

BTA Bank CJSC
Financial Statements

Year ended 31 December 2009

Together with Independent Auditors' Report

Contents

Independent auditors' report

Statement of financial position	1
Income statement	2
Statement of comprehensive income.....	3
Statement of changes in equity	4
Cash flow statement	5

Notes to financial statements

1. Principal activities	6
2. Basis of preparation.....	6
3. Summary of accounting policies	8
4. Significant accounting judgments and estimates	19
5. Cash and cash equivalents	19
6. Amounts due from credit institutions.....	19
7. Loans to customers	20
8. Investment securities	22
9. Property and equipment	22
10. Intangible assets.....	23
11. Taxation.....	24
12. Other assets and liabilities.....	25
13. Amounts due to the CBA	26
14. Amounts due to credit institutions.....	26
15. Amounts due to customers	26
16. Equity	27
17. Commitments and contingencies.....	28
18. Net fee and commission income.....	29
19. Net gains / (losses) from investment securities available-for-sale	29
20. Other income	29
21. Personnel and other operating expenses	29
22. Risk management.....	30
23. Fair values of financial instruments	37
24. Maturity analysis of assets and liabilities	39
25. Related party disclosures	39
26. Capital adequacy.....	41
27. Events after the reporting period	41

Independent auditors' report

To the Shareholders and Board of Directors of BTA Bank closed joint-stock company -

We have audited the accompanying financial statements of BTA Bank, which comprise the statement of financial position as at 31 December 2009, and the income statement, statements of comprehensive income, of changes in equity and of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the financial statements

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

Auditors' responsibility

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

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

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

Statement of financial position As of 31 December 2009

(Thousands of Armenian drams)

	Notes	2009	2008 (restated)	2007 (restated)
Assets				
Cash and cash equivalents	5	2,223,278	5,587,570	2,076,082
Amounts due from credit institutions	6	71,060	61,432	252,776
Loans to customers	7	3,910,999	5,018,015	12,195,906
Investment securities available-for-sale	8	1,559,065	40,873	540,885
Investment securities pledged under repurchase agreements	8	99,675	1,008,840	520,908
Property and equipment	9	344,325	408,817	377,986
Intangible assets	10	107,798	64,459	48,989
Other assets	12	126,424	197,963	300,033
Total assets		8,442,624	12,387,969	16,313,565
Liabilities				
Amounts due to the Central Bank	13	245,801	1,222,962	519,557
Amounts due to credit institutions	14	1,256,801	4,954,432	6,223,746
Amounts due to customers	15	1,760,621	1,004,855	4,177,783
Other liabilities	12	61,550	78,544	82,746
Total liabilities		3,324,773	7,260,793	11,003,832
Equity				
Share capital	16	6,520,000	6,520,000	5,300,000
Retained earnings (accumulated deficit)		(1,443,360)	(1,381,608)	14,717
Unrealized gains / (losses) on available-for-sale securities		41,211	(11,216)	(4,984)
Total equity		5,117,851	5,127,176	5,309,733
Total equity and liabilities		8,442,624	12,387,969	16,313,565

Signed and authorized for release on behalf of the Management Board of the Bank

Nur Bakbergenov

Head of Management Board

Tatevik Galstyan



Chief Accountant

April 29, 2010

Income statement
For the year ended 31 December 2009

(Thousands of Armenian drams)

	Notes	2009	2008 (restated)
Interest income			
Loans to customers		904,839	1,656,395
Amounts due from credit institutions		13,222	43,838
Investment securities		115,410	59,552
Cash and cash equivalents		64,381	64,581
		1,097,852	1,824,366
Interest expense			
Amounts due to the Central Bank		(68,300)	(31,862)
Amounts due to customers		(54,400)	(223,154)
Amounts due to credit institutions		(159,652)	(698,575)
		(282,352)	(953,591)
Net interest income			
		815,500	870,775
Allowance (reversal of allowance) for loan impairment	7	2,735	(525,038)
Net interest income after allowance for loan impairment		818,235	345,737
Net fee and commission income	18	43,952	55,962
Net gains/(losses) from investment securities available-for-sale	19	(31,701)	16,167
Net gains from foreign currencies:		43,808	306,161
- dealing		4,438	345,590
- translation differences		39,370	(39,429)
Other income	20	77,470	112,267
Non-interest income		133,529	490,557
Personnel expenses	21	(489,374)	(464,222)
Depreciation	9, 10	(50,101)	(43,288)
Other operating expenses	21	(469,585)	(543,154)
Loss on loans disposal	7	(16,325)	(1,177,271)
Other impairment and provisions	12	(1,237)	-
Non-interest expense		(1,026,622)	(2,227,935)
Loss before income tax expense		(74,858)	(1,391,641)
Income tax expense	11	13,106	(4,684)
Loss for the year		(61,752)	(1,396,325)

The accompanying notes on pages 6 to 41 are an integral part of these financial statements.

