

The Group's operations are highly integrated and primarily constitute a single industry segment, banking, that accounts for more than 98% of the Group's business. Accordingly for the purposes of IAS 14 "Segment Reporting" the Group is treated as one business segment. The Group's assets are concentrated primarily in Georgia, and the majority of the Group's revenues and net income is derived from operations in, and connected with, Georgia.

Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognized as additional paid-in capital.

Treasury shares

Where the Group or its subsidiaries purchases the Group's shares, the consideration paid including any attributable transaction costs net of income taxes is deducted from total shareholders' equity as treasury shares until they are cancelled or reissued. Where such shares are subsequently sold or reissued, any consideration received is included in shareholders' equity. Treasury shares are stated at par value, with adjustment of premiums against additional paid-in capital.

(Thousands of Georgian Lari)

3. Significant accounting policies (continued)

Dividends

Dividends are recognized 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 authorized for issue.

Contingencies

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

Income and expense recognition

Interest income and expense are recognized 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 recognized 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. Portfolio and other management advisory and service fees are recorded based on the applicable service contracts.

Foreign currency translation

The consolidated financial statements are presented in Georgian Lari, which is the Group's functional and presentation currency. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are translated into Georgian Lari at official NBG exchange rates at the balance sheet date. Gains and losses resulting from the translation of foreign currency transactions are recognized in the statement of income as gains less losses from foreign currencies (translation differences).

Differences between the contractual exchange rate of a certain transaction and the NBG exchange rate on the date of the transaction are included in gains less losses from foreign currencies (dealing). The official NBG exchange rates at December 31, 2005 and 2004 were 1.793 Lari and 1.825 Lari to 1 USD, respectively.

4. Significant accounting judgments and uncertainties

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 Group regularly reviews its loans and receivables to assess impairment. The Group uses its judgment to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available historical data relating to similar borrowers. Similarly, the Group 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 Group uses its judgment to adjust observable data for a group of loans or receivables to reflect current circumstances.

Impairment of goodwill
The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill as of December 31, 2005 was GEL 5,730 (2004 - GEL 4,389). More details are provided in Note 11.

(Thousands of Georgian Lari)

5. Cash and cash equivalents

As of December 31, cash and cash equivalents comprise:

	2005	*2004*
Cash on hand	24,908	35,892
Current and deposit accounts with the National Bank of Georgia	4,273	18,794
Current accounts with other credit institutions	4,475	15,521
Time deposits with credit institutions with effective maturity up to 90 days	23,580	32,540
Cash and cash equivalents	**57,236**	**102,747**

As of December 31, 2005, GEL 9,808 (2004 – GEL 48,687) was placed on current and term deposit accounts with internationally recognized and OECD banks that are the counter parties of the Group in performing international settlements. Of these amounts, GEL 538 (2004 – GEL 3,665) were pledged with counterparties as security for open commitments.

During 2005, the Group placed with and received short-term funds in various currencies from Georgian banks as well as banks located in Commonwealth of Independent States ("CIS"). As of December 31, 2005, the Group had an equivalent of GEL 5,311 (2004 – nil) in Euros placed as term deposits with Georgian banks.

6. Amounts due from credit institutions

As of December 31 amounts due from credit institutions comprise:

	2005	*2004*
Obligatory reserve with the National Bank of Georgia	28,977	23,245
Time deposits with effective maturity of more than 90 days or overdue	2,099	–
Inter-bank loans receivable	2,368	2,387
	33,444	**25,632**
Less – Allowances for impairment (Note 13)	(46)	(47)
Amounts due from credit institutions	**33,398**	**25,585**

Obligatory reserve with NBG represents amounts deposited with NBG relating to daily settlements and other activities. Credit institutions are required to maintain an interest earning cash deposit (obligatory reserve) with NBG, the amount of which depends on the level of funds attracted by the credit institution. The Group's ability to withdraw this deposit is not restricted by legislation.

As of December 31, 2005, time deposits and inter-bank loans include GEL 3,468 (2004 – 2,387) placed with JSC ProCredit Bank.

7. Loans to customers

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

	2005	*2004*
Private entities	174,492	109,761
Individuals	114,427	73,084
State entities	25,397	6,051
State budget or local authorities	–	53
Loans to customers	**314,316**	**188,949**

As of December 31, 2005, concentration of the Group's investments in outstanding loans receivable from ten largest third party borrowers comprised GEL 51,197 accounting for 16% of gross loan portfolio of the Group (2004 – GEL 23,586 or 13%). An allowance of GEL 3,091 (2004 – GEL 525) was created against these loans.

(Thousands of Georgian Lari)

7. Loans to customers (continued)

As of December 31 loans are principally issued within Georgia, and their distribution by industry sectors is as follows:

	2005	*2004*
Trade and services	107,803	60,931
Individuals	114,427	73,084
Mining	47,532	28,413
Construction	12,668	14,621
Transport and communication	6,467	3,836
Agriculture	1,055	1,721
Energy	208	89
Other	24,156	6,254
	314,316	**188,949**
Less – Allowance for loan impairment (Note 13)	(16,940)	(19,081)
Loans to customers, net	**297,376**	**169,868**

8. Net investment in lease

As of December 31 net investment in lease comprised the following:

	2005	*2004*
Minimum lease payments receivable	5,825	1,072
Less - Unearned finance lease income	(1,435)	(470)
	4,390	**602**
Less - Allowance for impairment	(76)	(4)
Net investment in lease	**4,314**	**598**

As of December 31, 2005, concentration of investments in five largest lessees comprised GEL 2,980 or 68% of total net investment in leases and finance income received from them comprised GEL 137 or 42% of total finance income from leases.

