

**Consolidated financial Statements and  
Independent Auditor's Report**

**ANELIK bank closed joint stock company**

**31 December 2010**

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Grant Thornton

## Independent auditor's report

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To the Shareholders and Board of Directors of Closed Joint Stock Company Anelik Bank:

We have audited the accompanying consolidated financial statements of Anelik Bank CJSC (the "Bank") and its subsidiary (together the "Group"), which comprise the consolidated statement of financial position as at December 31, 2010, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### *Management's responsibility for the consolidated financial statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### *Auditor's responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Group's preparation and



# Consolidated statement of comprehensive income

| In thousand Armenian drams                                 | Notes | Year ended<br>December 31, 2010 | Year ended<br>December 31, 2009 |
|--|-------|---------------------------------|---------------------------------|
| Interest and similar income                                | 6     | 4,808,792                       | 3,927,330                       |
| Interest and similar expense                               | 6     | (1,854,627)                     | (1,462,408)                     |
| <b>Net interest income</b>                                 |       | <b>2,954,165</b>                | <b>2,464,922</b>                |
| Fee and commission income                                  | 7     | 1,852,033                       | 2,020,798                       |
| Fee and commission expense                                 | 7     | (58,788)                        | (70,480)                        |
| <b>Net fee and commission income</b>                       |       | <b>1,793,245</b>                | <b>1,950,318</b>                |
| Net trading income   | 8     | 209,648                         | 307,827                         |
| Other income   | 9     | 97,423                          | 50,639                          |
| Impairment charge for credit losses                        | 10    | (161,956)                       | (769,404)                       |
| Impairment loss on investments available-for-sale          |       | (19,302)                        | (1,357)                         |
| Staff costs  | 11    | (1,860,394)                     | (1,628,875)                     |
| Depreciation of property and equipment                     | 18    | (334,272)                       | (380,283)                       |
| Amortization of intangible assets                          | 19    | (21,493)                        | (26,453)                        |
| Other expenses   | 12    | (2,162,505)                     | (1,909,505)                     |
| <b>Profit before income tax</b>                            |       | <b>494,559</b>                  | <b>57,829</b>                   |
| Income tax expense   | 13    | (169,444)                       | (107,261)                       |
| <b>Profit/(loss) for the year</b>                          |       | <b>325,115</b>                  | <b>(49,432)</b>                 |
| <b>Other comprehensive income:</b>                         |       |                                 |                                 |
| Net unrealized loss from changes in fair value             |       | -                               | (118)                           |
| Exchange rate difference arising on consolidation          |       | (66,457)                        | 250,005                         |
| <b>Other comprehensive income for the year, net of tax</b> |       | <b>(66,457)</b>                 | <b>249,887</b>                  |
| <b>Total comprehensive income for the year</b>             |       | <b>258,658</b>                  | <b>200,455</b>                  |

The accompanying notes on pages 7 to 51 are an integral part of these consolidated financial statements.

# Consolidated statement of financial position

| In thousand Armenian drams                     | Notes | As of<br>December 31, 2010 | As of<br>December 31, 2009 |
|--|-------|----------------------------|----------------------------|
| <b>ASSETS</b>                                  |       |                            |                            |
| Cash and balances with Central Banks           | 14    | 14,287,478                 | 12,505,461                 |
| Amounts due from other financial institutions  | 15    | 6,158,009                  | 4,683,653                  |
| Loans and advances to customers                | 16    | 29,444,094                 | 24,248,460                 |
| Investments available for sale                 | 17    | 71,540                     | 47,339                     |
| Investments held to maturity                   | 17    | 2,469,687                  | 1,805,837                  |
| Securities pledged under repurchase agreements | 25    | -                          | 546,592                    |
| Property, plant and equipment                  | 18    | 4,695,176                  | 3,862,324                  |
| Intangible assets                              | 19    | 238,399                    | 94,026                     |
| Prepaid income tax                             |       | 43,757                     | 66,092                     |
| Deferred income tax assets                     | 13    | 61,146                     | 60,300                     |
| Assets held for sale                           | 20    | 1,518,530                  | 497,916                    |
| Other assets                                   | 21    | 655,699                    | 277,985                    |
| <b>TOTAL ASSETS</b>                            |       | <b>59,643,515</b>          | <b>48,695,985</b>          |
| <b>LIABILITIES AND EQUITY</b>                  |       |                            |                            |
| <b>Liabilities</b>                             |       |                            |                            |
| Amounts due to financial institutions          | 22    | 19,858,451                 | 17,057,465                 |
| Amounts due to customers                       | 23    | 23,913,174                 | 16,307,872                 |
| Current income tax liabilities                 |       | 135,438                    | 1,088                      |
| Deferred income tax liabilities                | 13    | 44,787                     | 77,944                     |
| Other liabilities                              | 24    | 432,079                    | 250,688                    |
| <b>Total liabilities</b>                       |       | <b>44,383,929</b>          | <b>33,695,057</b>          |
| <b>Equity</b>                                  |       |                            |                            |
| Share capital                                  | 26    | 10,816,300                 | 10,816,300                 |
| Share premium                                  |       | 3,483,700                  | 3,483,700                  |
| Statutory general reserve                      |       | 122,568                    | 122,568                    |
| Other reserves                                 |       | 166,828                    | 314,682                    |
| Currency translation reserve                   |       | (461,531)                  | (395,074)                  |
| Retained earnings                              |       | 1,131,721                  | 658,752                    |
| <b>Total equity</b>                            |       | <b>15,259,586</b>          | <b>15,000,928</b>          |
| <b>TOTAL LIABILITIES AND EQUITY</b>            |       | <b>59,643,515</b>          | <b>48,695,985</b>          |

The consolidated financial statements from pages 3 to 51 were signed by the Bank's Chairman of Executive Board and Chief Accountant on 12 April 2011. The accompanying notes on pages 7 to 51 are an integral part of these consolidated financial statements.

S. CHZMEACHIAN  
Chairman of Executive Board



N. GRIGORYAN  
Chief accountant

## Consolidated statement of changes in equity

| In thousand Armenian<br>drams                        | Share<br>capital  | Share<br>premium | Statutory<br>general<br>reserve | Revaluation<br>reserve of<br>securities<br>available<br>for sale | Revaluation<br>reserve<br>of PPE | Currency<br>translation<br>reserve | Retained<br>earnings | Total             |
|--|-------------------|------------------|---------------------------------|--|----------------------------------|------------------------------------|----------------------|-------------------|
| <b>Balance as of December<br/>31, 2008</b>           | 5,300,000         | -                | 95,830                          | 10,439   | 304,361                          | (645,079)                          | 734,922              | 5,800,473         |
| Increase in share capital                            | 5,516,300         | -                | -                               | -  | -                                | -                                  | -                    | 5,516,300         |
| Increase in share premium                            | -                 | 3,483,700        | -                               | -  | -                                | -                                  | -                    | 3,483,700         |
| Distribution to reserve                              | -                 | -                | 26,738                          | -  | -                                | -                                  | (26,738)             | -                 |
| Transactions with owners                             | 5,516,300         | 3,483,700        | 26,738                          | -  | -                                | -                                  | (26,738)             | 9,000,000         |
| Loss for the year                                    | -                 | -                | -                               | -  | -                                | -                                  | (49,432)             | (49,432)          |
| <i>Other comprehensive<br/>income:</i>               |                   |                  |                                 |  |                                  |                                    |                      |                   |
| Exchange rate difference<br>arising on consolidation | -                 | -                | -                               | -  | -                                | 250,005                            | -                    | 250,005           |
| Net unrealized losses from<br>changes in fair value  | -                 | -                | -                               | (118)  | -                                | -                                  | -                    | (118)             |
| Total comprehensive<br>income for the year           | -                 | -                | -                               | (118)  | -                                | 250,005                            | (49,432)             | 200,455           |
| <b>Balance as of December<br/>31, 2009</b>           | <b>10,816,300</b> | <b>3,483,700</b> | <b>122,568</b>                  | <b>10,321</b>  | <b>304,361</b>                   | <b>(395,074)</b>                   | <b>658,752</b>       | <b>15,000,928</b> |
| Profit for the year                                  | -                 | -                | -                               | -  | -                                | -                                  | 325,115              | 325,115           |
| <i>Other comprehensive<br/>income:</i>               |                   |                  |                                 |  |                                  |                                    |                      |                   |
| Exchange rate difference<br>arising on consolidation | -                 | -                | -                               | -  | -                                | (66,457)                           | -                    | (66,457)          |
| Adjustment to reserve on<br>disposal of PPE          | -                 | -                | -                               | -  | (147,854)                        | -                                  | 147,854              | -                 |
| Total comprehensive<br>income for the year           | -                 | -                | -                               | -  | (147,854)                        | (66,457)                           | 472,969              | 258,658           |
| <b>Balance as of December<br/>31, 2010</b>           | <b>10,816,300</b> | <b>3,483,700</b> | <b>122,568</b>                  | <b>10,321</b>  | <b>156,507</b>                   | <b>(461,531)</b>                   | <b>1,131,721</b>     | <b>15,259,586</b> |

# Consolidated statement of cash flows

In thousand Armenian drams

|  | Year ended<br>December 31, 2010 | Year ended<br>December 31, 2009 |
|--|---------------------------------|---------------------------------|
| <b>Cash flows from operating activities</b>  |                                 |                                 |
| Profit before tax  | 494,559                         | 57,829                          |
| <i>Adjustments for:</i>  |                                 |                                 |
| Foreign currency translation net losses on non-trading assets and liabilities                  | 67,756                          | 142,265                         |
| Impairment charge for losses on financial assets   | 181,258                         | 769,404                         |
| Depreciation and amortisation allowances   | 355,765                         | 406,736                         |
| Loss from disposal of PPE  | 73,199                          | 2,779                           |
| Loss from disposal of assets held for sale   | 12,559                          | -                               |
| Interest receivable  | (11,767)                        | (40,122)                        |
| Interest payable   | 57,855                          | 14,506                          |
| <b>Cash flows from operating activities before changes in operating assets and liabilities</b> | <b>1,231,184</b>                | <b>1,353,397</b>                |
| <i>Net (increase)/decrease in operating assets</i>   |                                 |                                 |
| Deposits with the central banks  | (98,383)                        | (92,758)                        |
| Amounts due from other financial institutions  | 1,821,537                       | (199,615)                       |
| Loans and advances to customers  | (5,870,730)                     | (4,253,947)                     |
| Assets held for sale   | (1,033,173)                     | (402,079)                       |
| Other assets   | (374,829)                       | (67,266)                        |
| <i>Increase/(decrease) in operating liabilities</i>  |                                 |                                 |
| Amounts due to financial institutions  | 326,717                         | 159,117                         |
| Amounts due to customers   | 8,041,845                       | (544,106)                       |
| Other liabilities  | 108,104                         | (414,644)                       |
| <b>Net cash flow from/(used in) operating activities before income tax</b>                     | <b>4,152,272</b>                | <b>(4,461,901)</b>              |
| Income tax paid  | (46,762)                        | (125,615)                       |
| <b>Net cash flow from/(used in) operating activities</b>                                       | <b>4,105,510</b>                | <b>(4,587,516)</b>              |
| <b>Cash flows from investing activities</b>  |                                 |                                 |
| Purchase of investment securities  | (707,696)                       | (992,958)                       |
| Purchase of property and equipment   | (1,527,551)                     | (1,729,788)                     |
| Proceeds from sale of property and equipment   | 287,228                         | 24,559                          |
| Purchase of intangible assets  | (83,255)                        | (10,445)                        |
| <b>Net cash used in investing activities</b>   | <b>(2,031,274)</b>              | <b>(2,708,632)</b>              |
| <b>Cash flow from financing activities</b>   |                                 |                                 |
| Loans received from financial institutions   | 2,934,295                       | 760,845                         |
| Issue of share capital   | -                               | 5,516,300                       |
| Increase in share premium  | -                               | 3,483,700                       |
| <b>Net cash flow from financing activities</b>   | <b>2,934,295</b>                | <b>9,760,845</b>                |
| Foreign currency translation differences resulting from consolidation                          | (66,457)                        | 250,005                         |
| <b>Net increase in cash and cash equivalents</b>   | <b>4,942,074</b>                | <b>2,714,702</b>                |
| Cash and cash equivalents at the beginning of the year   | 15,381,223                      | 11,292,853                      |
| Effect of exchange rate differences on cash and cash equivalents                               | (533,421)                       | 1,373,668                       |
| <b>Cash and cash equivalents at the end of the year (Note 14)</b>                              | <b>19,789,876</b>               | <b>15,381,223</b>               |

## Supplementary information:

|                   |             |             |
|-------------------|-------------|-------------|
| Interest received | 4,797,024   | 4,174,594   |
| Interest paid     | (1,796,772) | (1,755,639) |

# Accompanying notes to the consolidated financial statements

## 1 Principal activities

Anelik Bank CJSC (the “Bank”) is the parent company in the Group, which is comprised of the Bank and its subsidiary CB “Anelik RU” Co. Ltd (together the “Group”). Anelik Bank CJSC has been reorganized from limited liability company into a closed joint stock company in April 2007. The Bank was incorporated in the Republic of Armenia (the RA) in 1990. The Bank is regulated by the legislation of RA and conducts its business under license number 9, granted on 31.10.96 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. Its main office is in Yerevan and it has 11 branches in Yerevan and in different regions.

