

**Microfinance Organization
CONSTANTA
FOUNDATION**

**Financial Statements
for the Year Ended 31 December 2005
and Independent Auditors' Report**

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

TABLE OF CONTENTS

	Page
STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS	1
INDEPENDENT AUDITORS' REPORT	2
FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005:	
Statement of activities	3
Balance sheet	4
Statement of changes in net assets	5
Statement of cash flows	6
Notes to the financial statements	7-25

INDEPENDENT AUDITORS' REPORT

To the Governing Board of Microfinance Organization Constanta Foundation:

We have audited the accompanying balance sheet of Microfinance Organization Constanta Foundation (the "Fund") as at 31 December 2005 and the related statements of activities, cash flows and changes in net assets (the "financial statements") for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Fund for the year ended 31 December 2004 were audited by other auditors whose report, dated 20 March 2005, expressed an unqualified opinion on those statements before restatement.

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 financial statements present fairly, in all material respects, the financial position of the Fund as at 31 December 2005, and the results of its operations and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

Deloitte & Touche

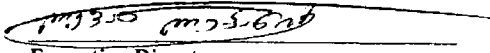
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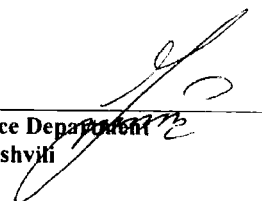
MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED 31 DECEMBER 2005**

	<u>Notes</u>	<u>Year ended 2005</u> GEL'000	<u>Year ended 2004(restated)</u> GEL'000
Interest and commission income	4	5,524	6,006
Interest and commission expense	4	(222)	-
NET INTEREST AND COMMISSION INCOME	4	5,302	6,006
Operating expenses	5	(4,520)	(3,860)
Other operating income		208	229
Net loss on foreign exchange operations		(16)	(268)
NET OPERATING INCOME BEFORE PROVISION FOR LOAN		974	2,107
Allowance for impairment losses	6	(858)	(1,375)
NET OPERATING INCOME		116	732
Donation income	8	560	890
PROFIT BEFORE INCOME TAXES		676	1,622
Corporate income tax	7	(51)	(360)
NET INCOME		625	1,262

On behalf of the Executive Board


Executive Director
Levan Lebanidze


Head of Finance Department
Zviad Mirianashvili

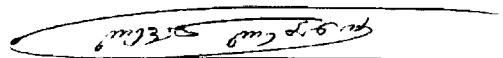
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MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

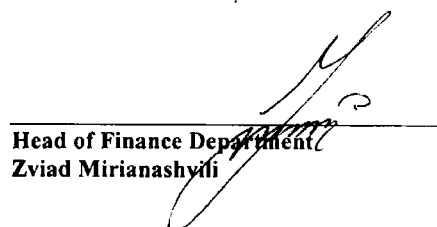
BALANCE SHEET AS AT 31 DECEMBER 2005

	<u>Notes</u>	<u>2005</u> GEL'000	<u>2004(restated)</u> GEL'000
ASSETS:			
Cash and cash equivalents	9	215	1,046
Loans to customers, less allowance for impairment losses	10	13,654	8,387
Property, plant and equipment and intangible assets	11	1,409	1,259
Income tax prepaid	7	358	90
Other assets		37	225
TOTAL ASSETS		<u>15,673</u>	<u>11,007</u>
LIABILITIES AND NET ASSETS:			
LIABILITIES			
Loans from banks and other institutions	12	4,080	-
Other liabilities		35	74
Total liabilities		<u>4,115</u>	<u>74</u>
NET ASSETS			
Accumulated funds		11,558	10,933
Total net assets		<u>11,558</u>	<u>10,933</u>
TOTAL LIABILITIES AND NET ASSETS		<u>15,673</u>	<u>11,007</u>

