

**Deloitte.**

**CONSTANTA  
FOUNDATION GROUP**

**Consolidated Financial Statements**  
For the Year Ended 31 December 2007

# CONSTANTA FOUNDATION GROUP

## TABLE OF CONTENTS

---

	<b>Page</b>
STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS	1
INDEPENDENT AUDITORS' REPORT	2-3
CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007:	
Consolidated income statement	4
Consolidated balance sheet	5
Consolidated statement of changes in net assets	6
Consolidated statement of cash flows	7
Notes to the consolidated financial statements	8-35

## CONSTANTA FOUNDATION GROUP

### STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

---

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

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group at 31 December 2007, the results of its operations, cash flows and changes in net assets for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

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

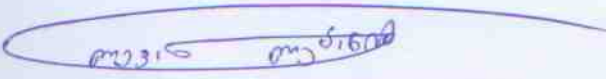
- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Preparing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

Management is also responsible for:

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

The consolidated financial statements for the year ended 31 December 2007 were authorized for issue on 14 July 2008 by the Management Board.

On behalf of the Management Board:

  
Executive Director  
Levan Lebanidze

14 July 2008

## INDEPENDENT AUDITORS' REPORT

To the Governing Board of Microfinance Organization Constanta Foundation:

We have audited the accompanying consolidated financial statements of Microfinance Organization Constanta Foundation Group, which comprise the consolidated balance sheet as at 31 December 2007, and the consolidated statements of income, of changes in net assets and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards.

This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Auditor's Responsibility

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

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

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

## Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects the financial position of Microfinance Organization Constanta Foundation Group as at 31 December 2007, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Deloitte & Touche*

*14 July 2008*

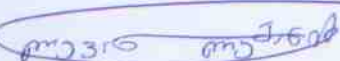
# CONSTANTA FOUNDATION GROUP

## CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2007

(in Georgian Lari and in thousands)

	Notes	Year ended 31 December 2007	Year ended 31 December 2006
Interest income	4,24	14,049	10,088
Interest expense	4,24	(4,736)	(2,284)
<b>NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS</b>		<b>9,313</b>	<b>7,804</b>
Allowance for impairment losses on interest bearing assets	5	(251)	(643)
<b>NET INTEREST INCOME</b>		<b>9,062</b>	<b>7,161</b>
Net (loss)/gain on foreign exchange operations	6	(308)	100
Fee and commission expense	7	(173)	(92)
Net gain on securities held for trading		61	-
Other income	8	892	290
Other expenses	9	(250)	-
<b>NET NON-INTEREST INCOME</b>		<b>222</b>	<b>298</b>
<b>OPERATING INCOME</b>		<b>9,284</b>	<b>7,459</b>
<b>OPERATING EXPENSES</b>	10, 24	<b>(10,708)</b>	<b>(5,932)</b>
<b>NET OPERATING (LOSS)/INCOME</b>		<b>(1,424)</b>	<b>1,527</b>
Donation income	11	1,266	647
<b>(LOSS)/PROFIT BEFORE INCOME TAX</b>		<b>(158)</b>	<b>2,174</b>
Income tax expense	12	(585)	(475)
<b>NET (LOSS)/PROFIT</b>		<b>(743)</b>	<b>1,699</b>
Attributable to:			
Equity holders of the parent		(543)	-
Minority interest		(200)	-
		<b>(743)</b>	<b>1,699</b>

On behalf of the Management Board:



Executive Director  
Levan Lebanidze  
14 July 2008

The notes on pages 8-35 form an integral part of these consolidated financial statements.

