JSC Kredobank (formerly Kredyt Bank (Ukraina)
Financial Statements

Year ended 31 December 2005
Together with Independent Auditors' Report

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Management of
Joint Stock Company Kredobank (formerly Kredyt Bank (Ukraina)

We have audited the accompanying balance sheet of Joint Stock Company Kredobank (the "Bank") as at 31 December 2005, and the related statements of income, changes in equity, and cash flows for the year then ended. These financial statements, on pages 1 to 28, are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we 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 Bank 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.

Ernst + Young Audit Services LLC

15 March 2006
Kyiv, Ukraine

BALANCE SHEET

As at 31 December 2005

(Thousands of Ukrainian hryvnia)

	Notes	31 December 2005	31 December 2004
Assets			
Cash and due from the NBU	5	223,391	109,046
Amounts due from credit institutions	6	85,644	96,495
Financial assets at fair value through profit or loss	7	39,477	7,871
Loans to customers	8	1,497,568	949,580
Investment securities available-for-sale		938	938
Deferred tax assets	9	15,904	14,919
Assets held for sale	11	7,515	-
Property and equipment	12	118,592	103,972
Intangible assets	13	3,556	4,008
Other assets	14	17,715	20,393
Total assets		**2,010,300**	**1,307,222**
Liabilities			
Amounts due to credit institutions	15	260,245	189,806
Amounts due to customers	16	1,536,528	990,354
Subordinated loans	17	73,579	-
Current tax liabilities		239	374
Other liabilities	14	5,324	3,108
Total liabilities		**1,875,915**	**1,183,642**
Equity			
Share capital		197,557	197,557
Treasury shares		-	(464)
Accumulated deficit		(63,172)	(73,513)
Total equity	18	**134,385**	**123,580**
Total liabilities and equity		**2,010,300**	**1,307,222**

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

Stepan Kubiv — Chairman of the Board

Taras Khoma — Deputy Chairman of the Board

15 March 2006

The accompanying notes on pages 5 to 28 are an integral part of these financial statements

STATEMENT OF INCOME

For the year ended 31 December 2005

(Thousands of Ukrainian hryvnia)

		Years ended 31 December	
	Notes	*2005*	*2004*
Interest income			
Loans to customers		192,499	148,513
Securities		6,586	4,857
Amounts due from credit institutions		2,162	6,398
Other		207	60
		201,454	**159,828**
Interest expense			
Amounts due to the NBU		(120)	(290)
Amounts due to credit institutions		(9,909)	(5,128)
Amounts due to customers		(105,577)	(87,785)
Subordinated loans		(1,059)	-
		(116,665)	**(93,203)**
Net interest income		**84,789**	**66,625**
Impairment of interest earning assets	10	(35,415)	(16,743)
Net interest income after impairment of interest earning assets		**49,374**	**49,882**
Fee and commission income		56,791	46,386
Fee and commission expense		(4,122)	(7,803)
Net fee and commission income	20	**52,669**	**38,583**
Gains less losses from foreign currencies:			
- dealing, net		13,752	13,438
- translation differences, net		(21)	(986)
Gains less losses from financial assets at fair value through profit or loss		(57)	(163)
Other income		1,719	1,491
Other non interest income		**15,393**	**13,780**
Salaries and benefits	21	(41,971)	(34,237)
Depreciation and amortisation	12,13	(11,354)	(11,621)
Other administrative and operating expenses	21	(44,904)	(40,686)
Impairment of other assets and provisions	10	(1,948)	(6,305)
Other non interest expense		**(100,177)**	**(92,849)**
Profit before income tax expense		**17,259**	**9,396**
Income tax expense	9	(6,936)	(3,111)
Profit for the year		**10,323**	**6,285**

The accompanying notes on pages 5 to 28 are an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2005

(Thousands of Ukrainian hryvnia)

	Share capital	*Treasury shares*	*Accumulated deficit*	*Total equity*
31 December 2003	**197,557**	**(227)**	**(79,798)**	**117,532**
Purchases of treasury shares		(237)	-	(237)
Profit for the year			6,285	6,285
31 December 2004	**197,557**	**(464)**	**(73,513)**	**123,580**
Sale of treasury shares		464	18	482
Profit for the year			10,323	10,323
31 December 2005	**197,557**	**-**	**(63,172)**	**134,385**

The accompanying notes on pages 5 to 28 are an integral part of these financial statements

STATEMENT OF CASH FLOWS

For the year ended 31 December 2005

(Thousands of Ukrainian hryvnia)

	Notes	Years ended 31 December 2005	2004
Cash flows from operating activities			
Interest and commissions received		258,986	206,233
Interest and commissions paid		(116,519)	(99,494)
Gains less losses from dealing in foreign currencies and securities		13,752	13,438
Other operating income received		2,307	1,328
Salaries and benefits		(41,565)	(34,237)
Other operating and administrative expenses paid		(43,802)	(41,732)
Cash flow from operating activities before changes in operating assets and liabilities		**73,159**	**45,536**
Net (increase) / decrease in operating assets			
Amounts due from credit institutions		-	(7,958)
Financial assets at fair value through profit or loss		(31,051)	17,118
Loans to customers		(632,104)	(203,442)
Other assets		(5,239)	(16,584)
Net increase / (decrease) in operating liabilities			
Amounts due to the NBU		-	(533)
Amounts due to credit institutions		85,841	4,795
Amounts due to customers		584,845	140,772
Debt securities issued		-	(231)
Other liabilities		547	(1,821)
Net cash flows from (used in) operating activities before income taxes		**75,998**	**(22,348)**
Income tax paid		(8,056)	(3,968)
Net cash flows from (used in) operating activities		**67,942**	**(26,316)**
Cash flows used in investing activities			
Purchases of property and equipment		(25,809)	(16,891)
Purchases of intangible assets		(433)	(1,497)
Proceeds from sale of property and equipment		472	236
Net cash flows used in investing activities		**(25,770)**	**(18,152)**
Cash flows used in financing activities			
Treasury shares sold/(purchased)		482	(237)
Subordinated loans received		73,225	-
Net cash flows from (used in) financing activities		**73,707**	**(237)**
Effect of exchange rate changes on cash and cash equivalents		(12,686)	3,612
Net change in cash and cash equivalents		**103,193**	**(41,093)**
Cash and cash equivalents, beginning	25	**198,303**	**239,396**
Cash and cash equivalents, ending	25	**301,496**	**198,303**

The accompanying notes on pages 5 to 28 are an integral part of these financial statements

(Thousands of Ukrainian hryvnia)

1. Principal activities

JSC Kredobank (the "Bank") was founded in 1990 as a joint stock company. Initially registered at the USSR State Bank, the Bank was re-registered at the National Bank of Ukraine (the "NBU") on 14 October 1991 under the name of West-Ukrainian Commercial Bank. In 2002, the Bank was renamed as Kredyt Bank (Ukraina). In November 2005, the shareholders of the Bank made the decision to rename the Bank into Kredobank. The Bank operates under a general banking licence #43 issued the NBU on 24 September 2001. This provides the Bank with the right to conduct banking operations, including currency operations. The Bank also possesses a licence for securities operations and custodial services from the State Commission for Securities and Stock Market, which was issued on 19 October 2004.