The registered office of the Bank is located at: Baghramyan 75, Yerevan.

CB “Anelik RU” Co. Ltd was formed as Moscow branch of “Anelik Bank” LLC and after restructured into CB “Anelik RU” Co. Ltd, which operates under the license N3443 granted by the Central Bank of the Russian Federation on 04.12.2003. The registered office of the Bank is located at: 19 Yamskogo Polya-1, Moscow, Russian Federation.

On 18 June 2009 the Bank became a subsidiary Creditbank SAL, which is incorporated in Lebanon. See note 26.

## 2 Business environment

Armenia continues to undergo political and economic changes. As emerging markets, 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, regional instability and international economic crisis.

The international economic crisis led to shortage of GDP of Armenia, as well as the cash flow transfers to Armenia from abroad upon which the economy of Armenia is significantly dependant. Though the Government and the Central Bank of Armenia have undertaken a number of preventing procedures, still there are uncertainties on the capital availability and acquisition cost both for the Group and for its customers, and in times of more severe market stress the effects of the crisis may be significant for Armenian economy and for the Group. 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 Group may be affected.

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

### 3 Basis of preparation

#### 3.1 Statement of compliance

The consolidated financial statements of the Group 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 consolidated 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, with the exception of buildings, which are stated at revalued amount.

#### 3.3 Functional and presentation currency

Functional currency of the Group’s consolidated entities is the currency of the primary economic environment in which the entities operate. The Bank’s functional currency and the Group’s presentation currency is Armenian Drams (“AMD”), since this currency best reflects the economic substance of the underlying events and transactions of the Group. The Group prepares statements in accordance with legislative requirements of RA and International Financial Reporting Standards. The consolidated 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 Group 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, 2010. The standards and interpretations which have had effect on the financial statements are presented below:

##### ***IAS 27 Consolidated and Separate Financial Statements (Revised 2008)***

The adoption of IFRS 3R required that the revised IAS 27 (IAS 27R) is adopted at the same time. IAS 27R introduced changes to the accounting requirements for transactions with non-controlling (formerly called 'minority') interests and the loss of control of a subsidiary. This standard requires that the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value, and a gain or loss is recognized in profit or loss. IAS 27 (revised) has had no impact on the current period, as none of the non-controlling interests have a deficit balance; there have been no transactions whereby an interest in an entity is retained after the loss of control of that entity, and there have been no transactions with non-controlling interests. These changes are applied prospectively

**IFRS 5 (Amendment) *Non-current Assets Held for Sale and Discontinued Operations***

Clarifies that IFRS 5 and other IFRSs that specifically refer to non-current assets (or disposal groups) classified as held for sale or discontinued operations set out all the disclosures required in respect of those assets or operations. IFRS 5 (Amendment) is applied for annual periods beginning on or after 1 January 2010.

**IAS 1 (Amendment) *Presentation of Financial Statements***

Amendment to clarify the classification of a liability that can, at the option of the counterparty, be settled by the issue of the entity's equity instruments. IAS 1 (Amendment) is applied retrospectively for annual periods beginning on or after 1 January 2010.

**IAS 7 (Amendment) *Statement of Cash Flows***

Amends IAS 7 to state explicitly that only an expenditure that results in a recognized asset can be classified as a cash flow from investing activities. IAS 7 (Amendment) is applied retrospectively for annual periods beginning on or after 1 January 2010.

**IAS 17 (Amendment) *Leases***

Amendment to IAS 17 clarifying that when a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance or an operating lease separately in accordance with the general guidance on lease classification in paragraphs 7-13 of IAS 17. IAS 17 (Amendment) is applied retrospectively for annual periods beginning on or after 1 January 2010.

**IAS 36 (Amendment) *Impairment of Assets***

Clarifies that the largest unit permitted by IAS 36 for the purpose of allocating goodwill to cash-generating units is the operating segment level defined in IFRS 8 before aggregation as permitted in that Standard. IAS 36 (Amendment) is applied for annual periods beginning on or after 1 January 2010.

**IAS 39 (Amendment) *Financial Instruments: Recognition and Measurement***

- Aims to clarify whether embedded prepayment options, in which the exercise price represented a penalty for early repayment of the loan, are considered closely related to the host debt contract.
- Aims to clarify that the scope exemption in IAS 39.2(g) applies only to binding (forward) contracts between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination at a future acquisition date.
- Clarifies when gains and losses on hedging instruments should be reclassified from equity to profit and loss account as a reclassification adjustment.

IAS 39 (Amendment) is applied prospectively for annual periods beginning on or after 1 January 2010.

**3.6 Standards and Interpretations not yet applied by the Group**

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 Group has not early adopted any of these pronouncements.

Management anticipates that all of the pronouncements will be adopted in the Group's accounting policy for the first period beginning after the effect date of the pronouncement. At the moment in management's estimation possible effect of most of the amendments on the Group's financial statements cannot be material.

#### IAS 32 (Amendment) *Financial instruments: Presentation-Classification of Right Issues*

The Amendment alters IAS 32 *Financial Instruments: Presentation* so that rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own (non-derivative) equity instruments. Prior to the Amendment, rights issues denominated in a foreign currency 'failed' equity classification and were required to be accounted for as derivative liabilities. IAS 32 (Amendment) is applied retrospectively for annual periods beginning on or after 1 February 2010.

#### IFRIC 19 *Extinguishing financial liabilities with equity instruments*

The interpretation clarifies the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability (debt for equity swap). It requires a gain or loss to be recognized in profit or loss, which is measured as the difference between the carrying amount of the financial liability and the fair value of the equity instruments issued. If the fair value of the equity instruments issued cannot be reliably measured, the equity instruments should be measured to reflect the fair value of the financial liability extinguished. It is not expected to have any impact on the group or the parent entity's financial statements.

#### IFRS 1 (Amendment) *Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters*

The amendment to IFRS 1 enables first-time adopters to benefit from the same relief from comparatives available to those already using IFRSs when applying Improving Disclosures about Financial Instruments (Amendments to IFRS 7) for the first time. Effective for annual periods beginning on or after 1 July 2010.

#### 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 entirety 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 entirety.

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

#### IAS 24 (revised), Related party disclosures

It supersedes IAS 24, 'Related party disclosures', issued in 2003. The revised standard clarifies and simplifies the definition of a related party and removes the requirement for government-related entities to disclose details of all transactions with the government and other government-related

entities. IAS 24 (revised) is effective for annual periods beginning on or after 1 January 2011. Earlier application, in whole or in part, is permitted.

#### IFRS 1 (Amendment) *Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters*

The IASB has published two limited amendments to IFRS 1 First-time adoption of International Financial Reporting Standards. The first amendment replaces references to a fixed date of '1 January 2004' with 'the date of transition to IFRSs', thus eliminating the need for companies adopting IFRSs for the first time to restate some transactions that occurred before the date of transition to IFRSs. The second amendment provides guidance on how an entity should present financial statements in accordance with IFRSs after a period when the entity was unable to comply with IFRSs because its functional currency was subject to severe hyperinflation. Effective for annual periods beginning on or after 1 July 2011.

#### IAS 12 (Amendment) *Recovery of underlying assets*

The IASB has published some limited scope amendments to IAS 12 Income Taxes, which are relevant only when an entity elects to use the fair value model for measurement in IAS 40 Investment Property. The amendments introduce a rebuttable presumption that in such circumstances, an investment property is recovered entirely through sale. Effective for annual periods beginning on or after 1 January 2012.

#### IFRIC 14 (Amendment) *'Prepayments of a minimum funding requirement'* issued in November 2009.

The amendments correct an unintended consequence of IFRIC 14, 'IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction'. Without the amendments, entities are not permitted to recognise as an asset some voluntary prepayments for minimum funding contributions. This was not intended when IFRIC 14 was issued, and the amendments correct the problem. The amendments are effective for annual periods beginning 1 January 2011. Earlier application is permitted. The amendments should be applied retrospectively to the earliest comparative period presented.

#### IFRS 9 *Financial Instruments*

The IASB aims to replace IAS 39 Financial Instruments: Recognition and Measurement in its entirety. The replacement standard (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. These chapters are effective for annual periods beginning 1 January 2013. Further chapters dealing with impairment methodology and hedge accounting are still being developed.

#### Annual Improvements 2010 (effective from 1 July 2010 and later)

The IASB has issued *Improvements to IFRS 2010* (2010 Improvements). Most of these amendments become effective in annual periods beginning on or after 1 July 2010 or 1 January 2011. The 2010 Improvements amend certain provisions of IFRS 1, IFRS 3R, IFRS 7, IAS 1, IAS 27, IAS 34 and IFRIC 13. The Group's preliminary assessments indicate that the 2010 Improvements will not have a material impact on the Group's financial statements, except for disclosure requirements for financial instruments, which 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.

#### 4 Summary of significant accounting policies

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

##### 4.1 Basis of consolidation

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

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to profit and loss in the period of acquisition. The minority interest is stated at the minority's proportion of the fair values of the assets and liabilities recognised. Subsequently, any losses applicable to the minority interest in excess of the minority interest are allocated against the interests of the parent. The equity attributable to equity holders of the parent and net income attributable to minority shareholders' interests are shown separately in the statement of financial position and statement of comprehensive income, respectively.

In translating the consolidated financial statements of a foreign subsidiary into the presentation currency for incorporation in the consolidated financial statements, the Group follows a translation policy in accordance with International Accounting Standard 21 "The Effects of Changes in Foreign Exchange Rates" ("IAS 21") and the following procedures are done:

- Assets and liabilities, both monetary and non-monetary, of the foreign entity are translated at closing rate;
- Income and expense items of the foreign entity are translated at the weighted average exchange rates for the year;
- All resulting exchange differences are classified as equity until the disposal of the investment;
- On disposal of the investment in the foreign entity related exchange differences are recognized in the statement of comprehensive income.

##### 4.2 Recognition of income and expenses

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group 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 Group 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 statement of comprehensive income 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 and expense*

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 Group'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.

#### **4.3 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 comprehensive income in net trading income, while gains less losses resulting from translation of non-trading assets are recognized in the statement of comprehensive 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 Group in the preparation of the consolidated financial statements are as follows:

|                 | December 31, 2010 | December 31, 2009 |
|-----------------|-------------------|-------------------|
| AMD/1 US Dollar | 363.44            | 377.89            |
| AMD/1 Euro      | 481.16            | 542.23            |
| AMD/1 RR        | 11.91             | 12.50             |

For the year 2010 the annual average AMD/1RR rate was 12.31 (2009: 11.56).

#### 4.4 Taxation

Income tax on the profit for the year comprises current and deferred tax. Income tax is recognized in the statement of comprehensive income 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.

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

The Republic of Armenia and Russian Federation also have various operating taxes, which are assessed on the Group's activities. These taxes are included as a component of other expenses in the statement of comprehensive income.

#### 4.5 Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, balances on correspondent accounts with the Central Bank of Armenia and the Central Bank of Russian Federation (excluding those funds deposited for the settlement of ArCa payment cards in CBA and balances of mandatory reserves held in the Central Bank of the Russian Federation), 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.