On behalf of the Executive Board



Executive Director
Levan Lebanidze



Head of Finance Department
Zviad Mirianashvili

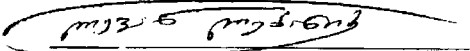
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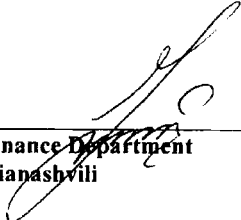
MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

**STATEMENT OF CHANGES IN ACCUMULATED FUNDS
FOR THE YEAR ENDED 31 DECEMBER 2005**

<u>Accumulated funds</u>	<u>2005</u> GEL'000	<u>2004(restated)</u> GEL'000
At the beginning of the year	10,933	9,671
Net income for the year	<u>625</u>	<u>1,262</u>
At the end of the year	<u>11,558</u>	<u>10,933</u>

On behalf of the Executive Board


Executive Director
Levan Lebanidze


Head of Finance Department
Zviad Mirianashvili

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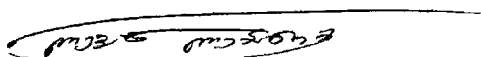
MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2005

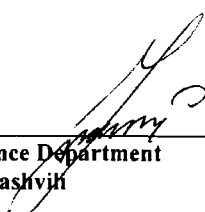
	Notes	Year ended <u>2005</u> GEL'000	Year ended <u>2004(restated)</u> GEL'000
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income taxes		676	1,622
Adjustments for:			
Loss on disposal of equipment		5	-
Allowance for impairment losses on loans to customers		858	1,375
Depreciation and amortization expense		257	196
Net change in interest accruals		170	541
Cash flows from operating activities before changes in operating assets and liabilities		1,966	3,734
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Loans to customers		(6,295)	(3,254)
Other assets		188	(162)
Increase/(decrease) in operating liabilities:			
Other liabilities		(39)	(146)
Cash (outflow)/inflow from operating activities before income taxes		(4,180)	172
Income tax paid		(319)	(450)
Net cash outflow from operating activities		(4,499)	(278)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property, equipment and intangible assets		(414)	(495)
Proceeds from sale of property and equipment		2	62
Net cash outflows from investing activities		(412)	(433)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from bank loans		4,080	-
Net cash inflow from financing activities		4,080	-
NET DECREASE IN CASH AND CASH EQUIVALENTS		(831)	(711)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	9	1,046	1,757
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	9	215	1,046

Interest received and paid by the Fund in cash during the year ended 31 December 2005 amounted to GEL 4,987 thousand and GEL 165 thousand, respectively (2004: GEL 6,064 thousand and zero, respectively).

On behalf of the Executive Board



Executive Director
Levan Lebanidze



Head of Finance Department
Zviad Mirianashvili

The notes on pages 7 to 25 form an integral part of these financial statements. The Independent Auditors' Report is on page 2.

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (in Georgian Lari and in thousands)

1. ORGANIZATION

Microfinance Organization Constanta Foundation is a non profit making 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, Tsinamdzgvishvili Street, Tbilisi, 0164, Georgia.

The principal activity of the Fund is the implementation of micro credit programs, being achieved through providing microfinance services to local micro and small entrepreneurs living in Georgia. Target groups of the Fund are legal entities and individuals with relatively low levels of income.

The Fund has nine branches, six outlets and eleven service points, covering different regions of Georgia.

As at 31 December 2005 and 2004 the Fund employed 236 and 230 people, respectively.

These financial statements were authorized for issue by the Governing Board on 25 April 2006.

2. BASIS OF PRESENTATION

Accounting basis

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These financial statements are presented in thousands of Georgian Lari ("GEL") unless otherwise indicated. These financial statements have been prepared on the accrual basis and under the historical cost convention.