The Bank's Head office is in Lviv at 78, Saharova St. In 2005, it had 18 branches (2004 - 18) located in Lviv and other regions of Ukraine. The Bank and its branches form a single legal entity. The Bank had 1,730 employees as at 31 December 2005 (2004 - 1,545 employees).

The Bank's customer base is mainly comprised of medium-sized enterprises. The Bank accepts deposits from the public and makes loans, transfers payments in Ukraine and abroad, exchanges currencies, invests funds and provides cash and settlements, and other banking services to its customers.

As at 31 December 2005, 97.3% of the issued paid-in share capital (2004 - 94.9%) was owned by non-residents: PKO BP S.A. (Poland) and the European Bank for Reconstruction and Development ("EBRD"). Details of the Bank's shareholders are presented in Note 18 and the Bank's transactions with its related parties are disclosed in Note 24.

The Bank is a subsidiary of PKO BP S.A. and is a part of the PKO BP S.A. Group ("PKO BP S.A. Group" or the "Group"). The Group is ultimately controlled by the State Treasury of Poland.

2. Basis of preparation

General

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

The Bank is required to maintain its books of account in Ukrainian hryvnia and prepare financial statements for regulatory purposes in accordance with the "Regulations on the Organisation of Accounting and Reporting for Ukrainian Banking Institutions" ("Ukrainian Accounting Regulation" or "UAR") issued by the National Bank of Ukraine and in accordance with Ukrainian Accounting Standards. These financial statements are based on the Bank's statutory books and records, as adjusted and reclassified in order to comply with IFRS. The reconciliation between UAR and IFRS is presented later in this note.

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, securities included into the category of financial assets at fair value through profit or loss have been measured at fair value.

These financial statements are presented in thousands of Ukrainian hryvnia ("UAH"), unless otherwise indicated.

Changes in accounting policies

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

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

IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations";
IAS 1 (revised) "Presentation of Financial Statements";
IAS 8 (revised) "Accounting Policies, Changes in Accounting Estimates and Errors";
IAS 10 (revised) "Events after the Balance Sheet Date";

(Thousands of Ukrainian hryvnia)

IAS 16 (revised) "Property, Plant and Equipment";
IAS 17 (revised) "Leases";
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";
IAS 36 (revised) "Impairment of Assets";
IAS 38 (revised) "Intangible Assets";
IAS 39 (revised) "Financial Instruments: Recognition and Measurement".

The principal effects of these changes in policies are discussed below.

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

Financial assets available-for-sale

The gains and losses on re-measurement of financial assets available-for-sale to fair value are recognised as a separate component of equity. The transitional provisions of IAS 39 allow the Bank to re-designate any financial asset and liability as "at fair value through profit or loss" when the Standard is first applied. Accordingly, as at 1 January 2005 the Bank re-designated certain available-for-sale securities as "at fair value through profit or loss". The comparative figures were amended accordingly.

The effect of adoption of the new and revised standards on the corresponding figures can be summarised as follows:

	As previously reported	*Effect of changes in accounting policies*	*As adjusted*
Balance sheet as at 31 December 2004			
Investment securities available-for-sale	8,809	(7,871)	938
Financial assets at fair value through profit or loss	-	7,871	7,871

IFRSs and IFRIC interpretations not yet effective

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

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".

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

Inflation accounting

The Ukrainian economy was regarded as being hyperinflationary for the ten-year period ended 31 December 2000. As such, the Bank has applied IAS 29 "Financial accounting in hyperinflationary economies". The effect of applying IAS 29 is that non-monetary items were restated using the Consumer Price Index to measuring units current at 31 December 2000, and these restated values were used as a basis for accounting in subsequent accounting periods.

(Thousands of Ukrainian hryvnia)

Reconciliation of UAR and IFRS equity and profit for the year

Equity and profit for the year are reconciled between UAR and IFRS as follows:

	2005		2004	
	Equity	*Profit for the year*	*Equity*	*Profit for the year*
Ukrainian Accounting Regulations	158,834	10,721	147,631	7,870
Inflation impact on non-monetary items	11,410	(495)	11,905	(356)
Impairment of financial assets	(37,473)	2,055	(39,528)	(3,478)
Initial recognition of financial instruments	(472)	(472)	-	-
Effect of accruals	(406)	(406)	-	(72)
Deferral of loan origination fees	(12,043)	(6,824)	(5,219)	(2,741)
Deferred tax	10,218	(1,336)	11,554	1,947
Difference in depreciation	4,317	7,080	(2,763)	3,115
International Financial Reporting Standards	**134,385**	**10,323**	**123,580**	**6,285**

3. Summary of accounting policies

Financial assets

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

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

Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading and those designated at fair value through profit or loss at inception. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Gains or losses on financial assets held for trading are recognised in the statement of income.

Held-to-maturity investments

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

Loans and receivables

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

(Thousands of Ukrainian hryvnia)

Available-for-sale financial assets

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

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

Allowances for impairment of financial assets carried at amortised cost

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

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

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

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

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the statement of income, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

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

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the NBU, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Amounts due from credit institutions

In the normal course of business, the Bank maintains current accounts or deposits for various periods of time with other banks. After initial recognition according to the accounting policies for financial assets described above, amounts due from credit institutions with a fixed maturity term are subsequently measured at amortised cost using the effective interest rate method. Those that do not have fixed maturities are carried at cost. Amounts due from credit institutions are carried net of any allowance for impairment.