# CONSTANTA FOUNDATION GROUP

## CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2007

(in Georgia Lari and in thousands)

	Notes	31 December 2007	31 December 2006
<b>ASSETS:</b>			
Cash	13	1,871	238
Deposits held with banks	14	9,309	16,867
Loans to customers	15, 24	42,036	33,782
Property, plant and equipment	16	7,484	1,756
Current income tax asset		496	-
Deferred tax asset		-	21
Other assets	17,24	2,229	506
<b>TOTAL ASSETS</b>		<b>63,425</b>	<b>53,170</b>
<b>LIABILITIES AND NET ASSETS</b>			
<b>LIABILITIES:</b>			
Loans from banks and other financial institutions	18	44,743	39,451
Other borrowed funds	19	2,762	-
Current income tax liability		499	369
Deferred tax liability	12	62	-
Other liabilities	20	388	93
<b>Total liabilities</b>		<b>48,454</b>	<b>39,913</b>
<b>NET ASSETS:</b>			
Net assets attributable to equity holders of the parent:			
Accumulated funds	21	11,253	13,257
Fixed assets revaluation reserve		1,247	-
<b>Total net assets attributable to equity holders of the parent</b>		<b>12,500</b>	<b>13,257</b>
Minority interest		2,471	-
<b>Total net assets</b>		<b>14,971</b>	<b>13,257</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>		<b>63,425</b>	<b>53,170</b>

On behalf of the Executive Board:



Executive Director  
Levan Lebanidze  
14 July 2008

The notes on pages 8-35 form an integral part of these consolidated financial statements.

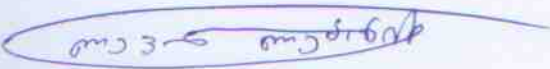
# CONSTANTA FOUNDATION GROUP

## CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS FOR THE YEAR ENDED 31 DECEMBER 2007

(in Georgian Lari and in thousands)

	Accumulated funds	Fixed assets revaluation reserve	Total	Minority interest	Total net assets
31 December 2005	11,558	-	11,558	-	11,558
Net profit	1,699	-	1,699	-	1,699
31 December 2006	13,257	-	13,257	-	13,257
Share capital contribution attributable to minority holders (nominal amount)	-	-	-	3,036	3,036
Discount adjustment at initial recognition of the capital contribution	(1,461)	-	(1,461)	(365)	(1,826)
Gains on revaluation of fixed assets	-	1,247	1,247	-	1,247
Net Loss	(543)	-	(543)	(200)	(743)
31 December 2007	11,253	1,247	12,500	2,471	14,971

On behalf of the Executive Board: \_\_\_\_\_

  
Executive Director

Levan Lebanidze

14 July 2008

The notes on pages 8-35 form an integral part of these consolidated financial statements.

# CONSTANTA FOUNDATION GROUP

## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2007

(in Georgian Lari and in thousands)

	Notes	Year ended 31 December 2007	Year ended 31 December 2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Income before income tax		(158)	2,174
Adjustments for:			
Loss on disposal of equipment		-	27
Allowance for impairment losses on loans to customers		251	643
Depreciation and amortization charge		792	292
Net change in interest accruals		741	450
Loss on foreign exchange operations		(348)	(152)
Cash flows from operating activities before changes in operating assets and liabilities		1,278	3,434
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Loans to customers		(8,417)	(21,540)
Deposits held with banks		7,558	(17,100)
Other assets		(294)	(476)
Increase/(decrease) in operating liabilities			
Other liabilities		295	700
Cash flows from operating activities before taxation		420	(34,982)
Income tax paid		(712)	-
Net cash outflow from operating activities		(292)	(34,982)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of property, plant and equipment		(5,325)	(865)
Purchase of intangible assets		(170)	-
Proceeds from sale of property and equipment		54	91
Net cash outflows from investing activities		(5,441)	(774)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from other borrowed funds		2,753	-
Proceeds from bank loans		4,871	35,804
Net cash inflow from financing activities		7,624	35,804
NET INCREASE IN CASH AND CASH EQUIVALENTS		1,891	48
Effect of exchange rates on cash and cash equivalents		(258)	(25)
CASH AND CASH EQUIVALENTS at the beginning of the year	13	238	215
CASH AND CASH EQUIVALENTS at the end of the year	13	1,871	238

On behalf of the Executive Board:

  
Executive Director  
Levan Lebanidze  
14 July 2008

The notes on pages 8-35 form an integral part of these consolidated financial statements.