Future minimum lease payments to be received for the five years following December 31, 2005, are disclosed below:

	2005	*2004*
Within 1 year	177	32
From 1 to 5 years	5,326	1,040
More than 5 years	322	–
Minimum lease payments receivable	**5,825**	**1,072**

Difference between the minimum lease payments to be received in the future and the net investment in leases represents unearned finance income. The effective interest rate on the lease portfolio is 16% per annum. Minimum lease payments to be received after December 31, 2005 and 2004 are payable to the Company in the following currencies:

	2005	*2004*
US Dollars	5,380	1,072
Euros	445	–
Minimum lease payments receivable	**5,825**	**1,072**

(Thousands of Georgian Lari)

9. Investment securities

As of December 31 available-for-sale securities comprise:

	2005	*2004*
Ministry of Finance Treasury Bills	7,819	19,569
Corporate shares	508	59
Available-for-sale securities	**8,327**	**19,628**

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

	2005		*2004*	
	%	*Maturity*	*%*	*Maturity*
Ministry of Finance Treasury Bills	12.85%	2006	15.75%	2005

Held-to-maturity securities comprise:

	2005		*2004*	
	Carrying value	*Nominal value*	*Carrying value*	*Nominal value*
Corporate bonds	2,169	2,281	–	–
Ministry of Finance Treasury Bills	111	114	–	–
Held-to-maturity securities	**2,280**	**2,395**	**–**	**–**

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

	2005		*2004*	
	%	*Maturity*	*%*	*Maturity*
Corporate bonds	14.00%	2006	–	–
Ministry of Finance Treasury Bills	13.60%	2006	–	–

10. Property and equipment

Movements in property and equipment during 2005 were as follows:

	Buildings	*Furniture & fixtures*	*Computers & equipment*	*Motor vehicles*	*Leasehold improvements*	*Assets under construction*	*Total*
Cost or revaluation							
December 31, 2004	**17,456**	**8,025**	**5,911**	**1,249**	**998**	**–**	**33,639**
Acquisition through business combinations (Note 22)	–	24	39	28	–	–	91
Additions	4,003	3,489	2,650	13	64	1,688	11,907
Disposals	(261)	(8)	(22)	(73)	(15)	–	(379)
Transfers	1,064	(176)	58	106	267	(1,319)	–
December 31, 2005	**22,262**	**11,354**	**8,636**	**1,323**	**1,314**	**369**	**45,258**
Accumulated impairment December 31, 2004 and 2005	**467**	**–**	**–**	**–**	**–**	**–**	**467**
Accumulated depreciation							
December 31, 2004	**320**	**2,197**	**2,715**	**575**	**206**	**–**	**6,013**
Charge for the year	408	896	1,389	233	149	–	3,075
Disposals	(9)	(39)	(17)	(32)	(15)	–	(112)
December 31, 2005	**719**	**3,054**	**4,087**	**776**	**340**	**–**	**8,976**
Net book value							
December 31, 2004	**16,669**	**5,828**	**3,196**	**674**	**792**	**–**	**27,159**
December 31, 2005	**21,076**	**8,300**	**4,549**	**547**	**974**	**369**	**35,815**

(Thousands of Georgian Lari)

10. Property and equipment (continued)

Movements in property and equipment during 2004 were as follows:

	Buildings	*Furniture & fixtures*	*Computers & equipment*	*Motor vehicles*	*Leasehold improvements*	*Total*
Cost or revaluation						
December 31, 2003	**13,233**	**5,971**	**3,848**	**1,049**	**636**	**24,737**
Acquisitions	1,694	1,121	197	45	–	3,057
Additions	2,529	943	1,997	216	497	6,182
Disposals	–	(10)	(131)	(61)	(135)	(337)
December 31, 2004	**17,456**	**8,025**	**5,911**	**1,249**	**998**	**33,639**
Accumulated impairment						
December 31, 2003 and 2004	**467**	**–**	**–**	**–**	**–**	**467**
Accumulated depreciation						
December 31, 2003	**104**	**1,513**	**2,077**	**429**	**123**	**4,246**
Charge for the year	216	684	757	207	115	1,979
Disposals	–	–	(119)	(61)	(32)	(212)
December 31, 2004	**320**	**2,197**	**2,715**	**575**	**206**	**6,013**
Net book value						
December 31, 2003	**12,662**	**4,458**	**1,771**	**620**	**513**	**20,024**
December 31, 2004	**16,669**	**5,828**	**3,196**	**674**	**792**	**27,159**

The Group engaged an independent appraiser to determine the fair value of its buildings. Fair value is determined by reference to market-based evidence. The latest date of the revaluation was 31 December 2003. If the buildings were measured using the cost model, the carrying amounts would be as follows:

	2005	*2004*
Cost	19,086	14,280
Accumulated depreciation and impairment	630	285
Net carrying amount	**18,456**	**13,995**

11. Intangible assets

Movements in intangible assets during 2005 were as follows:

	Goodwill	*Computer software*	*Total*
Cost			
December 31, 2004	**4,389**	**3,462**	**7,851**
Acquisition through business combinations (Note 22)	1,497	3	1,500
Additions	81	1,009	1,090
Disposals	–	(319)	(319)
December 31, 2005	**5,967**	**4,155**	**10,122**
Accumulated amortization and impairment			
December 31, 2004	**–**	**1,565**	**1,565**
Charge for amortization	–	907	907
Charge for impairment	237	11	248
Disposals	–	(283)	(283)
December 31, 2005	**237**	**2,200**	**2,437**
Net book value:			
December 31, 2004	**4,389**	**1,897**	**6,286**
December 31, 2005	**5,730**	**1,955**	**7,685**

(Thousands of Georgian Lari)

11. Intangible assets (continued)

Movements in intangible assets during 2004 were as follows:

	Goodwill	*Computer software*	*Total*
Cost			
December 31, 2003	**–**	**2,960**	**2,960**
Additions	4,389	502	4,891
December 31, 2004	**4,389**	**3,462**	**7,851**
Accumulated amortization			
December 31, 2003	**–**	**935**	**935**
Charge for the year	–	630	630
December 31, 2004	**–**	**1,565**	**1,565**
Net book value			
December 31, 2003	**–**	**2,025**	**2,025**
December 31, 2004	**4,389**	**1,897**	**6,286**

As of December 31 the impairment charge of GEL 11 related to obsolete software.