#### 4.6 Amounts due from other financial institutions

In the normal course of business, the Group 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.

#### 4.7 Financial instruments

The Group recognizes financial assets and liabilities on its statement of financial position 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 Group 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 Group 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.

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 comprehensive income.

#### *Held-to-maturity investments*

Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. Were the Group 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 Group provides money directly to a debtor with no intention of trading the receivable.

Loans granted by the Group 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 statement of comprehensive income 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 comprehensive income. However, interest calculated using the effective interest method is recognised in the statement of comprehensive income. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Group'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.

#### 4.8 Impairment of financial assets

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

##### *Assets carried at amortized cost*

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 Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be 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 comprehensive 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 Group 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 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 Group 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 Group. 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 Group 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 amortisation) and its current fair value, less any impairment loss previously recognised in the statement on income, is transferred from equity to the statement of comprehensive income. Reversals in respect of equity instruments classified as available-for-sale are not recognised in the statement of comprehensive income. Reversals of impairment losses on debt instruments are reversed through the statement of comprehensive income if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

## **4.9 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 Group has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- the Group either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

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

#### *Financial liabilities*

A financial liability is 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 comprehensive income.

#### **4.10 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 statement of financial position 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 item in statement of financial position. 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 in the statement of financial position. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

#### **4.11 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 statement of financial position 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 statement of financial position, 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".

#### **4.12 Leases**

##### *Operating - Group as lessee*

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

#### **4.13 Property, plant and equipment**

Property, plant and equipment ("PPE") are recorded at historical cost less accumulated depreciation. The Group's buildings are stated at fair value 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.

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<br>(years) | Rate<br>(%) |
|--------------------|------------------------|-------------|
| Buildings          | 30                     | 3.33        |
| Computers          | 3-8                    | 12.5-33.33  |
| Vehicles           | 3-10                   | 10-33.33    |
| Other fixed assets | 4.5-10                 | 10-22.6     |

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 not depreciated.

Repairs and maintenance are charged to the statement of comprehensive income 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 Group. 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.

Any revaluation surplus is credited to the revaluation reserve for property and equipment included in the revaluation reserve for property and equipment in equity section of the statement of financial position, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in the statement of comprehensive income, in which case the increase is recognised in the statement of comprehensive income. A revaluation deficit is recognised in the statement of comprehensive income, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

When revalued assets are sold, the amounts attributed to disposed item of assets and included in the revaluation reserve are transferred to retained earnings.

#### 4.14 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 over the useful economic lives of 5 to 10 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.

#### 4.15 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 statement of comprehensive income 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.

#### 4.16 Borrowings

Borrowings, which include amounts due to the Government of RA and Central Bank of Armenia, amounts due to financial institutions, amounts due to customers 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 comprehensive income when the liabilities are derecognised as well as through the amortisation process.

#### 4.17 Pensions

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

#### 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 consolidated financial statements at fair value, in "Other liabilities", being the premium received. Subsequently to initial recognition, the Group'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 Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

#### 4.20 Share capital

##### *Share capital*

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.

#### *Dividends*

Dividends are recognised as a liability and deducted from equity at the statement of financial position 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 consolidated 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 statement of financial position 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 consolidated 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 consolidated financial statements are presented below:

#### *Classification of investment securities*

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

#### *Related party transactions*

In the normal course of business the Group enters into transactions with its related parties. These transactions are priced predominantly at market rates. 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 receivables*

The Group reviews its problem loans and advances at each reporting date to assess whether an allowance for impairment should be recorded in the statement of comprehensive income. 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 Group 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 takes 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 27.

During 2009 the State Revenue Committee adjacent to RA Government has provided new interpretation on application of some articles of the RA Law on Profit tax to the fixed assets revaluated by banks, according to which economic profits receivable from compensation of carrying value of revaluated fixed assets are non taxable, therefore, the taxation base for these assets approximates their carrying value which supposes that in the future taxable amounts will not occur. The Management of the Bank has not reviewed its previous estimations, i.e. has not derecognized previously estimated deferred tax liability related to the fixed assets and continues its tax accounting as before.

*Impairment of available-for-sale equity investments*

The Group 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 Group 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                    | 2010             | 2009             |
|---|------------------|------------------|
| Loans and advances to customers               | 4,449,497        | 3,634,604        |
| Amounts due from other financial institutions | 66,328           | 107,077          |
| Debt investment securities held-to-maturity   | 190,456          | 140,210          |
| Reverse repurchase transactions               | -                | 8,640            |
| Interest accrued on impaired financial assets | 93,749           | 27,774           |
| Other interest income                         | 8,762            | 9,025            |
| <b>Total interest and similar income</b>      | <b>4,808,792</b> | <b>3,927,330</b> |

| In thousand Armenian drams                | 2010             | 2009             |
|---|------------------|------------------|
| Amounts due to customers                  | 1,176,536        | 795,709          |
| Amounts due to financial institutions     | 650,991          | 639,058          |
| Repurchase transactions                   | 1,874            | 8,513            |
| Other interest expenses                   | 25,226           | 19,128           |
| <b>Total interest and similar expense</b> | <b>1,854,627</b> | <b>1,462,408</b> |

## 7 Fee and commission income and expense

| In thousand Armenian drams             | 2010             | 2009             |
|--|------------------|------------------|
| Cash collection                        | 176,666          | 56,890           |
| Wire transfer fees                     | 1,548,027        | 1,858,439        |
| Plastic cards operations               | 107,156          | 89,778           |
| Other fees and commissions             | 20,184           | 15,691           |
| <b>Total fee and commission income</b> | <b>1,852,033</b> | <b>2,020,798</b> |

| In thousand Armenian drams                    | 2010          | 2009          |
|---|---------------|---------------|
| Wire transfer fees                            | 6,655         | 5,169         |
| Cash operations                               | 18,697        | 19,776        |
| Fee for maintenance of correspondent accounts | 27,186        | 34,739        |
| Other expenses                                | 6,250         | 10,796        |
| <b>Total fee and commission expense</b>       | <b>58,788</b> | <b>70,480</b> |

## 8 Net trading income

| In thousand Armenian drams                                | 2010           | 2009           |
|---|----------------|----------------|
| Gains less losses from transactions in foreign currencies | 209,648        | 307,827        |
| <b>Total net trading income</b>                           | <b>209,648</b> | <b>307,827</b> |

## 9 Other income

| In thousand Armenian drams                      | 2010          | 2009          |
|---|---------------|---------------|
| Fines and penalties received                    | 19,614        | 16,766        |
| Income from sale of fixed assets                | -             | 10,350        |
| Guarantees and other credit related commitments | 32,578        | 1,752         |
| Dividend income                                 | 109           | 69            |
| Donations                                       | 14,208        | 3,731         |
| Other income                                    | 30,914        | 17,971        |
| <b>Total other income</b>                       | <b>97,423</b> | <b>50,639</b> |

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

| In thousand Armenian drams                       | 2010           | 2009           |
|--|----------------|----------------|
| Loans and advances to customers (Note 16)        | 163,489        | 753,048        |
| Other assets (Note 21)                           | (1,533)        | 16,356         |
| <b>Total impairment charge for credit losses</b> | <b>161,956</b> | <b>769,404</b> |

## 11 Staff costs

| In thousand Armenian drams    | 2010             | 2009             |
|-------------------------------|------------------|------------------|
| Wages and salaries            | 1,758,139        | 1,537,606        |
| Social security contributions | 102,255          | 91,269           |
| <b>Total staff costs</b>      | <b>1,860,394</b> | <b>1,628,875</b> |

## 12 Other expenses

| In thousand Armenian drams   | 2010             | 2009             |
|--|------------------|------------------|
| Operating lease  | 434,922          | 366,226          |
| Fixed assets maintenance (buildings, intangibles, etc)                             | 352,636          | 284,893          |
| Taxes, other than income tax, duties   | 333,160          | 279,693          |
| Advertising and representative expenses  | 272,851          | 308,765          |
| Communications   | 157,197          | 168,405          |
| Losses from disposal of fixed assets   | 73,199           | 2,779            |
| Net losses from foreign currency translation of non-trading assets and liabilities | 67,756           | 142,265          |
| Business trip expenses   | 60,993           | 60,455           |
| Expenses related to payment systems  | 60,088           | 62,429           |
| Security   | 46,036           | 45,934           |
| Consulting and other services  | 36,725           | 23,949           |
| Office supplies  | 15,624           | 15,857           |
| Losses from disposal of assets held for sale                                       | 12,559           | -                |
| Penalties paid   | 2,255            | 3,153            |
| Other expenses   | 236,504          | 144,702          |
| <b>Total other expense</b>   | <b>2,162,505</b> | <b>1,909,505</b> |

## 13 Income tax expense

| In thousand Armenian drams      | 2010           | 2009           |
|---------------------------------|----------------|----------------|
| Current tax expense             | 206,417        | 70,758         |
| Deferred tax                    | (36,973)       | 36,503         |
| <b>Total income tax expense</b> | <b>169,444</b> | <b>107,261</b> |

The corporate income tax within the Republic of Armenia is levied at the rate of 20% (2009: 20%). The corporate income tax within the Russian Federation is levied at the rate of 20% (2009: 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%. Deferred tax has been recalculated in 2009 in respect of change in tax rate in Russian Federation from 24% to 20% from January 1, 2009.

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

| In thousand Armenian drams                           | 2010           | Effective rate (%) | 2009    | Effective rate (%) |
|--|----------------|--------------------|---------|--------------------|
| <b>Profit before tax</b>                             | <b>494,559</b> |                    | 57,829  |                    |
| Income tax at the rate of 20%                        | <b>98,912</b>  | <b>20</b>          | 11,566  | 20                 |
| Non-deductible expenses                              | <b>69,067</b>  | <b>14</b>          | 79,853  | 138                |
| Foreign exchange losses                              | <b>1,465</b>   | -                  | 3,507   | 6                  |
| Adjustment of deferred tax due to change in tax rate | -              | -                  | 12,335  | 21                 |
| <b>Income tax expense</b>                            | <b>169,444</b> | <b>34</b>          | 107,261 | 185                |

## Deferred tax calculation in respect of temporary differences:

| In thousand Armenian drams                                  | 2009            | Recognized in consolidated statement of comprehensive income | Recognized in equity | 2010            |
|---|-----------------|--|----------------------|-----------------|
| Loans and advances to customers                             | -               | 7,972  | -                    | 7,972           |
| Accrued expenses and other liabilities                      | 10,103          | 2,322  | -                    | 12,425          |
| Financial investments available-for-sale of subsidiary bank | -               | 3,865  | -                    | 3,865           |
| PPE of subsidiary bank                                      | 17,567          | (10,168)   | -                    | 7,399           |
| Allowances for impairment and provisions of subsidiary bank | 16,844          | (2,548)  | -                    | 14,296          |
| Accrued expenses and other liabilities of subsidiary bank   | 42,744          | 111  | -                    | 42,855          |
| Tax losses carried forward of subsidiary bank               | -               | 11,965   | -                    | 11,965          |
| <b>Total deferred tax assets</b>                            | <b>87,258</b>   | <b>13,519</b>  | -                    | <b>100,777</b>  |
| Reserve adjustment of subsidiary bank                       | (1,644)         | 591  | -                    | (1,053)         |
| Revaluation of the PPE                                      | (68,705)        | 26,392   | -                    | (42,313)        |
| Other provisions  | (19,342)        | (3,529)  | -                    | (22,871)        |
| <b>Total deferred tax liability</b>                         | <b>(89,691)</b> | <b>23,454</b>  | -                    | <b>(66,237)</b> |
| Currency translation difference                             | (15,211)        | -  | (2,970)              | (18,181)        |
| <b>Total deferred tax asset of subsidiary</b>               | <b>60,300</b>   | <b>3,816</b>   | <b>(2,970)</b>       | <b>61,146</b>   |
| <b>Total deferred tax liability of parent</b>               | <b>(77,944)</b> | <b>33,157</b>  | -                    | <b>(44,787)</b> |
| <b>Total movement during the year</b>                       | <b>(17,644)</b> | <b>36,973</b>  | <b>(2,970)</b>       | <b>16,359</b>   |

| In thousand Armenian drams                                  | 2008            | Recognized in consolidated statement of comprehensive income | Recognized in equity | 2009            |
|---|-----------------|--|----------------------|-----------------|
| Loans and advances to customers                             | 16,578          | (16,578)   | -                    | -               |
| Accrued expenses and other liabilities                      | 12,536          | (2,433)  | -                    | 10,103          |
| PPE of subsidiary bank                                      | 22,151          | (4,584)  | -                    | 17,567          |
| Allowances for impairment and provisions of subsidiary bank | 21,081          | (4,237)  | -                    | 16,844          |
| Accrued expenses and other liabilities of subsidiary bank   | 53,367          | (10,623)   | -                    | 42,744          |
| <b>Total deferred tax assets</b>                            | <b>125,713</b>  | <b>(38,455)</b>  | <b>-</b>             | <b>87,258</b>   |
| Reserve adjustment of subsidiary bank                       | (2,835)         | 1,191  | -                    | (1,644)         |
| Revaluation of the PPE                                      | (71,791)        | 3,086  | -                    | (68,705)        |
| Other provisions  | (17,017)        | (2,325)  | -                    | (19,342)        |
| <b>Total deferred tax liability</b>                         | <b>(91,643)</b> | <b>1,952</b>   | <b>-</b>             | <b>(89,691)</b> |
| Currency translation difference                             | (26,789)        | -  | 11,578               | (15,211)        |
| Total deferred tax asset of subsidiary                      | 66,975          | (18,253)   | 11,578               | 60,300          |
| Total deferred tax liability of parent                      | (59,694)        | (18,250)   | -                    | (77,944)        |
| Total movement during the year                              | 7,281           | (36,503)   | 11,578               | (17,644)        |

The currency translation difference included in the total net movement recognized in equity is shown in the exchange rate difference arising on consolidation for 2010 and 2009 in the consolidated statement of changes in equity.