# CONSTANTA FOUNDATION GROUP

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

### 1. ORGANISATION

Microfinance Organization Constanta Foundation is a non for profit micro financial organization. It was established as an association on 31 January 1997 by the Decree number 3/29 of the Ministry of Justice. The association was succeeded by the Fund Constanta that was registered on 4 December 1998 by the Decree number 30/7 of the Ministry of Justice.

The organization was further re-registered on 31 March 2005 by the Decree number 42 of the Ministry of Justice, as Microfinance Organization Constanta Foundation (the "Fund").

The registered address of the Fund is 115, Tsinamdzgvrishvili Street, Tbilisi, 0164, Georgia.

The following subsidiary is consolidated in the financial statements:

Name	Country of operation	The ownership interest		Type of operation
		2007	2006	
JSC Constanta	Georgia	80	-	Microfinance

JSC Constanta was formed as a joint stock company under the laws of Georgia on 8 November 2007. The registered share capital of the JSC as of 31 December 2007 amounted to GEL 18,000,000. The company's principal activity will be commercial activities, originating loans and guarantees, attracting customer accounts and trading foreign currencies.

On 29 December 2007 the Foundation incorporated a limited liability company "Constanta Plus" in Georgia. The authorized capital of the limited liability company amounted to GEL 12,140,680 as at 31 December 2007 which was paid up by contributing 80% shares of JSC Constanta.

As at 31 December 2007 the following shareholders owned shares of the JSC Constanta:

Shareholder	31 December 2007
	%
LLC Constanta Plus	80.0%
Lebanidze Tamar	8.6%
Lebanidze Levan	5.2%
Mirianashvili Zviad	2.2%
Ghachava Gia	2.2%
Vardziashvili Gela	0.6%
Turnava Natela	0.6%
Jakhua Manana	0.6%
<b>Total</b>	<b>100%</b>

These consolidated financial statements were authorized for issue by the Management Board of the Group on 14 July 2008.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### Statement of compliance

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

### Basis of preparation

These financial statements are presented in thousands of Georgian Lari ("GEL"), unless otherwise indicated. These financial statements have been prepared under the historical cost convention, except for the measurement at fair value of certain financial instruments.

### Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Microfinance Foundation and an entities controlled by the Fund (its subsidiaries) made up to 31 December 2007. Control is achieved where the Fund has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. The minority interest is stated at the minority's proportion of the fair values of the assets and liabilities recognized. Subsequently, any losses applicable to the minority interest in excess of the minority interest are allocated against the interests of the parent. The equity attributable to equity holders of the parent and net income attributable to minority shareholders' interests are shown separately in the consolidated balance sheet and income statement, respectively.

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

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

The difference, if any, between the carrying amount of minority interest and the amount received on its purchase is recognized in equity attributable to the equity holders of the parent.

### Key assumptions

The preparation of consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts. Such estimates and assumptions are based on the information available to the Group's management as of the date of the consolidated financial statements. Therefore, actual results could differ from those estimates and assumptions. Estimates that are particularly susceptible to change relate to the provisions for impairment losses and the fair value of financial instruments.

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

	31 December 2007	31 December 2006
Loans to customers	42,885	34,739
Allowance for impairment losses	849	957
Loans to customers, net	42,036	33,782

Loans to customers are measured at amortized cost less allowance for impairment losses. The estimation of allowances for impairments involves the exercise of significant judgment.

The Group estimates allowances for impairment with the objective of maintaining balance sheet provisions at a level believed by management to be sufficient to absorb probable losses incurred in the Group's loan portfolio. The calculation of provisions on impaired loans is based on the likelihood of the asset being written off and the estimated loss on such a write-off. These assessments are made using statistical techniques based on historic experience. These determinations are supplemented by various formulaic calculations and the application of management judgment.

The Group considers accounting estimates related to provisions for loans key sources of estimation uncertainty because: (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of losses relating to impaired loans and advances are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses (as reflected in the provisions) and actual losses will require the Group to take provisions which, if significantly different, could have a material impact on its future income statement and its balance sheet. The Group's assumptions about estimated losses are based on past performance, past customer behavior, the credit quality of recent underwritten business and general economic conditions, which are not necessarily an indication of future losses.