Goodwill acquired through business combinations has been allocated to the following cash-generating units for impairment testing purposes:

- JSC Bank of Georgia
- JSC British Caucasus Insurance Company
- JSC Georgian Card
- Georgian Leasing Company LLC

The recoverable amount of each cash-generating unit has been determined based on a value-in-use calculation through a cash flow projection based on the approved budget under the assumption that business will not grow and the cash flow will be stable. The discount rate applied to cash flow projections is the weighted average cost of capital ("WACC") of each particular cash-generating unit.

Based on the impairment test goodwill allocated to JSC Georgian Card and Georgian Leasing Company was fully impaired and the impairment charge totaled GEL 236 for the year ended December 31st, 2005.

As of December 31 carrying amount of goodwill (less impairment) allocated to each of the cash-generating units:

	WACC applied for impairment	*Carrying amount of goodwill*	
		2005	*2004*
JSC Bank of Georgia	12%	1,892	1,892
JSC British Caucasus Insurance Company	19%	2,341	2,261
JSC Georgian Card	45%	–	192
Georgian Leasing Company LLC	35%	–	44
JSC Euro Pace	47%	1,497	–
Total		**5,730**	**4,389**

12. Taxation

As of December 31 the corporate income tax expense comprises:

	2005	*2004*
Current tax charge	206	428
Deferred tax charge (benefit)	2,902	(1,209)
Income tax expense (gain)	**3,108**	**(781)**

(Thousands of Georgian Lari)

12. Taxation (continued)

Georgian legal entities must file individual tax declarations. The tax rate for banks for profits other than on state securities was 20% for 2005 and 2004. The tax rate for companies other than banks was also 20% for 2005 and 2004. The tax rate for interest income on state securities was 10% for State taxes.

The effective income tax rate differs from the statutory income tax rates. As of December 31 a reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2005	*2004*
Income (loss) before taxation	**16,735**	**(8,130)**
Statutory tax rate	20%	20%
Theoretical income tax expense (gain) at the statutory rate	**3,347**	**(1,626)**
State securities at lower tax rate	(248)	(330)
Permanent differences	(169)	–
Change in unrecognized deferred tax assets	63	–
Non-tax-deductible expenses:		
- impairment of intangible assets	48	–
- other impairment losses	48	60
- representative	11	29
- losses on asset disposals	–	199
- repairs	–	49
- legal	–	15
- other	8	395
Tax charge of prior periods	–	428
Income tax expense	**3,108**	**(781)**

Georgia currently has a number of laws related to various taxes imposed by state governmental authorities. Applicable taxes include value added tax, corporate income tax (profits tax), a turnover based tax, and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to 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 Group is in substantial compliance with the tax laws affecting its operations. However, the risk remains that relevant authorities could take differing positions with regard to interpretive issues.

Deferred tax assets and liabilities as of December 31, 2005 and 2004 comprise:

	2005	*2004*
Tax effect of deductible temporary differences:		
Tax loss carried forward	446	1,754
Intangible assets	119	
Allowances for impairment and provisions for other losses	59	–
Property and equipment	30	145
Net investment in lease	12	–
	666	**1,899**
Unrecognized deferred tax assets	(63)	–
Deferred tax asset	**603**	**1,899**
Tax effect of taxable temporary differences:		
Property and equipment	1,638	1,048
Loans to customers	665	–
Allowances for receivables	124	36
Other liabilities	185	–
Other assets	78	–
Deferred tax liability	**2,690**	**1,084**
Net deferred tax assets (liability)	**(2,087)**	**815**

(Thousands of Georgian Lari)

12. Taxation (continued)

The Group has available tax losses carried forward of GEL 446 which begins to expire in the period 2006-2009, if not utilized.

As of December 31 tax assets and liabilities consist of the following:

	2004	*2003*
Current tax assets	2,570	2,592
Deferred tax assets	–	815
Tax assets	**2,570**	**3,407**
Current tax liabilities	–	203
Deferred tax liabilities	2,087	–
Tax liabilities	**2,087**	**203**

13. Allowances for impairment and provisions

Movements in allowances for impairment of interest earning assets were as follows:

	Due from credit institutions	*Loans to customers*	*Total*
December 31, 2003	**25**	**9,262**	**9,287**
Charge	22	20,489	20,511
Write-offs	–	(11,409)	(11,409)
Recoveries		739	739
December 31, 2004	**47**	**19,081**	**19,128**
Charge (reversal)	(1)	6,229	6,228
Write-offs	–	(11,061)	(11,061)
Recoveries	–	2,691	2,691
December 31, 2005	**46**	**16,940**	**16,986**

Movements in allowances for other assets and provisions were as follows:

	Investments in associates	*Other assets*	*Guarantees and commitments*	*Total*
December 31, 2003	**103**	**1,208**	**472**	**1,783**
Charge (reversal)	61	999	499	1,559
Transfer from a merger of subsidiary	–	141	–	141
Write-offs	(61)	(978)	–	(1,040)
Recoveries	–	74	–	74
December 31, 2004	**103**	**1,303**	**971**	**2,377**
Charge (reversal)	176	(232)	336	280
Write-offs	–	(162)	(332)	(493)
Recoveries	–	10	–	10
December 31, 2005	**279**	**919**	**975**	**2,173**

Allowances for impairment of assets are deducted from the related assets. Provisions for guarantees and commitments are recorded in liabilities. In accordance with the Georgian legislation, loans must be written off if overdue for more than 150 days.

(Thousands of Georgian Lari)

14. Other assets and liabilities

As of December 31 other assets comprise:

	2005	*2004*
Insurance premiums receivable	3,300	1,727
Foreclosed assets	2,474	3,654
Receivable from money transfers	2,184	920
Prepayment for purchase of fixed assets	1,064	–
Operating taxes receivable	613	549
Settlements on operations with securities	513	840
Investment in associates, net	520	588
Other	1,365	762
	12,033	**9,040**
Less – Allowance for impairment of other assets (Note 13)	(919)	(1,303)
Other assets	**11,114**	**7,737**

Foreclosed assets represent repossessed assets from the borrowers of the Bank. Those assets are not used for its intended purposes and are just held for speculative purposes with an intend of selling it.