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

Functional currency

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

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

3. SIGNIFICANT ACCOUNTING POLICIES

Recognition and measurement of financial instruments

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

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

Cash and cash equivalents

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

Non-accrual loans

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

Allowance for impairment losses

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

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

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

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

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

Property, plant and equipment and intangible assets

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

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

Buildings	5-10
Computers	20-25
Furniture and equipment	20-25
Vehicles	20-25
Other fixed assets	10-20
Intangible assets	5-10

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 the carrying values exceed the estimated recoverable amounts, the assets are written down to their recoverable amount. An impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation charge for property, plant and equipment is adjusted in future periods to allocate the asset's revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

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 profit and loss account 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 Fund's current tax expense is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

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

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the profit and loss account, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

During 2005 and 2004 the base corporate income tax rate in Georgia was 20%.

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

Loans from banks

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

Provisions

Provisions are recognized when the Fund 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.

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

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. If the Fund ceased to exist, according to Georgian legislation its net assets should be distributed to the similar organizations.

Donations received

Donations received include donations from government or other parties in the form of transfers 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.

Contingencies

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

Recognition of income and expense

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

Foreign currency translation

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

Rates of exchange

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

	<u>31 December 2005</u>	<u>31 December 2004</u>
GEL/USD	1.793	1.825
GEL/EUR	2.125	2.485

Offset of financial assets and liabilities

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

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

Reclassifications

Certain reclassifications have been made to the financial statement as at 31 December 2004 to conform to the presentation as at 31 December 2005.

Restatement

The financial statements as at 31 December 2004 and for the year then ended have been restated to correct errors made as a result of incorrect application of accounting policies and the recognition of revenue in the incorrect period. The effects of the restatements on those financial statements are summarized below. Net assets as at 31 December 2003 have been reduced by GEL 37 thousand, which is the amount of the correction relating to periods prior to the year 2004.

	<u>Before restatement</u> GEL'000	<u>Loans to customers</u> GEL'000	<u>Deferred tax assets (gross)</u> GEL'000	<u>Accumulated funds</u> GEL'000	<u>Restated</u> GEL'000
Before restatement		7,846	571	10,663	
Interest and commission income	5,465	541	-	541	6,006
Donation income	-	-	-	-	890
Corporate income tax	(126)		(234)	(234)	(360)
Net income of periods prior to the year ended 31 December 2004	-	-	(37)	(37)	
Restated		<u>8,387</u>	<u>300</u>	<u>10,933</u>	

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

4. NET INTEREST AND COMMISSION INCOME

Net interest and commission income comprises:

	Year ended 2005 GEL'000	Year ended 2004(restated) GEL'000
Interest and commission income		
Interest income on loans to customers	4,817	5,523
Revenues from administrative fees	677	390
Other income	30	93
Total interest and commission income	<u>5,524</u>	<u>6,006</u>
Interest and commission expense		
Interest expenses on loans	169	-
Commission fees on loans	45	-
Interest expense on overdrafts	8	-
Total interest and commission expense	<u>222</u>	<u>-</u>
Net interest and commission income	<u>5,302</u>	<u>6,006</u>

5. OPERATING EXPENSES

Operating expenses comprise:

	Year ended 2005 GEL'000	Year ended 2004 GEL'000
Salary expenses	2,124	1,760
Social taxes	435	495
Rent expenses	266	239
Depreciation and amortization	257	196
Advertisement expenses	197	41
Communication expenses	174	104
Security expense	143	91
Repair and maintenance	128	179
Stationery	110	97
Fuel expenses	115	112
Professional services	87	104
Business trips	91	70
Bank fees	62	56
Other expenses	331	316
Total operating expenses	<u>4,520</u>	<u>3,860</u>

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

6. ALLOWANCE FOR IMPAIRMENT LOSSES

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

	<u>2005</u> GEL'000	<u>2004</u> GEL'000
At the beginning of the year	1,550	288
Allowance	858	1,375
Write off	<u>(1,939)</u>	<u>(113)</u>
At the end of the year	<u>469</u>	<u>1,550</u>

7. INCOME TAXES

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

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

Temporary differences as at 31 December 2005 and 2004 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences as at 31 December 2005 and 2004 comprise:

	<u>2005</u> GEL'000	<u>2004(restated)</u> GEL'000
Deferred assets:		
Loans to customers	<u>469</u>	<u>1,550</u>
Total deferred assets	<u>469</u>	<u>1,550</u>
Deferred liabilities:		
Property, plant and equipment and intangible assets	<u>220</u>	<u>49</u>
Total deferred liabilities	<u>220</u>	<u>49</u>
Net deferred asset	<u>249</u>	<u>1,501</u>
Deferred tax asset at the statutory rate of 20 %	50	300
Less valuation allowance	<u>(50)</u>	<u>(300)</u>
Net deferred tax asset	<u>-</u>	<u>-</u>

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

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

	Year ended 2005 GEL'000	Year ended 2004(restated) GEL'000
Profit before income taxes	676	1,622
Statutory tax rate	20%	20%
Theoretical tax at the statutory tax rate	135	324
Tax effect of permanent differences	166	(264)
Effect of changes in income tax rate	-	-
Change in valuation allowance	(250)	300
Income tax expense	<u>51</u>	<u>360</u>
Current income tax expense	<u>51</u>	<u>360</u>
Income tax expense	<u>51</u>	<u>360</u>

Income tax assets and liabilities consist of the following:

	2005 GEL'000	2004 GEL'000
Income tax prepaid	<u>358</u>	<u>90</u>
Total income tax asset	<u>358</u>	<u>90</u>

8. DONATION INCOME

Donation income comprises:

	Year ended 2005 GEL'000	Year ended 2004(restated) GEL'000
Chemonics International	276	107
Care International in Caucasus	249	400
Merci Corps	35	368
CGAP	-	15
Total donation income	<u>560</u>	<u>890</u>

9. CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise:

	2005 GEL'000	2004 GEL'000
Cash on hand in national currency	27	75
Cash in banks in national currency	156	476
Cash in banks in foreign currency	<u>32</u>	<u>495</u>
Total cash and cash equivalents	<u>215</u>	<u>1,046</u>

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

10. LOANS TO CUSTOMERS

Loans to customers comprise:

	<u>2005</u> GEL'000	<u>2004(restated)</u> GEL'000
Loans to customers	13,855	9,499
Accrued interest income on loans to customers	268	438
	<u>14,123</u>	<u>9,937</u>
Less allowance for impairment losses	(469)	(1,550)
Total loans to customers, net	<u>13,654</u>	<u>8,387</u>

	<u>2005</u> GEL'000	<u>2004</u> GEL'000
Loans collateralized by real estate	1,855	572
Loans collateralized by household equipment and inventory	3,551	1,674
Uncollateralized loans	8,449	7,253
Accrued interest income on loans to customers	268	438
	<u>14,123</u>	<u>9,937</u>
Less allowance for impairment losses	(469)	(1,550)
Total loans to customers, net	<u>13,654</u>	<u>8,387</u>

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

	<u>2005</u> GEL'000	<u>2004</u> GEL'000
Analysis by type		
Group	8,449	7,253
Individuals	5,181	2,190
Agricultural	225	56
Accrued interest income on loans to customers	268	438
	<u>14,123</u>	<u>9,937</u>
Less allowance for impairment losses	(469)	(1,550)
Total loans to customers, net	<u>13,654</u>	<u>8,387</u>

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

11. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS, NET

	<u>Buildings</u> GEL'000	<u>Vehicles</u> GEL'000	<u>Computers and office equipment</u> GEL'000	<u>Furniture and fixtures</u> GEL'000	<u>Intangible and other assets</u> GEL'000	<u>Total</u> GEL'000
At cost						
31 December 2004	780	172	647	144	21	1,764
Additions	23	28	268	75	20	414
Disposals	-	(41)	(64)	(11)	-	(116)
31 December 2005	<u>803</u>	<u>159</u>	<u>851</u>	<u>208</u>	<u>41</u>	<u>2,062</u>
Accumulated depreciation						
31 December 2004	97	87	264	53	4	505
Charge for the year	39	29	150	34	5	257
Eliminated on disposals	-	(41)	(58)	(10)	-	(109)
31 December 2005	<u>136</u>	<u>75</u>	<u>356</u>	<u>77</u>	<u>9</u>	<u>653</u>
Net book value						
31 December 2005	<u>667</u>	<u>84</u>	<u>495</u>	<u>131</u>	<u>32</u>	<u>1,409</u>
31 December 2004	<u>683</u>	<u>85</u>	<u>383</u>	<u>91</u>	<u>17</u>	<u>1,259</u>