(Thousands of Ukrainian hryvnia)

Repurchase and reverse repurchase agreements and securities lending

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the balance sheet and, in case the transferee has the right by contract or custom to sell or repledge them, reclassified as securities pledged under sale and repurchase agreements. The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as amounts due from credit institutions or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

Securities lent to counterparties are retained in the financial statements. Securities borrowed are not recorded in the financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded within gains less losses from trading securities in the statement of income. The obligation to return them is recorded at fair value as a trading liability.

Operating leases

Leases of assets under which the risks and rewards of ownership are effectively retained with the lessor are classified as operating leases. Lease payments under operating lease are recognised as expenses on a straight-line basis over the lease term in the statement of income.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:
- the rights to receive cash flows from the asset have expired;
- the Bank has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- the Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

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

Financial liabilities

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

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

Taxation

The current income tax charge is calculated in accordance with Ukrainian taxation regulations.

Deferred income tax is provided, using the balance sheet liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax liabilities are recognised for all taxable temporary differences. Deferred income tax assets are recognised for all deductible temporary differences to the extent only that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised. Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset

(Thousands of Ukrainian hryvnia)

is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Ukraine also has various operating taxes, which are assessed on the Bank's activities. These taxes are included as a component of administrative and operating expenses in the statement of income.

Property and equipment

Property and equipment are carried at cost or restated cost (for assets acquired prior to 31 December 2000) less accumulated depreciation. Depreciation of assets under construction and those not placed in service commences from the date the assets are placed in service. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	50
Furniture, fixtures and other assets	10
Banking equipment	10
Motor vehicles	4
Computers	5

Leasehold improvements are amortised over the shorter of the life of the related leased asset or term of the respective lease agreement.

The carrying amounts of property and equipment 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 amounts. Impairment is recognised in the respective period and is included in other administrative and operating expenses.

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

Intangible assets

Intangible assets include acquired licences for computer software. Intangible assets are stated at cost net of accumulated amortisation. Amortisation is provided so as to write down the cost of an asset on a straight-line basis over its estimated useful economic life. The useful life is 5 years.

Assets classified as held for sale

The Bank classifies a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the non-current asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable.

The sale qualifies as highly probable if the Bank's management is committed to a plan to sell the non-current asset and an active program to locate a buyer and complete the plan must have been initiated. Further, the non-current asset must have been actively marketed for a sale at price that is reasonable in relation to its current fair value and in addition the sale should be expected to qualify for recognition as a completed within one year from the date of classification of the non-current asset as held for sale.

The Bank measures an asset classified as held for sale at the lower of its carrying amount and fair value less costs to sell. The Bank recognises an impairment loss for any initial or subsequent write-down of the asset to fair value less costs to sell if events or changes in circumstance indicate that their carrying amount may be impaired.

Amounts due credit institutions and customers

Amounts due to credit institutions, including banks, and customers, including subordinated loans, are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, such financial liabilities are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in income when the liabilities are derecognised as well as through the amortisation process.

(Thousands of Ukrainian hryvnia)

Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) 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.

Retirement and other benefit obligations

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

Share capital

Share capital contributions received before 31 December 2000 are recognised at restated cost following the application of IAS 29 "Financial accounting in hyperinflationary economies".

Offsetting

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

Contingencies

Contingent liabilities are not recognised 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. A contingent asset is not recognised in the financial statements but disclosed when an inflow of economic benefits is probable.

Income and expense recognition

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

Foreign currency translation

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

Differences between the contractual exchange rate of a certain transaction and the NBU exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official NBU exchange rates at 31 December 2005 and 2004, were UAH 5.05 and 5.3054 hryvnia to 1 US dollar and UAH 5.9716 and UAH 7.2175 to 1 euro, respectively. The official NBU exchange rates as at date of issue of these financial statements were UAH 5.05 hryvnia to 1 US dollar and UAH 6.0337 to 1 euro.

(Thousands of Ukrainian hryvnia)

4. Significant accounting judgements and estimates

Estimation uncertainty

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

Allowance for impairment of loans and receivables

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

Tax and other regulatory compliance

Ukrainian legislation and regulations regarding taxation and other operational matters, including currency exchange control and custom regulations, continue to evolve. Legislation and regulations are not always clearly written and are subject to varying interpretations by local, regional and national authorities, and other Governmental bodies. Instances of inconsistent interpretations are not unusual. Management believes that its interpretation of the relevant legislation is appropriate and that the Bank has complied with all regulations and paid or accrued all taxes and withholdings that are applicable.

At the same time there is a risk that transactions and interpretations that have not been challenged in the past may be challenged by the authorities in the future, although this risk significantly diminishes with passage of time. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome.

5. Cash and due from the NBU

Cash and due from the NBU comprise:

	2005	*2004*
Cash on hand	96,775	61,664
Current account with the NBU	97,612	47,382
Time deposit with the NBU	29,004	-
Cash and due from the NBU	**223,391**	**109,046**

Current account with the NBU represents amount deposited with the NBU relating to daily settlements and other activities. The Bank is also required to maintain, in the form of a non-interest earning cash deposit, certain cash reserves with the NBU (obligatory reserve), which are computed as a percentage of certain of the Bank's liabilities less cash on hand and other eligible balances. There are no restrictions on the withdrawal of funds from the NBU, however, if minimum average reserve requirements are not met, the Bank could be subject to certain penalties. The Bank was obligated to and maintained the minimal cumulative average reserve calculated on a daily basis over a monthly period. The average daily requirement for the period from 1 to 31 December 2005 was UAH 92,975 thousand (2004: UAH 60,937 thousand). The Bank meets the NBU obligatory reserve requirements as at 31 December 2005 and 2004.

As at 31 December 2005, the time deposit with the NBU bears interest at 5% and matures in January 2006.

(Thousands of Ukrainian hryvnia)

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2005	2004
Current accounts		
Ukrainian banks	47	1
OECD banks	68,357	34,743
CIS and other foreign banks	1,654	4,319
	70,058	**39,063**
Time deposits		
Ukrainian banks	15,622	56,107
OECD banks	-	2,087
CIS and other foreign banks	-	-
	15,622	**58,194**
Less – Allowance for impairment	(36)	(762)
Amounts due from credit institutions	**85,644**	**96,495**

As at 31 December 2005, UAH 64,339 thousand was placed on current accounts with two internationally recognised OECD banks, who are the main counterparties of the Bank in performing international settlements (2004 – UAH 28,048 thousand with two OECD bank).