Due to the fact that the members of the Group operate in different tax jurisdictions, the deferred tax assets and liabilities are not offset in the statements.

#### 14 Cash, cash equivalents and balances with Central Banks

| In thousand Armenian drams  | 2010              | 2009              |
|---|-------------------|-------------------|
| Cash on hand  | 5,099,623         | 5,520,885         |
| Cash in transit   | 10,000            |                   |
| Correspondent account with the CB of Armenia and CB of the Russian Federation | 8,646,643         | 6,551,747         |
| <b>Included in cash and cash equivalents</b>                                  | <b>13,756,266</b> | <b>12,072,632</b> |
| Mandatory reserves in the Central Bank of the Russian Federation              | 104,939           | 84,688            |
| Deposited funds with the CBA  | 426,273           | 348,141           |
| <b>Total cash and balances with the Central Banks</b>                         | <b>14,287,478</b> | <b>12,505,461</b> |
| Cash and balances with the central banks, included in cash flow               | 13,756,266        | 12,072,632        |
| Placements with other banks (note 15)   | 6,033,610         | 3,308,591         |
| <b>Total cash and cash equivalents</b>  | <b>19,789,876</b> | <b>15,381,223</b> |

As at 31 December 2010 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 3,132,024 thousand (2009: AMD 1,650,787 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. Cash on hand, other money market placements, correspondent account, deposited funds with CBA and mandatory reserve deposits are non-interest bearing.

Mandatory reserves in the Central Bank of the Russian Federation was created in accordance with the banking legislation of the Russian Federation. There is a restriction on the withdrawal on these funds.

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

## 15 Amounts due from other financial institutions

| In thousand Armenian drams                                 | 2010             | 2009             |
|--|------------------|------------------|
| Correspondent accounts with financial institutions         | 6,033,610        | 3,308,591        |
| <b>Included in cash and cash equivalents</b>               | <b>6,033,610</b> | <b>3,308,591</b> |
| Loans and deposits to financial institutions               | 27,989           | 900,998          |
| Other amounts  | 96,410           | 474,064          |
| <b>Total amounts due from other financial institutions</b> | <b>6,158,009</b> | <b>4,683,653</b> |

As at 31 December 2010 the amounts due from other financial institutions in amounts of AMD 2,754,078 thousand (45%) (2009: 1,533,857 AMD thousand (33%)) were due from four banks.

As of 31 December 2009 included in amounts due from other financial institutions are guarantee deposits placed by the Bank for its operations in the amount of AMD 94,472 thousand.

During 2009, the Bank placed with and simultaneously received short-term funds from Armenian and foreign banks in various currencies (these amounts are included in other amounts). As at 31 December 2009, the Group placed an equivalent of AMD 377,861 thousand, as deposit in euro in the Parent Bank, which were related to deposits received from the same bank. (See Notes 22, 28).

## 16 Loans and advances to customers

| In thousand Armenian drams                   | 2010              | 2009              |
|--|-------------------|-------------------|
| Loans to customers                           | 29,790,231        | 24,675,156        |
| Overdrafts                                   | 8,024             | -                 |
| Loans utilised by credit cards               | 135,278           | 58,576            |
|  | <b>29,933,533</b> | <b>24,733,732</b> |
| Less allowance for loan impairment           | (489,439)         | (485,272)         |
| <b>Total loans and advances to customers</b> | <b>29,444,094</b> | <b>24,248,460</b> |

As of 31 December 2010 accrued interest income included in loans and advances to customers amounted to AMD 271,310 thousand (2009: AMD 261,762 thousand).

As of 31 December 2010, the Group had a concentration of loans represented by AMD 9,484,341 thousand due from the ten largest third party entities and parties related with them (32% of gross loan portfolio) (2009: AMD 6,457,078 thousand or 26%). An allowance of AMD 94,851 thousand (2009: AMD 109,770 thousand) was made against these loans.

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

| In thousand Armenian drams                   | 2010              | 2009              |
|--|-------------------|-------------------|
| Privately held companies                     | 20,520,933        | 16,144,929        |
| Individuals                                  | 5,580,271         | 5,026,160         |
| Sole proprietors                             | 3,832,329         | 3,562,643         |
|  | <b>29,933,533</b> | <b>24,733,732</b> |
| Less allowance for loan impairment           | (489,439)         | (485,272)         |
| <b>Total loans and advances to customers</b> | <b>29,444,094</b> | <b>24,248,460</b> |

### Loans to individuals comprise the following products:

| In thousand Armenian drams                             | 2010             | 2009             |
|--|------------------|------------------|
| Mortgage loans   | 1,893,241        | 1,431,978        |
| Consumer loans   | 3,617,923        | 3,401,859        |
| Car loans  | 69,107           | -                |
| Other  | -                | 192,323          |
| <b>Total loans and advances to individuals (gross)</b> | <b>5,580,271</b> | <b>5,026,160</b> |

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

| In thousand Armenian drams  |                |                          |                  | 2010           |
|---|----------------|--------------------------|------------------|----------------|
|   | Individuals    | Privately held companies | Sole proprietors | Total          |
| At 1 January 2010   | 99,915         | 314,122                  | 71,235           | 485,272        |
| Charge/(reversal) for the year  | 236,405        | (233,967)                | 161,051          | 163,489        |
| Amounts written off   | (254,232)      | (162,468)                | (170,440)        | (587,140)      |
| Recoveries  | 88,309         | 300,572                  | 38,937           | 427,818        |
| At 31 December 2010   | <b>170,397</b> | <b>218,259</b>           | <b>100,783</b>   | <b>489,439</b> |
| Individual impairment   | 30,658         | 15,747                   | 5,747            | 52,152         |
| Collective impairment   | 139,738        | 202,513                  | 95,036           | 437,287        |
|   | <b>170,396</b> | <b>218,260</b>           | <b>100,783</b>   | <b>489,439</b> |
| Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance | <b>159,791</b> | <b>220,345</b>           | <b>50,013</b>    | <b>430,149</b> |

| In thousand Armenian drams  |                         |             |                          |                  | 2009      |
|---|-------------------------|-------------|--------------------------|------------------|-----------|
|   | State owned enterprises | Individuals | Privately held companies | Sole proprietors | Total     |
| At 1 January 2009   | 26                      | 163,958     | 221,845                  | 25,485           | 411,314   |
| Charge/(reversal) for the year  | (26)                    | 136,546     | 463,692                  | 152,836          | 753,048   |
| Amounts written off   | -                       | (271,298)   | (371,550)                | (110,310)        | (753,158) |
| Recoveries  | -                       | 70,709      | 135                      | 3,224            | 74,068    |
| At 31 December 2009   | -                       | 99,915      | 314,122                  | 71,235           | 485,272   |
| Individual impairment   | -                       | -           | 55,857                   | -                | 55,857    |
| Collective impairment   | -                       | 99,915      | 258,265                  | 71,235           | 429,415   |
|   | -                       | 99,915      | 314,122                  | 71,235           | 485,272   |
| Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance | -                       | -           | 150,574                  | -                | 150,574   |

The maturity analysis of loan portfolio is presented in note 30.

As at 31 December 2010 and 2009 the estimated fair value of loans and advances to customers approximates their carrying amount. Refer to Note 29.

Credit, currency, liquidity and interest rate analyses of loans and advances to customers are disclosed in Note 31. The information on related party balances is disclosed in Note 28.

## 17 Investment securities

| In thousand Armenian<br>drams                           | Available-for-<br>sale | Held-to-<br>maturity | 2010             |                        | 2009                |                  |
|---|------------------------|----------------------|------------------|------------------------|---------------------|------------------|
|   |                        |                      | Total            | Available-for-<br>sale | Held-to<br>maturity | Total            |
| <b>Unquoted investments</b>                             |                        |                      |                  |                        |                     |                  |
| Shares of Armenian companies                            | 35,966                 | -                    | 35,966           | 35,966                 | -                   | 35,966           |
| Shares of OECD countries companies                      | 11,373                 | -                    | 11,373           | 11,373                 | -                   | 11,373           |
| Securities issued by the Ministry of Finance of Armenia | -                      | 2,427,953            | 2,427,953        | -                      | 1,764,148           | 1,764,148        |
| Corporate bonds of RA                                   | -                      | 41,734               | 41,734           | -                      | 41,689              | 41,689           |
| Shares of Russian companies                             | 24,201                 | -                    | 24,201           | -                      | -                   | -                |
| <b>Total investments</b>                                | <b>71,540</b>          | <b>2,469,687</b>     | <b>2,541,227</b> | <b>47,339</b>          | <b>1,805,837</b>    | <b>1,853,176</b> |

All debt securities have fixed coupons.

The Group has not reclassified any financial assets measured at amortised cost rather than fair value during the year (2009: nil).

Unquoted available-for-sale equity instruments in Armenian companies are recorded at cost since their fair value cannot be reliably estimated. There is no market for these investments and the Group intends to hold it for the long term.

As of December 31, 2010 the Group has recognised an impairment loss for securities available-for-sale in amount of AMD 19,302 thousand (2009: AMD 1,357 thousand)

Held-to-maturity investments:

| In thousand Armenian drams                | 2010             | 2009             |
|---|------------------|------------------|
| Nominal value                             | 2,567,365        | 1,870,492        |
| Premium                                   | -                | 63               |
| Discount                                  | (99,521)         | (66,904)         |
| Accrued interest                          | 1,843            | 2,186            |
| <b>Total investments held to maturity</b> | <b>2,469,687</b> | <b>1,805,837</b> |

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

| In thousand Armenian drams                      | 2010      |          | 2009      |          |
|---|-----------|----------|-----------|----------|
|   | %         | Maturity | %         | Maturity |
| Treasury bills of the Ministry of Finance of RA | 7.93-9.00 | 2011     | 6.75-7.88 | 2011     |
| Corporate bonds                                 | 9.50      | 2011     | 9.5       | 2011     |

As at 31 December 2009 debt securities held to maturity at fair value of AMD 546,592 thousand were pledged to third parties in sale and repurchase agreements for periods not exceeding 1 month. See Note 25. These securities have been reclassified as securities pledged under repurchase agreements on the face of the consolidated statement of financial position.