Statement of comprehensive income
For the year ended 31 December 2009

(Thousands of Armenian drams)

	<u>Note</u>	<u>2009</u>	<u>2008 (restated)</u>
Loss for the year		(61,752)	(1,396,325)
Other comprehensive income			
Unrealised gains on investment securities available-for-sale		45,879	8,379
Realised gains/(losses) on investment securities available-for-sale reclassified to the income statement		19,654	(16,167)
Income tax relating to components of other comprehensive income	11	(13,106)	1,557
Other comprehensive income for the year, net of tax		<u>52,427</u>	<u>(6,231)</u>
Total comprehensive income for the year		<u>(9,325)</u>	<u>(1,402,556)</u>

The accompanying notes on pages 6 to 41 are an integral part of these financial statements.

Statement of changes in equity
For the year ended 31 December 2009

(Thousands of Armenian drams)

	Share capital	Unrealized gains / (losses) on available- for-sale securities	Reserves and retained earnings	Total equity
31 December 2007 (restated)	5,300,000	(4,984)	14,717	5,309,733
Comprehensive income for the year	–	(6,232)	(1,396,325)	(1,402,557)
Issue of share capital	1,220,000	–	–	1,220,000
31 December 2008 (restated)	6,520,000	(11,216)	(1,381,608)	5,127,176
Comprehensive income for the year	–	52,427	(61,752)	(9,325)
31 December 2009	6,520,000	41,211	(1,443,360)	5,117,851

The accompanying notes on pages 6 to 41 are an integral part of these financial statements.

Cash flow statement

For the year ended 31 December 2009

(Thousands of Armenian drams)

	<i>Notes</i>	2009	2008
Cash flows from operating activities			
Interest received		1,090,081	1,863,657
Interest paid		(440,619)	(1,181,335)
Fees and commissions received		73,998	76,449
Fees and commissions paid		(30,045)	(20,487)
Realised gains less losses from dealing in foreign currencies		4,438	345,590
Other income received		76,945	112,267
Losses on loans disposal		(16,325)	(1,177,271)
Personnel expenses paid		(489,374)	(456,663)
Other operating expenses paid		(449,557)	(528,119)
Cash flows from operating activities before changes in operating assets and liabilities		(180,458)	(965,912)
<i>Net (increase)/decrease in operating assets</i>			
Amounts due from credit institutions		(10,658)	231,161
Loans to customers		1,519,579	6,646,539
Other assets		128,130	125,078
<i>Net increase /(decrease) in operating liabilities</i>			
Amounts due to credit institutions		(4,773,724)	(554,783)
Amounts due to customers		641,404	(3,037,884)
Other liabilities		(151,651)	(18,594)
Net cash flows from operating activities before income tax		(2,827,378)	2,425,605
Income tax paid		(19,206)	(49,455)
Net cash from/(used in) operating activities		(2,846,584)	2,376,150
Cash flows from investing activities			
Purchase of investment securities		(2,756,769)	(1,550,098)
Proceeds from sale and redemption of investment securities		2,202,496	1,564,302
Purchase of property and equipment		(71,955)	(115,370)
Proceeds from sale of property and equipment		2,635	25,466
Net cash from/(used in) investing activities		(623,593)	(75,700)
Cash flows from financing activities			
Proceeds from issue of share capital		–	1,220,000
Net cash from/(used in) financing activities		–	1,220,000
Effect of exchange rates changes on cash and cash equivalents		105,885	(8,962)
Net increase/(decrease) in cash and cash equivalents		(3,364,292)	3,511,488
Cash and cash equivalents, beginning		5,587,570	2,076,082
Cash and cash equivalents, ending	5	2,223,278	5,587,570

The accompanying notes on pages 6 to 41 are an integral part of these financial statements.