As at 31 December 2005, deposits due from Ukrainian banks include UAH 8,046 thousand of guarantee deposits, placed with Ukrainian banks mainly in respect of customers' transactions, such as letters of credit, guarantees and transactions with cards (2004 - UAH 3,425 thousand). Such placements are normally non-interest bearing.

7. Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss comprise securities designated into this category at inception:

	2005	2004
Corporate bonds	25,165	6,575
Certificates of deposit of NBU	10,000	-
State bonds	2,275	79
Investment certificates	2,037	1,000
Promissory notes	-	217
	39,477	**7,871**

Investment certificates represent certificates of two closed private diversified mutual funds managed by an asset management company. As at 31 December 2005 and 2004, these funds comprise a portfolio of corporate bonds and other money market instruments available on the Ukrainian financial market, including short-term deposits with Ukrainian banks. Investment certificates are redeemable during 2006. As at year end, the average gain on the investment certificates was at 15%.

Nominal interest rates and maturities are as follows:

	2005		2004	
	%	Maturity	%	Maturity
Corporate bonds	16%-18%	2007-2010	15%-16%	2005-2006
Certificates of deposit of NBU	6%	2006	-	-
State bonds	11%-12%	2009	11%	2009
Promissory notes	-	-	30%	2005

(Thousands of Ukrainian hryvnia)

8. Loans to customers

Loans to customers comprise:

	2005	*2004*
Loans to customers	1,571,769	1,004,385
Promissory notes	12,142	10,385
Overdrafts	30,146	18,243
	1,614,057	**1,033,013**
Less – Allowance for impairment	(116,489)	(83,433)
Loans to customers	**1,497,568**	**949,580**

As at 31 December 2005, the total gross amount of overdue loans comprised UAH 105,902 thousand with provisions made against these loans amounting to UAH 82,076 thousand (2004 – UAH 65,643 thousand and UAH 42,756 thousand, respectively).

Loans have been extended to the following types of customers:

	2005	*2004*
Corporate customers	1,331,259	960,923
Retail customers	282,798	72,090
	1,614,057	**1,033,013**
Less – Allowance for impairment	(116,489)	(83,433)
Loans to customers	**1,497,568**	**949,580**

Loans are made principally within Ukraine to the following industry sectors:

	2005	*%*	*2004*	*%*
Trading	534,857	33.1	396,381	38.4
Manufacturing	313,831	19.5	228,046	22.1
Retail customers	282,798	17.5	72,090	7.0
Agriculture and food processing	179,996	11.2	180,581	17.5
Services	81,988	5.1	32,680	3.1
Transport	49,860	3.1	34,607	3.3
Real estate and construction	39,100	2.4	22,716	2.2
Sports and recreation	30,219	1.9	3,398	0.3
Financial services	29,153	1.8	45,212	4.4
Mining	24,141	1.5	63	0.0
Printing	21,376	1.3	2,850	0.3
Research and science	8,306	0.5	-	-
Telecommunications	2,053	0.1	3,247	0.3
Energy	495	0.0	7,244	0.7
Other industries	15,884	1.0	3,898	0.4
	1,614,057	**100**	**1,033,013**	**100**
Less – Allowance for impairment	(116,489)		(83,433)	
Loans to customers	**1,497,568**		**949,580**	

(Thousands of Ukrainian hryvnia)

9. Taxation

The corporate income tax expense comprises:

	2005	2004
Current tax charge	7,921	4,423
Deferred tax credit	(985)	(1,312)
Income tax expense	**6,936**	**3,111**

In 2005, Ukrainian corporate income tax was levied on taxable income less allowable expenses at a rate of 25% (2004 – 25%).

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

	2005	2004
Income before tax	17,259	9,396
Statutory tax rate	25%	25%
Theoretical income tax expense at the statutory rate	4,315	2,349
Effect of revaluation of property and equipment for tax purposes	(495)	-
Non-deductible expenditures	1,732	1,367
Change in valuation allowance against deferred tax asset	1,601	158
Tax deductions	(217)	(763)
Income tax expense	**6,936**	**3,111**

Deferred tax assets and liabilities consist of the following:

	2005	2004
Tax effect of deductible temporary differences:		
Loans to customers	13,641	10,779
Other assets	5,455	5,129
Amounts due to customers	1,357	866
Amounts due from credit institutions	1,105	1,369
Other liabilities	136	11
Securities	-	433
Deferred tax assets	**21,694**	**18,587**
Tax effect of taxable temporary differences:		
Securities	(258)	-
Property and equipment	(2,752)	(2,489)
Deferred tax liability	**(3,010)**	**(2,489)**
Net deferred tax position	**18,684**	**16,098**
Less – Valuation allowance	(2,780)	(1,179)
Deferred tax asset, net	**15,904**	**14,919**

The movement in net deferred tax asset is as follows:

	2005	2004
Balances at 1 January	**14,919**	**13,607**
Credit to the statement of income	985	1,312
Balances at 31 December	**15,904**	**14,919**

(Thousands of Ukrainian hryvnia)

10. Allowances for losses

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

	Loans to customers	*Due from credit institutions*	*Investment securities*	*Total*
31 December 2003	**66,494**	**1,169**	**375**	**68,038**
Translation differences	26	8	-	34
Charge/(release)	17,329	(415)	(171)	16,743
Write-offs	(416)	-	-	(416)
31 December 2004	**83,433**	**762**	**204**	**84,399**
Translation differences	(2,245)	(382)	-	(2,627)
Charge/(release)	35,759	(344)	-	35,415
Write-offs	(458)	-	-	(458)
31 December 2005	**116,489**	**36**	**204**	**116,729**

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

	Guarantees and commitments	*Other assets*	*Total*
31 December 2003	**-**	**13,518**	**13,518**
Translation difference	-	61	61
Charge	-	6,305	6,305
Write-offs	-	(10,335)	(10,335)
31 December 2004	**-**	**9,549**	**9,549**
Translation difference	-	(171)	(171)
Charge	441	1,507	1,948
Write-offs	-	(6,977)	(6,977)
31 December 2005	**441**	**3,908**	**4,349**

Allowances for impairment of assets are deducted from the related assets. Provisions for guarantees and commitments are recorded in liabilities.

11. Assets held for sale

As at 31 December 2005, assets held for sale include non-current assets, representing collateral under loans extended to customers, taken over by the Bank as a result of its foreclosure. The Bank intends to complete disposal of these assets by the end of 2006. See also Note 14.