## 18 Property, plant and equipment

| In thousand Armenian<br>drams      | Land and<br>buildings | Leasehold<br>improve-<br>ments | Computers        | Vehicles       | Assets<br>under<br>construc-<br>tion | Other PPE      | Total            |
|------------------------------------|-----------------------|--------------------------------|------------------|----------------|--------------------------------------|----------------|------------------|
| <b>COST</b>                        |                       |                                |                  |                |                                      |                |                  |
| At December 31, 2008               | 1,458,790             | 373,966                        | 821,989          | 321,724        | -                                    | 455,979        | 3,432,448        |
| Additions                          | -                     | 1,618                          | 41,635           | 42,807         | 1,587,600                            | 31,249         | 1,704,909        |
| Disposals                          | (5,123)               | (11,848)                       | (29,192)         | (9,879)        | -                                    | (15,228)       | (71,270)         |
| Currency translation<br>difference | -                     | 1,924                          | 48,304           | 25,298         | -                                    | 16,188         | 91,714           |
| <b>At December 31, 2009</b>        | <b>1,453,667</b>      | <b>365,660</b>                 | <b>882,736</b>   | <b>379,950</b> | <b>1,587,600</b>                     | <b>488,188</b> | <b>5,157,801</b> |
| Additions                          | -                     | 5,629                          | 427,042          | -              | 979,705                              | 148,786        | 1,561,162        |
| Disposals                          | (407,932)             | -                              | (160,113)        | -              | -                                    | (11,305)       | (579,350)        |
| Currency translation<br>difference | -                     | (557)                          | (15,919)         | (8,495)        | -                                    | (8,640)        | (33,611)         |
| <b>At December 31, 2010</b>        | <b>1,045,735</b>      | <b>370,732</b>                 | <b>1,133,746</b> | <b>371,455</b> | <b>2,567,305</b>                     | <b>617,029</b> | <b>6,106,002</b> |
| <b>DEPRECIATION</b>                |                       |                                |                  |                |                                      |                |                  |
| At December 31, 2008               | -                     | 144,235                        | 376,737          | 144,854        | -                                    | 226,464        | 892,290          |
| Depreciation charge                | 63,760                | 91,910                         | 136,098          | 42,699         | -                                    | 45,816         | 380,283          |
| Disposals                          | (5,123)               | (3,247)                        | (19,043)         | (9,024)        | -                                    | (7,495)        | (43,932)         |
| Currency translation<br>difference | -                     | 305                            | 39,812           | 15,099         | -                                    | 11,620         | 66,836           |
| <b>At December 31, 2009</b>        | <b>58,637</b>         | <b>233,203</b>                 | <b>533,604</b>   | <b>193,628</b> | <b>-</b>                             | <b>276,405</b> | <b>1,295,477</b> |
| Depreciation charge                | 55,371                | 82,353                         | 117,953          | 38,436         | -                                    | 40,159         | 334,272          |
| Disposals                          | (33,796)              | -                              | (159,637)        | -              | -                                    | (5,777)        | (199,210)        |
| Currency translation<br>difference | -                     | (176)                          | (10,167)         | (5,590)        | -                                    | (3,780)        | (19,713)         |
| <b>At December 31, 2010</b>        | <b>80,212</b>         | <b>315,380</b>                 | <b>481,753</b>   | <b>226,474</b> | <b>-</b>                             | <b>307,007</b> | <b>1,410,826</b> |
| <b>CARRYING VALUE</b>              |                       |                                |                  |                |                                      |                |                  |
| <b>At December 31, 2010</b>        | <b>965,523</b>        | <b>55,352</b>                  | <b>651,993</b>   | <b>144,981</b> | <b>2,567,305</b>                     | <b>310,022</b> | <b>4,695,176</b> |
| At December 31, 2009               | 1,395,030             | 132,457                        | 349,132          | 186,322        | 1,587,600                            | 211,783        | 3,862,324        |
| At December 31, 2008               | 1,458,790             | 229,731                        | 445,252          | 176,870        | -                                    | 229,515        | 2,540,158        |

### Revaluation of assets

The buildings owned by the Bank were evaluated as at 31 December 2008 by an independent appraiser Appraisal Society LLC acting under license AG 0755, using a combination of the market, income and cost methods resulting in a revaluation of AMD 300,832 thousand. Management has based their estimate of the fair value of the buildings on the results of the independent appraisal.

The net book value of buildings that would have been recognized under the historic cost method is AMD 786,268 thousand, as at 31 December 2010 (2009: AMD 1,051,760 thousand).

### Assets under construction

In August 2009 the Bank acquired an office building in Yerevan, for AMD 1,587,600 thousand. The Bank intends to use the premises as the Head office. The renovation is expected to be completed in 2011. In July 2010 the Bank acquired additional premises of the same building in the amount of AMD 351,800 thousand.

*Fully depreciated items*

As at 31 December 2010 fixed assets included fully depreciated and amortized assets in amount of AMD 100,533 thousand (2009: AMD 71,218 thousand).

*Fixed assets in the phase of installation*

As at 31 December 2010 fixed assets included assets in the phase of installation in amount of AMD 78,430 thousand (2009: AMD 13,520 thousand), which are not amortized and are classified in accordance with their type.

**19 Intangible assets**

| In thousand Armenian drams      | Licenses      | Acquired software licenses | Other         | Total          |
|---------------------------------|---------------|----------------------------|---------------|----------------|
| <b>COST</b>                     |               |                            |               |                |
| At December 31, 2008            | 32,273        | 78,261                     | 67,633        | 178,167        |
| Additions                       | 3,556         | -                          | -             | 3,556          |
| Disposals                       | (3,372)       | (197)                      | (12,806)      | (16,375)       |
| Currency translation difference | -             | 11,730                     | -             | 11,730         |
| <b>At December 31, 2009</b>     | <b>32,457</b> | <b>89,794</b>              | <b>54,827</b> | <b>177,078</b> |
| Additions                       | 31,304        | 134,075                    | 2,048         | 167,427        |
| Disposals                       | (287)         | -                          | -             | (287)          |
| Currency translation difference | -             | (3,387)                    | -             | (3,387)        |
| <b>At December 31, 2010</b>     | <b>63,474</b> | <b>220,482</b>             | <b>56,875</b> | <b>340,831</b> |
| <b>AMORTISATION</b>             |               |                            |               |                |
| At December 31, 2008            | 16,065        | 32,384                     | 19,685        | 68,134         |
| Amortisation charge             | 5,833         | 8,890                      | 11,730        | 26,453         |
| Adjustment for disposal         | (3,372)       | (173)                      | (12,806)      | (16,351)       |
| Currency translation difference | -             | 4,816                      | -             | 4,816          |
| <b>At December 31, 2009</b>     | <b>18,526</b> | <b>45,917</b>              | <b>18,609</b> | <b>83,052</b>  |
| Amortisation charge             | 4,696         | 11,091                     | 5,706         | 21,493         |
| Adjustment for disposal         | (287)         | -                          | -             | (287)          |
| Currency translation difference | -             | (1,826)                    | -             | (1,826)        |
| <b>At December 31, 2010</b>     | <b>22,935</b> | <b>55,182</b>              | <b>24,315</b> | <b>102,432</b> |
| <b>CARRYING VALUE</b>           |               |                            |               |                |
| <b>At December 31, 2010</b>     | <b>40,539</b> | <b>165,300</b>             | <b>32,560</b> | <b>238,399</b> |
| At December 31, 2009            | 13,931        | 43,877                     | 36,218        | 94,026         |
| At December 31, 2008            | 16,208        | 45,877                     | 47,948        | 110,033        |

**20 Assets held for sale**

| In thousand Armenian drams        | 2010             | 2009           |
|-----------------------------------|------------------|----------------|
| Immovable property                | 1,230,186        | 208,362        |
| Other property                    | 281,474          | 270,806        |
| Assets put out of use             | 6,870            | 18,748         |
| <b>Total assets held for sale</b> | <b>1,518,530</b> | <b>497,916</b> |

The immovable and other property have passed to the Bank as a result of defaults of borrowers. The Group intends to sale the assets within one year.

## 21 Other assets

| In thousand Armenian drams    | 2010           | 2009           |
|-------------------------------|----------------|----------------|
| Prepayments and other debtors | 540,920        | 283,081        |
| Settlements with employees    | 70             | 263            |
| Other assets                  | 63,069         | 50,105         |
|                               | <b>604,059</b> | <b>333,449</b> |
| Less allowance for impairment | (89,423)       | (81,194)       |
|                               | <b>514,636</b> | <b>252,255</b> |
| Other prepaid taxes           | 11,810         | 14,541         |
| Materials                     | 129,253        | 11,189         |
| <b>Total other assets</b>     | <b>655,699</b> | <b>277,985</b> |

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

| In thousand Armenian drams      | Total           |
|---------------------------------|-----------------|
| <b>At December 31, 2008</b>     | 74,813          |
| Charge for the year             | 16,356          |
| Amounts written off             | (11,590)        |
| Recoveries                      | 7,240           |
| Currency translation difference | (5,625)         |
| At December 31, 2009            | <b>81,194</b>   |
| Reversal for the year           | <b>(1,533)</b>  |
| Amounts written off             | <b>(11,879)</b> |
| Recoveries                      | <b>5,737</b>    |
| Currency translation difference | <b>15,904</b>   |
| <b>At December 31, 2010</b>     | <b>89,423</b>   |

## 22 Amounts due to financial institutions

| In thousand Armenian drams                           | 2010              | 2009              |
|--|-------------------|-------------------|
| Obligations of the CBA                               | 3,555,124         | 4,182,373         |
| Correspondent accounts of other banks                | 8,424,635         | 7,812,180         |
| Loans from international financial institutions      | 3,132,729         | 4,286,737         |
| Loans and deposits from other financial institutions | 4,698,301         | 377,664           |
| Current accounts of other financial institutions     | 47,662            | 20,507            |
| Other amounts  | -                 | 378,004           |
| <b>Total amounts due to financial institutions</b>   | <b>19,858,451</b> | <b>17,057,465</b> |

As of 31 December 2010 the obligations of CBA include loans received within the scope of Small and medium business financing program, Mortgage loan financing program and Small hydro-energetic stations' financing program of German-Armenian fund in the amount of AMD 3,555,124 thousand (2009: AMD 3,635,488 thousand) and as of 31 December 2009 amounts under repurchase agreements AMD 546,885 thousand (see note 25).

Loans and deposits from international financial institutions include loans from European Bank for Reconstruction and Development, which have variable interest rates.

As of 31 December 2010 loans and deposits from other financial institutions include time deposits from the Group's shareholder Creditbank S.A.L. in the amount of 2,008,248 AMD thousand (2009: nil) and another Lebanese bank in the amount of 1,823,560 AMD thousand (2009: nil). They carry fixed interest rates.

During 2009, the Group placed with and received short-term funds from Armenian and foreign banks in various currencies (these amounts are included in other amounts). As of December 31 2009, the Group received an equivalent of AMD 378,004 thousand in US Dollars, including interests accrued as deposits in US dollars of the parent bank, which relate to deposits in euro granted to the same bank (See Notes 15 and 28).

The Group has not had any defaults of principal, interest or other breaches with respect to its liabilities during the period (2009: nil).

### 23 Amounts due to customers

| In thousand Armenian drams            | 2010                     | 2009                     |
|---------------------------------------|--------------------------|--------------------------|
| <b>Government of the RA</b>           |                          |                          |
| Time deposits                         | 561,670                  | 865,783                  |
| Loans received                        | 3,367,923                | 2,423,075                |
|                                       | <u>3,929,593</u>         | <u>3,288,858</u>         |
| <b>Corporate customers</b>            |                          |                          |
| Current/Settlement accounts           | 5,509,079                | 2,960,652                |
| Time deposits                         | 679,528                  | 679,900                  |
|                                       | <u>6,188,607</u>         | <u>3,640,552</u>         |
| <b>Retail customers</b>               |                          |                          |
| Current/Demand accounts               | 2,433,514                | 1,986,344                |
| Time deposits                         | 11,361,460               | 7,392,118                |
|                                       | <u>13,794,974</u>        | <u>9,378,462</u>         |
| <b>Total amounts due to customers</b> | <u><u>23,913,174</u></u> | <u><u>16,307,872</u></u> |

All customer deposits carry fixed interest rates.

Loans received from RA government include loans received within the scope of "Small and medium business financing", "Consumer Loan Financing" and "Other financing" programs. The administration and supervision over these loans is performed by German-Armenian Fund. The refinancing loans are subject to certain requirements in accordance with the general loan agreement.