Investment in associates includes allowance for diminishing in value provided against it in amount of GEL 279 (2004 – GEL 103). (Note 13)

As of December 31 other liabilities comprise:

	2005	*2004*
Provisions for employee benefits	4,967	–
Creditors	3,857	520
Unearned premiums reserve	2,154	1,467
Reinsurance accounts payable	1,680	825
Amounts payable for acquisitions	841	2,644
Fines and penalties payable	671	–
Insurance claims reserves	545	188
Other taxes payable	555	–
Dividends payable	115	124
Other	693	308
Other liabilities	**16,078**	**6,076**

15. Amounts owed to credit institutions

As of December 31 amounts owed to credit institutions comprise:

	2005	*2004*
Current accounts	144	113
Time deposits and loans	37,007	23,627
Borrowings from international financial institutions	41,722	24,594
Amounts owed to credit institutions	**78,873**	**48,334**

During 2005, the Group received short-term funds from Georgian banks in different currencies. As of December 31, 2005, the Group had an equivalent of GEL 5,311 (2004 – GEL 4,349) in Euros received as deposits from Georgian banks, which relate to term deposits placed with the same banks (see Note 5).

(Thousands of Georgian Lari)

15. Amounts owed to credit institutions (continued)

As of December 31, 2005 and 2004, borrowings from international credit institutions included borrowings from DEG, IFC, EBRD, BSTDB, AKA and CommerzBank AG. All these loans bear floating interest rates tied either to LIBOR or EURIBOR, ranging from LIBOR plus 1.3% to LIBOR plus 5.25% (2004 – 2% to 5.25%), for USD borrowings and, from EURIBOR plus 4.25% to EURIBOR plus 6% (2004 – 4.25% to 6%), for EURO borrowings. Contractual maturities of these facilities range from 5 to 10 years (2004 – 5 to 10 years) while expected maturities range from 2 to 6 years (2004 – 2 to 5 years).

Borrowing agreements contain various covenants, which establish limits for capital adequacy, liquidity, currency position, credit exposures and other measurements. As of December 31, 2005, the Group was not in compliance with certain covenants related to its borrowings from EBRD, BSTDB and DEG and IFC. Subsequent to December 31, 2005 the Group obtained compliance waivers from the relevant institutions.

16. Amounts owed to customers

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

	2005	*2004*
Current accounts	137,296	141,578
Time deposits	132,656	110,551
Amounts owed to customers	**269,952**	**252,129**
Held as security against letters of credit	**652**	**3,661**
Held as security against guarantees	**1,422**	**1,240**

As of December 31, 2005, amounts owed to customers of GEL 37,008 (13%) were due to the ten largest third party customers (2004 - GEL 61,116 (25%)).

As of December 31 amounts owed to customers comprise the following:

	2005	*2004*
Individuals	154,564	114,218
Private enterprises	86,123	110,081
State and budgetary organizations	27,456	26,556
Employees	1,809	1,274
Amounts owed to customers	**269,952**	**252,129**

As of December 31 customer accounts by industry sector is as follows:

	2005	*2004*
Individuals	156,373	115,492
Trade and services	38,262	28,270
Transport and communication	17,396	32,336
Energy	14,044	11,845
Construction	8,018	10,954
Mining	6,974	11,863
Agriculture	343	609
Other	28,542	40,760
Amounts owed to customers	**269,952**	**252,129**

(Thousands of Georgian Lari)

17. Debt securities issued

As of December 31 debt securities issued consisted of the following:

	2005	*2004*
Promissory notes issued	1,143	–
Debt securities issued	**1,143**	**–**

Interest-bearing corporate promissory notes that were issued by the Group as of December 31, 2005 had an aggregate nominal value of GEL 1,126 and mature in September 2007. Original term of the promissory notes is 2 years and the applicable interest rate is 11% per annum.

18. Equity

As of December 31, 2005, authorized share capital comprised 19,783,409 common shares, of which 14,728,784 were issued and fully paid (2004 – 14,783,409 common shares, of which 11,273,386 were issued and fully paid). Each share has a nominal value of one (1) Georgian Lari. Shares issued and outstanding as of December 31, 2005 are described below.

Movements in shares outstanding, issued and fully paid were as follows:

	Number of shares	*Amount of shares*
	Ordinary	*Ordinary*
December 31, 2003	**9,855,606**	**9,856**
Issuance of shares	1,417,780	1,417
Purchase of treasury shares	(1,365,996)	(1,366)
Sale of treasury shares	1,365,996	1,366
December 31, 2004	**11,273,386**	**11,273**
Issuance of shares	3,455,398	3,456
December 31, 2005	**14,728,784**	**14,729**

Share capital of the Group was contributed by the shareholders in Georgian Lari and US Dollars and they are entitled to dividends and capital distributions in Georgian Lari. As of December 31, 2005, net income attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding during the year were GEL 13,638 and 11,980,473, respectively (2004 – net loss of GEL 7,349 and 9,442,042, respectively).

On December 22, 2005 shareholders of the Bank approved an increase of share capital by additional 5,000,000 ordinary shares. In November 2005, the Group committed to issue 95,000 shares in exchange for control of an acquired subsidiary (Note 23).

As of December 31, 2005, treasury shares of GEL 81 at par value and share premium of GEL 300 comprise the Group's shares owned by its subsidiary, Galt & Taggart Securities, purchased in the open market.

During the year ended December 31, 2005 shares of GEL 308 at par value and share premium of GEL 709 were granted as compensation to top management.

The Bank did not declare any dividends for the year ending December 31st, 2005. At the Shareholders' Meeting in March 2004, the Group declared dividends of GEL 2,500 in respect of 2003 which comprises GEL 0.00025 per share.

