Grant Thornton
An instinct for growth™

# Financial Statements and Independent Auditor's Report

## "Armbusinessbank" closed joint stock company

31 December 2011

# Contents

Grant Thornton

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# Independent auditor's report


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To the Shareholders and Board of Directors of Closed Joint Stock Company "Armbusinessbank":

We have audited the accompanying financial statements of the "Armbusinessbank" CJSC (the "Bank"), which comprise the statement of financial position as of December 31, 2011, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

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

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

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

*Opinion*

In our opinion, the financial statements give a true and fair view of the financial position of the "Armbusinessbank" CJSC as of December 31, 2011, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Emphasis of a matter*

Without qualifying our opinion, we draw your attention to notes 17 and 21 of the financial statements, which relate to the loan portfolio and other assets of the Bank. There is material concentration of the Bank's loan portfolio and other assets in those provided to shareholders and the organizations collaborating with them at the amount of AMD 20,244,759 thousand and AMD 12,467,143 thousand respectively. Management of the Bank is confident that the mentioned loans and receivables will be recovered within the contractual terms and concentration will not jeopardize financial position of the Bank in the future.

Gagik Gyulbudaghyan
Managing Partner

Armen Vanyan
Head of audit

Grant Thornton CJSC
23 April, 2012
Yerevan

# Statement of comprehensive income

| In thousand Armenian drams | Notes | **Year ended December 31, 2011** | Year ended December 31, 2010 |
|---|---|---|---|
| Interest and similar income | 6 | **14,847,836** | 10,427,671 |
| Interest and similar expense | 6 | **(9,039,571)** | (5,806,968) |
| **Net interest income** | | **5,808,265** | 4,620,703 |
| Fee and commission income | 7 | **1,078,204** | 1,119,149 |
| Fee and commission expense | 7 | **(282,065)** | (263,477) |
| **Net fee and commission income** | | **796,139** | 855,672 |
| Net trading income | 8 | **1,318,841** | 1,368,564 |
| Gains less losses on investments available for sale | | **(852,391)** | 56,302 |
| Other income | 9 | **77,567** | 36,060 |
| Impairment charge for credit losses | 10 | **(1,628,343)** | (1,557,985) |
| Impairment charge for financial investments | | **(1,949)** | (295) |
| Staff costs | 11 | **(1,802,583)** | (1,512,943) |
| Depreciation of property and equipment | 19 | **(806,313)** | (637,069) |
| Amortization of intangible assets | 20 | **(28,544)** | (37,883) |
| Foreign currency translation net loss/(gain) of non-trading assets and liabilities | | **10,727** | (60,904) |
| Other expenses | 12 | **(1,744,421)** | (1,406,166) |
| **Profit before income tax** | | **1,146,995** | 1,724,056 |
| Income tax expense | 13 | **(253,620)** | (400,944) |
| **Profit for the year** | | **893,375** | 1,323,112 |
| **Other comprehensive income:** | | | |
| Net unrealized gains/ (losses) from changes in fair value of investments available-for-sale | | **(1,406,101)** | 75,773 |
| Net (gains)/losses realized to net profit on disposal of available-for-sale instruments | | **1,498,504** | (61,887) |
| Income tax relating to components of other comprehensive income | | **(18,481)** | (2,777) |
| **Other comprehensive income for the year, net of tax** | | **73,922** | 11,109 |
| **Total comprehensive income for the year** | | **967,297** | 1,334,221 |

The accompanying notes on pages 7 to 53 are an integral part of these financial statements.

# Statement of financial position

| In thousand Armenian drams | Notes | As of December 31, 2011 | As of December 31, 2010 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with CBA | 14 | **19,611,767** | 13,046,849 |
| Amounts due from other financial institutions | 15 | **5,346,819** | 1,688,133 |
| Derivative financial assets | 16 | **777,215** | 870,584 |
| Loans and advances to customers | 17 | **108,741,959** | 77,205,248 |
| Investments available for sale | 18 | **819,163** | 2,015,109 |
| Investments held to maturity | 18 | **51,304** | 51,805 |
| Securities pledged under repurchase agreements | 27 | **6,050,120** | 2,431,251 |
| Property, plant and equipment | 19 | **9,299,386** | 7,676,763 |
| Intangible assets | 20 | **364,249** | 213,081 |
| Deferred tax asset | 13 | **288,429** | 65,497 |
| Assets held for sale | | **2,741,745** | 1,450,357 |
| Other assets | 21 | **13,045,745** | 10,342,300 |
| **TOTAL ASSETS** | | **167,137,901** | 117,056,977 |
| **LIABILITIES AND EQUITY** | | | |
| **Liabilities** | | | |
| Amounts due to the CBA | 22 | **17,164,040** | 9,946,240 |
| Derivative financial liabilities | 16 | **-** | 30,425 |
| Amounts due to other financial institutions | 23 | **22,541,632** | 21,872,933 |
| Financial liabilities held for trading | 24 | **10,173,850** | 7,362,308 |
| Amounts due to customers | 25 | **94,228,848** | 60,075,899 |
| Current income tax liabilities | | **230,756** | - |
| Other liabilities | 26 | **266,251** | 253,945 |
| **Total liabilities** | | **144,605,377** | 99,541,750 |
| **Equity** | | | |
| Share capital | 28 | **17,500,000** | 13,450,000 |
| Statutory general reserve | | **264,688** | 198,533 |
| Other reserves | | **87,377** | 13,455 |
| Retained earnings | | **4,680,459** | 3,853,239 |
| **Total equity** | | **22,532,524** | 17,515,227 |
| **TOTAL LIABILITIES AND EQUITY** | | **167,137,901** | 117,056,977 |

The financial statements from pages 3 to 53 were signed by the Bank's Chairman of the Executive Board and Chief Accountant on 23 April 2012.

The accompanying notes on pages 7 to 53 are an integral part of these financial statements.

Ara Kirakosyan
Chairman of the Executive Board

Ruzan Khachatryan
Chief accountant

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АРМБИЗНЕСБАНК
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# Statement of changes in equity

| In thousand Armenian drams | Share capital | Statutory general reserve | Revaluation reserve of investments available for sale | Retained earnings | Total |
|---|---|---|---|---|---|
| **Balance as of January 1, 2010** | 13,450,000 | 157,422 | 2,346 | 2,571,238 | 16,181,006 |
| Distribution to reserve | - | 41,111 | - | (41,111) | - |
| Transactions with owners | - | 41,111 | - | (41,111) | - |
| Profit for the year | - | - | - | 1,323,112 | 1,323,112 |
| **Other comprehensive income:** | | | | | |
| Net unrealized gain from changes in fair value of investments available-for-sale | - | - | 75,773 | - | 75,773 |
| Net gains realized to comprehensive income statement on disposal of available-for-sale instruments | - | - | (61,887) | - | (61,887) |
| Income tax relating to components of other comprehensive income | - | - | (2,777) | - | (2,777) |
| Total comprehensive income for the year | - | - | 11,109 | 1,323,112 | 1,334,221 |
| **Balance as of December 31, 2010** | **13,450,000** | **198,533** | **13,455** | **3,853,239** | **17,515,227** |
| Increase in share capital | **4,050,000** | **-** | **-** | **-** | **4,050,000** |
| Distribution to reserve | **-** | **66,155** | **-** | **(66,155)** | **-** |
| Transactions with owners | **4,050,000** | **66,155** | **-** | **(66,155)** | **4,050,000** |
| Profit for the year | **-** | **-** | **-** | **893,375** | **893,375** |
| **Other comprehensive income:** | | | | | |
| Net unrealized loss from changes in fair value | **-** | **-** | **(1,406,101)** | **-** | **(1,406,101)** |
| Net losses realized to comprehensive income statement on disposal of available-for-sale instruments | **-** | **-** | **1,498,504** | **-** | **1,498,504** |
| Income tax relating to components of other comprehensive income | **-** | **-** | **(18,481)** | **-** | **(18,481)** |
| Total comprehensive income for the year | **-** | **-** | **73,922** | **893,375** | **967,297** |
| **Balance as of December 31, 2011** | **17,500,000** | **264,688** | **87,377** | **4,680,459** | **22,532,524** |

# Statement of cash flows

| In thousand Armenian drams | **Year ended December 31, 2011** | Year ended December 31, 2010 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Profit before tax | **1,146,995** | 1,724,056 |
| *Adjustments for:* | | |
| Impairment charge for credit losses | **1,628,343** | 1,557,985 |
| Amortization and depreciation allowances | **834,857** | 674,952 |
| Gain from disposal of PPE | **12,146** | - |
| Foreign currency translation net loss/(gain) of non-trading assets and liabilities | **(10,727)** | 60,904 |
| Recovery of loans previously written off | **500,258** | 99,261 |
| Other | **62,944** | (375,583) |
| Interests receivable | **(715,241)** | (125,996) |
| Interests payable | **422,328** | 94,017 |
| **Cash flows from operating activities before changes in operating assets and liabilities** | **3,881,903** | 3,709,596 |
| *(Increase)/decrease in operating assets* | | |
| Amounts due from the CBA | **1,302** | (411,768) |
| Amounts due from other financial institutions | **(65,338)** | (536,203) |
| Loans and advances to customers | **(31,399,737)** | (22,307,768) |
| Other assets | **(2,956,645)** | (550,544) |
| Securities pledge under repurchase agreements | **(3,618,869)** | (2,418,609) |
| Investments available for sale | **1,260,005** | (659,749) |
| Amounts due to financial institutions | **(3,529,750)** | 3,322,344 |
| Amounts due to customers | **31,440,975** | 18,902,658 |
| Financial liabilities held for trading | **2,811,542** | (1,432,495) |
| Other liabilities | **(54,444)** | 605,429 |
| **Net cash flow used in operating activities before income tax** | **(2,229,056)** | (1,777109) |
| Income tax paid | **(264,277)** | (771,700) |
| **Net cash used in operating activities** | **(2,493,333)** | (2,548,809) |
| **Cash flows from investing activities** | | |
| Sale of investment securities | **77** | 51,806 |
| Purchase of property and equipment | **(2,482,734)** | (3,713,113) |
| Proceeds from sale of property and equipment | **41,652** | 34,805 |
| Purchase of intangible assets | **(179,712)** | (54,013) |
| **Net cash used in investing activities** | **(2,620,717)** | (3,680,515) |
| **Cash flow from financing activities** | | |
| Proceeds from issue of share capital | **4,050,000** | - |
| Loans received from the CBA | **7,191,991** | 176,812 |
| Loans received from financial institutions | **3,717,801** | 4,891,050 |
| **Net cash from financing activities** | **14,959,792** | 5,067,862 |
| **Net increase/(decrease) in cash and cash equivalents** | **9,845,742** | (1,161,462) |
| Cash and cash equivalents at the beginning of the year | **13,940,808** | 15,317,239 |
| Exchange differences on cash and cash equivalents | **286,301** | (214,969) |
| **Cash and cash equivalents at the end of the year (Note 14)** | **24,072,851** | 13,940,808 |
| Supplementary information: | | |
| Interest received | **14,132,595** | 10,514,871 |
| Interest paid | **(8,617,243)** | (5,884,753) |

# Accompanying notes to the financial statements

## 1 Principal activities

“Armbusinessbank” CJSC (previous “Hayinvestbank” CJSC) (the “Bank”) is a closed joint-stock company, which was incorporated in the Republic of Armenia in 1991. The Bank is regulated by the legislation of RA and conducts its business under license number 40, granted on 10 December, 1991 by the Central Bank of Armenia (the “CBA”).

The Bank accepts deposits from the public and extends credit, transfers payments in Armenia and abroad, exchanges currencies and provides other banking services to its commercial and retail customers.

The Bank’s main office and its 11 branches are located in Yerevan, 11 branches are located in different regions of Armenia and 6 branches are located in the Republic of Nagorno Karabakh. The registered office of the Bank is located at: 48 Nalbandyan Street, Yerevan.

## 2 Armenian business environment

Armenia continues to undergo political and economic changes. As an emerging market, Armenia does not possess a developed business and regulatory infrastructure that generally exists in a more mature free market economy. In addition, economic conditions continue to limit the volume of activity in the financial markets, which may not be reflective of the values for financial instruments. The main obstacle to further economic development is a low level of economic and institutional development, along with a centralized economic base.

There are still uncertainties about the economic situation of countries, collaborating with the RA, due to the forecasted slowdown in the world economy, which may lead to the shortage of money transfers from abroad, as well as to the decline in the prices of mining products, upon which the economy of Armenia is significantly dependant. In times of more severe market stress the situation of Armenian economy and of the Bank may be exposed to deterioration. However, as the number of variables and assumptions involved in these uncertainties is big, management cannot make a reliable estimate of the amounts by which the carrying amounts of assets and liabilities of the Bank may be affected.