As at 31 December 2010 included in amounts due to customers are deposits amounting to 367,582 thousand held as security against guarantees issued and loans in amount of AMD 2,040 thousand and AMD 365,542 thousand respectively (2009: AMD 91,089 thousand for guarantees issued). The fair value of those deposits approximates the carrying amount.

At 31 December 2010 the aggregate balance of top ten customers (excluding Government of the RA) of the Group (including relating parties, see Note 28) amounts to AMD 3,555,840 thousand (2009: AMD 1,851,835 thousand) or 18% of total corporate and retail customer accounts (2009: 14%).

The Group has not had any defaults of principal, interest or other breaches with respect to its liabilities during the period (2009: nil).

## 24 Other liabilities

| In thousand Armenian drams         | 2010           | 2009           |
|------------------------------------|----------------|----------------|
| Accounts payables                  | 105,426        | 20,532         |
| Tax payable, other than income tax | 66,129         | 17,376         |
| Due to personnel                   | 196,817        | 208,380        |
| Other                              | 63,707         | 4,400          |
| <b>Total other liabilities</b>     | <b>432,079</b> | <b>250,688</b> |

## 25 Securities pledged under repurchase agreements

| In thousand Armenian drams          | 2010  |           | 2009    |           |
|-------------------------------------|-------|-----------|---------|-----------|
|                                     | Asset | Liability | Asset   | Liability |
| Investment securities (Note 17, 22) | -     | -         | 546,592 | 546,885   |
|                                     | -     | -         | 546,592 | 546,885   |

## 26 Equity

As at 31 December 2010 the Group's registered and paid-in share capital was AMD 10,816,300 thousand. In accordance with the Group's statutes, the share capital consists of 216,326 ordinary shares, all of which have a par value of AMD 50,000 each.

The respective shareholdings as at 31 December 2010 and 2009 may be specified as follows:

| In thousand Armenian drams | 2010                  |                            |
|----------------------------|-----------------------|----------------------------|
|                            | Paid-in share capital | % of total paid-in capital |
| Credit Bank S.A.L.         | 5,516,300             | 51.00                      |
| Arthur Arakelyan           | 1,325,000             | 12.25                      |
| Samvel Chzmachian          | 1,325,000             | 12.25                      |
| Galina Voronina            | 1,325,000             | 12.25                      |
| Armen Ghazaryan            | 1,325,000             | 12.25                      |
|                            | <b>10,816,300</b>     | <b>100</b>                 |

As at 31 December 2010, the Group did not possess any of its own shares.

In 2009, additional 110,326 shares have been issued at the amount of AMD 5,516,300. As a result of the allocation of these shares a share premium arose at the amount of AMD 3,483,700 thousand.

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.

The share capital of the Group was contributed by the shareholders in Armenian Drams and they are entitled to dividends and any capital distribution in Armenian Drams.

Distributable among shareholders reserves equal the amount of retained earnings, determined according to the Armenian 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 Group's share capital reported in statutory books.

## 27 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.

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

As of 31 December 2010 there were no legal actions and complaints taken against the Group.

Therefore, the Group has not made any respective provision related to such tax and legal matters.

Before 30 April 2011 the subsidiary Bank Anelik RU Co. Ltd is obliged to submit the Central Bank of the Russian Federation documents concerning the change in the capital structure of the Group which has occurred in 2009. In the case if the subsidiary Bank fails to satisfy the requirements of the Central Bank of RF, the latter may withdraw the Bank's license to the attraction of deposits and servicing of current accounts of individuals. However, the Management believes that in the worst possible scenario, the situation will have no material effect on the Group's activities, the structure of assets and liabilities and financial results.

### *Loan commitment, guarantee and other financial facilities*

In the normal course of business, the Group 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 statement of financial position.

As of 31 December the nominal or contract amounts were:

| In thousand Armenian drams              | 2010             | 2009           |
|---|------------------|----------------|
| Undrawn loan commitments                | 1,351,032        | 383,997        |
| Guarantees                              | 967,602          | 358,256        |
| <b>Total credit related commitments</b> | <b>2,318,634</b> | <b>742,253</b> |

### *Operating lease commitments – Group as a lessee*

In the normal course of business the Group enters into commercial lease agreements for branches premises.

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

| In thousand Armenian drams                   | 2010             | 2009           |
|--|------------------|----------------|
| Not later than 1 year                        | 429,002          | 415,790        |
| Later than 1 year and not later than 5 years | 806,376          | 552,900        |
| <b>Total operating lease commitments</b>     | <b>1,235,378</b> | <b>968,690</b> |

#### *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 Group does not have full coverage for business interruption, or for third party liability in respect of property or environmental damage arising from accidents on Group property or relating to Group's operations. Until the Group obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Group's operations and financial position.

Starting from September 2005 the Bank is 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.

#### *Capital commitments*

The Bank had capital commitments in respect of renovation of the newly acquired office building totalling AMD 104,167 thousand as at 31 December 2010. The Bank's Management has already allocated the necessary resources in respect of this commitment. The Bank's Management believes that future net revenues and funding will be sufficient to cover this and any similar such commitments.

### **28 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 consolidated financial statements, related parties include shareholders, members of Group's Management as well as other persons and enterprises related with and controlled by them respectively.

The ultimate controlling party of the Group is Mr. Tarek Khalife.

More than 50% of members of the Bank's board of directors are Credit Bank S.A.L. representatives, which gives the latter the power to control the decisions of the Group. As at 31 December 2010 the Bank had investment in CB "Anelik RU" Co Ltd, in which the Bank holds directly 100% of the shares and voting rights.

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                           | 2010             |                          | 2009           |                          |
|--|------------------|--------------------------|----------------|--------------------------|
|  | Shareholders     | Key management personnel | Shareholders   | Key management personnel |
| <b>Assets</b>  |                  |                          |                |                          |
| <b>Amounts due from other financial institutions</b> |                  |                          |                |                          |
| Balance outstanding at January 1, gross              | 377,861          | -                        | -              | -                        |
| Additions during the year                            |                  | -                        | 377,861        | -                        |
| Repayments during the year                           | (377,861)        | -                        | -              | -                        |
| <b>Balance outstanding at December 31</b>            | <b>-</b>         | <b>-</b>                 | <b>377,861</b> | <b>-</b>                 |
| <b>Loans</b>   |                  |                          |                |                          |
| Loans outstanding at January 1, gross                | 81,080           | 23,780                   | 18,096         | 29,891                   |
| Loans issued during the year                         | 151,480          | 109,906                  | 211,055        | 21,392                   |
| Loan repayments during the year                      | (184,278)        | (38,765)                 | (148,071)      | (27,503)                 |
| Loans outstanding at December 31, gross              | 48,282           | 94,921                   | 81,080         | 23,780                   |
| Less: allowance for loan impairment                  | (1,255)          | (2,401)                  | (810)          | (141)                    |
| <b>Loans outstanding at December 31</b>              | <b>47,027</b>    | <b>92,520</b>            | <b>80,270</b>  | <b>23,639</b>            |
| Impairment charge for credit losses/(reversal)       | 445              | 2,260                    | 637            | (56)                     |
| Interest income on loans                             | 8,286            | 7,749                    | 4,663          | 2,593                    |
| <b>Investments available-for-sale</b>                |                  |                          |                |                          |
| Balance outstanding at January 1, gross              | -                | -                        | -              | -                        |
| Additions during the year                            | 24,201           | -                        | -              | -                        |
| <b>Balance outstanding at December 31</b>            | <b>24,201</b>    | <b>-</b>                 | <b>-</b>       | <b>-</b>                 |
| <b>Other assets</b>                                  |                  |                          |                |                          |
| Accounts receivable at January 1                     | -                | -                        | -              | -                        |
| Additions during the year                            | 41,685           | -                        | -              | -                        |
| Balance outstanding at December 31                   | 41,685           | -                        | -              | -                        |
| <b>Liabilities</b>                                   |                  |                          |                |                          |
| <b>Amounts due to financial institutions</b>         |                  |                          |                |                          |
| Deposits and current accounts at January 1           | 425,971          | -                        | -              | -                        |
| Received during the year                             | 29,101,226       | -                        | 9,921,150      | -                        |
| Repaid during the year                               | (27,338,782)     | -                        | (9,495,179)    | -                        |
| <b>Deposits and current accounts at December 31</b>  | <b>2,188,415</b> | <b>-</b>                 | <b>425,971</b> | <b>-</b>                 |
| Interest expense                                     | 80,607           | -                        | 114            | -                        |
| <b>Amounts due to customers</b>                      |                  |                          |                |                          |
| Deposits and current accounts at January 1           | 90,937           | 28,077                   | 156,393        | 58,097                   |
| Received during the year                             | 4,597,233        | 2,525,437                | 1,043,108      | 587,374                  |
| Repaid during the year                               | (4,646,503)      | (2,431,416)              | (1,127,210)    | (658,654)                |
| Exchange rate differences                            | 7,960            | (11,820)                 | 18,646         | 41,260                   |
| <b>Deposits and current accounts at December 31</b>  | <b>49,627</b>    | <b>110,278</b>           | <b>90,937</b>  | <b>28,077</b>            |
| Interest expense on deposits                         | 1,272            | 4,365                    | 1,188          | 527                      |

**Items of consolidated comprehensive income***Income*

|  |         |        |         |       |
|--|---------|--------|---------|-------|
| Donations                                | -       | 14,208 | -       | 3,731 |
| <i>Expenses</i>                          |         |        |         |       |
| Advertising expenses                     | 18,041  | -      | -       | -     |
| Operating lease payments                 | 283,479 | -      | 273,600 | -     |
| Capital expenses made on leased property | 5,629   | -      | 1,618   | -     |

The loans issued to directors and other key management personnel (and close family members) during the year have interest rates of 10.5-16% (2009: 12-17%), depending on the loan type. The loans advanced to the directors and key management personnel during the year are collateralised by cash and real estate.

In accordance with the lease agreements signed between the Bank and one of the Bank's shareholders, the premises belonged to the latter by the ownership right were leased for the activity of the Bank's branches in Yerevan.

Compensation of key management personnel was comprised of the following:

| In thousand Armenian drams               | 2010           | 2009           |
|--|----------------|----------------|
| Salaries and other short-term benefits   | 600,974        | 599,948        |
| Social security costs                    | 26,096         | 21,221         |
| <b>Total key management compensation</b> | <b>627,070</b> | <b>621,169</b> |

## 29 Fair value of financial instruments

*Financial instruments not measured at fair value*

| In thousand Armenian drams                     | 2010           |            | 2009           |            |
|--|----------------|------------|----------------|------------|
|  | Carrying value | Fair value | Carrying value | Fair value |
| <b>FINANCIAL ASSETS</b>                        |                |            |                |            |
| Cash and balances with central banks           | 14,287,478     | 14,287,478 | 12,505,461     | 12,505,461 |
| Amounts due from financial institutions        | 6,158,009      | 6,158,009  | 4,683,653      | 4,683,653  |
| Loans and advances to customers                | 29,444,094     | 29,444,094 | 24,248,460     | 24,248,460 |
| Investment securities held to maturity         | 2,469,687      | 2,482,376  | 1,805,837      | 1,813,086  |
| Securities pledged under repurchase agreements | -              | -          | 546,592        | 547,123    |
| <b>FINANCIAL LIABILITIES</b>                   |                |            |                |            |
| Amounts due to financial institutions          | 19,858,451     | 19,858,451 | 17,057,465     | 17,057,465 |
| Amounts due to customers                       | 23,913,174     | 23,913,174 | 16,307,872     | 16,307,872 |

*Amounts due from and to financial institutions*

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.

*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. The carrying amount of loans approximates their fair value.

*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. The measurement of fair value of securities issued by the RA Ministry of Finance and corporate bonds of Armenian companies is based on the yield curve set by the CBA, according to which as of December 31, 2010 the profitability of debt securities with duration of 6 months and 1 year comprise correspondingly 7.93% and 9%.

*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.