(Thousands of Armenian drams)

1. Principal activities

BTA Bank closed joint stock company (the “Bank”) is the legal successor of “Sevan Bank”, renamed “Michazgain Investition Bank”, then renamed into “BTA InvestBank”. It was formed on 25 October 1991 as a closed joint stock company under the laws of the Republic of Armenia. Pursuant to a decision by the general shareholders' meeting as of 1 February 2008, the Bank was renamed into BTA Bank (CJSC). The Bank operates under licence of banking activity and financial operations number 31 issued by the Central Bank of Armenia (the “CBA”) on 25 October 1991 (last updated on 31 October 2008).

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 four branches in Yerevan, one branch in Gyumri. The Bank’s registered legal address is 48/1 Nalbandyan Str., Yerevan 0010.

Starting 2005 the Bank is a member of the obligatory deposit insurance system. The system operates under the Armenian laws and regulations and is governed by the Law on Guarantee of Physical Persons Deposits. Insurance covers Bank’s liabilities to individual depositors for the amount up to 2,000 thousand Armenian Drams (up to 1,000 thousand Armenian Drams for deposits in foreign currency) for each individual in case of business failure and revocation of the banking license.

As of 31 December 2009 and 2008, the following shareholders held the shares of BTA Bank (CJSC):

Name of shareholder	%
BTA Bank JSC (Kazakhstan)	49
ZRL Beteiligungs GmbH	31
Mobilex Energy Limited LLC	16
PSC AMK Invest LLC	4
Total	100

The Bank is not ultimately controlled by any individual in accordance with the International Accounting Standard 24 (“IAS 24”) “Related Party Disclosures”. As of 31 December 2009 and 31 December 2008, members of the Board of Directors and Management Board do not hold any shares of the Bank.

The Bank is a partner of BTA Bank JSC (Kazakhstan) in the Republic of Armenia. The banks closely interact and cooperate with each other during the joint servicing of the foreign trade clients and projects in order to create a sustainable financial and trade base aimed at development and higher profitability of the both banks’ businesses. These financial statements were approved by the Board of Directors of the Bank on 29 April 2010.

2. Basis of preparation

General

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

The Bank is required to maintain its records and prepare its financial statements for regulatory purposes in Armenian Drams in accordance with Armenian accounting and banking legislation and related instructions (“AABL”). These financial statements are based on the Bank’s AABL books and records, as adjusted and reclassified in order to comply with IFRS.

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, trading and available-for-sale securities, derivative financial instruments have been measured at fair value.

These financial statements are presented in thousands of Armenian Drams (“AMD”), unless otherwise indicated.

(Thousands of Armenian drams)

2. Basis of preparation (continued)

Correction of errors

During preparation of the financial statements for the year ended 31 December 2009, the Bank identified the following prior period errors:

- ▶ The Bank did not recognize income tax expense in amount of AMD 2,803.

The Bank has corrected these errors by restating the comparative information for the year ended 31 December 2008 in accordance with IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”, as follows:

	As previously reported	Correction of errors	As restated
Statement of financial position			
Retained earnings (accumulated deficit)	(1,378,805)	(2,803)	(1,381,608)
Unrealized gains / (losses) on available-for-sale securities	(14,019)	2,803	(11,216)
Income statement			
Income tax expense	(1,881)	(2,803)	(4,684)
Loss for the year	(1,393,522)	(2,803)	(1,396,325)

Reclassifications

The following reclassifications have been made to 2008 balances to conform to the 2009 presentation.

	As previously reported	Reclassification	As adjusted
Statement of financial position			
Cash and cash equivalents	4,918,097	669,473	5,587,570
Amounts due from credit institutions	730,905	(669,473)	61,432
Investment securities: - available-for-sale	1,049,713	(1,008,840)	40,873
Investment securities pledged under repurchase agreements	–	1,008,840	1,008,840
Current tax assets	44,185	(44,185)	–
Other assets	153,778	44,185	197,963
Income statement			
Personnel expenses	459,013	5,209	464,222
Other operating expenses	548,363	(5,209)	543,154

Going concern

These financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business.

The Bank made a loss of AMD 61,752 for the year ended 31 December 2009 and as of that date its accumulated losses amounted to AMD 1,443,360 and its total assets decreased by AMD 3,945,345 in 2009.

As at 31 December 2009 and 2008 the Bank had significant activities’ restrictions for loans granting, cap on interest on deposits attracted, restrictions on new branches opening and certain operations with related parties as well as overdue unsatisfied prescription for share capital increase imposed by the CBA.