The accounting policy for the impairment of financial instruments is discussed in Note 3 below.

#### **Functional currency**

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

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

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

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

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

Cash and cash equivalents include cash on hand and cash balances in banks.

#### **Deposits held with banks**

In the normal course of business, the Group maintains advances and deposits for various periods of time with other banks. Due from banks with a fixed maturity term are subsequently measured at amortized cost using the effective interest method. Those that do not have fixed maturities are carried at amortized cost based on expected maturities. Amounts due from credit institutions are carried net of any allowance for impairment losses.

### **Loans to customers**

Loans to customers are non-derivative assets with fixed or determinable payments that are not quoted in an active market other than those classified in other categories of financial assets.

Loans granted by the Group are initially recognized at fair value plus related transaction costs. Where the fair value of consideration given does not equal the fair value of the loan, for example where the loan is issued at lower than market rates, the difference between the fair value of consideration given and the fair value of the loan is recognized as a loss on initial recognition of the loan and included in the consolidated income statement according to nature of these losses. Subsequently, loans are carried at amortized cost using the effective interest method. Loans to customers are carried net of any allowance for impairment losses.

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

Loans and advances are written off against allowance for impairment losses in case of uncollectibility of loans and advances, including through repossession of collateral. Loans and advances are written off against allowance for impairment losses in case of being in arrears more than 180 days.

### **Allowance for impairment losses**

The Group accounts for impairment losses on financial assets when there is objective evidence that a financial asset or group of financial assets is impaired. Impairment losses are measured as the difference between carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted at the financial asset's original effective interest rate, for financial assets which are carried at amortized cost. If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. For financial assets carried at cost, the impairment losses are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows, discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

The determination of impairment losses is based on an analysis of the risk assets and reflects the amount which, in the judgment of management, is adequate to provide for losses incurred. Provisions are made as a result of an individual appraisal of risk assets for financial assets that are individually significant, and an individual or collective assessment for financial assets that are not individually significant.

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

The Group accounts for impairment losses on financial assets at amortised cost using allowance account, for financial assets measured at cost through direct write off.

It should be understood that estimates of losses involve an exercise of judgment. While it is possible that in particular periods the Group may sustain losses that are substantial relative to the allowance for impairment losses, it is the judgment of management that the allowance for impairment losses is adequate to absorb losses incurred on the risk assets.

## Property, plant and equipment and intangible assets

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

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

Buildings	5%
Furniture and equipment	20%
Vehicles	20%
Other	20%
Intangible assets	10%

Leasehold improvements are amortized over the life of the related leased asset. Expenses related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

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

An impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation charge for property, plant and equipment and intangible assets is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

## Taxation

Income tax expense represents the sum of the current and deferred tax expense.

The current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's current tax expense is calculated using tax rates that have been enacted during the reporting period.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognized for taxable temporary differences arising on property, equipment and intangible assets, and interest accrued on loans to customers, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to net assets, in which case the deferred tax is also dealt with in net assets.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the balance sheet if:

- The Group has a legally enforceable right to set off current income tax assets against current income tax liabilities; and
- Deferred income tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

### **Loans from banks**

Loans and deposits from Banks are initially recognized at fair value. Subsequently, amounts due are stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the consolidated income statement over the period of the borrowings using the effective interest method.

### **Provisions**

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

### **Net assets**

The Fund's net assets represent the surplus of total assets over total liabilities. Net assets arise from excess of income over expenditures. Excess of income over expenditures has to be used for micro credit operations.

Contributions to net assets are recognized at their cost. External costs directly attributable to the issue of new shares, other than on a business combination, are deducted from net assets net of any related income taxes.

### **Donations received**

Donations received include donations from government or other parties in the form of transfers of cash, property and other types of assets to the Fund. These donations are recognized as income whenever there is a reasonable expectation that the organization will comply with the conditions of their use, if applicable.

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

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

## Recognition of income and expense

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

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

Interests earned on assets at fair value are classified within interest income.