**29.1 Fair value hierarchy**

The fair value 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  |          |               |          | 2010          |
|-----------------------------|----------|---------------|----------|---------------|
|                             | Level 1  | Level 2       | Level 3  | Total         |
| <b>FINANCIAL ASSETS</b>     |          |               |          |               |
| Unquoted equity investments | -        | 11,373        | -        | 11,373        |
| <b>Total</b>                | <b>-</b> | <b>11,373</b> | <b>-</b> | <b>11,373</b> |

| In thousand Armenian drams  |          |               |          | 2009          |
|-----------------------------|----------|---------------|----------|---------------|
|                             | Level 1  | Level 2       | Level 3  | Total         |
| <b>FINANCIAL ASSETS</b>     |          |               |          |               |
| Unquoted equity investments | -        | 11,373        | -        | 11,373        |
| <b>Total</b>                | <b>-</b> | <b>11,373</b> | <b>-</b> | <b>11,373</b> |

Unquoted equity investments consist of unquoted securities of class C in VISA and SWIFT Companies, the fair value of which is being determined based on the information on share price received by these Companies.

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

*Unquoted equity investments of RA and RF*

The fair value of Group's unquoted RA and RF equity investments cannot be reliably measured and is therefore excluded from this disclosure. Refer to note 17 for further information about this equity investment.

### 30 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 31.3 for the Group's contractual undiscounted repayment obligations.

| In thousand<br>Armenian drams                    |                                       |                          |                           |                                    |                         |                      |                               | 2010              |
|--|---------------------------------------|--------------------------|---------------------------|------------------------------------|-------------------------|----------------------|-------------------------------|-------------------|
|  | Demand<br>and less<br>than 1<br>month | From<br>1 to 3<br>months | From<br>3 to 12<br>months | Subtotal<br>less than<br>12 months | From<br>1 to 5<br>years | More than<br>5 years | Subtotal<br>over 12<br>months | Total             |
| <b>ASSETS</b>                                    |                                       |                          |                           |                                    |                         |                      |                               |                   |
| Cash and balances with<br>Central Banks          | 13,861,205                            | -                        | -                         | 13,861,205                         | 426,273                 | -                    | 426,273                       | 14,287,478        |
| Amounts due from other<br>financial institutions | 6,130,002                             | -                        | -                         | 6,130,002                          | 28,007                  | -                    | 28,007                        | 6,158,009         |
| Loans and advances to<br>customers               | 1,785,385                             | 1,400,316                | 5,953,644                 | 9,139,345                          | 11,506,289              | 8,798,460            | 20,304,749                    | 29,444,094        |
| Investments available<br>for sale                | -                                     | -                        | -                         | -                                  | -                       | 71,540               | 71,540                        | 71,540            |
| Investments held to<br>maturity                  | 99,717                                | 581,188                  | 1,788,782                 | 2,469,687                          | -                       | -                    | -                             | 2,469,687         |
|  | <u>21,876,309</u>                     | <u>1,981,504</u>         | <u>7,742,426</u>          | <u>31,600,239</u>                  | <u>11,960,569</u>       | <u>8,870,000</u>     | <u>20,830,569</u>             | <u>52,430,808</u> |
| <b>LIABILITIES</b>                               |                                       |                          |                           |                                    |                         |                      |                               |                   |
| Amounts due to<br>financial institutions         | 10,551,842                            | 673,908                  | 648,464                   | 11,874,214                         | 7,308,018               | 676,219              | 7,984,237                     | 19,858,451        |
| Amounts due to<br>customers                      | 8,485,238                             | 1,821,980                | 7,974,027                 | 18,281,245                         | 5,616,886               | 15,043               | 5,631,929                     | 23,913,174        |
|  | <u>19,037,080</u>                     | <u>2,495,888</u>         | <u>8,622,491</u>          | <u>30,155,459</u>                  | <u>12,924,904</u>       | <u>691,262</u>       | <u>13,616,166</u>             | <u>43,771,625</u> |
| <b>Net position</b>                              | <u>2,839,229</u>                      | <u>(514,384)</u>         | <u>(880,065)</u>          | <u>1,444,780</u>                   | <u>(964,335)</u>        | <u>8,178,738</u>     | <u>7,214,403</u>              | <u>8,659,183</u>  |
| <b>Accumulated gap</b>                           | <u>2,839,229</u>                      | <u>2,324,845</u>         | <u>1,444,780</u>          |                                    | <u>480,445</u>          | <u>8,659,183</u>     |                               |                   |

| In thousand<br>Armenian drams                        |                                    |                          |                           |   |                         |                      |  | 2009              |
|--|------------------------------------|--------------------------|---------------------------|---|-------------------------|----------------------|--|-------------------|
|  | Demand and<br>less than 1<br>month | From<br>1 to 3<br>months | From<br>3 to 12<br>months | <i>Subtotal<br/>less than<br/>12 months</i> | From<br>1 to 5<br>years | More than<br>5 years | <i>Subtotal<br/>over 12<br/>months</i> | Total             |
| <b>ASSETS</b>  |                                    |                          |                           |   |                         |                      |  |                   |
| Cash and balances<br>with Central Banks              | 12,072,632                         | -                        | -                         | 12,072,632                                  | 432,829                 | -                    | 432,829                                | 12,505,461        |
| Amounts due from<br>other financial<br>institutions  | 4,589,181                          | -                        | 94,472                    | 4,683,653                                   | -                       | -                    | -                                      | 4,683,653         |
| Loans and advances<br>to customers                   | 892,281                            | 455,726                  | 16,245,073                | 17,593,080                                  | 1,996,910               | 4,658,470            | 6,655,380                              | 24,248,460        |
| Investments<br>available for sale                    | -                                  | -                        | -                         | -   | -                       | 47,339               | 47,339                                 | 47,339            |
| Investments held to<br>maturity                      | 111,201                            | 432,930                  | 1,221,870                 | 1,766,001                                   | 39,836                  | -                    | 39,836                                 | 1,805,837         |
| Securities pledged<br>under repurchase<br>agreements | -                                  | -                        | 546,592                   | 546,592                                     | -                       | -                    | -                                      | 546,592           |
|  | <u>17,665,295</u>                  | <u>888,656</u>           | <u>18,108,007</u>         | <u>36,661,958</u>                           | <u>2,469,575</u>        | <u>4,705,809</u>     | <u>7,175,384</u>                       | <u>43,837,342</u> |
| <b>LIABILITIES</b>                                   |                                    |                          |                           |   |                         |                      |  |                   |
| Amounts due to<br>financial institutions             | 8,936,592                          | 342,778                  | 2,637,071                 | 11,916,441                                  | 4,770,766               | 370,258              | 5,141,024                              | 17,057,465        |
| Amounts due to<br>customers                          | 5,070,048                          | 1,185,509                | 5,508,789                 | 11,764,346                                  | 4,164,854               | 378,672              | 4,543,526                              | 16,307,872        |
|  | <u>14,006,640</u>                  | <u>1,528,287</u>         | <u>8,145,860</u>          | <u>23,680,787</u>                           | <u>8,935,620</u>        | <u>748,930</u>       | <u>9,684,550</u>                       | <u>33,365,337</u> |
| Net position   | <u>3,658,655</u>                   | <u>(639,631)</u>         | <u>9,962,147</u>          | <u>12,981,171</u>                           | <u>(6,466,045)</u>      | <u>3,956,879</u>     | <u>(2,509,167)</u>                     | <u>10,472,005</u> |
| Accumulated gap                                      | <u>3,658,655</u>                   | <u>3,019,024</u>         | <u>12,981,171</u>         |   | <u>6,515,126</u>        | <u>10,472,005</u>    |  |                   |

### 31 Risk management

The Group'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. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business. The Group's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Group's financial performance.

The Group's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Group regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

Risk management is carried out by a Risk Management Department under policies approved by the Board of Directors. The Risk Management Department identifies, evaluates and hedges financial risks in close co-operation with the Group's operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments. In addition, internal audit, in accordance with the procedures established by the Board, is responsible for the independent review of adherence to the limits established by the Board, operational risk, risk management and the control environment. The most important types of risk are credit risk, liquidity risk, market risk and other operational risk. Market risk includes currency risk, interest rate and other price risk.

### 31.1 Credit risk

The Group takes on exposure to credit risk, which is the risk that counterparty will cause a financial loss for the Group by failing to discharge an obligation. Credit risk is the most important risk for the Group's business; management therefore carefully manages its exposure to credit risk. The Group, based on the credit risk management policy, established by the Board, applies various methods to manage and prevent 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 Group'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 implemented by the Risk Management Department, based on the policies approved by the Board, and reported to the Board of Directors regularly.

#### 31.1.1 Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below represents a worst case scenario of credit risk exposure to the Group at 31 December 2010 and 2009, without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the statement of financial position.

| In thousand Armenian drams                     | Notes | Gross maximum exposure<br>as of<br>December 31, 2010 | Gross maximum exposure<br>as of<br>December 31, 2009 |
|--|-------|--|--|
| Balances with Central Banks                    | 14    | 9,177,855  | 6,984,576  |
| Amounts due from other financial institutions  | 15    | 6,158,009  | 4,683,653  |
| Loans and advances to customers                | 16    | 29,444,094   | 24,248,460   |
| Investments available for sale                 | 17    | 71,540   | 47,339   |
| Investments held to maturity                   | 17    | 2,469,687  | 1,805,837  |
| Securities pledged under repurchase agreements | 25    | -  | 546,592  |
| <b>Total</b>                                   |       | <b>47,321,185</b>                                    | <b>38,316,457</b>                                    |
| Credit related commitments                     | 27    | 2,318,634  | 742,253  |
| <b>Total credit risk exposure</b>              |       | <b>49,639,819</b>                                    | <b>39,058,710</b>                                    |

When financial instruments are recorded at fair value the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

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

#### Geographical sectors

The following table breaks down the Group'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             |
|---|-------------------|------------------|--------------------------|-------------------|
| Balances with Central Banks                   | 4,984,677         | -                | 4,193,178                | 9,177,855         |
| Amounts due from other financial institutions | 108,966           | 2,943,615        | 3,105,428                | 6,158,009         |
| Loans and advances to customers               | 29,259,971        | -                | 184,123                  | 29,444,094        |
| Investments available for sale                | 35,966            | 11,373           | 24,201                   | 71,540            |
| Investments held to maturity                  | 2,469,687         | -                | -                        | 2,469,687         |
| <b>As at 31 December 2010</b>                 | <b>36,859,267</b> | <b>2,954,988</b> | <b>7,506,930</b>         | <b>47,321,185</b> |
| As at 31 December 2009                        | 30,115,847        | 1,993,199        | 6,207,411                | 38,316,457        |

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

#### Industry sectors

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

| In thousand Armenian drams                    | Financial institutions | Manufacturing     | Trade            | Service          | Construction     | Consumer sector  | Other            | Total             |
|---|------------------------|-------------------|------------------|------------------|------------------|------------------|------------------|-------------------|
| Balances with Central Banks                   | 9,177,855              | -                 | -                | -                | -                | -                | -                | 9,177,855         |
| Amounts due from other financial institutions | 6,158,009              | -                 | -                | -                | -                | -                | -                | 6,158,009         |
| Loans and advances to customers               | 48,081                 | 10,086,204        | 6,408,639        | 3,649,058        | 1,725,179        | 5,382,638        | 2,144,295        | 29,444,094        |
| Investments available for sale                | 47,339                 | -                 | -                | -                | -                | -                | 24,201           | 71,540            |
| Investments held to maturity                  | 2,427,953              | 41,734            | -                | -                | -                | -                | -                | 2,469,687         |
| <b>As at 31 December 2010</b>                 | <b>17,859,237</b>      | <b>10,127,938</b> | <b>6,408,639</b> | <b>3,649,058</b> | <b>1,725,179</b> | <b>5,382,638</b> | <b>2,168,496</b> | <b>47,321,185</b> |
| As at 31 December 2009                        | 14,067,997             | 6,384,775         | 7,402,213        | 2,671,458        | 1,183,809        | 4,836,023        | 1,770,182        | 38,316,457        |

### 31.1.3 Risk limit control and mitigation policies

According to the policies approved by the Board the Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of credit risk by product, industry sector and by country are approved annually by the Board of Directors within the framework of the Group's strategic development program, while Investment Committee monitors and approves monthly credit risk by product, industry sector, level of investment, limits on the amount of risk accepted and measures to reduce the credit risk.