(Thousands of Armenian drams)

2. Basis of preparation (continued)

Going concern (continued)

These conditions including significant dependence on financing from main shareholder which is currently uncertain indicate the existence of a material uncertainty which may cast significant doubt about the Bank's ability to continue as a going concern, therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. Management expects the Bank to release from any limitations of activities in 2010 and engage potential investors to increase share capital and ensure adequate financing to enable the Bank to continue its operations.

3. Summary of accounting policies

Changes in accounting policies

The Bank has adopted the following amended IFRS and new IFRIC Interpretations during the year. The principal effects of these changes are as follows:

Improvements to IFRS

In May 2008, the IASB issued amendments to IFRS, which resulted from the IASB's annual improvements project. They comprise amendments that result in accounting changes for presentation, recognition or measurement purposes as well as terminology or editorial amendments related to a variety of individual IFRS standards. Most of the amendments are effective for annual periods beginning on or after 1 January 2009, with earlier application permitted. Amendments included in May 2008 "Improvements to IFRS" did not have any impact on the accounting policies, financial position or performance of the Bank, except for the amendment to IAS 20 "Accounting for Government Grants and Disclosure of Government Assistance", as described below.

IAS 20 has been amended to require that loans received from the government that have a below-market rate of interest be recognized and measured in accordance with IAS 39 "Financial Instruments: Recognition and Measurement". The benefit of the government loan is measured at the inception of the loan as the difference between the cash received and the amount at which the loan is initially recognised in the statement of financial position. This benefit is accounted for in accordance with IAS 20. The amendment is applied prospectively to government loans received on or after 1 January 2009.

IAS 1 Presentation of Financial Statements (Revised)

A revised IAS 1 was issued in September 2007, and became effective for annual periods beginning on or after 1 January 2009. This revised Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income: it presents all items of recognised income and expense, either in one single statement, or in two linked statements. The revised standard also requires that the income tax effect of each component of comprehensive income be disclosed. In addition, it requires entities to present a comparative statement of financial position as at the beginning of the earliest comparative period when the entity has applied an accounting policy retrospectively, makes a retrospective restatement, or reclassifies items in the financial statements.

The Bank has elected to present comprehensive income in two separate statements: income statement and statement of comprehensive income. The Bank retrospectively reclassified items in the financial statements.

IFRS 7 "Financial Instruments: Disclosures"

The amendments to IFRS 7 were issued in March 2009, to enhance fair value and liquidity disclosures. With respect to fair value, the amendments require disclosure of a three-level fair value hierarchy, by class, for all financial instruments recognised at fair value and specific disclosures related to the transfers between levels in the hierarchy and detailed disclosures related to level 3 of the fair value hierarchy. In addition, the amendments modify the required liquidity disclosures with respect to derivative transactions and assets used for liquidity management. Comparative information has not been provided as permitted by the transition provisions of the amendment.

IAS 23 "Borrowing Costs"(Revised)

A revised IAS 23 Borrowing costs was issued in March 2007, and became effective for financial years beginning on or after 1 January 2009. The standard has been revised to require capitalisation of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the Standard, the Bank adopted this as a prospective change. No changes were made for borrowing costs incurred to 1 January 2009 that have been expensed.

(Thousands of Armenian drams)

3. Summary of accounting policies

Changes in accounting policies (continued)

IAS 24 “Related party disclosures” (Revised)

The revised IAS 24, issued in November 2009, simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. Previously, an entity controlled or significantly influenced by a government was required to disclose information about all transactions with other entities controlled or significantly influenced by the same government. The revised standard requires disclosure about these transactions only if they are individually or collectively significant. The revised IAS 24 is effective for annual periods beginning on or after 1 January 2011, with earlier application permitted. The Bank has decided to early adopt the revised IAS 24 from 1 January 2009.

Amendments to IAS 32 “Financial Instruments: Presentation” and IAS 1 “Presentation of Financial Statements” – Puttable Financial Instruments and Obligations Arising on Liquidation

These amendments were issued in February 2008, and became effective for annual periods beginning on or after 1 January 2009. The amendments require puttable instruments that represent a residual interest in an entity to be classified as equity, provided they satisfy certain conditions. These amendments did not have any impact on the Bank.

Amendments to IFRS 2 “Share-based Payment”- Vesting Conditions and Cancellations

Amendment to IFRS 2 were issued in January 2008 and became effective for annual periods beginning on or after 1 January 2009. This amendment clarifies the definition of vesting conditions and prescribes the accounting treatment of an award that is effectively cancelled because a non-vesting condition is not satisfied. This amendment did not have any impact on the financial position or performance of the Bank.