(Thousands of Georgian Lari)

18. Equity (continued)

Movements in other reserves were as follows:

	Revaluation reserve for property and equipment	*Statutory general reserve*	*Total*
As of December 31, 2003	**5,604**	**9,721**	**15,325**
Depreciation of revaluation reserve, net of tax	(112)	–	(112)
Transfer of statutory reserve to retained earnings	–	(9,721)	(9,721)
As of December 31, 2004	**5,492**	**–**	**5,492**
Depreciation of revaluation reserve, net of tax	(112)	–	(112)
Sale of revalued asset	(11)	–	(11)
As of December 31, 2005	**5,369**	**–**	**5,369**

Nature and purpose of other reserves

Revaluation reserve for property and equipment
The revaluation reserve for property and equipment is used to record increases in the fair value of buildings and decreases to the extent that such decrease relates to an increase on the same asset previously recognized in equity.

Nature and purpose of other reserves (continued)

Unrealized gains(losses) on investment securities available-for-sale
This reserve records fair value changes on available-for-sale investments. As the fair value of these investments approximates the amortized cost of those investments no fair value adjustment is reflected in equity.

19. Commitments and contingencies

Operating environment

Georgia continues to undergo substantial political, economic and social changes. As an emerging market, Georgia does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature market economy. Furthermore, the Georgian Government has not yet fully implemented the reforms necessary to create banking, judicial, taxation and regulatory systems that usually exist in more developed markets. As a result, operations in Georgia involve risks that are not typically associated with those in developed markets. Such risks persist in the current environment with results that include but are not limited to, a currency that is not freely convertible outside, onerous currency controls and low liquidity levels for debt and equity markets.

The Group could be affected, for the foreseeable future, by these risks and their consequences. As a result, there are significant uncertainties that may affect future operations, the recoverability of the Group's assets, and the ability of the Group to maintain or pay its debts as they mature. The accompanying financial statements do not include any adjustments that may result from the future clarification of these uncertainties. Such adjustments, if any, will be reported in the Group's financial statements in the period when they become known and estimable.

Legal

In the ordinary course of business, the Group 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 Group.

(Thousands of Georgian Lari)

19. Commitments and contingencies (continued)

Financial commitments and contingencies

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

	2005	*2004*
Credit related commitments		
Undrawn loan commitments	15,751	8,783
Letters of credit	20,888	14,770
Guarantees	34,777	19,454
	71,416	**43,007**
Operating lease commitments		
Not later than 1 year	1,238	1,639
Later than 1 year but not later than 5 years	3,323	4,355
Later than 5 years	1,052	2,167
	5,613	**8,161**
Capital expenditure commitments	**216**	**2**
Less – Provisions	(975)	(971)
Less – Cash held as security against letters of credit and guarantees	(2,073)	(4,901)
Financial commitments and contingencies	**74,197**	**45,298**

Insurance

The Group's premises are insured for GEL 14,342 (2004 – GEL 10,910). As of December 31, 2005, the Group has obtained Bankers Blanket Bond insurance and Directors and Officers liability insurance coverage.

20. Net fees and commission income

During the year ended December 31 net fees and commission income comprises:

	2005	*2004*
Settlements operations	9,053	6,941
Guarantees and letters of credit	2,913	2,219
Cash collection	2,870	2,399
Currency conversion operations	780	998
Securities operations	573	–
Consulting	133	–
Other	431	502
Fees and commission income	**16,753**	**13,059**
Settlements operations	1,171	1,306
Cash operations	245	362
Currency conversion operations	55	153
Other	110	42
Fees and commission expense	**1,581**	**1,863**
Net fees and commission income	**15,172**	**11,196**

(Thousands of Georgian Lari)

21. Salaries and administrative expenses

During the year ended December 31 salaries and other employee benefits, as well as administrative expenses comprise:

	2005	*2004*
Salaries and bonuses	19,501	9,753
Social security costs	3,718	3,140
Salaries and other employee benefits	**23,219**	**12,893**
Occupancy and rent	1,890	2,160
Security	1,248	1,136
Marketing and advertising	1,141	905
Communication	948	695
Operating taxes	958	785
Legal and other professional services	942	702
Office supplies	876	613
Repair and maintenance	847	1,064
Personnel training and recruitment	560	455
Business trips	398	147
Corporate hospitality and entertainment	244	107
Banking services	238	216
Insurance	–	187
Other	261	191
Administrative expenses	**10,551**	**9,363**

As of December 31, 2005, personnel training and recruitment expenses included 329 KGEL (2004 – 365 KGEL) of external recruitment costs incurred for the purposes of recruiting new management.

22. Business combination

On November 14, 2005 the Group acquired 100% of the voting shares of JSC Euro Pace – a non-life insurance company. The fair value of identifiable assets, liabilities and contingent liabilities of JSC "Euro Pace" as of the date of acquisition were provisionally estimated at:

	Recognized on acquisition	*Carrying value*
Cash and cash equivalents	1,115	1,115
Property and equipment (Note 10)	91	91
Intangible assets (Note 11)	3	3
Other assets	967	967
	2,176	**2,176**
Provisions	–	–
Current tax liability	69	69
Other liabilities	1,042	1,042
	1,111	**1,111**
Fair value of net assets	**1,065**	**1,065**
Goodwill arising on acquisition (Note 11)	1,497	1,497
Consideration paid	**2,562**	**2,562**

(Thousands of Georgian Lari)

22. Business combinations (continued)

The total cost of the combination was GEL 2,562 which was paid partially with cash and partially with shares of the Group. Cash compensation comprised of GEL 1,850 while share compensation comprised of 95,000 shares of the Group for 7.50 a share (market price) totaling GEL 712. The net cash outflow on acquisition was as follows:

	2005
Cash paid	1,850
Less: cash acquired with the subsidiary	1,115
Net cash outflow	**735**

If the combination had taken place at the beginning of the year, the net income of the Group would have been GEL 13,905 and revenue would have been GEL 57,460. The profit of the acquired subsidiary was not consolidated since the acquisition date was close to year-end and the amount of GEL 46 was immaterial to the Group.