(Thousands of Ukrainian hryvnia)

12. Property and equipment

The movements of property and equipment were as follows:

	Property	*Computers and equipment*	*Furniture, fixtures and other assets*	*Motor vehicles*	*Construction in progress*	*Total*
Cost						
31 December 2004	**74,747**	**40,919**	**17,478**	**4,886**	**4,246**	**142,276**
Additions	13,7	8,3	2,537	1,218	-	25,8
Transfers	2,9	-	-	-	(2,9	-
Disposals	(881)	(531)	(31)	(436)	-	(1,8
31 December 2005	**90,587**	**48,708**	**19,984**	**5,668**	**1,259**	**166,206**
Accumulated depreciation						
31 December 2004	**9,2**	**16,842**	**8,511**	**3,708**	-	**38,304**
Charge for the year	1,810	5,823	1,980	856	-	10,469
Disposals	(259)	(443)	(19)	(438)	-	(1,1
31 December 2005	**10,794**	**22,222**	**10,472**	**4,126**	**-**	**47,614**
Net book value						
31 December 2004	**65,504**	**24,077**	**8,967**	**1,178**	**4,246**	**103,972**
31 December 2005	**79,793**	**26,486**	**9,512**	**1,542**	**1,259**	**118,592**

	Property	*Computers and equipment*	*Furniture, fixtures and other assets*	*Motor vehicles*	*Construction in progress*	*Total*
Cost						
31 December 2003	**73,8**	**31,8**	**15,637**	**4,5**	**809**	**126,5**
Additions	1,4	9,1	2,31	520	3,437	16,8
Disposals	(477)	(82)	(476)	(146)	-	(1,1
31 December 2004	**74,7**	**40,9**	**17,478**	**4,8**	**4,246**	**142,2**
Accumulated depreciation						
31 December 2003	**7,1**	**11,2**	**7,084**	**3,0**	**-**	**28,5**
Charge for the year	2,2	5,6	1,796	796	-	10,4
Disposals	(114)	(46)	(369)	(146)	-	(675)
31 December 2004	**9,2**	**16,8**	**8,511**	**3,7**	**-**	**38,3**
Net book value						
31 December 2003	**66,6**	**20,5**	**8,553**	**1,4**	**809**	**98,0**
31 December 2004	**65,5**	**24,0**	**8,967**	**1,1**	**4,246**	**103,9**

As at 31 December 2005, property comprises land and buildings occupied by the Bank with a carrying value of UAH 76,944 thousand and leasehold improvements with a carrying value of UAH 2,849 thousand (2004 – UAH 61,562 thousand and UAH 3,942 thousand, respectively).

13. Intangible assets

The movements of intangible assets, which comprise software licences, were as follows:

	Cost	*Accumulated amortization*	*Net book value*
31 December 2003	**4,532**	**(877)**	**3,655**
Additions/charge for the year	1,497	(1,144)	
31 December 2004	**6,029**	**(2,021)**	**4,008**
Additions/charge for the year	433	(885)	
31 December 2005	**6,462**	**(2,906)**	**3,556**

(Thousands of Ukrainian hryvnia)

14. Other assets and liabilities

Other assets comprise:

	2005	2004
Prepayments	5,750	3,399
Receivables for collateral sold	4,349	-
Cash issued to couriers for distribution to clients	3,088	2,387
Settlements with clients	2,129	1,501
Balances on transit accounts:		
Settlements on payments cards	1,105	2,121
Settlements with Western Union system	206	277
Settlements for operations with securities	689	799
Materials	685	432
Assets taken over for resale	-	17,215
Blocked accounts	-	877
Other accrued income	1,946	367
Other	1,676	567
	21,623	**29,942**
Less – Allowance for impairment	(3,908)	(9,549)
Other assets	**17,715**	**20,393**

As at 31 December 2005, prepayments mainly comprise prepayments for premises of UAH 2,329 thousand and prepayments for other taxes of UAH 1,366 thousand (2004 – mainly prepayments for other taxes of UAH 1,665 thousand).

The Bank acts as an agent for cash transfer operations under the Meest money transfer programme. Cash issued to couriers represents cash funds, which were provided to couriers who deliver cash to the Bank's customers.

As at 31 December 2004, assets taken for resale represent collateral under loans issued by the Bank, taken over as a result of foreclosing on loans. As at 31 December 2005, these assets were partially sold or reclassified as assets held for sale (Note 11).

Other liabilities comprise:

	2005	2004
Payables to individuals deposits guarantee fund	1,054	854
Transit accounts	609	6
Provision for commitments	441	-
Settlements on payments cards	331	614
Payables for purchased equipment	-	184
Prepaid other taxed	249	109
Other liabilities	191	151
	2,875	1,918
Accrued salary payable	406	-
Accrued administrative and operating expenses	2,043	1,190
	2,449	1,190
Other liabilities	**5,324**	**3,108**

(Thousands of Ukrainian hryvnia)

15. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2005	2004
Current accounts		
Ukrainian banks	1,842	1,531
OECD banks	462	81
	2,304	**1,612**
Time deposits		
Ukrainian banks	40,855	55,428
OECD banks	157,172	132,766
OECD credit institutions	59,914	-
	257,941	**188,194**
Due to credit institutions	**260,245**	**189,806**

As at 31 December 2005, the Bank received funds of UAH 15,067 thousand from the EBRD under a loan agreement for financing of the franchisee network of an international enterprise (2004 – UAH 10,493 thousand). These funds are included in time deposits from OECD banks.

As at 31 December 2005, time deposits from OECD banks include UAH 13,833 thousand received under credit facilities from two foreign banks and used to finance letters of credit and loans to customers (2004 –nil).

As at 31 December 2005, time deposits from OECD credit institutions represent credit facilities provided by one US based non-banking institution to finance import operations of the Bank's clients (2004 – nil).

16. Amounts due to customers

Amounts due to customers comprise:

	2005	2004
Current accounts		
Companies	352,293	186,971
Individuals	113,618	70,224
	465,911	**257,195**
Time deposits		
Companies	258,995	112,899
Individuals	811,622	620,259
	1,070,617	**733,158**
Due to customers	**1,536,528**	**990,354**

As at 31 December 2005, amounts due to corporate customers of UAH 239,581 thousand (39%) were due to the ten largest third party customers (2004 - UAH 75,651 thousand (25%)).