Accordingly, the financial statements of the Bank do not include the effects of adjustments, which might have been considered necessary.

## 3 Basis of preparation

### 3.1 Statement of compliance

The financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as developed and published by the International Accounting Standards Board (IASB), and Interpretations issued by the International Financial Reporting Interpretations Committee (“IFRIC”).

### 3.2 Basis of measurement

The financial statements have been prepared on a fair value basis for financial assets and liabilities at fair value through profit or loss and available for sale assets, except those for which a reliable measure of fair value is not available. Other financial assets and liabilities are stated at amortized cost and non-financial assets and liabilities are stated at historical cost.

### 3.3 Functional and presentation currency

Functional currency of the Bank is the currency of the primary economic environment in which the Bank operates. The Bank’s functional currency and the Bank’s presentation currency is Armenian Drams (“AMD”), since this currency best reflects the economic substance of the underlying events and transactions of the Bank. These financial statements are based on the Bank’s books and records as adjusted and reclassified in order to comply with IFRS. The financial statements are presented in thousands of AMD, which is not convertible outside Armenia.

### 3.4 Reclassifications

Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year.

### 3.5 Changes in accounting policies

In the current year the Bank has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the “IASB”) and International Financial Reporting Interpretations Committee (the “IFRIC”) of the IASB that are relevant to its operations and effective for annual reporting periods beginning on January 1, 2011. The standards and interpretations which have had effect on the financial statements are presented below:

IFRS 7 (Amendment) *Financial Instruments: Disclosures*

The amendment clarifies the disclosure requirements of the standard to remove inconsistencies, duplicative disclosure requirements. Namely, it eliminated the requirements to disclose:

- the carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated,
- maximum exposure to credit risk for financial instruments whose carrying amount best represents the maximum exposure to credit risk,
- description and estimate of fair value of collateral held for past due or impaired financial assets.

IFRS 7 (Amendment) is applied for annual periods beginning on or after 1 January 2011.

IAS 1 (Amendment) *Presentation of Financial Statements*

Clarifies that entities may present the required reconciliations for each component of other comprehensive income either in the statement of changes in equity or in the notes to the financial statements. The amendment is applied for annual periods beginning on or after 1 January 2011.

### 3.6 Standards and Interpretations not yet applied by the Bank

At the date of authorization of these financial statements, certain new Standards, amendments and interpretations to the existing Standards have been published but are not yet effective. The Bank has not early adopted any of these pronouncements.

Management anticipates that all of the pronouncements will be adopted in the Bank’s accounting policy for the first period beginning after the effective date of the pronouncement. Information on new standards, amendments and interpretations that are expected to be relevant to the Bank's financial statements is provided below. Certain other new standards and interpretations have been issued but are not expected to have a material impact on the Bank's financial statements.

IFRS 7 (Amendment) *Transfer of Financial Assets*

The amendment aims to help users of financial statements evaluate the risk exposure relating to more complex transfers of financial assets and the effect of those risks on an entity's financial position. The additional disclosures required are designed to provide information that enables users:

- To understand the relationship between transferred financial asset that are not derecognized in their entirely and the associated liabilities

- To evaluate the nature of and risks associated with any continuing involvement of the reporting entity in financial assets that are derecognized in their entirely.

This amendment is effective for annual periods beginning on or after July 1, 2011.

IAS 32 (Amendment) *Offsetting Financial Assets and Financial Liabilities*

The amendments to IAS 32 add application guidance to address inconsistencies in applying IAS 32's criteria for offsetting financial assets and financial liabilities in the following two areas:

- The meaning of 'currently has a legally enforceable right of set-off': the amendments clarify that a right of set-off is required to be legally enforceable in the normal course of business, the event of default and the event of insolvency or bankruptcy of the entity and all of the counterparties, and that the right must also exist for all counterparties.
- Since there was diversity in practice related to the interpretation of 'simultaneous settlement' in IAS 32, the IASB has therefore clarified the principle behind net settlement and included an example of a gross settlement system with characteristics that would satisfy the IAS 32 criterion for net settlement.

The amendments are effective for annual reporting periods beginning on or after 1 January 2014 and are required to be applied retrospectively.

IFRS 7 (Amendment) *Offsetting Financial Assets and Financial Liabilities*

The amendment adds qualitative and quantitative disclosures to IFRS 7 relating to gross and net amounts of recognized financial instruments that are (a) set off in the statement of financial position and (b) subject to enforceable master netting arrangements and similar agreements, even if not set off in the statement of financial position.
The amendments are effective for annual reporting periods beginning on or after 1 January 2013, and are required to be applied retrospectively.

IFRS 9 *Financial Instruments*

The IASB aims to replace IAS 39 Financial Instruments: Recognition and Measurement in its entirety. IFRS 9 is being issued in phases. To date, the chapters dealing with recognition, classification, measurement and derecognition of financial assets and liabilities have been issued. Further chapters dealing with impairment methodology and hedge accounting are still being developed.

The IASB has issued an amendment to IFRS 9 which deferred the mandatory effective date of IFRS from 1 January 2013 to 1 January 2015. This means that all the phases of the project to replace IAS

39 will now have the same mandatory effective date. The amendments also provide relief from the requirement to restate comparative financial statements for the effect of applying IFRS 9. This relief was originally only available to companies that chose to apply IFRS 9 prior to 2012. Additional transition disclosures will now be required to help understand the initial application of the Standard.

Management have yet to assess the impact of this new standard on the Bank's financial statements.

IFRS 13 *Fair Value Measurement*

IFRS 13 does not affect which items are required to be fair-valued, but clarifies the definition of fair value and provides related guidance and enhanced disclosures about fair value measurements. It is applicable for annual periods beginning on or after 1 January 2013. The Bank's management have yet to assess the impact of this new standard on the financial statements.

IAS 1 *Presentation of Financial Statements*

The IAS 1 Amendments require an entity to group items presented in other comprehensive income into those that, in accordance with other IFRSs: (a) will not be reclassified subsequently to profit or loss and (b) will be reclassified subsequently to profit or loss when specific conditions are met. It is applicable for annual periods beginning on or after 1 July 2012. The Bank's management expects this will change the current presentation of items in other comprehensive income; however, it will not affect the measurement or recognition of such items.

## 4 Summary of significant accounting policies

The following significant accounting policies have been applied in the preparation of the financial statements. The accounting policies have been consistently applied.

### 4.1 Recognition of income and expenses

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. Expense is recognized to the extent that it is probable that the economic benefits will flow from the Bank and the expense can be reliably measured. The following specific criteria must also be met before revenue is recognized:

*Interest income and expense*

Interest income and expense for all interest-bearing financial instruments, except for those classified as held for trading or designated at fair value through profit or loss, are recognised within 'interest income' and 'interest expense' in the income statement using the effective interest method.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original effective interest rate applied to the new carrying amount.

*Fee and commission income*

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. Portfolio and other management advisory and service fees are recorded based on the applicable service contracts. Asset management fees related to investment funds are recorded over the period the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time.

*Dividend income*

Revenue is recognized when the Bank's right to receive the payment is established.

*Net trading income*

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realized and unrealized fair value changes, interest, dividends and foreign exchange differences related to trading assets and liabilities. Net trading income also includes gains less losses from trading in foreign currencies.

## 4.2 Foreign currency translation

Transactions in foreign currencies are initially recorded in the functional currency rate ruling at the date of the transactions. Gains and losses resulting from the translation of trading assets are recognised in the statement of income in net trading income, while gains less losses resulting from translation of non-trading assets are recognized in the statement of income in other income or other expense. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date.

Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount are recognised in equity.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the fair value reserve in equity.

Differences between the contractual exchange rate of a certain transaction and the prevailing average exchange rate on the date of the transaction are included in gains less losses from trading in foreign currencies in net trading income.

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

| | **December 31, 2011** | December 31, 2010 |
|---|---|---|
| AMD/1 US Dollar | **385.77** | 363.44 |
| AMD/1 Euro | **498.72** | 481.16 |

## 4.3 Taxation

Income tax on the profit for the year comprises current and deferred tax. Income tax is recognized in the income statement except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years. In the case when financial statements are authorized for issue before appropriate tax returns are submitted, taxable profits or losses are based on estimates. Tax authorities might have more stringent position in interpreting tax legislation and in reviewing tax calculations. As a result tax authorities might claim additional taxes for those transactions, for which they did not claim previously. As a result significant additional taxes, fines and penalties could arise. Tax review can include 3 calendar years immediately preceding the year of a review. In certain circumstances tax review can include even more periods.

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

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

The Republic of Armenia also has various operating taxes, which are assessed on the Bank's activities. These taxes are included as a component of other expenses in the statement of income.

### 4.4 Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, balances on correspondent accounts with the Central Bank of Armenia (excluding those funds deposited for the settlement of ArCa payment cards), and amounts due from other banks, which can be converted into cash at short notice and which are subject to an insignificant risk of changes in value.

Cash and cash equivalents are carried at amortised cost.

### 4.5 Amounts due from other financial institutions

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

### 4.6 Financial instruments

The Bank 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 financial assets and liabilities are recognised using settlement date accounting. Regular way purchases of financial instruments that will be subsequently measured at fair value between trade date and settlement date are accounted for in the same way as for acquired instruments.

When financial assets and liabilities 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.

After initial recognition all financial liabilities, other than liabilities at fair value through profit or loss (including held for trading) are measured at amortized cost using effective interest method. After initial recognition financial liabilities at fair value through profit or loss are measured at fair value.

The Bank classified its financial assets into the following categories: loans and receivables, financial instruments at fair value through profit or loss, available-for-sale financial instruments and held-to-maturity investments. The classification of investments between the categories is determined at acquisition based on the guidelines established by the management. The Bank determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end.

*Financial assets at fair value through profit or loss*

This category has two subcategories: financial assets held for trading and those designated at fair value through profit or loss. A financial asset is classified in this category if acquired for the purpose of selling in the short-term or if so designated by management from the initial acquisition of that asset.

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

Derivative instruments embedded in other financial instruments are treated as separate derivatives if their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value with unrealized gains and losses reported in income. An embedded derivative is a component of a hybrid (combined) financial instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a similar way to a stand-alone derivative.

Financial assets and financial liabilities are designated at fair value through profit or loss when:

- Doing so significantly reduces measurement inconsistencies that would arise if the related derivatives were treated as held for trading and the underlying financial instruments were carried at amortised cost for such as loans and advances to customers or banks and debt securities in issue;
- Certain investments, such as equity investments, that are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis are designated at fair value through profit and loss; and
- Financial instruments, such as debt securities held, containing one or more embedded derivatives significantly modify the cash flows, are designated at fair value through profit and loss.

Derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on financial assets held for trading are recognised in the statement of income.

*Held-to-maturity investments*

Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturities that the Bank’s management has the positive intention and ability to hold to maturity. Were the Bank to sell other than insignificant amount of held-to-maturity assets not close to their maturity, the entire category would be reclassified as available-for-sale. Held-to-maturity investments are carried at amortized cost using the effective interest rate method, less any allowance for impairment.

*Loans and receivables*
Loans and receivables are financial assets with fixed or determinable payments, which arise when the Bank provides money directly to a debtor with no intention of trading the receivable.

Loans granted by the Bank with fixed maturities are initially recognized at fair value plus related transaction costs. Where the fair value of consideration given does not equal the fair value of the loan, for example where the loan is issued at lower than market rates, the difference between the fair value of consideration given and the fair value of the loan is recognized as a loss on initial recognition of the loan and included in the income statement as losses on origination of assets. Subsequently, the loan carrying value is measured using the effective interest method. Loans to customers that do not have fixed maturities are accounted for under the effective interest method based on expected maturity. Loans to customers are carried net of any allowance for impairment losses.

*Available-for-sale financial instruments*
Investments available for sale represent debt and equity investments that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. 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. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Bank's right to receive payment is established.

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. Otherwise the investments are stated at cost less any allowance for impairment.

## 4.7 Impairment of financial assets

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

*Assets carried at amortized cost*
A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset ("loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Criteria used to determine that there is objective evidence of an impairment loss may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty (for example, equity ratio, net income percentage of sales), default or delinquency in interest or principal payments, breach of loan covenants or conditions, deterioration in the value of collateral, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

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 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 shall be reduced through use of an allowance account. The amount of the loss shall be recognised in the statement of income. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. The Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

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.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If future write-off is later recovered, the recovery is credited to the allowance account.

*Renegotiated loans*

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

*Available-for-sale financial assets*

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

### 4.8 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.

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

*Financial liabilities*

A financial liability is 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.

### 4.9 Repurchase and reverse repurchase agreements

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 and faced as the separate balance sheet item. The corresponding liability is presented within amounts due to financial institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as amounts due from other financial institutions or loans and advances to customers as appropriate and are not recognized on the balance sheet. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

### 4.10 Securities lending and borrowing

Securities lending and borrowing transactions are usually collateralised by securities or cash. The transfer of the securities to counterparties is only reflected on the balance sheet if the risks and rewards of ownership are also transferred. Cash advanced or received as collateral is recorded as an asset or liability.