23. Financial risk management

Management of risk is fundamental to the banking business and is an essential element of the Group's operations. The main financial risks inherent to the Group'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 Group's risk management policies in relation to these risks follows.

Credit risk

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

The exposure to any one borrower 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.

(Thousands of Georgian Lari)

23. Financial risk management (continued)

Geographical concentration

The geographical concentration of Bank's monetary assets and liabilities is set out below:

	2005				*2004*			
	Georgia	***OECD***	***CIS and other foreign banks***	***Total***	***Georgia***	***OECD***	***CIS and other foreign banks***	***Total***
Assets:								
Cash and cash equivalents	46,787	9,291	1,158	57,236	52,684	48,687	1,376	102,747
Due from credit institutions	32,710	688	–	33,398	25,585	–	–	25,585
Loans to customers	297,376	–	–	297,376	169,868	–	–	169,868
Net investmente in lease	4,314	–	–	4,314	598	–	–	598
Investment securities:								
- available-for-sale	8,327	–	–	8,327	19,628	–	–	19,628
- held-to-maturity	2,280	–	–	2,280	–	–	–	–
All other assets	57,102	171	366	57,639	43,376	1,047	323	44,746
	448,896	**10,150**	**1,524**	**460,570**	**311,739**	**49,734**	**1,699**	**363,172**
Liabilities:								
Owed to credit institutions	29,316	49,557	–	78,873	4,884	43,176	274	48,334
Owed to customers	269,952	–	–	269,952	252,129	–	–	252,129
Debt securities issued	1,143	–	–	1,143	–	–	–	–
All other liabilities	15,720	3,196	224	19,140	6,466	615	168	7,249
	316,131	**52,753**	**224**	**369,108**	**263,479**	**43,791**	**442**	**307,712**
Net balance sheet position	**132,765**	**(42,603)**	**1,300**	**91,462**	**48,260**	**5,943**	**1,257**	**55,460**

Market risk

The Group is exposed to market risks. Market risks arise from open positions in interest rate and currency products, all of which are exposed to general and specific market movements. The Group 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.

With respect to undrawn loan commitments the Group 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.

(Thousands of Georgian Lari)

23. Financial risk management (continued)

Currency risk

The Group is exposed to effects of fluctuation in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors 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 NBG. The Group's exposure to foreign currency exchange rate risk follows:

	2005				*2004*			
	GEL	***Freely convertible***	***Non convertible***	***Total***	***GEL***	***Freely convertible***	***Non convertible***	***Total***
Assets:								
Cash and cash equivalents	24,086	31,671	1,479	57,236	30,947	71,554	246	102,747
Due from credit institutions	32,402	957	39	33,398	23,245	2,340	–	25,585
Loans to customers	85,189	212,187	–	297,376	20,155	149,713	–	169,868
Net investment in lease	–	4,314	–	4,314	–	598	–	598
Investment securities:								
- available-for-sale	8,327	–	–	8,327	19,628	–	–	19,628
- held-to-maturity	2,280	–	–	2,280	–	–	–	–
All other assets	52,472	5,083	84	57,639	42,943	1,803	–	44,746
	204,756	**254,212**	**1,602**	**460,570**	**136,918**	**226,008**	**246**	**363,172**
Liabilities:								
Owed to credit institutions	5,023	73,823	27	78,873	71	48,263	–	48,334
Owed to customers	76,495	193,416	41	269,952	59,947	192,182	–	252,129
Debt securities issued	1,143	–	–	1,143	–	–	–	–
All other liabilities	14,227	4,913	–	19,140	5,935	1,314	–	7,249
	96,888	**272,152**	**68**	**369,108**	**65,953**	**241,759**	**–**	**307,712**
Net balance sheet position	**107,868**	**(17,940)**	**1,534**	**91,462**	**70,965**	**(15,751)**	**246**	**55,460**

Freely convertible currencies represent mainly US Dollar amounts, but also include currencies from other OECD countries. Non-freely convertible amounts relate to currencies of CIS countries, excluding Georgia. The Group's principal cash flows, revenues and operating expenses are largely generated in Georgian Lari. As a result, future movements in the exchange rate between the Georgian Lari and US Dollar will affect the carrying value of the Group's USD denominated monetary assets and liabilities.

(Thousands of Georgian Lari)

23. 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 of financial instruments. The Group's interest rate policy is reviewed and approved by the Board of Directors.

The table below summarizes the Group's exposure to interest rate risk as at December 31, 2005. Included in the table are the Group's monetary assets and liabilities at carrying amounts, classified by the earlier of contractual repricing or expected maturity dates.

	2005							
	On demand	***Less than 1 month***	***1 to 3 months***	***3 months to 1 year***	***1 to 5 years***	***Over 5 years***	***Past due***	***Total***
Assets:								
Cash and cash equivalents	32,863	21,711	2,662	–	–	–	–	57,236
Due from credit institutions	28,976	–	136	2,986	1,300	–	–	33,398
Loans to customers	–	39,093	29,968	75,655	120,779	27,145	4,736	297,376
Net investment in lease	–	108	–	24	3,949	233	–	4,314
Investment securities:								
- available-for-sale	–	944	4,379	2,498	–	506	–	8,327
- held-to-maturity	–	–	111	2,169	–	–	–	2,280
	61,839	**61,856**	**37,256**	**83,332**	**126,028**	**27,884**	**4,736**	**402,931**
Liabilities:								
Owed to credit institutions	144	28,661	14,007	36,061	–	–	–	78,873
Owed to customers	145,051	7,619	25,773	35,889	55,391	229	–	269,952
Debt securities issued	–	–	–	–	1,143	–	–	1,143
	145,195	**36,280**	**39,780**	**71,950**	**56,534**	**229**	**–**	**349,968**
Net position	**(83,356)**	**25,576**	**(2,524)**	**11,382**	**69,494**	**27,655**	**4,736**	**52,963**