As at 31 December 2005 the Fund's buildings were pledged as collateral valued in the amount of GEL 667 thousand against a loan received from the JSC Bank Republic (note 12).

12. LOANS FROM BANKS AND OTHER INSTITUTIONS

Loans from banks and other institutions comprise:

	<u>Interest rates</u> %	<u>2005</u> GEL'000	<u>2004</u> GEL'000
Microvest I	12	1,801	-
Bank Republic	15	1,200	-
Microvest II	12	719	-
OikoCredit	12	360	-
Total loans from banks and other institutions		<u>4,080</u>	<u>-</u>

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

13. FINANCIAL COMMITMENTS AND CONTINGENCIES

Capital commitments

The Fund had no material commitments for capital expenditures outstanding as at 31 December 2005.

Legal proceedings

In the normal course of business, claims against the Fund are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these financial statements.

Taxes

Due to the presence in Georgian commercial legislation, and tax legislation in particular, of provisions allowing more than one interpretation, and also due to the practice developed in a generally unstable environment by the tax authorities of making arbitrary judgment of business activities, if a particular treatment based on management's judgment of the Fund's business activities was to be challenged by the tax authorities, the Fund may be assessed additional taxes, penalties and interest. The limitation period is usually three years after the tax authorities make an examination of taxpayer's records. The Fund believes that it has already made all tax payments, and therefore no allowances were made in the financial statements.

Pensions and retirement plans

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

Operating environment

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

14. SUBSEQUENT EVENTS

In March 2006, the Fund obtained a loan from Impulse Microfinance Investment in the amount of EUR 750 thousand at an annual interest rate of 8.5% and a loan from JSC Bank Republic in the amount of GEL 1,637 thousand at an annual interest rate of 13%. The Fund also signed a new revolving credit line agreement with JSC Bank Republic in the amount of GEL 1,800 thousand.

On 9 March 2006 the Fund deposited EUR 750 thousand in JSC Bank Republic at an annual interest rate of 9%.

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

15. TRANSACTIONS WITH RELATED PARTIES

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

- (a) Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the Fund (this includes holding companies, subsidiaries and fellow subsidiaries);
- (b) Associates – enterprises in which the Fund has significant influence and which is neither a subsidiary nor a joint venture of the investor;
- (c) Individuals owning, directly or indirectly, an interest in the voting power of the Fund that gives them significant influence over the Fund;
- (d) Key management personnel, that is, those persons having authority and responsibility for planning, directing and controlling the activities of the Fund, including directors and officers of the Fund (also non-executive directors and close members of the families of such individuals);
- (e) Enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the Fund and enterprises that have a member of key management in common with the Fund;
- (f) Parties with joint control over the Fund;
- (g) Joint ventures in which the Fund is a venture; and
- (h) Post-employment benefit plans for the benefit of employees of the Fund, or of any entity that is a related party to the Fund.

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

	<u>2005</u>	<u>2005</u>	<u>2004</u>	<u>2004</u>
	<u>Related party transactions</u>	<u>Total category as per financial statements caption</u>	<u>Related party transactions</u>	<u>Total category as per financial statements caption</u>
	GEL'000	GEL'000	GEL'000	GEL'000
Loans to customers, gross	273	13,855	276	9,499
Accrued interest on loans to customers	3	268	-	438
Allowance for impairment losses	-	(469)	(11)	(1,550)
Loans to customers, net	<u>276</u>	<u>13,654</u>	<u>265</u>	<u>8,387</u>

The Fund generated interest income from related parties in the amount of GEL 52 thousand and GEL 50 thousand during 2005 and 2004, respectively.