Securities borrowed are not recognized on the balance sheet, unless they are sold to third parties, in which case the obligation to return the securities is recorded as a trading liability and measured at fair value with any gains or losses included in "Net trading income".

### 4.11 Leases

*Operating - Bank as leasee*

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

### 4.12 Property, plant and equipment

Property, plant and equipment ("PPE") are recorded at historical cost less accumulated depreciation. If the recoverable value of PPE is lower than its carrying amount, due to circumstances not considered to be temporary, the respective asset is written down to its recoverable value. Land is carried at historical cost. It has unlimited useful life and thus is not depreciated.

Depreciation is calculated using the straight-line method based on the estimated useful life of the asset. The following depreciation rates have been applied:

| | Useful life (years) | Rate (%) |
|---|---|---|
| Buildings | 20 | 5 |
| Computers | 3-5 | 33-20 |
| Vehicles | 7 | 14 |
| Office equipments | 8 | 13 |
| Other fixed assets | 10 | 10 |

Leasehold improvements are capitalized and depreciated over the shorter of the lease term and their useful lives on a straight-line basis. Assets under the course of construction are accounted based on actual expenditures less any impairment losses. Upon completion of construction assets are transferred to property plant and equipment and accounted at their carrying amounts. Assets under the course of construction are not depreciated until they are ready for usage.

Repairs and maintenance are charged to the income statement during the period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits in excess of the originally assessed standard of performance of the existing asset will flow to the Bank. Major renovations are depreciated over the remaining useful life of the related asset.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in operating profit.

### 4.13 Intangible assets

Intangible assets include computer software, licences and other.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised on a straight-line basis over the useful economic lives of 15 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end.

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

Costs associated with maintaining computer software programmes are recorded as an expense as incurred.

### 4.14 Assets held for sale

A non-current asset is classified as held for sale if it is highly probable that the asset's carrying amount will be recovered through a sale transaction rather than through continuing use. Such sale transaction shall be principally completed within one year from the date of classification of an asset as held for sale.

Assets held for sale are measured at the lower of its carrying amount and fair value less costs to sell. If the fair value less costs to sell of an asset held for sale is lower than its carrying amount, an impairment loss is recognized in the income statement as loss from assets held for sale. Any subsequent increase in an asset's fair value less costs to sell is recognized to the extent of the cumulative impairment loss that was previously recognized in relation to that specific asset.

### 4.15 Grants

Grants relating to the assets are included in other liabilities and are credited to the income statement on a straight line basis over the expected lives of the related assets.

### 4.16 Borrowings

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

### 4.17 Pensions

The Bank does not have any pension arrangements separate from the State pension system of the Republic of Armenia, 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.

### 4.18 Financial guarantees

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantees are initially recognized in the financial statements at fair value, in "Other liabilities", being the premium received. Subsequently to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

### 4.19 Provisions

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

### 4.20 Share capital

*Share capital*

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

*Treasury shares*

Where the Bank purchases the Bank's shares, the consideration paid, including any attributable transaction costs, net of income taxes, is deducted from total equity as treasury shares until they are cancelled or reissued. Where such shares are subsequently sold or reissued, any consideration received is included in equity. Treasury shares are stated at weighted average cost.

*Dividends*

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

### 4.21 Offsetting

Financial assets and liabilities, and income and expenses, are offset and the net amount 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 realise the asset and settle the liability simultaneously.

## 5 Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities, income and expense. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from these estimates.

The most significant areas of judgements and estimates with regards to these financial statements are presented below:

*Classification of investment securities*

Securities owned by the Bank comprise Armenian state bonds and corporate shares. Upon initial recognition, the Bank designates securities as held to maturity and available-for-sale financials assets with recognition of changes in fair value through equity.

*Related party transactions*

In the normal course of business the Bank enters into transactions with its related parties. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

*Allowance for impairment of loans and other advances*

The Bank reviews its problem loans and advances at each reporting date to assess whether an allowance for impairment should be recorded in the income statement. In particular, judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific allowances against individually significant loans and advances, the Bank also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This take into consideration factors such as any deterioration in country risk, industry, and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

*Tax legislation*

Armenian tax legislation is subject to varying interpretations. Refer to Note 29.

*Impairment of available-for-sale equity investments*

The Bank determined that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged required judgement. In making this judgement, the Bank evaluates among other factors, the volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational or financing cash flows.

## 6 Interest and similar income and expense

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| Loans and advances to customers | **12,389,041** | 9,012,538 |
| Debt securities available-for-sale | **681,002** | 195,782 |
| Debt securities held to maturity | **4,982** | 9,195 |
| Amounts due from other financial institutions | **19,269** | 5,100 |
| Reverse repurchase transactions | **547,560** | 879,381 |
| Other interest income | **18,396** | 8,488 |
| Interest accrued on impaired financial assets | **1,187,586** | 317,187 |
| **Total interest and similar income** | **14,847,836** | 10,427,671 |
| Amounts due to customers | **4,701,405** | 3,049,123 |
| Amounts due to the CBA and other financial institutions | **3,409,678** | 2,246,492 |
| Repurchase transactions | **927,990** | 508,736 |
| Other interest expenses | **498** | 2,617 |
| **Total interest and similar expense** | **9,039,571** | 5,806,968 |

## 7 Fee and commission income and expense

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| Cash operations | **249,947** | 178,188 |
| Wire transfer fees | **278,741** | 408,132 |
| Plastic cards operations | **262,698** | 192,408 |
| Service fee for account maintenance | **6,729** | 8,008 |
| Guarantees and letters of credit | **236,327** | 287,657 |
| Other fees and commission income | **43,762** | 44,756 |
| **Total fee and commission income** | **1,078,204** | **1,119,149** |
| Wire transfer fees | **119,615** | 165,805 |
| Cash collection | **96,800** | 22,405 |
| Collection services | **31,314** | 21,932 |
| Other expenses | **34,336** | 53,335 |
| **Total fee and commission expense** | **282,065** | 263,477 |

## 8 Net trading income

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| Net gain/(loss) from financial liabilities held for trading | **439,860** | (71,047) |
| Net income from trading in foreign currency | **703,206** | 860,083 |
| Net income from derivative instruments | **175,775** | 579,528 |
| **Total net trading income** | **1,318,841** | 1,368,564 |

## 9 Other income

| In thousand Armenian drams | 2011 | 2010 |
|---|---|---|
| Income from sale of fixed assets | - | 130 |
| Fines and penalties received | 54 | 52 |
| Income from grants related to assets | 82 | 82 |
| Income from account closing | 3,978 | 9,541 |
| Income from disposal of repossessed property | 42,232 | - |
| Other income | 31,221 | 26,255 |
| **Total other income** | 77,567 | 36,060 |

## 10 Impairment charge/(reversal) for credit losses

| In thousand Armenian drams | 2011 | 2010 |
|---|---|---|
| Amounts due from other financial institutions (Note 15) | 36,886 | (20,154) |
| Loans and advances to customers (Note 17) | 1,303,916 | 1,491,277 |
| Other assets (Note 21) | 287,541 | 86,862 |
| **Total impairment charge for credit losses** | 1,628,343 | 1,557,985 |

## 11 Staff costs

| In thousand Armenian drams | 2011 | 2010 |
|---|---|---|
| Wages and salaries | 1,633,499 | 1,372,011 |
| Social security contributions | 169,084 | 140,932 |
| **Total staff costs** | 1,802,583 | 1,512,943 |

## 12 Other expenses

| In thousand Armenian drams | 2011 | 2010 |
|---|---|---|
| Repair and maintenance of fixed assets | 396,851 | 272,376 |
| Advertising costs | 132,214 | 113,670 |
| Business trip expenses | 69,462 | 38,860 |
| Communications | 125,849 | 98,565 |
| Operating lease | 62,379 | 64,185 |
| Taxes, other than income tax, duties | 190,599 | 125,442 |
| Consulting and other services | 35,996 | 21,968 |
| Security | 118,136 | 97,727 |
| Loss from sale of fixed assets | 12,146 | - |
| Representative expenses | 188,392 | 51,983 |
| Office supplies | 55,980 | 51,518 |
| Loss from disposal of repossessed property | - | 310,380 |
| Penalties paid | 1,788 | 3,481 |
| Losses from operations with precious metals | 2,339 | - |
| Other expenses | 352,290 | 156,011 |
| **Total other expense** | 1,744,421 | 1,406,166 |

## 13 Income tax expense

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| Current tax expense | **495,033** | 396,416 |
| Deferred tax | **(241,413)** | 4,528 |
| **Total income tax expense** | **253,620** | 400,944 |

The corporate income tax within the Republic of Armenia is levied at the rate of 20% (2010: 20%). Differences between IFRS and RA statutory tax regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profit tax purposes. Deferred income tax is calculated using the principal tax rate of 20%.

Numerical reconciliation between the tax expenses and accounting profit is provided below:

| In thousand Armenian drams | **2011** | **Effective rate (%)** | 2010 | Effective rate (%) |
|---|---|---|---|---|
| **Profit before tax** | **1,146,995** | | 1,724,056 | |
| Income tax at the rate of 20% | **229,399** | **20** | 344,811 | 20 |
| Non-deductible expenses | **26,366** | **2** | 43,952 | 2 |
| Foreign exchange (gains)/losses | **(2,145)** | **-** | 12,181 | 1 |
| **Total income tax expense** | **253,620** | **22** | 400,944 | 23 |

Deferred tax calculation in respect of temporary differences:

| In thousand Armenian drams | 2010 | Recognized in comprehensive income statement | Recognized in equity | **2011** |
|---|---|---|---|---|
| Other liabilities | **16,006** | **6,229** | **-** | **22,235** |
| Other assets | **39,217** | **66,102** | **-** | **105,319** |
| Investments available-for-sale | **-** | **7,886** | **-** | **7,886** |
| Loans and advances to customers | **107,746** | **144,377** | **-** | **252,123** |
| **Total deferred tax assets** | **162,969** | **224,594** | **-** | **387,563** |
| Loans and advances to customers | **(27,441)** | **(6,563)** | **-** | **(34,004)** |
| Provisions | **(66,667)** | **23,382** | **-** | **(43,285)** |
| Adjustment of fair value of securities | **(3,364)** | **-** | **(18,481)** | **(21,845)** |
| **Total deferred tax liability** | **(97,472)** | **16,819** | **(18,481)** | **(99,134)** |
| **Net deferred tax asset** | **65,497** | **241,413** | **(18,481)** | **288,429** |

| In thousand Armenian drams | 2009 | Recognized in comprehensive income statement | Recognized in equity | 2010 |
|---|---|---|---|---|
| Other liabilities | 19,907 | (3,901) | - | 16,006 |
| Other assets | 87,633 | (48,416) | - | 39,217 |
| Investments available-for-sale | 659 | (659) | - | - |
| Amounts due from other financial institutions | 3,604 | (3,604) | - | - |
| Loans and advances to customers | - | 107,746 | - | 107,746 |
| **Total deferred tax assets** | 111,803 | 51,166 | - | 162,969 |
| Loans and advances to customers | (13,323) | (14,118) | - | (27,441) |
| Provisions | (25,091) | (41,576) | - | (66,667) |
| Adjustment of fair value of securities | (587) | - | (2,777) | (3,364) |
| **Total deferred tax liability** | (39,001) | (55,694) | (2,777) | (97,472) |
| **Net deferred tax asset** | 72,802 | (4,528) | (2,777) | 65,497 |

## 14 Cash, cash equivalents and balances with CBA

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| Cash on hand | **4,134,005** | 3,590,104 |
| Correspondent account with the CBA | **14,738,701** | 8,716,382 |
| **Included in cash and cash equivalents** | **18,872,706** | 12,306,486 |
| Deposits with the CBA | **739,061** | 740,363 |
| **Total cash and balances with the CBA** | **19,611,767** | 13,046,849 |
| Cash and balances with the CBA, included in cash flow | **18,872,706** | 12,306,486 |
| Placements with other banks (Note 15) | **5,200,145** | 1,634,322 |
| **Total cash and cash equivalents** | **24,072,851** | 13,940,808 |

As at 31 December 2011 correspondent account with Central Bank of Armenia represents the obligatory minimum reserve deposits with the CBA, which is computed at 8% of certain obligations of the Bank denominated in Armenian drams and 12% of certain obligations of the Bank, denominated in foreign currency and amounts to AMD 11,362,750 thousand (2010: AMD 7,122,730 thousand). There are no restrictions on the withdrawal of funds from the CBA, however, if minimum average requirement is not met, the Bank could be subject to penalties. Mandatory reserve deposits are non-interest bearing.