	2004							
	On demand	***Less than 1 month***	***1 to 3 months***	***3 months to 1 year***	***1 to 5 years***	***Over 5 years***	***Past due***	***Total***
Assets:								
Cash and cash equivalents	58,670	44,077	–	–	–	–	–	102,747
Due from credit institutions	23,245	–	2,340	–	–	–	–	25,585
Loans to customers	–	21,269	13,282	31,799	85,710	16,322	1,486	169,868
Net investment in lease	–	15	–	3	580	–	–	598
Investment securities:								
- held-to-maturity	–	–	1,682	17,887	–	59	–	19,628
	81,915	**65,361**	**17,304**	**49,689**	**86,290**	**16,381**	**1,486**	**318,426**
Liabilities:								
Owed to credit institutions	–	3,086	9,520	35,728	–	–	–	48,334
Owed to customers	158,920	10,810	26,860	44,303	9,881	1,355	–	252,129
	158,920	**13,896**	**36,380**	**80,031**	**9,881**	**1,355**	**–**	**300,463**
Net position	**(77,005)**	**51,465**	**(19,076)**	**(30,342)**	**76,409**	**15,026**	**1,486**	**17,963**

Interest rate risk arises from the possibility that changes in interest rates will affect the value of the financial instruments. The Group's interest rate policy is reviewed and approved by the Group's Assets and Liabilities Management Committee.

(Thousands of Georgian Lari)

23. Financial risk management (continued)

Interest rate risk (continued)

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

	2005		*2004*	
	GEL	***Foreign currencies***	***GEL***	***Foreign currencies***
Due from credit institutions	**8%**	**2%**	10%	2%
Investment securities:				
- held-to-maturity	**14%**	**–**	–	–
- Available-for-sale	**13%**	**–**	16%	–
Loans to customers	**21%**	**15%**	24%	20%
Owed to credit institutions	**10%**	**7%**		5%
Owed to customers	**10%**	**8%**	5%	7%

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 future expected cash flows on clients' and banking operations, which is a part of the assets/liabilities management process. The Board 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 tables on the following page provide an analysis of banking assets and liabilities grouped on the basis of the remaining period from the balance sheet date to the contractual maturity.

	2005							
	On demand	***Less than 1 month***	***1 to 3 months***	***3 months to 1 year***	***1 to 5 years***	***Over 5 years***	***Past due***	***Total***
Assets:								
Cash and cash equivalents	32,863	21,711	2,662	–	–	–	–	57,236
Due from credit institutions	28,976	–	136	2,986	1,300	–	–	33,398
Loans to customers	–	39,093	29,968	75,655	120,779	27,145	4,736	297,376
Net investment in lease	–	108	–	24	3,949	233	–	4,314
Investment securities:								
- available-for-sale	–	944	4,379	2,498	–	506	–	8,327
- held-to-maturity	–	–	111	2,169	–	–	–	2,280
	61,839	**61,856**	**37,256**	**83,332**	**126,028**	**27,884**	**4,736**	**402,931**
Liabilities:								
Owed to credit institutions	41,781	22,572	2,401	3,560	8,559	-	–	78,873
Owed to customers	145,051	7,619	25,773	35,889	55,392	228	–	269,952
Debt securities issued	–	–	–	–	1,143	–	–	1,143
	186,832	**30,191**	**28,174**	**39,449**	**65,094**	**228**	**–**	**349,968**
Net position	**(124,993)**	**31,665**	**9,082**	**43,883**	**60,934**	**27,656**	**4,736**	**52,963**
Accumulated gap	**(124,993)**	**(93,328)**	**(84,246)**	**(40,363)**	**20,571**	**48,227**	**52,963**	

(Thousands of Georgian Lari)

23. Financial risk management (continued)

Liquidity risk (continued)

	2004							
	On demand	*Less than 1 month*	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*Over 5 years*	*Past due*	*Total*
Assets:								
Cash and cash equivalents	58,670	44,077	–	–	–	–	–	102,747
Due from credit institutions	23,245	–	2,340	–	–	–	–	25,585
Loans to customers	–	21,269	13,282	31,799	85,710	16,322	1,486	169,868
Net investment in lease	–	15	–	3	580	–	–	598
Investment securities:								
- held-to-maturity	–	–	1,682	17,887	–	59	–	19,628
	81,915	**65,361**	**17,304**	**49,689**	**86,290**	**16,381**	**1,486**	**318,426**
Liabilities:								
Owed to credit institutions	–	3,086	9,520	10,230	16,373	9,125	–	48,334
Owed to customers	158,920	10,810	26,860	44,303	9,881	1,355	–	252,129
	158,920	**13,896**	**36,380**	**54,533**	**26,254**	**10,480**	**–**	**300,463**
Net position	**(77,005)**	**51,465**	**(19,076)**	**(4,844)**	**60,036**	**5,901**	**1,486**	**17,963**
Accumulated gap	**(77,005)**	**(25,540)**	**(44,616)**	**(49,460)**	**10,576**	**16,477**	**17,963**	

The Group's capability to discharge its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time. Long-term credits are generally not available in Georgia, except for programs established by international financial institution. 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 in less than one month in the tables above.

The Bank was in breach of several debt covenants as of December 31, 2005. Subsequent to December 31, 2005 the Bank received compliance waivers from the respective financial institutions. As the compliance waivers were received after December 31, 2005 and as required by IAS 1, loans from financial institutions of GEL 16,431 with contractual maturities ranging from 13 to 57 months were presented in on demand category. As of December 31, 2005, before considering the impact of the required presentation of such loans in accordance with IAS 1, the Group's accumulated negative liquidity gap for the maturities up to 1 year totals GEL 23,932.

24. 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 or liquidation sale. As no readily available market exists for a large part of the Group's financial instruments, judgment is necessary in arriving at fair value, based on current economic conditions and the specific risks attributable to the instrument. 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 following methods and assumptions are used by the Group to estimate the fair value of these financial instruments:

Amounts due from and owed to credit institutions

For assets maturing within one month, the carrying amount approximates fair value due to the relatively short- term maturity of these financial instruments. For the assets maturing in over one month, the fair value represents the present value of estimated future cash flows discounted at the average year-end market rates. For longer-term deposits, the interest rates applicable as of December 31, 2005 and 2004 reflect market rates and, consequently, the fair value approximates the carrying amounts.