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

## Foreign currency translation

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

## Rates of exchange

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

	31 December 2007	31 December 2006
Georgian Lari/1 US Dollar	1.5916	1.7135
Georgian Lari/1 Euro	2.3315	2.2562

## Offset of financial assets and liabilities

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

### Adoption of new standards

In the current year, the Group has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the IASB) and the International Financial Reporting Interpretations Committee (the IFRIC) of the IASB that are relevant to its operations and effective for annual reporting periods beginning on 1 January 2007. The adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Group's accounting policies that have affected the amounts reported for the current or prior years.

**Adoption of IFRS 7** – Effective 1 January 2007, the Group adopted IFRS 7 “Financial Instruments: Disclosure” (“IFRS 7”). IFRS 7 establishes new requirements and recommendations on financial instrument disclosure. The Group discloses all information required under IFRS 7 in its annual consolidated financial statements for the year 2007.

Certain new IFRSs became effective for the Group from 1 January 2007. Listed below are those new or amended standards or interpretations which are or in the future could be relevant to the Group's operations and the nature of their impact on the Group's accounting policies.

**Adoption of IFRS 8** – Effective 1 January 2009, the new IFRS 8 “Operating Segments” will replace IAS 14 “Operating Segments”. The management is currently assessing the impact of the adoption of these new and revised Standards in future periods.

### 3. PRIOR PERIOD RECLASSIFICATIONS

Certain reclassifications have been made to the financial statements as at 31 December 2006 and for the year then ended to conform to the presentation as at 31 December 2007 and for the year then ended as current year presentation provides better view of the financial position of the Group.

Nature of reclassification	Amount	Balance sheet/Income statement line as per the previous report	Balance sheet/Income statement line as per current report
Intangible assets transferred from property, plant and equipment to intangible assets	108	Property, plant and equipment	Other assets
Prepaid commission fee on loans from international financial institutions transferred to loans from financial institutions	164	Other Assets	Due to banks and financial institutions
Advances received comprising of borrowers' advance payment transfer to loans to customers.	210	Other liabilities	Loans to customers
Deferred commission income comprising of loan origination fee transfer to loans to customers.	360	Other liabilities	Loans to customers
Income from penalties included in other commission income transfer to other income	71	Commission income	Other income
Fee on origination of loans to customers included in commission income transferred to interest income	907	Commission income	Interest income
Fee on loans to from financial institutions included in fee and commission expense transferred to interest expense	58	Commission expense	Interest expense
Banking service fees and charges transferred from operating expenses to fee and commission expense	96	Operating expenses	Commission expense
Intangible assets transferred from property, plant and equipment to other assets	108	Property, plant and equipment	Other assets

#### 4. NET INTEREST INCOME

	Year ended 31 December 2007	Year ended 31 December 2006
<b>Interest income comprises:</b>		
Interest income on assets recorded at amortized cost comprises:		
Interest on loans to customers	12,584	9,326
Interest income on deposits held with banks	1,465	752
Other	-	10
<b>Total interest income on financial assets recorded at amortized cost</b>	<b>14,049</b>	<b>10,088</b>
<b>Interest expense comprises:</b>		
Interest expense on liabilities recorded at amortized cost comprise:		
Interest expenses on loans	(4,717)	(2,263)
Interest expense on overdrafts	(19)	(21)
Other interest expenses	-	-
<b>Total interest expense on financial assets recorded at amortized cost</b>	<b>(4,736)</b>	<b>(2,284)</b>
<b>Net interest income before provision for impairment losses on interest bearing assets</b>	<b>9,313</b>	<b>7,804</b>

#### 5. ALLOWANCE FOR IMPAIRMENT LOSSES

The movements in allowance for impairment losses on loans to customers were as follows:

	Year ended 31 December 2007	Year ended 31 December 2006
At the beginning of the year	957	469
Provision	251	643
Recoveries of loans previously written off	124	97
Writtenoff	(483)	(252)
<b>At the end of the year</b>	<b>849</b>	<b>957</b>

#### 6. NET (LOSS)/GAIN ON FOREIGN EXCHANGE OPERATIONS

Net (loss)/gain on foreign exchange operations comprise:

	Year ended 31 December 2007	Year ended 31 December 2006
Currency translation differences	40	152
Foreign exchange loss	(348)	(52)
<b>Total net (loss)/gain on foreign exchange operations</b>	<b>(308)</b>	<b>100</b>

7. FEE AND COMMISSION EXPENSE

Fee and commission expense comprise:

	Year ended 31 December 2007	Year ended 31 December 2006
<b>Fee and commission expense:</b>		
Cash operations	124	68
Settlements	25	14
Credit cards operations	1	1
Other	23	9
<b>Total fee and commission expense</b>	<b>173</b>	<b>92</b>

8. OTHER INCOME

Other income comprises:

	Year ended 31 December 2007	Year ended 31 December 2006
Fines and penalties received	822	261
Insurance premiums	41	-
Other	29	29
	<b>892</b>	<b>290</b>

9. OTHER EXPENSES

Other expenses comprise:

	Year ended 31 December 2007	Year ended 31 December 2006
Loss from sale of fixed assets	44	-
Loss on revaluation of fixed assets	206	-
	<b>250</b>	<b>-</b>

## 10. OPERATING EXPENSES

Operating expenses comprise:

	Year ended 31 December 2007	Year ended 31 December 2006
Salaries and bonuses	4,317	2,905
Unified social tax contribution	845	594
Depreciation and amortization	792	292
Advertising costs	739	338
Operating lease	731	252
Taxes, other than income tax	503	154
Professional services	561	200
Communications	331	206
Security	280	198
Business trip expenses	252	134
Fuel	203	130
Insurance	174	100
Stationery	134	152
Utility	124	73
Assets maintenance	118	75
Training	104	41
Transportation	39	27
Membership fee	37	11
Sponsorship	24	-
Legal services	21	21
Other expenses	379	29
	<u>10,708</u>	<u>5,932</u>

## 11. DONATION INCOME

Donation income comprises:

	Year ended 31 December 2007	Year ended 31 December 2006
Chemonics International	280	358
Care International in Caucasus	898	289
Merci Corps	88	-
Total donation income	<u>1,266</u>	<u>647</u>

## 12. INCOME TAXES

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

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

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at 31 December 2007 and 2006 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences as at 31 December 2007 and 2006 comprise:

	Year ended 31 December 2007	Year ended 31 December 2006
<b>Deductible temporary differences:</b>		
Loans to customers	680	315
Other liabilities	<u>-</u>	<u>360</u>
<b>Total deductible temporary differences</b>	<u><b>680</b></u>	<u><b>675</b></u>
<b>Taxable temporary differences:</b>		
Property, plant and equipment	1,096	408
Other assets	<u>-</u>	<u>164</u>
<b>Total taxable temporary differences</b>	<u><b>1,096</b></u>	<u><b>572</b></u>
Net (taxable)/deductible temporary differences	<u>(416)</u>	<u>103</u>
<b>Net deferred tax (liability)/asset at the statutory tax rate</b>	<u><b>(62)</b></u>	<u><b>21</b></u>

Relationships between tax expenses and accounting profit for the years ended 31 December 2007 and 2006 are explained as follows:

	Year ended 31 December 2007	Year ended 31 December 2006
(Loss)/Profit before income taxes	<u>(158)</u>	<u>2,174</u>
Theoretical tax at the statutory tax rate	(32)	435
Tax effect of tax rate change	(37)	-
Tax effect of permanent differences	<u>654</u>	<u>40</u>
<b>Income tax expense</b>	<u><b>585</b></u>	<u><b>475</b></u>
Current income tax expense	502	496
Deferred income tax expense/(benefit)	<u>83</u>	<u>(21)</u>
<b>Income tax expense</b>	<u><b>585</b></u>	<u><b>475</b></u>
<b>Deferred income tax assets/(liabilities)</b>	<b>2007</b>	<b>2006</b>
Beginning of the period	21	-
(Increase)/decrease in income tax liability for the period charged to profit	<u>(83)</u>	<u>21</u>
<b>End of the period</b>	<u><b>(62)</b></u>	<u><b>21</b></u>