Deposited funds with CBA include a guaranteed deposit for settlements via ArCa payment system.

The following non-cash transactions took place in 2011:

- repayment of AMD 1,405,124 thousand loan by foreclosure of property (2010: AMD 1,895,915 thousand)

## 15 Amounts due from other financial institutions

| In thousand Armenian drams | 2011 | 2010 |
|---|---|---|
| Correspondent accounts with financial institutions | **5,191,869** | 1,632,879 |
| Other accounts | **8,276** | 1,443 |
| **Included in cash and cash equivalents** | **5,200,145** | 1,634,322 |
| Deposited funds in financial institutions | **200,597** | 70,848 |
| | **200,597** | 70,848 |
| Less allowance for impairment | **(53,923)** | (17,037) |
| **Total amounts due from other financial institutions** | **5,346,819** | **1,688,133** |

As at 31 December 2011 the amounts due from other financial institutions in amounts of AMD 4,528,487 thousand (87%) were due from three banks, which represent significant concentration (2010: AMD 1,415,674 thousand (84%) were due from four banks).

As at 31 December 2011 the deposit accounts with financial institutions include guarantee amounts provided by the Bank for its operations through Master Card payment system in the amount of AMD 123,253 thousand (2010: AMD 48,881 thousand, as well as frozen accounts in non-resident Banks with regard to letters of credit provided by the Bank in the amount of AMD 21,967 thousand).

The movement in allowance for impairment losses on amounts due from other financial institutions was as follows:

| In thousand Armenian drams | Total |
|---|---|
| **At January 1, 2010** | 37,191 |
| Reversal for the year | (20,154) |
| **At December 31, 2010** | **17,037** |
| Charge for the year | **36,886** |
| **At December 31, 2011** | **53,923** |

## 16 Derivative financial instruments

The fair values of derivative instruments held are set out below.

| In thousand Armenian drams | | | **2011** | | | 2010 |
|---|---|---|---|---|---|---|
| | **Notional amount** | **Fair value of assets** | **Fair value of liabilities** | Notional amount | Fair value of assets | Fair value of liabilities |
| **Derivatives held for trading** | | | | | | |
| Swaps – foreign | **11,045,367** | **741,964** | **-** | 8,588,087 | 842,059 | - |
| Swaps - domestic | **6,695,575** | **35,251** | **-** | 4,080,023 | 28,525 | 30,425 |
| **Total derivative financial instruments** | **17,740,942** | **777,215** | **-** | 12,668,110 | 870,584 | 30,425 |

All the domestic swap transactions are signed with the local banks, and the foreign swap transactions are signed with the non-resident legal entities cooperating with the shareholders of the Bank.

## 17 Loans and advances to customers

| In thousand Armenian drams | 2011 | 2010 |
|---|---|---|
| Loans to customers | **98,603,033** | 68,757,505 |
| Reverse repurchase agreements | **10,788,335** | 9,135,448 |
| Leasing | **2,575** | 3,369 |
| Guarantee payments | **1,022,914** | 43,214 |
| Overdrafts | **657,248** | 921,735 |
| | **111,074,105** | 78,861,271 |
| Less allowance for loan impairment | **(2,332,146)** | (1,656,023) |
| **Total loans and advances to customers** | **108,741,959** | 77,205,248 |

As of 31 December 2011 accrued interest income included in loans and advances to customers amounted to AMD 1,385,910 thousand (2010: AMD 642,052 thousand).

As of 31 December 2011 the effective interest rates on loans and advances to customers ranged from 5.7% to 26.9% for loans in AMD (2010: from 5.7% to 29.5%) and from 9.4% to 24.4% for loans in USD, EUR and other freely convertible currencies (2010: from 6.7% to 24.4%).

As of December 31, 2011, the Bank had a concentration of loans represented by AMD 28,210,850 thousand due from the ten largest third party entities and parties related with them (25.3% of gross loan portfolio) (2010: AMD 16,273,016 thousand due from ten largest third party entities and parties related with them or 20.6%). An allowance of AMD 409,285 thousand (2010: AMD 162,730 thousand) was made against these loans.

As of December 31, 2011, the Bank had a concentration of loan portfolio represented by AMD 20,244,759 thousand (2010: AMD 13,493,071 thousand) with regard to shareholders and organizations collaborating with them (18.18% of the gross loan portfolio) (2010: 17.1%). An allowance of AMD 201,699 thousand was made against these loans (2010: AMD 443,178 thousand). The Management believes that the repayments of these loans will be made within terms set by contracts and concentration will not jeopardize financial position of the Bank in the future.

Analysis of loans and advances to customers by industry sectors is presented below:

| In thousand Armenian drams | 2011 | 2010 |
|---|---|---|
| Manufacturing | **15,683,329** | 9,165,678 |
| Construction | **16,539,676** | 16,211,821 |
| Trading | **25,619,712** | 10,404,819 |
| Consumer | **7,185,304** | 5,153,830 |
| Agriculture | **5,799,352** | 2,659,898 |
| Mortgage loans | **13,712,109** | 9,115,195 |
| Other | **26,534,623** | 26,150,030 |
| | **111,074,105** | 78,861,271 |
| Less allowance for impairment | **(2,332,146)** | (1,656,023) |
| **Total loans and advances to customers** | **108,741,959** | 77,205,248 |

Reconciliation of allowance account for losses on loans and advances by class is as follows:

| In thousand Armenian drams | Manufacture | Const-ruction | Trading | Consumer | Agriculture | Mort-gage | Other | **2011** Total |
|---|---|---|---|---|---|---|---|---|
| At 1 January 2011 | **174,208** | **267,531** | **593,947** | **110,424** | **53,850** | **135,995** | **320,068** | **1,656,023** |
| Charge for the year | **272,486** | **17,351** | **427,066** | **193,525** | **111,567** | **7,223** | **274,698** | **1,303,916** |
| Amounts written off | **(242,097)** | **(7,908)** | **(383,928)** | **(161,592)** | **(42,972)** | **(33,867)** | **(255,687)** | **(1,128,051)** |
| Recoveries | **38,367** | **60,171** | **155,518** | **104,735** | **9,477** | **119,476** | **12,514** | **500,258** |
| At 31 December 2011 | **242,964** | **337,145** | **792,603** | **247,092** | **131,922** | **228,827** | **351,593** | **2,332,146** |
| Individual impairment | **107,663** | **184,501** | **553,499** | **18,511** | **15,983** | **63,681** | **90,235** | **1,034,073** |
| Collective impairment | **135,301** | **152,644** | **239,104** | **228,581** | **115,939** | **165,146** | **261,358** | **1,298,073** |
| | **242,964** | **337,145** | **792,603** | **247,092** | **131,922** | **228,827** | **351,593** | **2,332,146** |
| Gross amount of loans individually impaired, before deducting any individually assessed impairment allowance | **2,153,251** | **1,275,268** | **1,978,666** | **108,508** | **59,779** | **63,681** | **398,850** | **6,038,003** |

| In thousand Armenian drams | Manufacture | Const-ruction | Trading | Consumer | Agriculture | Mort-gage | Other | 2010 Total |
|---|---|---|---|---|---|---|---|---|
| At 1 January 2010 | 50,637 | 193,050 | 342,270 | 124,676 | 39,287 | 166,427 | 161,640 | 1,077,987 |
| Charge for the year | 155,948 | 157,158 | 387,746 | 211,566 | 121,612 | 250,044 | 207,203 | 1,491,277 |
| Amounts written off | (32,377) | (82,677) | (186,219) | (262,730) | (107,049) | (280,476) | (59,417) | (1,010,945) |
| Recoveries | - | - | 50,150 | 36,912 | - | - | 10,642 | 97,704 |
| At 31 December 2010 | 174,208 | 267,531 | 593,947 | 110,424 | 53,850 | 135,995 | 320,068 | 1,656,023 |
| Individual impairment | 66,425 | 79,602 | 476,717 | 36,269 | 20,275 | 23,322 | 119,318 | 821,928 |
| Collective impairment | 107,783 | 187,929 | 117,230 | 74,155 | 33,575 | 112,673 | 200,750 | 834,095 |
| | 174,208 | 267,531 | 593,947 | 110,424 | 53,850 | 135,995 | 320,068 | 1,656,023 |
| Gross amount of loans individually impaired, before deducting any individually assessed impairment allowance | 157,688 | 570,829 | 986,717 | 164,439 | 62,480 | 134,281 | 292,600 | 2,369,034 |

Loans and advances by customer profile may be specified as follows:

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| State owned enterprises | **423,422** | 1,279,972 |
| Privately held companies | **80,706,744** | 56,239,529 |
| Individuals | **25,805,414** | 17,550,574 |
| Sole proprietors | **2,571,394** | 2,437,496 |
| Non-profit organizations | **1,567,131** | 1,353,700 |
| | **111,074,105** | 78,861,271 |
| Less allowance for loan impairment | **(2,332,146)** | (1,656,023) |
| **Total loans and advances to customers** | **108,741,959** | 77,205,248 |

Loans to individuals comprise the following products:

| In thousand Armenian drams | 2011 | 2010 |
|---|---|---|
| Agriculture | **1,708,368** | 1,175,922 |
| Car loans | **406,795** | 436,391 |
| Mortgage | **12,828,743** | 9,013,346 |
| Consumer | **6,683,443** | 4,744,774 |
| Other | **4,178,065** | 2,180,141 |
| **Total loans and advances to individuals (gross)** | **25,805,414** | 17,550,574 |

The Bank accepted securities as collateral for commercial loans, which is permitted to sell or repledge.

Fair value of assets pledged and carrying value of loans under reverse repurchase agreements as of 31 December 2011 are presented as follows:

| In thousand Armenian drams | 2011 | | 2010 | |
|---|---|---|---|---|
| | **Fair value of collateral** | **Carrying value of loans** | Fair value of collateral | Carrying value of loans |
| Securities issued by the Ministry of Finance of RA | **10,735,064** | **10,788,335** | 8,552,242 | 9,135,448 |
| **Total assets pledged and loans under reverse repurchase agreements** | **10,735,064** | **10,788,335** | 8,552,242 | 9,135,448 |

As of 31 December 2011 out of total accepted securities AMD 10,173,850 thousand (2010: AMD 7,362,308 thousand) were repledged or lent to third parties for periods not exceeding one month from the transfer (Note 24).

At 31 December 2011 and at 31 December 2010 the estimated fair value of loans and advances to customers approximates it carrying value. Refer to Note 31.

Credit, currency, liquidity and interest rate analyses of loans and advances to customers are disclosed in Note 33. The information on related party balances is disclosed in Note 30.

Maturity analysis of loans and advances to customers is disclosed in Note 32.

## 18 Investment securities

| | **As of December 31, 2011** | | | As of December 31, 2010 | | |
|---|---|---|---|---|---|---|
| In thousand Armenian drams | **Available-for-sale** | **Held-to-maturity** | **Total** | Available-for-sale | Held-to-maturity | Total |
| **Unquoted investments** | | | | | | |
| Shares of Armenian companies | **10,093** | **-** | **10,093** | 12,045 | - | 12,045 |
| Securities issued by the Ministry of Finance of Armenia | **790,836** | **-** | **790,836** | 2,003,064 | - | 2,003,064 |
| Corporate bonds | **-** | **51,304** | **51,304** | - | 51,805 | 51,805 |
| Promissory notes | **18,234** | **-** | **18,234** | - | - | - |
| **Total investments** | **819,163** | **51,304** | **870,467** | 2,015,109 | 51,805 | 2,066,914 |

All debt securities have fixed coupons.

The Bank has not reclassified any financial assets measured at amortised cost rather than fair value during the year (2010: either).

The fair value of unquoted available-for-sale debt securities is measured using a valuation technique, which uses current market rates to discount future cash flows of the financial instruments.

All unquoted available-for-sale equity shares are recorded at cost since its fair value cannot be reliably estimated. There is no quoted market on these investments and the Bank intends to hold them for a long term.

Available for sale debt securities by effective interest rates and maturity dates comprise:

| In thousand Armenian drams | **2011** | | 2010 | |
|---|---|---|---|---|
| | **%** | **Maturity** | % | Maturity |
| Securities issued by the Ministry of Finance of Armenia | **13,1%** | **2014-2015** | 7.5-13.5% | 2011-2028 |
| Promissory notes | **8,5%** | **2012** | - | - |

Available for sale debt securities at fair value in the amount of AMD 6,050,120 thousand (2010: AMD 2,431,251 thousand) were sold to third parties on reverse repurchase agreements for periods not exceeding one month. These securities were classified as securities pledged under repurchase agreements on the face of the balance sheet (Note 27).