(Thousands of Georgian Lari)

24. Fair values of financial instruments (continued)

Investment securities

Held-to-maturity investment securities comprise securities with fixed interest rates, which reflect market interest rates and, consequently, the fair value approximates the carrying amounts.

The fair value of available-for-sale investments equals their carrying value.

Loans to customers

The estimate was made by discounting of scheduled future cash flows of the individual loans through the estimated maturity using prevailing market rates as of the respective year-end. As of December 31, 2005 and 2004, fair value of loans to customers approximates their carrying value.

Amounts owed to customers

For balances maturing within one month the carrying amount approximates fair value due to the relatively short term maturity of these financial instruments. For longer term fixed interest bearing deposits and other borrowings the estimated fair value is based on discounted cash flows using interest rates for new debts with similar remaining maturity. As of December 31, 2005 and 2004, fair value of amounts owed to customers approximates their carrying value.

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

	2005		***2004***	
	Carrying Amount	***Fair Value***	***Carrying Amount***	***Fair Value***
Financial assets				
Amounts due from credit institutions	**33,398**	**33,398**	25,585	25,585
Loans to customers	**297,376**	**297,376**	169,868	169,868
Investment securities held-to-maturity	**2,280**	**2,280**	–	–
Financial liabilities				
Due to credit institutions	**78,873**	**78,873**	48,334	48,334
Due to customers	**269,952**	**269,952**	252,129	252,129
Debt securities issued	**1,143**	**–**	–	–

25. 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.

(Thousands of Georgian Lari)

25. Related party transactions (continued)

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:

	2005				*2004*			
	Share-holders	*Entities under common control*	*Associates*	*Top manage-ment personnel*	*Share-holders*	*Entities under common control*	*Associates*	*Top manage-ment personnel*
Loans outstanding as of January 1, gross	**–**	**6,190**	**966**	**652**	**253**	**1,467**	**565**	**643**
Loans issued during the year	–	14,201	2,720	918	–	5,208	1,693	663
Loan repayments during the year	–	(3,658)	(414)	(427)	(253)	(485)	(1,292)	(654)
Loans outstanding as of December 31, gross	**–**	**16,733**	**3,272**	**1,143**	**–**	**6,190**	**966**	**652**
Less: Allowance for impairment as of December 31	–	(1,257)	(116)	(23)	–	(124)	(337)	(15)
Loans outstanding as of December 31, net	**–**	**15,476**	**3,156**	**1,120**	**–**	**6,066**	**629**	**637**
Deposits as of January 1	**–**	**2**	**1,837**	**12**	**–**	**–**	**528**	**2,592**
Deposits received during the year	–	252	23,457	5,062	–	4	14,606	3,824
Deposits repaid during the year	–	(2)	(23,543)	(4,961)	–	(2)	(13,297)	(6,404)
Deposits as of December 31	**–**	**252**	**1,751**	**113**	**–**	**2**	**1,837**	**12**
Interest income on loans	–	1,312	255	118	–	18	190	35
Impairment of loans	–	1,058	(221)	8	–	124	325	2
Interest expense on deposits	–	1	71	5	–	–	73	4
Commitments and guarantees received	–	2,932	8	–	–	–	–	–
Fee and commission income	–	28	36	2	–	–	19	2

All transactions with related parties were conducted on market conditions except for some of the loans issued to associates that were granted with principal and interest payable at maturity.

Compensation of top management personnel comprised the following:

	2005	*2004*
Salaries and other short-term benefits	942	937
Share based payment compensation	1,017	–
Recruitment costs	–	365
Social security costs	392	404
Total top management compensation	**2,351**	**1,706**

During the year the Group provided its top management with share based compensation. The total amount of compensation under that plan during the year ended December 31, 2005 totaled to GEL 1,017 or 308,335 ordinary shares of the Bank. All shares are fully vested ordinary shares. The fair value of the shares at the grant date (August 18, 2004) was 3.299 Georgian Lari per share. The fair value of the shares was based on the weighted average observable market prices for the shares traded at Georgian Stock Exchange at the grant date.

The total quantity of the shares granted at the grant date was 600,000 newly issued ordinary shares of which 500,000 shares are to vest over 3 year period starting August 18, 2004. The remaining 100,000 shares are fully vested at December 31, 2005.

(Thousands of Georgian Lari)

26. Capital adequacy

The NBG requires banks to maintain a capital adequacy ratio of 12% of risk-weighted assets. As of December 31, 2005 and 2004, the Group's capital adequacy ratio on this basis exceeded the statutory minimum.

The Group's international risk based capital adequacy ratio, computed in accordance with the Basle Accord guidelines issued in 1988 exceeded the recommended minimum ratio of 8% as of December 31, 2005 and 2004.

27. Subsequent events

Acquisitions

Subsequent to year end, on February 20, 2006 the Group acquired all assets and liabilities of JSC Intellect Bank. The entity was experiencing difficulties and the temporary administrator assigned by NBG concluded the sale. The consideration given for the acquisition was a nominal GEL 0.001. The Group is in process of determining the fair value of identifiable assets, liabilities and contingent liabilities of JSC Intellect Bank as of the acquisition date.

Funding obtained

As part of the acquisition of JSC Intellect Bank (Note 27) the Group obtained a 2-year credit facility of GEL 20,000 from the NBG at 6.2% per annum, plus an exemption from the NBG's required prudential ratios for the entire 12-months period following the acquisition date.

On March 27, 2006 the Group obtained a credit facility from Citygroup. A 25,000 thousand US Dollar loan was granted to the Bank on market terms, with the contractual maturity of 18 months. Additionally, the Group obtained a 10,000 thousand US Dollar, 10-year loan facility from World Business Capital. The loan is on market terms and is partially secured with a guarantee issued by OPIC.