17. Subordinated loans

In August and December 2005, the Bank received two long-term loans of USD 7,000 thousand and USD 7,500 thousand, respectively, from PKO BP S.A. These loans bear interest at LIBOR+3%, mature in 2013 and are subordinated in favour of the claims of all other creditors.

(Thousands of Ukrainian hryvnia)

18. Equity

The movement of fully paid and outstanding shares was as follows:

	Number of shares	*Nominal amount*	*Total restated value*
31 December 2003	**14,332,219,469**	**143,322**	**197,330**
Purchase of treasury shares	(23,683,919)	(237)	(237)
31 December 2004	**14,308,535,550**	**143,085**	**197,093**
Sale of treasury shares	46,411,366	464	464
31 December 2005	**14,354,946,916**	**143,549**	**197,557**

At 31 December 2005, the Bank's authorised share capital comprised 14,354,946,916 (2004 – 14,354,946,916) ordinary shares, with a nominal value of UAH 0.01 per share. All shares have equal voting rights. As at 31 December 2005, 14,354,946,916 shares were issued, fully paid and registered (2004 – 14,308,535,550 shares).

The respective interests of shareholders are as follows:

Shareholder	***2005***	***2004***
PKO BP S.A.	69.0%	66.6%
EBRD	28.3%	28.3%
Other (Ukrainian shareholders)	2.7%	5.1%
	100.0%	**100.0%**

The share capital of the Bank was contributed by the shareholders in Ukrainian hryvnia or euro and they are entitled to dividends and any capital distribution in Ukrainian hryvnia.

At the shareholder's meeting held on 9 March 2006, the shareholders of the Bank announced the 16th issue of shares with an increase in the share capital by UAH 75,750 thousand (or 7,575,000,000 shares).

The Bank's distributable reserves are determined by the amount of its reserves as disclosed in the accounts prepared in accordance with UAR. As at 31 December 2005, the statutory accounts of the Bank disclosed distributable reserves of UAH 10,721 thousand (2004 – UAH 1,598 thousand) and the amount of non-distributable reserves was UAH 4,524 thousand (2004 - UAH 2,926 thousand). Non-distributable reserves are represented by a general reserve fund, which is created to cover general banking risks, including future losses and other unforeseen risks or contingencies.

19. Commitments and contingencies

Operating Environment

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

Legal

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

(Thousands of Ukrainian hryvnia)

Financial commitments and contingencies

The Bank's financial commitments and contingencies comprise the following:

	2005	*2004*
Credit related commitments		
Undrawn loan commitments	68,330	38,756
Letters of credit	29,079	4,474
Guarantees	26,173	14,855
Promissory note guarantees	17,640	777
	141,222	**58,862**
Less - provision	(441)	-
Total commitments	**140,781**	**58,862**

Promissory note guarantees are provided in respect of promissory notes issued by the Bank's customers in favour of the tax authorities.

In addition to credit related commitments outstanding at the year end, the movements on accounts of letters of credit, guarantees and promissory note guarantees during 2005 comprised UAH 42,891 thousand, UAH 15,819 thousand and UAH 89,804 thousand, respectively (2004 - UAH 32,308 thousand, UAH 28,743 thousand and UAH 18,124 thousand).

Capital commitments

As at 31 December 2005, the Bank had capital commitments of UAH 4,000 thousand in respect of the acquisition of intangible assets (2004 – UAH 6,360 thousand).

Financial covenants

The Bank is a party to debt arrangements with the EBRD (see Note 15), which contain certain financial covenants relating to the financial performance and general risk profile of the Bank. Such financial covenants may restrict the Bank's ability to execute certain business strategies and enter into other significant transactions in the future. The Bank has not complied with certain covenants as at 31 December 2005, however the Bank obtained an appropriate waiver letter in respect of 31 December 2005 and the subsequent period until 31 March 2006.

Insurance

The Bank has obtained insurance coverage against physical damage and loss, from a Ukrainian insurance company in respect of property and equipment (including buildings, equipment, computers and vehicles) for a sum insured of UAH 113,762 thousand (2004 - UAH 103,162 thousand).

20. Fees and commissions

Fees and commissions comprise:

	2005	*2004*
Fees and commission income		
Cash and settlement operations	31,798	30,521
Credit services	13,672	7,599
Currency conversion	8,771	6,129
Operations with guarantees and letters of credit	1,846	1,552
Securities dealing fees	508	172
Other	196	413
	56,791	**46,386**
Fees and commission expenses		
Cash and settlement operations	(1,719)	(6,074)
Currency conversion	(1,408)	(1,606)
Other	(995)	(123)
	(4,122)	**(7,803)**
Fees and commissions, net	**52,669**	**38,583**

(Thousands of Ukrainian hryvnia)

21. Salaries and other administrative and operating expenses

Salaries and benefits, other administrative and operating expenses comprise:

	2005	2004
Salaries and bonuses	31,885	26,386
Employment taxes	10,086	7,851
Salaries and benefits	**41,971**	**34,237**
Occupancy and rent	7,441	7,522
Legal and consultancy	4,428	2,153
Security	4,054	4,209
Office expenses	4,036	4,957
Payments to individuals' deposits guarantee fund	3,834	3,136
Repairs and maintenance	3,745	3,305
EDP costs	3,137	2,796
Communications	2,517	2,598
Marketing and advertising	2,475	2,008
Operating taxes	1,873	2,678
Loss on property and equipment disposal	1,184	232
Business travel and related expenses	1,351	1,112
Charity	293	1,152
Penalties incurred	19	121
Other	4,517	2,707
Other administrative and operating expenses	**44,904**	**40,686**

The aggregate remuneration and other benefits paid to members of the Management Board for 2005 is UAH 2,295 thousand (2004 – UAH 2,288 thousand).

22. Risk management policies

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

Credit risk

The Bank is exposed to credit risk which is the risk that a counter party will be unable to pay amounts in full when due. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. The Management Board and/or Credit Committee approve limits on the level of credit risk by borrower and product. Where appropriate, the Bank obtains collateral. Such risks are monitored on a continuous basis and are subject to annual or more frequent reviews.

The exposure to any one borrower including banks is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Management Board and/or 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.

Market risk

The Bank takes on exposure 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 Bank manages market risk through periodic estimation of potential losses that could arise from adverse changes in market conditions and establishing and maintaining appropriate stop-loss limits and margin and collateral requirements.