Held-to-maturity investments

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| Nominal value | **49,923** | 50,000 |
| Accrued interest | **1,381** | 1,805 |
| **Total investments held to maturity** | **51,304** | 51,805 |

Held-to-maturity securities upon profitability and maturity terms:

| In thousand Armenian drams | **2011** | | 2010 | |
|---|---|---|---|---|
| | **%** | **Maturity** | % | Maturity |
| Corporate bonds | **12%** | **2013** | 11% | 2011 |

## 19 Property, plant and equipment

| In thousand Armenian drams | Land and buildings | Machinery and equipment | Vehicles | Fixtures and fittings | Assets under construction | Lease-hold improve-ments | Other | Total |
|---|---|---|---|---|---|---|---|---|
| **COST** | | | | | | | | |
| Cost at January 1, 2010 | 1,688,474 | 1,566,771 | 223,261 | 260,641 | 1,283,259 | 75,267 | 329,633 | 5,427,306 |
| Additions | 3,086,156 | 145,862 | 35,679 | 39,286 | 275,301 | 12,571 | 118,258 | 3,713,113 |
| Disposals | - | (13,751) | - | (5,252) | - | (64,336) | (28,273) | (111,612) |
| Reclassifications | 1,469,914 | - | - | - | (1,469,914) | - | - | - |
| **At December 31, 2010** | **6,244,544** | **1,698,882** | **258,940** | **294,675** | **88,646** | **23,502** | **419,618** | **9,028,807** |
| Additions | **883,418** | **858,745** | **163,839** | **77,401** | **296,872** | **5,494** | **196,965** | **2,482,734** |
| Disposals | **-** | **(20,792)** | **(21,768)** | **-** | **-** | **-** | **(82,517)** | **(125,077)** |
| **At December 31, 2011** | **7,127,962** | **2,536,835** | **401,011** | **372,076** | **385,518** | **28,996** | **534,066** | **11,386,464** |
| **DEPRECIATION** | | | | | | | | |
| At January 1, 2010 | 117,393 | 432,115 | 89,157 | 42,081 | - | 41,838 | 69,198 | 791,782 |
| Depreciation charge | 122,016 | 307,293 | 54,103 | 56,700 | - | 30,132 | 66,825 | 637,069 |
| Disposals | - | (7,841) | - | (1,220) | - | (63,640) | (4,106) | (76,807) |
| **At December 31, 2010** | **239,409** | **731,567** | **143,260** | **97,561** | **-** | **8,330** | **131,917** | **1,352,044** |
| Depreciation charge | **205,557** | **371,931** | **58,875** | **59,805** | **-** | **7,254** | **102,891** | **806,313** |
| Disposals | **-** | **(20,441)** | **(20,755)** | **-** | **-** | **-** | **(30,083)** | **(71,279)** |
| **At December 31, 2011** | **444,966** | **1,083,057** | **181,380** | **157,366** | **-** | **15,584** | **204,725** | **2,087,078** |
| **CARRYING VALUE** | | | | | | | | |
| **At December 31, 2011** | **6,682,996** | **1,453,778** | **219,631** | **214,710** | **385,518** | **13,412** | **329,341** | **9,299,386** |
| At December 31, 2010 | 6,005,135 | 967,315 | 115,680 | 197,114 | 88,646 | 15,172 | 287,701 | 7,676,763 |
| At December 31, 2009 | 1,571,081 | 1,134,656 | 134,104 | 218,560 | 1,283,259 | 33,429 | 260,435 | 4,635,524 |

As at 31 December 2011 and 2010, the Bank does not possess any fixed assets pledged as security for liabilities or whose title is otherwise restricted.

*Assets under construction*

As at the reporting period the Bank's assets under construction are the following.

- In 2008 the Bank has acquired land on Sarkavag Street, Yerevan with the purpose of opening a branch, for AMD 17,920 thousand and the building on the land is under the construction. The costs for completion of the construction are estimated at the amount of AMD 24,188 thousand. The works are expected to be completed within the next twelve months.

- In 2011 the Bank has acquired administrative building on 2/15 Getapnya Street, in Dilijan for AMD 120,000 thousand which is under the construction. The costs for completion of the construction are estimated at the amount of AMD 1,868 thousand. The works are expected to be completed within the next twelve months.

- In 2011 the Bank has acquired administrative building on 77/60 Raffi Street, Yerevan for AMD 79,750 thousand which is under the construction. The costs for completion of the construction are estimated at the amount of AMD 1,014 thousand. The works are expected to be completed within the next twelve months.

- In 2011 the Bank has acquired administrative building on Vazgen Sargsyan Street, in NKR Stepanakert for AMD 250,000 thousand which is under the construction. The costs for completion of the construction are estimated at the amount of AMD 21,193 thousand. The works are expected to be completed within the next twelve months.

*Fully depreciated items*

As at 31 December 2011 fixed assets included fully depreciated assets at cost in the amount of AMD 87,057 thousand (2010: AMD 52,166 thousand).

*Fixed assets in the phase of installation*

As at 31 December 2011 fixed assets included assets in the phase of installation in the amount of AMD 527,736 thousand (2010: AMD 90,996 thousand), which are not amortized and are classified in accordance with their type.

*Capital commitments*

The bank has capital commitments on the construction of branches. The amount of AMD 48,263 thousand is required for the completion of the mentioned construction. The Bank has already provided the required amounts for completion of the construction.

## 20 Intangible assets

| In thousand Armenian drams | Licenses | Acquired software licenses | Other | Total |
|---|---|---|---|---|
| **COST** | | | | |
| At January 1, 2010 | 138,905 | 51,051 | 61,957 | 251,913 |
| Additions | 50,305 | 3,708 | - | 54,013 |
| Disposals | - | (60) | - | (60) |
| **At December 31, 2010** | **189,210** | **54,699** | **61,957** | **305,866** |
| Additions | **63,000** | **102,493** | **14,219** | **179,712** |
| **At December 31, 2011** | **252,210** | **157,192** | **76,176** | **485,578** |
| **AMORTISATION** | | | | |
| At January 1, 2010 | 28,872 | 13,985 | 12,105 | 54,962 |
| Amortisation charge | 25,195 | 6,720 | 5,968 | 37,883 |
| Disposals | - | (60) | - | (60) |
| **At December 31, 2010** | **54,067** | **20,645** | **18,073** | **92,785** |
| Amortisation charge | **11,647** | **11,629** | **5,268** | **28,544** |
| **At December 31, 2011** | **65,714** | **32,274** | **23,341** | **121,329** |
| **CARRYING VALUE** | | | | |
| **At December 31, 2011** | **186,496** | **124,918** | **52,835** | **364,249** |
| At December 31, 2010 | 135,143 | 34,054 | 43,884 | 213,081 |
| At December 31, 2009 | 110,033 | 37,066 | 49,852 | 196,951 |

As at 31 December 2011 and 2010, the Bank does not possess any intangible assets pledged as security for liabilities or whose title is otherwise restricted.

## 21 Other assets

| In thousand Armenian drams | As of December 31, 2011 | As of December 31, 2010 |
|---|---|---|
| Amounts receivable from the sale of securities | **12,467,143** | 9,388,000 |
| Prepayments and other debtors | **356,765** | 609,435 |
| Amounts receivable | **355,730** | 363,541 |
| Other assets | **47,050** | 61,794 |
| | **13,226,688** | 10,422,770 |
| Less allowance for impairment | **(292,444)** | (132,208) |
| | **12,934,244** | 10,290,562 |
| Prepaid income taxes | **-** | 17,758 |
| Materials | **111,067** | 33,546 |
| Other | **434** | 434 |
| **Total other assets** | **13,045,745** | 10,342,300 |

Amounts receivable from the sale of securities was formed as a result of sale of securities by the Bank with deferred payment terms to several non-resident Companies during 2011. The accounts receivable was recognized at the time of sale measured at fair value of securities. The difference between the fair value and nominal value of cash flow receivable by the contract amounted to AMD 2,328,515 thousand, of which AMD 2,028,794 thousand (2010: AMD 242,077 thousand) was recognized as interest income in 2011 and is included in Note "Interest and similar income" in the section "Loans and advances to customers" (Note 6).

Management of the Bank is confident that the mentioned receivable will be recovered within the contractual terms and concentration will not jeopardize financial position of the Bank in the future.

Reconciliation of allowance account for losses on other assets is as follows:

| In thousand Armenian drams | Total |
|---|---|
| **At January 1, 2010** | 104,433 |
| Charge for the year | 86,862 |
| Amounts written off | (60,644) |
| Recoveries | 1,557 |
| **At December 31, 2010** | **132,208** |
| Charge for the year | **287,541** |
| Amounts written off | **(130,505)** |
| Recoveries | **3,200** |
| **At December 31, 2011** | **292,444** |

## 22 Amounts due to the CBA

| In thousand Armenian drams | As of December 31, 2011 | As of December 31, 2010 |
|---|---|---|
| Loans | **2,896,105** | 1,466,723 |
| Loans under repurchase agreements | **5,788,418** | - |
| Subordinate debt | **8,479,517** | 8,479,517 |
| **Total amounts due to the CBA** | **17,164,040** | 9,946,240 |

Obligations of CBA include loans received within the scope of "Housing finance" loan project of German-Armenian fund.

Subordinate debt was received from the CBA during 2009 with a maturity term of 5 years and 7.5% of annual interest rate.

The Bank has not had any defaults of principal, interest or other breaches with respect to its liabilities during the period (2010: either).

## 23 Amounts due to other financial institutions

| In thousand Armenian drams | **As of December 31, 2011** | As of December 31, 2010 |
|---|---|---|
| Correspondent accounts of other banks | **342** | 804,321 |
| Current accounts of other financial institutions | **110,806** | 218,274 |
| Loans and deposits from financial institutions | **8,352,332** | 8,780,861 |
| Loans from other financial institutions | **13,819,551** | 9,673,221 |
| Loans under repurchase agreements | **258,601** | 2,396,256 |
| **Total amounts due to financial institutions** | **22,541,632** | **21,872,933** |

All deposits from financial institutions have fixed interest rates.

The Bank has not had any defaults of principal, interest or other breaches (2010: either).

As of 31 December 2011 the effective interest rates on amounts due to financial institutions ranged from 2.7% to 12.2% for borrowings in AMD (2010: from 4.1% to 9.4%) and from 2% to 10.5% for borrowings in USD, EUR and other freely convertible currencies (2010: from 3.1% to 12.7%).

## 24 Financial liabilities held for trading

| In thousand Armenian drams | **As of December 31, 2011** | As of December 31, 2010 |
|---|---|---|
| Securities received from other non-resident institutions (Note 17) | **10,173,850** | 7,362,308 |
| **Total financial liabilities held for trading** | **10,173,850** | 7,362,308 |

## 25 Amounts due to customers

| In thousand Armenian drams | **As of December 31, 2011** | As of December 31, 2010 |
|---|---|---|
| **Government of the RA** | | |
| Current/Settlement accounts | **164,902** | 67,674 |
| Loans received from the RA government | **5,626,682** | 6,405,143 |
| | **5,791,584** | 6,472,817 |
| **Corporate customers** | | |
| Current/Settlement accounts | **31,028,814** | 15,643,444 |
| Time deposits | **6,893,096** | 6,894,469 |
| | **37,921,910** | 22,537,913 |

| In thousand Armenian drams | **As of December 31, 2011** | As of December 31, 2010 |
|---|---|---|
| **Retail customers** | | |
| Current/Demand accounts | **3,348,553** | 2,483,706 |
| Time deposits | **47,166,801** | 28,581,463 |
| | **50,515,354** | 31,065,169 |
| **Total amounts due to customers** | **94,228,848** | 60,075,899 |

All customer deposits carry fixed interest rates.

Loans received from the RA Government include loans received from "Millennium Challenge Account - Armenia", "Rural finance facility-Project Implementation Unit State Institution" and within the scope of "Small and medium business loan project"and "Housing Finance Loan program" of German-Armenian Fund in the amount of AMD 5,586,784 thousand (2010: AMD 6,405,143 thousand, as well as time deposits placed by the Ministry of Finance of the Republic of Nagorno Karabagh in the amount of AMD 800,131 thousand).

As at 31 December 2011 included in current accounts of corporate customers are deposits amounting to AMD 55,351 thousand (2010: AMD 24,517 thousand, and AMD 21,996 thousand held as security against letters of credit issued and guarantees issued). The fair value of those deposits approximates the carrying amount.

At 31 December 2011 the aggregate balance of top ten customers of the Bank (including relating parties, see Note 30) amounts to AMD 19,938,301 thousand (2010: AMD 17,940,643 thousand) or 36% of total customer accounts (2010: 30%).

There is a material concentration related to the Bank's shareholders and organizations collaborating with them amounting to AMD 19,950,246 thousand (2010: AMD 6,268,897 thousand) or 21.2% of total customer borrowings (2010: 10.4%).