During the years ended 31 December 2005 and 2004 the Fund originated loans to related party customers amounting to GEL 394 thousand and GEL 435 thousand respectively, and received loans repaid of GEL 385 thousand and GEL 297 thousand, respectively.

During the year ended 31 December 2005 the Fund has incurred expenses of GEL 38 thousand for professional services provided by Tamar Lebanidze, the member of the Governing Board.

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

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

During the years ended 31 December 2005 and 2004 the Fund incurred expenses for key management compensation of GEL 129 thousand and GEL 90 thousand, respectively.

16. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments is made in accordance with the requirements of IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement". Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. As no readily available published price quotations in an active market exist for a large part of the Fund's financial instruments, judgment is necessary in arriving at fair value using a valuation technique, based on current economic conditions and specific risks attributable to the instrument. The estimates presented herein are not necessarily indicative of the amounts the Fund could realize in a market exchange from the sale of its full holdings of a particular instrument.

17. RISK MANAGEMENT POLICIES

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

The Fund manages the following risks:

Liquidity risk

Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due. In order to manage liquidity risk, the Fund performs daily monitoring of expected future cash flows on financing operations, which is a part of the assets/liabilities management process.

Cash flow interest rate risk

Cash flow interest rate risk the risk that the future cash flow of a financial instrument will fluctuate because of changes in market interest rates.

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

Effective interest rates for loans to customers were 58% and 97% as at 31 December 2005 and 2004, respectively.

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

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

	Up to <u>1 month</u> GEL'000	1 month to <u>3 months</u> GEL'000	3 months to <u>6 months</u> GEL'000	6 months to <u>1 year</u> GEL'000	1 year to 5 <u>years</u> GEL'000	Maturity <u>undefined</u> GEL'000	2005 <u>Total</u> GEL'000
ASSETS							
Loans to customers, net	454	1,959	5,290	3,460	2,491	-	13,654
Total interest earning assets	454	1,959	5,290	3,460	2,491	-	13,654
Cash and cash equivalents	215	-	-	-	-	-	215
Property, plant and equipment and intangible	-	-	-	-	-	1,409	1,409
Other assets, net	37	-	-	-	-	-	37
Income tax prepaid	-	-	-	-	358	-	358
TOTAL ASSETS	706	1,959	5,290	3,460	2,849	1,409	15,673
LIABILITIES							
Loans from banks and other institutions	1,200	-	-	717	2,163	-	4,080
Total interest bearing Liabilities	1,200	-	-	717	2,163	-	4,080
Other liabilities	35	-	-	-	-	-	35
TOTAL LIABILITIES	1,235	-	-	717	2,163	-	4,115
Liquidity gap	(529)	1,959	5,290	2,743	686		
Interest sensitivity gap	(746)	1,959	5,290	2,743	328		
Cumulative interest sensitivity gap	(746)	1,213	6,503	9,246	9,574		
Cumulative interest sensitivity gap as a percentage of total assets	(5%)	8%	41%	59%	61%		

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

	Up to <u>1 month</u> GEL'000	1 month to <u>3 months</u> GEL'000	3 months to <u>6 months</u> GEL'000	6 months to <u>1 year</u> GEL'000	1 year to 5 <u>years</u> GEL'000	Maturity <u>undefined</u> GEL'000	2004 <u>Total</u> GEL'000
ASSETS							
Loans to customers, net	1,910	1,533	3,016	1,397	531	-	8,387
Total interest earning assets	1,910	1,533	3,016	1,397	531	-	8,387
Cash and cash equivalents	1,046	-	-	-	-	-	1,046
Property, plant and equipment and intangible	-	-	-	-	-	1,259	1,259
Other assets, net	225	-	-	-	-	-	225
Income tax prepaid	90	-	-	-	-	-	90
TOTAL ASSETS	3,271	1,533	3,016	1,397	531	1,259	11,007
LIABILITIES							
Other liabilities	24	50	-	-	-	-	74
TOTAL LIABILITIES	24	50	-	-	-	-	74
Liquidity gap	3,247	1,483	3,016	1,397	531		
Interest sensitivity gap	1,910	1,533	3,016	1,397	531		
Cumulative interest sensitivity gap	1,910	3,443	6,459	7,856	8,387		
Cumulative interest sensitivity gap as a percentage of total assets	17%	31%	59%	71%	76%		