Currency risk

The Bank is exposed to the effects of fluctuation in the prevailing foreign currency exchange rates on its financial position and cash flows. The Management Board sets limits on the level of exposure by currencies (primarily US

(Thousands of Ukrainian hryvnia)

dollars and euro), by branches and in total. These limits also comply with the minimum requirements of the National Bank of Ukraine. The Bank's exposure to foreign currency exchange rate risk follows:

			2005		
	UAH	USD	EUR	Other	Total
Assets:					
Cash and due from the NBU	178,786	17,669	24,284	2,652	**223,391**
Financial assets at fair value	39,477	-	-	-	**39,477**
Due from credit institutions	2,725	32,967	45,676	4,276	**85,644**
Investment securities	938	-	-	-	**938**
Loans to customers	696,135	671,028	130,405	-	**1,497,568**
Tax asset	15,904	-	-	-	**15,904**
Other monetary assets	6,444	2,856	203	726	**10,229**
	940,409	**724,520**	**200,568**	**7,654**	**1,873,151**
Liabilities:					
Due to credit institutions	5,125	183,833	71,118	169	**260,245**
Due to customers	910,140	484,549	134,828	7,011	**1,536,528**
Subordinated loans	-	73,579	-	-	**73,579**
Tax liability	239	-	-	-	**239**
Other liabilities	4,824	289	211	-	**5,324**
	920,328	**742,250**	**206,157**	**7,180**	**1,875,915**
Net balance sheet position	**20,081**	**(17,730)**	**(5,589)**	**474**	**(2,764)**

			2004		
	UAH	USD	EUR	Other	Total
Assets:					
Cash and due from the NBU	77,947	13,726	14,325	3,048	**109,046**
Financial assets at fair value	7,871	-	-	-	**7,871**
Due from credit institutions	7,337	60,542	20,577	8,039	**96,495**
Investment securities	938	-	-	-	**938**
Loans to customers	491,814	367,634	90,132	-	**949,580**
Tax asset	14,919	-	-	-	**14,919**
Other monetary assets	7,062	2,119	366	521	**10,068**
	607,888	**444,021**	**125,400**	**11,608**	**1,188,917**
Liabilities:					
Due to credit institutions	55,551	111,493	21,430	1,332	**189,806**
Due to customers	531,849	343,078	105,381	10,046	**990,354**
Tax liability	374	-	-	-	**374**
Other liabilities	2,879	191	27	-	**3,097**
	590,653	**454,762**	**126,838**	**11,378**	**1,183,631**
Net balance sheet position	**17,235**	**(10,741)**	**(1,438)**	**230**	**5,286**

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

Interest rate risk

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

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

(Thousands of Ukrainian hryvnia)

	2005					
	Less than 1 month	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*Over 5 years*	*Total*
Assets:						
Cash and due from the NBU	223,391	-	-	-	-	**223,391**
Financial assets at fair value	-	759	18,541	20,177	-	**39,477**
Due from credit institutions	78,069	-	7,575	-	-	**85,644**
Investment securities	938	-	-	-	-	**938**
Loans to customers	56,428	75,289	334,199	825,379	206,273	**1,497,568**
Tax asset	-	-	15,904	-	-	**15,904**
Other monetary assets	3,523	3,620	2,336	750	-	**10,229**
	362,349	**79,668**	**378,555**	**846,306**	**206,273**	**1,873,151**
Liabilities:						
Due to credit institutions	171,549	-	73,671	15,025	-	**260,245**
Due to customers	643,712	218,575	518,667	106,135	49,439	**1,536,528**
Subordinated loans	73,579	-	-	-	-	**73,579**
Tax liabilities	-	-	239	-	-	**239**
Other liabilities	1,077	3,834	413	-	-	**5,324**
	889,917	**222,409**	**592,990**	**121,160**	**49,439**	**1,875,915**
Total interest sensitivity gap	**(527,568)**	**(142,741)**	**(214,435)**	**725,146**	**156,834**	**(2,764)**

As at 31 December 2004, the Bank's analysis of monetary assets and liabilities by the earlier of contractual repricing or maturity dates did not differ significantly from the analysis by contractual maturity dates.

As at 31 December 2005 and 2004, the effective average interest rates by currencies for interest generating/bearing monetary financial instruments were as follows:

	2005		2004	
	UAH	*USD/euro*	*UAH*	*USD/euro*
Due from NBU	5%	-	-	-
Due from credit institutions	-	10.5%	20%	5.3%
Financial assets at fair value	13%	-	17%	-
Loans to customers	19%	13%	21%	13%
Due to credit institutions	7%	6%	13%	5%
Subordinated loans	-	9%	-	-
Customer deposits	13%	7%	15%	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 Bank monitors on a daily basis the future expected cash flows on client accounts and cash flows from its banking operations. This is a part of the Bank's normal asset and liability management process. The Board sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of inter-bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

The following tables 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 date.

(Thousands of Ukrainian hryvnia)

	2005					
	Less than 1 month	**1 to 3 months**	**3 months to 1 year**	**1 to 5 years**	**Over 5 years**	**Total**
Assets:						
Cash and due from the NBU	223,391	-	-	-	-	**223,391**
Financial assets at fair value	-	759	18,541	20,177	-	**39,477**
Due from credit institutions	78,069	-	7,575	-	-	**85,644**
Investment securities	938	-	-	-	-	**938**
Loans to customers	56,428	75,289	334,199	825,379	206,273	**1,497,568**
Tax asset	-	-	15,904	-	-	**15,904**
Other monetary assets	3,523	3,620	2,336	750	-	**10,229**
	362,349	**79,668**	**378,555**	**846,306**	**206,273**	**1,873,151**
Liabilities:						
Due to credit institutions	95,428	-	64,479	100,338	-	**260,245**
Due to customers	643,712	218,575	518,667	106,135	49,439	**1,536,528**
Subordinated loans	-	-	-	-	73,579	**73,579**
Tax liabilities	-	-	239	-	-	**239**
Other liabilities	1,077	3,834	413	-	-	**5,324**
	740,217	**222,409**	**583,798**	**206,473**	**123,018**	**1,875,915**
Net position	**(377,868)**	**(142,741)**	**(205,243)**	**639,833**	**83,255**	**(2,764)**
Accumulated gap	**(377,868)**	**(520,609)**	**(725,852)**	**(86,019)**	**(2,764)**	