As of 31 December 2011 the effective interest rates on amounts due to customers ranged from 3% to 13.2% for amounts attracted in AMD (2010: from 3% to 13%) and from 3% to 11.1% for amounts attracted in USD, EUR and other freely convertible currencies (2010: from 1.4% to 11.1%)

## 26 Other liabilities

| In thousand Armenian drams | **As of December 31, 2011** | As of December 31, 2010 |
|---|---|---|
| Accounts payables | **59,698** | 38,715 |
| Tax payable, other than income tax | **89,403** | 138,461 |
| Revenues of future periods | **40,234** | 6,191 |
| Grants related to assets | **2,201** | 2,283 |
| Due to personnel | **74,700** | 54,020 |
| Other | **15** | 14,275 |
| **Total other liabilities** | **266,251** | 253,945 |

### Grants related to assets

| In thousand Armenian drams | As of December 31, 2011 | As of December 31, 2010 |
|---|---|---|
| At January 1 | **2,283** | 2,365 |
| Recognised as income (Note 9) | **(82)** | (82) |
| **At December 31** | **2,201** | 2,283 |

## 27 Securities pledged under repurchase agreements

| In thousand Armenian drams | Asset | | Liability | |
|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 |
| Investment securities (Note 18, 22, 23) | **6,050,120** | 2,431,251 | **6,047,019** | 2,396,256 |
| | **6,050,120** | 2,431,251 | **6,047,019** | 2,396,256 |

## 28 Equity

As at 31 December 2011 the Bank's registered and paid-in share capital was AMD 17,500,000 thousand. In accordance with the Bank's statues, the share capital consists of 35,000 shares, all of which have a par value of AMD 500 thousand each.

The respective shareholdings as at 31 December 2011 and 2010 may be specified as follows:

| In thousand Armenian drams | **2011** | | 2010 | |
|---|---|---|---|---|
| | **Paid-in share capital** | **% of total paid-in capital** | Paid-in share capital | % of total paid-in capital |
| "Ukrprombank" LLC | **-** | **-** | 1,750,000 | 13 |
| "Christy Management" Inc. | **17,500,000** | **100** | 11,700,000 | 87 |
| | **17,500,000** | **100** | 13,450,000 | 100 |

As at 31 December 2011, the Bank did not possess any of its own shares.

The holders of ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at annual and general meetings of the Bank.

In 2011 the shareholders of the Bank increased its share capital by AMD 4,050,000 thousand.

The share capital of the Bank was contributed by the shareholder in Armenian Drams and he is entitled to dividends and any capital distribution in Armenian Drams.

Distributable among shareholders reserves equal the amount of retained earnings calculated in accordance with the RA legislation. Non-distributable reserves are represented by a reserve fund, which is created as required by the statutory regulations, in respect of general banking risks, including future losses and other unforeseen risks or contingencies. The reserve has been created in accordance with the Bank’s statutes that provide for the creation of a reserve for these purposes of not less than 5% of the Bank’s net profit of the previous year reported in statutory books.

## 29 Contingent liabilities and commitments

*Tax and legal matters*

The taxation system in Armenia is characterized by frequently changing legislation, which is often unclear, contradictory and subject to interpretation. Often, differing interpretations exist among various taxation authorities and jurisdictions.

Often tax authorities claim additional taxes for transactions and accounting methods, for which they did not claim previously. As a result additional fines and penalties could arise. Tax review can include 3 calendar years immediately preceding the year of a review. In certain circumstances tax review can include earlier periods.

Management believes that the Bank has complied with all regulations and has completely settled all its tax liabilities.

Management also believes that the ultimate liability, if any, arising from legal actions and complaints taken against the Bank, will not have a material adverse impact on the financial condition or results of future operations of the Bank.

*Loan commitment, guarantee and other financial facilities*

In the normal course of business, the Bank is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the balance sheet.

As of 31 December the nominal or contract amounts were:

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| Undrawn loan commitments | **2,966,317** | 4,775,052 |
| Guarantees | **14,411,808** | 21,650,979 |
| Letters of credit | **-** | 21,966 |
| **Total commitments and contingent liabilities** | **17,378,125** | 26,447,997 |

The maximum exposure to credit risk of Loan commitments, guarantee and other financial facilities is best represented by the total amount of these commitments and contingent liabilities.

*Operating lease commitments – Bank as a lessee*

In the normal course of business the Bank enters into commercial lease agreements for buildings and premises.

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| Not later than 1 year | **33,096** | 24,036 |
| Later than 1 year and not later than 5 years | **92,211** | 59,667 |
| **Total operating lease commitments** | **125,307** | 83,703 |

### *Capital commitments*

The bank has capital commitments regarding the construction of the branches. For the completion of the mentioned construction AMD 48,263 thousand will be required from the Bank. The Bank has already allocated the necessary resources for the completion of the construction.

### *Insurance*

The insurance industry in Armenia is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Bank does not have full coverage for business interruption, or for third party liability in respect of property or environmental damage arising from accidents on Bank property or relating to Bank operations. Until the Bank obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Bank's operations and financial position.

Starting from 2005 the Bank is a member of the obligatory deposit insurance system. The system operates under the Armenian laws and regulations and is governed by the Law on Guarantee of Physical Persons Deposits. Insurance covers Bank's liabilities to individual depositors for the amount up to AMD 4,000 thousand (up to AMD 2,000 thousand for deposits in foreign currency) for each individual in case of business failure and revocation of the banking license.

## 30 Transactions with related parties

In accordance with IAS 24 *Related Party Disclosures*, parties are considered to be related if one party has ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. For the purpose of the present financial statements, related parties include shareholders, members of Bank's Management as well as other persons and enterprises related with and controlled by them respectively.

The ultimate controlling party of the Bank is the resident of the Russian Federation Vitaly Grigoriyants.

A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits and other transactions.

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

| In thousand Armenian drams | **2011** | | 2010 | |
|---|---|---|---|---|
| | **Shareholders** | **Key management personnel** | Shareholders | Key management personnel |
| ***Loans and advances to customers*** | | | | |
| Loans outstanding at January 1, gross | **32,225** | **2,538,207** | 230,342 | 1,321,736 |
| Loans issued during the year | **131,598** | **25,959,850** | 213,027 | 4,998,033 |
| Loan repayments during the year | **(107,160)** | **(19,076,621)** | (411,144) | (3,781,562) |
| Loans outstanding at December 31, gross | **56,663** | **9,421,436** | 32,225 | 2,538,207 |
| Less: allowance for loan impairment | **(567)** | **(94,214)** | (322) | (25,382) |
| **Loans outstanding at December 31** | **56,096** | **9,327,222** | 31,903 | 2,512,825 |
| Interest income on loans | **10,837** | **411,142** | 38,852 | 176,983 |
| Impairment charge/ (reversal) | **245** | **68,832** | (1,981) | 2,858 |
| ***Amounts due to customers*** | | | | |
| Deposits at January 1 | **22,355** | **6,198,527** | 9,844 | 6,838,699 |
| Deposits received during the year | **9,498,078** | **173,022,986** | 1,732,203 | 82,825,815 |
| Deposits repaid during the year | **(9,513,717)** | **(179,091,883)** | (1,719,692) | (83,465,987) |
| **Deposits at December 31** | **6,716** | **129,630** | 22,355 | 6,198,527 |
| Interest expense on deposits | **153** | **6,680** | 623 | 401,727 |
| **Amounts due from other financial institutions** | | | | |
| Balance at January 1 | **18,020** | **-** | 1,105 | - |
| Increase | **1,876** | **-** | 39,409 | - |
| Decrease | **(19,896)** | **-** | (22,494) | - |
| **Balance at December 31** | **-** | **-** | 18,020 | - |
| ***Amounts due to financial institutions*** | | | | |
| At January 1 | **181,278** | **-** | **466,934** | **1,973** |
| Increase | **887,798** | **-** | **3,702,229** | **208** |
| Decrease | **(1,069,076)** | **-** | **(3,987,885)** | **(2,181)** |
| **At December 31** | **-** | **-** | **181,278** | **-** |
| Interest expenses | **613** | **-** | **16,763** | **208** |
| ***Comprehensive Income statement items*** | | | | |
| Commission income | **9** | **6,556** | 14 | 437 |
| Other income | **-** | **4,285** | 2,701 | 29,806 |
| Other operating expenses | **8** | **82** | - | - |

Compensation of key management personnel was comprised of the following:

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| Salaries and other short-term benefits | **218,123** | 171,918 |
| Social security costs | **20,158** | 15,893 |
| **Total key management compensation** | **238,281** | 187,811 |

The loans issued to directors and other key management personnel (and close family members) during the year are repayable over fifteen years and have interest rates of 11.8% (2010: 11%). The loans advanced to the directors during the year are collateralised by loan guarantees in the amount of AMD 91,109 thousand, real estate in the amount of AMD 375,500 thousand and salary (2010: loan guarantees in the amount of AMD 134,327 thousand, real estate in the amount of AMD 1,184,270 thousand and salary).

## 31 Fair value of financial instruments

*Financial instruments not measured at fair value*

The fair value of financial assets and liabilities, not presented on the balance sheet at their fair value, are presented below with their carrying values:

| In thousand Armenian drams | 2011 | | 2010 | |
|---|---|---|---|---|
| | Carrying value | Fair value | Carrying value | Fair value |
| **FINANCIAL ASSETS** | | | | |
| Cash and balances with CBA | **19,611,767** | **19,611,767** | 13,046,849 | 13,046,849 |
| Amounts due from other financial institutions | **5,346,819** | **5,346,819** | 1,688,133 | 1,688,133 |
| Loans and advances to customers | **108,741,959** | **108,741,959** | 77,205,248 | 77,205,248 |
| Investments held to maturity | **51,304** | **51,270** | 51,805 | 51,775 |
| Other assets | **12,467,143** | **12,467,143** | 9,388,000 | 9,388,000 |
| **FINANCIAL LIABILITIES** | | | | |
| Amounts due to the CBA | **17,164,040** | **17,164,040** | 9,946,240 | 9,946,240 |
| Amounts due to financial institutions | **22,541,632** | **22,541,632** | 21,872,933 | 21,872,933 |
| Amounts due to customers | **94,228,848** | **94,228,848** | 60,075,899 | 60,075,899 |

*Amounts due from and to financial institutions and the CBA*

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

*Loans and advances to customers*

The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on credit risk of the counterparty and ranged from 6% to 24% per annum and usually approximate current interest rates.

*Investment securities held to maturity*

Market values have been used to determine the fair value of investment securities held-to-maturity traded on an active market. For securities that are not traded on an active market, the fair value was estimated as the present value of estimated future cash flows discounted at the year-end market rates.

*Other borrowings*

The estimated fair value of fixed interest-bearing deposits and other borrowings not quoted in an active market is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

*Other assets, liabilities and borrowings*

The estimated fair value of fixed interest-bearing deposits and other borrowings not quoted in an active market is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

## 31.1 Fair value hierarchy

Financial assets and liabilities measured at fair value in the statement of financial position are presented in accordance with the fair value hierarchy. This hierarchy groups financial assets and liabilities into three levels based on the significance of inputs used in measuring the fair value of the financial assets and liabilities. The fair value hierarchy has the following levels:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset and liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

| In thousand Armenian drams | | | | 2011 | | | | 2010 |
|---|---|---|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| **FINANCIAL ASSETS** | | | | | | | | |
| Unquoted securities issued by the Ministry of Finance of Armenia | **-** | **6,859,190** | **-** | **6,859,190** | - | 4,434,315 | - | 4,434,315 |
| Derivative financial assets | **-** | **777,215** | **-** | **777,215** | - | 870,584 | - | 870,584 |
| **Total** | **-** | **7,636,405** | **-** | **7,636,405** | - | 5,304,899 | - | 5,304,899 |
| **FINANCIAL LIABILITIES** | | | | | | | | |
| Derivative financial liabilities | **-** | **-** | **-** | **-** | - | 30,425 | - | 30,425 |
| Financial liabilities held for trading | **-** | **10,173,850** | **-** | **10,173,850** | - | 7,362,308 | - | 7,362,308 |
| **Total** | **-** | **10,173,850** | **-** | **10,173,850** | - | 7,392,733 | - | 7,392,733 |
| **NET FAIR VALUE** | **-** | **(2,537,445)** | **-** | **(2,537,445)** | - | (2,087,834) | - | (2,087,834) |

The methods of fair value measurement and valuation technique have not been changed compared with prior reporting period.

*Unquoted equity investments*

The fair value of Bank's investment unquoted equity investments cannot be reliably measured and is therefore excluded from this disclosure. Refer to note 18 for further information about this equity investment.

*Derivatives*

Where derivatives are traded either on exchanges or liquid over-the-counter market the Bank uses the closing price at the reporting date.