The exposure to any one borrower including banks and financial organizations is further restricted by sub-limits approved by the Board and covering on- and off-balance sheet exposures. 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*

In accordance with the approved by the Board credit risk management policy the Group 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 Group 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, equipment, inventory and accounts receivable;
- Charges over precious metals and cars;
- Charges over financial instruments such as debt securities and equities.

Longer-term finance and lending to corporate entities are generally secured. In addition, in order to minimise the credit loss the Group 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                           | 2010              | 2009              |
|--|-------------------|-------------------|
| Loans collateralized by real estate                  | 26,982,497        | 19,374,474        |
| Loans collateralized by guarantees of enterprises    | 98,743            | 465,980           |
| Loans collateralized by inventories                  | -                 | 1,259,887         |
| Loans collateralized by shares of other companies    | 589,040           | 278,048           |
| Loans collateralized by equipment                    | 945,240           | 1,904,843         |
| Loans collateralized by gold and precious metals     | 957,040           | 766,945           |
| Loans collateralized by cash                         | 136,053           | 103,059           |
| Other collateral                                     | 5,911             | 421,648           |
| Unsecured loans                                      | 219,009           | 158,848           |
| <b>Total loans and advances to customers (gross)</b> | <b>29,933,533</b> | <b>24,733,732</b> |

#### *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 Group on behalf of a customer authorising a third party to draw drafts on the Group 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 Group 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 Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

#### 31.1.4 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 Group addresses impairment assessment into areas: individually assessed allowances and collectively assessed allowances.

##### *Individually assessed allowances*

The Group 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      | 2010  | 2009  |
|---------------------------------|-------|-------|
| Loans and advances to customers |       |       |
| Privately held companies        | 0.90% | 1.10% |
| Individuals                     | 2.60% | 1.70% |
| Sole proprietors                | 2.50% | 1.40% |

*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             |                   |                |                |                   | 2010             |
|--|-------------------|----------------|----------------|-------------------|------------------|
|  | Less than 30 days | 31 to 60 days  | 61 to 90 days  | More than 91 days | Total            |
| <b>Loans and advances to customers</b> |                   |                |                |                   |                  |
| Privately held companies               | 59,301            | 84,994         | 94,757         | 66,837            | 305,889          |
| Individuals                            | 79,129            | 73,674         | 145,291        | 198,899           | 496,993          |
| Sole proprietors                       | 33,934            | 23,301         | 75,308         | 73,429            | 205,972          |
| <b>Total</b>                           | <b>172,364</b>    | <b>181,969</b> | <b>315,356</b> | <b>339,165</b>    | <b>1,008,854</b> |

| In thousand Armenian drams             |                   |               |               |                   | 2009           |
|--|-------------------|---------------|---------------|-------------------|----------------|
|  | Less than 30 days | 31 to 60 days | 61 to 90 days | More than 91 days | Total          |
| <b>Loans and advances to customers</b> |                   |               |               |                   |                |
| Privately held companies               | 89,568            | 20,291        | 46,103        | 47,658            | 203,620        |
| Individuals                            | 75,399            | 49,852        | 30,042        | 221,932           | 377,225        |
| Sole proprietors                       | 49,121            | 3,215         | 7,204         | 182,896           | 242,436        |
| <b>Total</b>                           | <b>214,088</b>    | <b>73,358</b> | <b>83,349</b> | <b>452,486</b>    | <b>823,281</b> |

The value of collateral that the Group holds relating to past due loans at 31 December 2010 amounts to AMD 1,184,105 thousand. (2009: AMD 2,157,019 thousand). The collateral consists of real estate and equipment.

*Loans and advances individually impaired*

The total gross amount of individually impaired loans and advances to customers before taking into consideration the cash flows from collateral held is AMD 430,149 thousand (2009: AMD 150,574). Refer to Note 16. The fair value of collateral that the Group holds relating to loans individually determined to be impaired at 31 December 2010 amounts to AMD 845,414 thousand (2009: AMD 158,853 thousand). The collateral consists of real estate and equipment.

*Renegotiated loans*

The carrying amount for renegotiated financial assets by class is presented below:

| In thousand Armenian drams             |  | 2010             | 2009             |
|--|--|------------------|------------------|
| <b>Loans and advances to customers</b> |  |                  |                  |
| Privately held companies               |  | 1,055,398        | 1,661,571        |
| Individuals                            |  | 128,237          | 233,979          |
| Sole proprietors                       |  | 311,640          | 434,064          |
| <b>Total renegotiated loans</b>        |  | <b>1,495,275</b> | <b>2,329,614</b> |

**31.2 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 Group

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 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 Group has no significant concentration of market risk.

### 31.2.1 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 to a reasonable possible change in interest rates, with all other variables held constant, of the Group's statement of comprehensive income.

The sensitivity of the statement of comprehensive income 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 2010, including the effect of hedging instruments. At 31 December 2010 the Group did not own fixed rate available-for-sale financial assets.

| Currency | Change in % | 2010                               | Change in % | 2009                               |
|----------|-------------|------------------------------------|-------------|------------------------------------|
|          |             | Sensitivity of net interest income |             | Sensitivity of net interest income |
| USD      | +2%         | (40,799)                           | +2%         | (30,776)                           |
| EUR      | +2%         | (20,621)                           | +2%         | (45,334)                           |
| USD      | -2%         | 40,799                             | -2%         | 30,776                             |
| EUR      | -2%         | 20,621                             | -2%         | 45,334                             |

#### *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 Group had significant exposure at 31 December 2010 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 statement of comprehensive income (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in statement of comprehensive income, while a positive amount reflects a net potential increase.

| Currency | Change in currency rate in % | 2010                        | Change in currency rate in % | 2009                        |
|----------|------------------------------|-----------------------------|------------------------------|-----------------------------|
|          |                              | Effect on profit before tax |                              | Effect on profit before tax |
| USD      | +20%                         | 21,524                      | +20%                         | 127,843                     |
| EUR      | +20%                         | (4,417)                     | +20%                         | (4,530)                     |
| USD      | -20%                         | (21,524)                    | -20%                         | (127,843)                   |
| EUR      | -20%                         | 4,417                       | -20%                         | 4,530                       |

The Group's exposure to foreign currency exchange risk is as follow:

| In thousand Armenian drams                               | Armenian<br>Dram  | Freely<br>convertible<br>currencies | Non-freely<br>convertible<br>currencies | Total             |
|--|-------------------|-------------------------------------|---|-------------------|
| <b>ASSETS</b>  |                   |                                     |   |                   |
| Cash and balances with the CBA                           | 2,719,205         | 6,362,140                           | 5,206,133                               | 14,287,478        |
| Amounts due from other financial institutions            | 64,861            | 5,724,538                           | 368,610                                 | 6,158,009         |
| Loans and advances to customers                          | 16,218,695        | 13,127,297                          | 98,102                                  | 29,444,094        |
| Investments available for sale                           | 47,339            | -                                   | 24,201                                  | 71,540            |
| Investments held to maturity                             | 2,469,687         | -                                   | -                                       | 2,469,687         |
|  | <u>21,519,787</u> | <u>25,213,975</u>                   | <u>5,697,046</u>                        | <u>52,430,808</u> |
| <b>LIABILITIES</b>                                       |                   |                                     |   |                   |
| Amounts due to financial institutions                    | 4,090,805         | 12,121,336                          | 3,646,310                               | 19,858,451        |
| Amounts due to customers                                 | 9,624,011         | 13,136,038                          | 1,153,125                               | 23,913,174        |
|  | <u>13,714,816</u> | <u>25,257,374</u>                   | <u>4,799,435</u>                        | <u>43,771,625</u> |
| <b>Net position as at 31 December 2010</b>               | <u>7,804,971</u>  | <u>(43,399)</u>                     | <u>897,611</u>                          | <u>8,659,183</u>  |
| <b>Credit related commitments as at 31 December 2010</b> | <u>448,936</u>    | <u>1,869,698</u>                    | <u>-</u>                                | <u>2,318,634</u>  |
| Total financial assets as at December 31 2009            | 19,290,095        | 19,433,169                          | 5,114,078                               | 43,837,342        |
| Total financial liabilities as at December 31 2009       | 10,833,026        | 18,505,649                          | 4,026,662                               | 33,365,337        |
| Net position as at 31 December 2009                      | <u>8,457,069</u>  | <u>927,520</u>                      | <u>1,087,416</u>                        | <u>10,472,005</u> |
| Credit related commitments as at 31 December 2009        | <u>200,651</u>    | <u>541,602</u>                      | <u>-</u>                                | <u>742,253</u>    |

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.

### 31.3 Liquidity risk

Liquidity risk is the risk that the Group 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 Group 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 Group, according to the approved by the Board risk management policy and liquidity risk management directions, applies various methods to manage liquidity risk and meet the liquidity demands. 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 and in the Central Bank of the Russian Federation in accordance with the banking legislation of the Russian Federation in the amount of 0.2-3.5% of the Bank's attracted means. 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 Group 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 liquidity ratios against regulatory requirements. The Bank calculates liquidity ratios on a daily basis in accordance with the requirement of the Central Bank of Armenia.

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2010 based on contractual undiscounted repayment obligations. See note 30 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 Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

In thousand Armenian drams 2010

|   | Demand<br>and less<br>than 1<br>month | From<br>1 to 3<br>months | From<br>3 to 12<br>months | From<br>1 to 5 years | More than<br>5 years | Total             |
|---|---------------------------------------|--------------------------|---------------------------|----------------------|----------------------|-------------------|
| <b>FINANCIAL LIABILITIES</b>                    |                                       |                          |                           |                      |                      |                   |
| Amounts due to financial institutions           | 11,231,654                            | 712,532                  | 1,017,924                 | 8,218,105            | 868,596              | 22,048,811        |
| Amounts due to customers                        | 8,666,525                             | 1,954,192                | 8,674,380                 | 6,375,276            | 81,743               | 25,752,116        |
| <b>Total undiscounted financial liabilities</b> | <b>19,898,179</b>                     | <b>2,666,724</b>         | <b>9,692,304</b>          | <b>14,593,381</b>    | <b>950,339</b>       | <b>47,800,927</b> |
| <b>Credit related commitments</b>               | <b>9,632</b>                          | <b>12,578</b>            | <b>342,997</b>            | <b>1,953,427</b>     | <b>-</b>             | <b>2,318,634</b>  |

In thousand Armenian drams 2009

|   | Demand<br>and less<br>than 1<br>month | From<br>1 to 3<br>months | From<br>3 to 12<br>months | From<br>1 to 5 years | More than<br>5 years | Total             |
|---|---------------------------------------|--------------------------|---------------------------|----------------------|----------------------|-------------------|
| <b>FINANCIAL LIABILITIES</b>                    |                                       |                          |                           |                      |                      |                   |
| Amounts due to financial institutions           | 9,298,122                             | 699,181                  | 3,197,299                 | 4,980,717            | 470,812              | 18,646,131        |
| Amounts due to customers                        | 5,286,902                             | 1,334,239                | 5,664,892                 | 4,705,010            | 435,035              | 17,426,078        |
| <b>Total undiscounted financial liabilities</b> | <b>14,585,024</b>                     | <b>2,033,420</b>         | <b>8,862,191</b>          | <b>9,685,727</b>     | <b>905,847</b>       | <b>36,072,209</b> |
| <b>Credit related commitments</b>               | <b>1,315</b>                          | <b>4,150</b>             | <b>404,230</b>            | <b>332,558</b>       | <b>-</b>             | <b>742,253</b>    |

### 32 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 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, policies 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, share premium, retained earnings including current year profit, and general reserve. Regulatory capital is calculated in accordance with the requirements of the Central Bank of Armenia and accounting standards of the Republic of Armenia. 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 2010 and 2009 the amount of regulatory capital, risk weighted assets and capital adequacy ratio calculated in accordance with the requirements of Central Bank of Armenia are provided below.

| In thousand Armenian drams      | 2010              | 2009              |
|---------------------------------|-------------------|-------------------|
| Tier 1 capital                  | 12,502,127        | 14,448,815        |
| Tier 2 capital                  | (333,428)         | (115,280)         |
| <b>Total regulatory capital</b> | <b>12,168,699</b> | <b>14,333,535</b> |
| Risk-weighted assets            | 54,690,782        | 39,432,008        |
| <b>Capital adequacy ratio</b>   | <b>22,25%</b>     | <b>36,35%</b>     |

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.