	2004					
	Less than 1 month	**1 to 3 months**	**3 months to 1 year**	**1 to 5 years**	**Over 5 years**	**Total**
Assets:						
Cash and due from the NBU	109,046	-	-	-	-	109,046
Financial assets at fair value	-	217	3,017	4,637	-	7,871
Due from credit institutions	83,232	5,305	7,958	-	-	96,495
Investment securities	938	-	-	-	-	938
Loans to customers	88,857	127,713	379,731	325,590	27,689	949,580
Tax asset			4,032	10,887	-	14,919
Other monetary assets	6,594	1,764	210	1,500	-	10,068
	288,667	**134,999**	**394,948**	**342,614**	**27,689**	**1,188,917**
Liabilities:						
Due to credit institutions	100,974	7,903	6,258	64,178	10,493	189,806
Due to customers	354,486	166,320	336,257	114,558	18,733	990,354
Tax liabilities	-	374	-	-	-	374
Other liabilities	900	984	1,187	26	-	3,097
	456,360	**175,581**	**343,702**	**178,762**	**29,226**	**1,183,631**
Net position	**(167,693)**	**(40,582)**	**51,246**	**163,852**	**(1,537)**	**5,286**
Accumulated gap	**(167,693)**	**(208,275)**	**(157,029)**	**6,823**	**5,286**	

The Bank's capability of discharging its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. As shown in the table above, there is a significant deficit in the periods due in less than one year. Partly, this results from a significant concentration of short-term deposits from PKO BP S.A., which are utilised to provide loans to customers. The management of the Bank believes that the maturity of deposits will be rescheduled considering the nature of the relationship between the Bank and the related lender.

In the Ukrainian 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 year in the tables above. In addition, financial assets at fair value through profit or loss are shown at their latest contractual maturity, however such assets maybe realized in a short period of time without adverse price effects.

(Thousands of Ukrainian hryvnia)

Management monitors the Bank's liquidity position and has plans to reduce the liquidity gap in the period up to one year in 2006. These plans include controlling the growth in long-term loans, extending the maturity of customer deposits, increase of the Bank's capital. The Bank believes that in spite of a substantial portion of deposits from individuals being in the period up to 1 year, diversification of these deposits by number and type of depositors and past experience of the Bank indicates that these deposits provide a long-term and stable source of funding for the Bank.

Considering the above, management believes that the Bank will be able to meet its liquidity needs in 2006 and beyond. The plans as described above and overall liquidity management requires that the Bank extends the maturity of its customer deposits, which are subject to prevailing market conditions, including market liquidity, pricing and competitive pressures, and to secure additional long-term funding. Failure to extend the maturity of its customer deposits or to effectively implement any of the plans described above could have a materially adverse effect on the ability of the Bank to meet its obligations, including debt servicing, and, therefore, the Bank's results of operations and financial condition.

23. Fair values of financial instruments

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of IAS 32 "Financial Instruments: Disclosure and Presentation". Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties on arm's length conditions, other than in forced sale or liquidation. As no readily available market exists for a large part of the Bank'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 Bank could realise in a market exchange from the sale of its full holdings of a particular instrument.

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

	2005	
	Carrying amount	***Fair value***
Financial assets		
Amounts due from credit institutions	85,644	85,644
Loans to customers	1,497,568	1,494,274
Financial liabilities		
Amounts due to credit institutions	260,245	260,245
Due to customers	1,536,528	1,541,175
Subordinated loans	73,579	73,579

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

Amounts due from and to credit institutions and customers

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

Subordinated loans

This financing was obtained at market rates, which are considered also as appropriate year-end market rates. Consequently, the carrying value measured at amortised cost is a reasonable estimate of its fair value.

As at 31 December 2004, fair values of financial assets and liabilities not presented on the Bank's balance sheet at fair value approximated to their carrying values.

(Thousands of Ukrainian hryvnia)

24. Related party transactions

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

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

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

	2005		2004	
	Shareholders	Management	Shareholders	Management
Amounts due from credit institutions	660	-	961	-
Loans to customers	-	235	-	-
Amounts due to credit institutions	143,491	-	59,271	-
Amounts due to customers	-	1,381	-	222
Subordinated loans (Note 17)	73,579	-	-	-
Interest income due from credit institutions	186	-	-	-
Commission expenses to banks	-	-	113	-
Interest expenses:				
- amounts due to credit institutions	5,154	-	1,622	-
- amounts due to customers	-	126	-	24
- subordinated loans	1,059	-	-	-
Salaries and benefits, short-term (Note 21)		2,295		2,288

Included in the table above are the following outstanding transactions with related parties:

1) As at 31 December 2005 and 2004, due from credit institutions consisted of balances on current accounts with PKO BP S.A..

2) As at 31 December 2005, due to credit institutions include time deposits and loans of UAH 128,031 thousand received from PKO BP S.A. and UAH 15,067 thousand received from EBRD (2004 – UAH 48,718 thousand received from PKO BP S.A. and UAH 10,493 thousand from EBRD).

3) The amounts of interest expense to credit institutions for 2005 represent interests on transactions with PKO BP S.A. and EBRD amounting to UAH 4,311 thousand and UAH 843 thousand, respectively (2004 – UAH 1,330 thousand with Kredyt Bank S.A, UAH 44 thousand with PKO BP S.A., and UAH 248 thousand with EBRD).

25. Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the NBU, and due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances. As at 31 December 2005 and 2004, cash and cash equivalents included in the cash flow statement comprise the following balance sheet items:

	2005	2004
Cash on hand (see Note 5)	96,775	61,664
Amounts with the National Bank of Ukraine (see Note 5)	126,616	47,382
Current accounts with banks (see Note 6)	70,058	39,063
Time deposits with banks with contractual maturity of less than ninety days	8,047	50,194
Cash and cash equivalents	**301,496**	**198,303**

(Thousands of Ukrainian hryvnia)

26. Capital adequacy

The Bank is required to maintain a capital adequacy ratio of 10% of risk-weighted assets, computed based on UAR. As at 31 December 2005 and 2004, the Bank's capital adequacy ratio on this basis exceeded the statutory minimum.

The Bank's risk based capital adequacy ratio, computed in accordance with the Basle Accord guidelines issued in 1988, as at 31 December 2005 and 2004, was 12.0% and 11.4%, respectively. These ratios exceeded the minimum ratio of 8% recommended by the Basle Accord.