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

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

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

Currency risk

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

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

	GEL	USD 1 USD= 1.7925 GEL	EUR 1 EUR= 2.125 GEL	Currency undefined	2005 Total
ASSETS					
Cash and cash equivalents	183	31	1	-	215
Loans to customers, net	13,252	402	-	-	13,654
Property, plant and equipment and intangible assets, net	-	-	-	1,409	1,409
Income tax prepaid	358	-	-	-	358
Other assets, net	36	1	-	-	37
TOTAL ASSETS	13,829	434	1	1,409	15,673
LIABILITIES					
Loans from banks and other institutions	1,200	2,880	-	-	4,080
Other liabilities	35	-	-	-	35
TOTAL LIABILITIES	1,235	2,880	-	-	4,115
OPEN POSITION	12,594	(2,446)	1	1,409	11,558
	GEL	USD 1 USD= 1.825 GEL	EUR 1 EUR= 2.485 GEL	Currency undefined	2004 Total
ASSETS					
Cash and equivalents	551	490	5	-	1,046
Loans to customers, net	6,477	1,910	-	-	8,387
Property, plant and equipment and intangible assets, net	-	-	-	1,259	1,259
Income tax prepaid	90	-	-	-	90
Other assets, net	225	-	-	-	225
TOTAL ASSETS	7,343	2,400	5	1,259	11,007
LIABILITIES					
Other liabilities	73	1	-	-	74
TOTAL LIABILITIES	73	1	-	-	74
OPEN POSITION	7,270	2,399	5	1,259	10,933

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)

Credit risk

The Fund is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Fund 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.

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

Geographical concentration

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

			2005
	<u>Georgia</u>	<u>OECD</u>	<u>Total</u>
	<u>GEL'000</u>	<u>countries</u>	<u>GEL'000</u>
		<u>GEL'000</u>	
ASSETS			
Cash and cash equivalents	215	-	215
Loans to customers, net	13,654	-	13,654
Property, plant and equipment and intangible assets	1,409	-	1,409
Income tax prepaid	358	-	358
Other assets, net	37	-	37
TOTAL ASSETS	<u>15,673</u>	<u>-</u>	<u>15,673</u>
LIABILITIES			
Loans from banks and other institutions	1,200	2,880	4,080
Other liabilities	35	-	35
TOTAL LIABILITIES	<u>1,235</u>	<u>2,880</u>	<u>4,115</u>
NET POSITION	<u>14,438</u>	<u>(2,880)</u>	<u>11,558</u>

MICROFINANCE ORGANIZATION CONSTANTA FOUNDATION**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005 (continued)**

			2004
	<u>Georgia</u>	<u>OECD</u>	<u>Total</u>
	GEL'000	countries	GEL'000
		GEL'000	
ASSETS			
Cash and cash equivalents	1,046	-	1,046
Loans to customers, net	8,387	-	8,387
Property, plant and equipment and intangible assets	1,259	-	1,259
Income tax prepaid	90	-	90
Other assets, net	225	-	225
	<u>11,007</u>	<u>-</u>	<u>11,007</u>
TOTAL ASSETS	<u>11,007</u>	<u>-</u>	<u>11,007</u>
LIABILITIES			
Other liabilities	74	-	74
	<u>74</u>	<u>-</u>	<u>74</u>
TOTAL LIABILITIES	<u>74</u>	<u>-</u>	<u>74</u>
NET POSITION	<u>10,933</u>	<u>-</u>	<u>10,933</u>