Normally, the derivatives entered into by the Bank are not traded in active markets. The fair values of these contracts are estimated using valuation techniques that maximises the use of observable market inputs, eg. market exchange rates (Level 2). Most derivatives entered into by the Bank are included in Level 2 and consist of foreign currency swap contracts.

## 32 Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities analyzed according to when they are expected to be recovered or settled. See Note 33.3 for the Bank's contractual undiscounted repayment obligations.

| thousand Armenian drams | | | | | | | | 2011 |
|---|---|---|---|---|---|---|---|---|
| | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | Subtotal less than 12 months | From 1 to 5 years | More than 5 years | Subtotal over 12 months | Total |
| **SETS** | | | | | | | | |
| sh and balances with CBA | 19,611,767 | - | - | *19,611,767* | - | - | - | 19,611,767 |
| nounts due from other ancial institutions | 5,270,247 | - | 76,572 | *5,346,819* | - | - | - | 5,346,819 |
| rivative financial truments | 335,755 | 441,460 | - | *777,215* | - | - | - | 777,215 |
| ans and advances to stomers | 13,628,547 | 15,734,697 | 32,662,184 | *62,025,428* | 38,286,377 | 8,430,154 | *46,716,531* | 108,741,959 |
| estments available for sale | - | - | 38,929 | *38,929* | 770,141 | 10,093 | *780,234* | 819,163 |
| estments held to maturity | - | - | 26,342 | *26,342* | 24,962 | - | *24,962* | 51,304 |
| curities pledged under ourchase agreements | - | - | 106,344 | *106,344* | 685,454 | 5,258,322 | *5,943,776* | 6,050,120 |
| her assets | 4,129,067 | 8,338,076 | - | *12,467,143* | - | - | - | 12,467,143 |
| | 42,975,383 | 24,514,233 | 32,910,371 | *100,399,987* | 39,766,934 | 13,698,569 | *53,465,503* | 153,865,490 |
| **ABILITIES** | | | | | | | | |
| nounts due to the CBA | 7,760,437 | 306 | 43,535 | *7,804,278* | 9,314,845 | 44,917 | *9,359,762* | 17,164,040 |
| nounts due to financial titutions | 7,200,000 | 252,250 | 616,016 | *8,068,266* | 14,473,366 | - | *14,473,366* | 22,541,632 |
| nounts due to customers | 39,280,654 | 12,782,970 | 36,111,474 | *88,175,098* | 1,150,566 | 4,903,184 | *6,053,750* | 94,228,848 |
| ancial liabilities held for ding | 10,173,850 | - | - | *10,173,850* | - | - | - | 10,173,850 |
| | 64,414,941 | 13,035,526 | 36,771,025 | *114,221,492* | 24,938,777 | 4,948,101 | *29,886,878* | 144,108,370 |
| **t position** | (21,439,558) | 11,478,707 | (3,860,654) | *(13,821,505)* | 12,828,157 | 8,750,468 | *23,578,625* | 9,757,120 |
| **cumulated gap** | *(21,439,558)* | (9,960,851) | (13,821,505) | | 1,006,652 | 9,757,120 | | |

| thousand Armenian drams | | | | | | | | 2010 |
|---|---|---|---|---|---|---|---|---|
| | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | Subtotal less than 12 months | From 1 to 5 years | More than 5 years | Subtotal over 12 months | Total |
| **SETS** | | | | | | | | |
| sh and balances with CBA | 13,046,849 | - | - | *13,046,849* | - | - | - | 13,046,849 |
| nounts due from other ancial institutions | 1,666,387 | 21,746 | - | *1,688,133* | - | - | - | 1,688,133 |
| rivative financial assets | - | 870,584 | - | *870,584* | - | - | - | 870,584 |
| ans and advances to stomers | 4,942,636 | 5,540,126 | 28,878,855 | *39,361,617* | 25,221,212 | 12,622,419 | *37,843,631* | 77,205,248 |
| estments available for sale | - | - | 697,318 | *697,318* | 1,229,304 | 88,487 | *1,317,791* | 2,015,109 |
| estments held to maturity | - | - | 51,805 | *51,805* | - | - | - | 51,805 |
| curities pledged under ourchase agreement | - | - | - | - | 478,342 | 1,952,909 | *2,431,251* | 2,431,251 |
| her assets | - | 914,121 | 8,473,879 | *9,388,000* | - | - | - | 9,388,000 |
| | 19,655,872 | 7,346,577 | 38,101,857 | *65,104,306* | 26,928,858 | 14,663,815 | *41,592,673* | 106,696,979 |
| **ABILITIES** | | | | | | | | |
| nounts due to the CBA | 36,480 | 3,180 | 25,265 | *64,925* | 9,881,315 | - | *9,881,315* | 9,946,240 |
| nounts due to financial titutions | - | 30,425 | - | *30,425* | - | - | - | 30,425 |
| rivative financial liabilities | 7,069,728 | 3,174,306 | 2,116,552 | *12,360,586* | 4,260,639 | 5,251,708 | *9,512,347* | 21,872,933 |
| nounts due to customers | 18,165,201 | 18,898,095 | 17,589,033 | *54,652,329* | 2,878,066 | 2,545,504 | *5,423,570* | 60,075,899 |
| ancial liabilities held for ding | - | 7,362,308 | - | *7,362,308* | - | - | - | 7,362,308 |
| | 25,271,409 | 29,468,314 | 19,730,850 | *74,470,573* | 17,020,020 | 7,797,212 | *24,817,232* | 99,287,805 |
| **t position** | (5,615,537) | (22,121,737) | 18,371,007 | *(9,366,267)* | 9,908,838 | 6,866,603 | *16,775,441* | 7,409,174 |
| **cumulated gap** | (5,615,537) | (27,737,274) | (9,366,267) | | 542,571 | 7,409,174 | | |

## 33 Risk management

The Bank’s activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks.

Risk is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank’s continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank’s [Group’s] strategic planning process.

*Risk management structure*
The Board of the Bank is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

*Board of the Bank*
The Board of the Bank is responsible for the overall risk management approach and for approving the risk strategies and principles.

*Management Board*

The Management Board has the responsibility to monitor the overall risk process within the Bank .

*Risk management committee and Risk management and planning department*

The risk management committee and the Risk management and planning department of the Bank have the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. They are responsible for the fundamental risk issues and manage and monitor relevant risk decisions. As well as they are responsible for implementing and maintaining risk related procedures to ensure an independent control process.

The Risk management and planning department ensures the complete capture of the risks in risk measurement and reporting systems.

*Bank Treasury*

Bank Treasury is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the liquidity risk of the Bank.

*Internal audit*

Risk management processes throughout the Bank are audited annually by the internal audit function, that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management.

*Risk measurement and reporting systems*

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worst case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Risk Management Committee, afterwards to the Management Board. The report includes aggregate credit exposure, credit metric forecasts and hold limit exceptions.

## 33.1 Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Bank by failing to discharge an obligation. Credit risk is the most important risk for the Bank's business; management therefore carefully manages its exposure to credit risk. Credit exposures arise principally in lending activities that lead to loans and advances, and investment activities that bring debt securities and other bills into the Bank's asset portfolio. There is also credit risk in off-balance sheet financial instruments, such as loan commitments. The credit risk management and control are centralised in Risk Management and Planning Department and Risk Management Committee and reported to the Board of Directors regularly.

The carrying amounts of the Bank's financial assets best represent the maximum exposure to credit risk related to them, without taking account of any collateral held or other credit enhancements.

### 33.1.1 Risk concentrations of the maximum exposure to credit risk

*Geographical sectors*

The following table breaks down the Bank's main credit exposure at their carrying amounts, as categorized by geographical region as of 31 December.

| In thousand Armenian drams | Armenia | OECD countries | Other non-OECD countries | Total |
|---|---|---|---|---|
| Cash and balances with CBA | **19,611,767** | **-** | **-** | **19,611,767** |
| Amounts due from other financial institutions | **211,913** | **4,210,283** | **924,623** | **5,346,819** |
| Derivative financial assets | **35,251** | **-** | **741,964** | **777,215** |
| Loans and advances to customers | **88,613,818** | **-** | **20,128,141** | **108,741,959** |
| Investments available for sale | **819,163** | **-** | **-** | **819,163** |
| Investments held to maturity | **51,304** | **-** | **-** | **51,304** |
| Securities pledged under repurchase agreements | **6,050,120** | **-** | **-** | **6,050,120** |
| Other assets | **-** | **-** | **12,467,143** | **12,467,143** |
| **As at 31 December 2011** | **115,393,336** | **4,210,283** | **34,261,871** | **153,865,490** |
| As at 31 December 2010 | 81,451,487 | 1,158,758 | 24,086,734 | 106,696,979 |

Assets have been classified based on the country in which the counterparty is located.

*Industry sectors*

The following table breaks down the Bank's main credit exposure at their carrying amounts, as categorized by the industry sectors of the counterparties as of 31 December.

| thousand rmenian drams | Financial institutions | Manufac-turing | Construction | Trading | Consumer | Agricul ture | Mortgage | Other | Total |
|---|---|---|---|---|---|---|---|---|---|
| ash and balances ith CBA | **19,611,767** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **19,611,767** |
| mounts due from ther financial stitutions | **5,346,819** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **5,346,819** |
| erivative financial ssets | **35,251** | **-** | **-** | **741,964** | **-** | **-** | **-** | **-** | **777,215** |
| oans and dvances to ustomers | **-** | **15,440,365** | **16,202,531** | **24,827,109** | **6,938,212** | **5,667,430** | **13,483,282** | **26,183,030** | **108,741,959** |
| vestments vailable for sale | **819,163** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **819,163** |
| vestments held to aturity | **51,304** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **51,304** |
| ecurities pledged nder repurchase greements | **6,050,120** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **6,050,120** |
| ther assets | **-** | **-** | **-** | **12,467,143** | **-** | **-** | **-** | **-** | **12,467,143** |
| **s at 31 ecember 2011** | **31,914,424** | **15,440,365** | **16,202,531** | **38,036,216** | **6,938,212** | **5,667,430** | **13,483,212** | **26,183,030** | **153,865,490** |
| s at 31 December 010 | 19,209,867 | 8,973,206 | 15,871,386 | 10,186,326 | 5,045,604 | 2,604,042 | 8,923,783 | 35,882,765 | 106,696,979 |

### 33.1.2 Risk limit control and mitigation policies

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 geographical and industry segments.

Such risks are monitored on a revolving basis and subject to an annual or more frequent review, when considered necessary. Limits on the level of credit risk by product, industry sector and by country are approved, in line with changes in Bank’s operating environment, not less than annually, by the Board of Directors.

The exposure to any one borrower including banks and financial organizations is further restricted by sub-limits covering on- and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate.

Some other specific control and mitigation measures are outlined below.

*Collateral*

The Bank employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security for funds advances, which is common practice. The Bank implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Charges over business assets such as premises, inventory and accounts receivable;
- Charges over financial instruments such as debt securities and equities

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured. In addition, in order to minimise the credit loss the Bank will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured.

The analysis of loan portfolio by collateral is represented as follows:

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| Loans collateralized by real estate | **59,818,966** | 51,990,015 |
| Loans collateralized by guarantees of enterprises | **8,378,970** | 5,585,968 |
| Loans collateralized by materials | **8,504,581** | 4,169,122 |
| Loans collateralized by state securities | **10,788,335** | 9,135,448 |
| Loans collateralized by cash or guarantees of the Government | **13,282,941** | 2,876,046 |
| Other collateral | **10,300,312** | 5,104,672 |
| **Total loans and advances to customers (gross)** | **111,074,105** | 78,861,271 |

*Credit-related commitments*

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit carry the same credit risk as loans. Documentary and commercial letters of credit – which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions – are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct loan.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments.

However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

### 33.1.3 Impairment and provisioning policies

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment into areas: individually assessed allowances and collectively assessed allowances.

*Individually assessed allowances*

The Bank determines the allowances appropriate for each individually significant loan or advance on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty’s business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realizable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

*Collectively assessed allowances*

Allowances are assessed collectively for losses on loans and advances that are not significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans and advances where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans.

*Loans and advances neither past due or impaired*

The table below shows the credit quality by class of asset for loans and advances neither past due or impaired, based on the historical counterparty default rates.

| In thousand Armenian drams | **2011** | 2010 |
|---|---|---|
| Loans and advances to customers | | |
| Manufacturing | **1.0%** | 0.1% |
| Construction | **1.0%** | 0.2% |
| Trading | **1.0%** | 0.6% |
| Consumer | **3.2%** | 2.6% |
| Agriculture | **2.0%** | 1.8% |
| Mortgage | **1.2%** | 1.3% |
| Other | **1.0%** | 0.2% |

As of 31 December 2011 and 2010 the Bank has not had any losses on other financial assets bearing credit risk.

*Past due but not impaired loans*

Past due loans and advances include those that are only past due by a few days. The majority of the past due loans are not considered to be impaired. Analysis of past due loans by age and by class is provided below.

| In thousand Armenian drams | **Less than 30 days** | **31 to 60 days** | **61 to 90 days** | **More than 91 days** | **2011 Total** |
|---|---|---|---|---|---|
| Loans and advances to customers | | | | | |
| Manufacturing | **-** | **9,836** | **-** | **1,624,738** | **1,634,574** |
| Construction | **-** | **-** | **-** | **7,054** | **7,054** |
| Trading | **-** | **19,988** | **257,384** | **5,842** | **283,214** |
| Consumer | **7,841** | **39,452** | **-** | **21,538** | **68,831** |
| Agriculture | **30,269** | **64,523** | **78,107** | **37,069** | **209,968** |
| Mortgage | **5,049** | **9** | **26,226** | **-** | **31,284** |
| Other | **13,080** | **885,495** | **766,032** | **33,242** | **1,697,849** |
| **Total** | **56,239** | **1,019,303** | **1,127,749** | **1,729,483** | **3,932,774** |

| In thousand Armenian drams | Less than 30 days | 31 to 60 days | 61 to 90 days | More than 91 days | 2010 Total |
|---|---|---|---|---|---|
| Loans and advances to customers | | | | | |
| Manufacturing | - | - | 30,000 | 127,688 | 157,688 |
| Construction | 548,547 | - | - | 22,282 | 570,829 |
| Trading | 976,776 | 9,941 | - | - | 986,717 |
| Consumer | 35,069 | 19,269 | 10,089 | 100,012 | 164,439 |
| Agriculture | 30,975 | - | 5,326 | 26,179 | 62,480 |
| Mortgage | 81,596 | 11,336 | 9,977 | 31,372 | 134,281 |
| Other | 183,839 | 7,730 | 55 | 100,976 | 292,600 |
| **Total** | 1,856,802 | 48,276 | 55,447 | 408,509 | 2,369,034 |

## 33.2 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates and foreign exchange rates. The Bank classifies exposures to market risk into either trading or non-trading portfolios. The market risk for the trading portfolio is managed and monitored based on a VaR methodology which reflects the interdependency between risk variables. Non-trading positions are managed and monitored using other sensitivity analyses. Except for the concentrations within foreign currency, the Bank has no significant concentration of market risk.

### 33.2.1 Market risk – Non-trading

*Interest rate risk*

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Board of Directors has established limits on the interest rate gaps for stipulated periods. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits.

The following table demonstrates the sensitivity of the income statement to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's income statement.

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2011, including the effect of hedging instruments. The sensitivity of equity is calculated by revaluating fixed rate available-for-sale financial assets, at 31 December 2011 for the effects of the assumed changes in interest rates. The sensitivity of equity is analysed by maturity of the asset or swap. The total sensitivity of equity is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity band displays the sensitivity to non-parallel changes.

In thousand Armenian drams **2011**

| | | Sensitivity of equity | | | | |
|---|---|---|---|---|---|---|
| **Currency** | **Change in basis points** | **Up to 6 months** | **6 months to 1 year** | **1 year to 5 years** | **More than 5 years** | **Total** |
| AMD | **+1** | **-** | **(842)** | **(130,852)** | **(205,953)** | **(337,647)** |
| AMD | **-1** | **-** | **856** | **279,249** | **227,061** | **507,166** |

In thousand Armenian drams 2010

| | | Sensitivity of equity | | | | |
|---|---|---|---|---|---|---|
| Currency | Change in basis points | Up to 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
| AMD | +1 | (110) | (4,423) | (79,062) | (40,925) | (124,520) |
| AMD | -1 | 111 | 4,491 | 89,405 | 45,685 | 139,692 |

*Currency risk*

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board of Directors has set limits on positions by currency. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within established limits.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2011 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculated the effect of a reasonably possible movement of the currency rate against the Armenian dram, with all other variables held constant on the income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities) and other comprehensive income (due to the change in fair value of currency swaps and forward foreign exchange contracts used as cash flow hedges, and equity instruments). A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

| In thousand Armenian drams | 2011 | | 2010 | |
|---|---|---|---|---|
| Currency | Change in currency rate in % | Effect on profit before tax | Change in currency rate in % | Effect on profit before tax |
| USD | **(10)** | **(81,390)** | (10) | 1,079,300 |
| Euro | **(10)** | **400** | (10) | (12) |
| RR | **(10)** | **(4,777)** | (10) | (4,212) |
| USD | **10** | **81,390** | 10 | (1,079,300) |
| Euro | **10** | **(400)** | 10 | 12 |
| RR | **10** | **4,777** | 10 | 4,212 |

The Bank's exposure to foreign currency exchange risk is as follows:

| In thousand Armenian drams | Armenian Dram | Freely convertible currencies | Non-freely convertible currencies | Total |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and balances with the CBA | **12,695,666** | **6,784,978** | **131,123** | **19,611,767** |
| Amounts due from other financial institutions | **-** | **4,609,905** | **736,914** | **5,346,819** |
| Derivative financial assets | **-** | **777,215** | **-** | **777,215** |
| Loans and advances to customers | **55,041,662** | **53,215,516** | **484,781** | **108,741,959** |
| Investments available for sale | **819,163** | **-** | **-** | **819,163** |
| Investments held to maturity | **51,304** | **-** | **-** | **51,304** |
| Securities pledged under repurchase agreements | **6,050,120** | **-** | **-** | **6,050,120** |
| Other assets | **12,467,143** | **-** | **-** | **12,467,143** |
| | **87,125,058** | **65,387,614** | **1,352,818** | **153,865,490** |
| **LIABILITIES** | | | | |
| Amounts due to the CBA | **17,164,040** | **-** | **-** | **17,164,040** |
| Amounts due to financial institutions | **13,987,803** | **8,553,829** | **-** | **22,541,632** |
| Amounts due to customers | **19,544,551** | **73,484,315** | **1,199,982** | **94,228,848** |
| Financial liabilities held for trading | **10,173,850** | **-** | **-** | **10,173,850** |
| | **60,870,244** | **82,038,144** | **1,199,982** | **144,108,370** |
| **Net position as at 31 December 2011** | **26,254,814** | **(16,650,530)** | **152,836** | **9,757,120** |
| **Commitments and contingent liabilities as at 31 December 2011** | **12,218,651** | **5,159,474** | **-** | **17,378,125** |
| Total financial assets | 63,633,023 | 42,470,963 | 592,993 | 106,696,979 |
| Total financial liabilities | 42,990,215 | 55,812,357 | 485,233 | 99,287,805 |
| Net position as at 31 December 2010 | 20,642,808 | (13,341,394) | 107,760 | 7,409,174 |
| Commitments and contingent liabilities as at 31 December 2010 | 17,357,958 | 9,089,963 | 76 | 26,447,997 |

Freely convertible currencies represent mainly US dollar amounts, but also include currencies from other OECD countries. Non-freely convertible amounts relate to currencies of CIS countries, excluding Republic of Armenia.

### 33.3 Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily bases. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains an obligatory minimum reserve deposits with the Central Bank of Armenia equal to 8% of certain obligations of the Bank denominated in Armenian drams and 12% on certain obligations of the Bank denominated in foreign currency. See note 14. The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank.

The liquidity management of the Bank requires considering the level of liquid assets necessary to settle obligations as they fall due; maintaining access to a range of funding sources; maintaining funding contingency plans and monitoring balance sheet liquidity ratios against regulatory requirements. The Bank calculates liquidity ratios in accordance with the requirement of the Central Bank of Armenia.

| | Not audited | |
|---|---|---|
| **As at 31 December, these ratios were as follows:** | **2011, %** | **2010, %** |
| N21- Total liquidity ratio<br>(Highly liquid assets/ Total assets) | **19,28%** | 17,28% |
| H22- Current liquidity ratio<br>(Highly liquid assets /liabilities on demand) | **87,12%** | 100,62% |

Analysis of financial liabilities by remaining contractual maturities.

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2011 based on contractual undiscounted repayment obligations. See note 32 for the expected maturities of these liabilities. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

| In thousand Armenian drams | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | More than 5 years | 2011 Total |
|---|---|---|---|---|---|---|
| **NON-DERIVATIVE FINANCIAL LIABILITIES** | | | | | | |
| Amounts due to the CBA | **7,868,105** | **105,931** | **518,848** | **10,582,345** | **44,917** | **19,120,146** |
| Amounts due to financial institutions | **7,420,015** | **355,122** | **1,106,660** | **16,119,318** | **-** | **25,001,115** |
| Amounts due to customers | **40,251,523** | **12,974,715** | **37,375,376** | **1,254,117** | **5,148,343** | **97,004,074** |
| Financial liabilities held for trading | **10,173,850** | **-** | **-** | **-** | **-** | **10,173,850** |
| **Total undiscounted non-derivative financial liabilities** | **65,713,493** | **13,435,768** | **39,000,884** | **27,955,780** | **5,193,260** | **151,299,185** |
| **Derivative financial liabilities** | | | | | | |
| Currency swap contracts | | | | | | |
| Inflow | **6,750,975** | **-** | **11,506,870** | **-** | **-** | **18,257,845** |
| Outflow | **(6,737,332)** | **-** | **(10,665,427)** | **-** | **-** | **(17,402,759)** |
| **Commitments and contingent liabilities** | **3,754,232** | **2,574,706** | **5,304,167** | **5,745,020** | **-** | **17,378,125** |

| In thousand Armenian drams | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | More than 5 years | 2010 Total |
|---|---|---|---|---|---|---|
| **FINANCIAL LIABILITIES** | | | | | | |
| Amounts due to the CBA | 101,480 | 133,180 | 610,265 | 11,181,315 | - | 12,026,240 |
| Amounts due to financial institutions | 13,154,107 | 3,213,985 | 2,235,608 | 4,260,639 | 5,251,708 | 28,116,047 |
| Amounts due to customers | 18,507,116 | 19,465,038 | 18,644,375 | 3,450,750 | 2,698,234 | 62,765,513 |
| Financial liabilities held for trading | - | 7,489,260 | - | - | - | 7,489,260 |
| **Total undiscounted non-derivative financial liabilities** | 31,762,703 | 30,301,463 | 21,490,248 | 18,892,704 | 7,949,942 | 110,397,060 |
| **Derivative financial liabilities** | | | | | | |
| Currency swap contracts | | | | | | |
| Inflow | - | 14,003,412 | - | - | - | 14,003,412 |
| Outflow | - | (13,275,336) | - | - | - | (13,275,336) |
| **Commitments and contingent liabilities** | 5,781,045 | 3,834,132 | 8,958,289 | 7,874,531 | - | 26,447,997 |

Liquidity risk on derivative financial liabilities includes gross payments on foreign exchange and swap contracts, which mean that future cash inflows and outflows on those contracts should be disclosed separately, even if fair value of these contracts are accounted on the balance sheet as an asset.

## 33.4 Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's involvement with financial instruments, including processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness.

For the management of operational risk the appropriate internal control mechanisms are implemented in the working processes, operations and functions of the Bank. In order to avoid operational risk the execution of operations at least by the principle of "two persons" in the key positions, definition of procedures in a written form, the clear separation of authorities of employees and written approval of work responsibilities are of high importance in the Bank. The latter's maintenance is also the requirement of the ISO 9001:9008 quality control international standard, which is effective in the Bank from the year 2010.

Compliance with Bank standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the Bank to which they relate, with summaries submitted to the Board.

## 34 Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established in 1988 by the Basel Committee on Banking Supervision ("BIS rules/ratios") and adopted by the Central Bank of Armenia in supervising the Bank.

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, polices and processes from the previous years.

The minimum ratio between total capital and risk weighted assets required by the Central Bank of Armenia is 12%.

Regulatory capital consists of Tier 1 capital, which comprises share capital, retained earnings including current year profit, and general reserve. The other component of regulatory capital is Tier 2 capital, which includes revaluation reserves.

The risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature of and reflecting an estimate of credit, market and operating risks.

As of 31 December 2011 and 2010 the amount of regulatory capital, risk waited assets and capital adequacy ratio calculated in accordance with the requirements of Central Bank of Armenia are provided below.

| | Not audited | |
|---|---|---|
| In thousand Armenian drams | **2011** | 2010 |
| Tier 1 capital | **19,693,125** | 14,812,717 |
| Tier 2 capital | **3,467,377** | 5,082,868 |
| **Total regulatory capital** | **23,160,502** | 19,895,585 |
| Risk-weighted assets | **140,297,694** | 116,103,446 |
| **Capital adequacy ratio** | **16.51%** | 17.13% |

The Bank has complied with all externally imposed capital requirements through the period.

The Central Bank of Armenia has set the minimal required total capital at AMD 5,000,000 thousand from January 1 2009.

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