IFRS 8 “Operating Segments”

IFRS 8 became effective for annual periods beginning on or after 1 January 2009. This Standard requires disclosure of information about the Bank’s operating segments and replaces the requirement to determine primary (business) and secondary (geographical) reporting segments of the Bank. Adoption of this Standard did not have any impact on the financial position or performance of the Bank. The Bank determined that the operating segments are the same as the business segments previously identified under *IAS 14 ‘Segment Reporting’*.

IFRIC 13 “Customer Loyalty Programmes”

IFRIC Interpretation 13 was issued in June 2007 and became effective for annual periods beginning on or after 1 July 2008. This Interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. This interpretation did not have any impact on the Bank’s financial statements as no such schemes currently exist.

IFRIC 15 “Agreements for the Construction of Real Estate”

IFRIC Interpretation 15 was issued in July 2008 and is applicable retrospectively for annual periods beginning on or after 1 January 2009. IFRIC 15 clarifies when and how revenue and related expenses from the sale of a real estate unit should be recognized if an agreement between a developer and a buyer is reached before the construction of the real estate is completed. The interpretation also provides guidance on how to determine whether an agreement is within the scope of IAS 11 “Construction Contracts” or IAS 18 “Revenue” and supersedes the current guidance for real estate in the Appendix to IAS 18. This interpretation did not have any impact on the Bank’s financial statements.

IFRIC 16 “Hedges of a Net Investment in a Foreign Operation”

IFRIC Interpretation 16 was issued in July 2008 and is applicable for annual periods beginning on or after 1 October 2008. This Interpretation provides guidance on identifying the foreign currency risks that qualify for hedge accounting in the hedge of net investment, where within the group the hedging instrument can be held and how an entity should determine the amount of foreign currency gain or loss, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment. This interpretation did not have any impact on the Bank’s financial statements.

Amendments to IFRIC 9 “Reassessment of Embedded Derivatives”

The amendments require entities to assess whether to separate an embedded derivative from a host contract in the case where the entity reclassifies a hybrid financial asset out of the fair value through profit or loss category. This assessment is to be made based on circumstances that existed on the later of the date the entity first became a party to the contract and the date of any contract amendments that significantly change the cash flows of the contract. The amendments are applicable for annual periods ending on or after 30 June 2009. The application of the amendment did not have a significant impact on the Bank’s financial statements as no reclassifications were made for instruments that contained embedded derivatives.

(Thousands of Armenian drams)

3. Summary of accounting policies

Changes in accounting policies (continued)

IFRIC 18 Transfers of Assets from Customers

IFRIC 18 was issued in January 2009 and becomes effective for transfers of assets from customers received on or after 1 July 2009 with early application permitted, provided valuations were obtained at the date those transfers occurred. This interpretation should be applied prospectively. IFRIC 18 provides guidance on accounting for agreements in which an entity receives from a customer an item of property, plant and equipment that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services or to do both. This interpretation did not have any impact on the financial position or performance of the Bank as the Bank has no transfers of assets from its customers.

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

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

'Day 1' profit

Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognises the difference between the transaction price and fair value (a 'Day 1' profit) in the income statement. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognised in the income statement when the inputs become observable, or when the instrument is derecognised.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category 'financial assets at fair value through profit or loss'. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognised in the income statement.

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Bank has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortised cost. Gains and losses are recognised in the income statement when the investments are impaired, as well as through the amortisation process.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

(Thousands of Armenian drams)

3. Summary of accounting policies (continued)

Financial assets (continued)

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognised in other comprehensive income 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 other comprehensive income is reclassified to the income statement. However, interest calculated using the effective interest method is recognised in the income statement.

Determination of fair value

The fair value for financial instruments traded in active market at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Offsetting

Financial assets and liabilities are offset and the net amount is 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 to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- ▶ a financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity;
- ▶ other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category of the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

Cash and cash equivalents

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

Repurchase and reverse repurchase agreements and securities lending

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the 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. The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as amounts due from credit institutions or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

(Thousands of Armenian drams)

3. Summary of accounting policies (continued)

Repurchase and reverse repurchase agreements and securities lending (continued)

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

Derivative financial instruments

In the normal course of business, the Bank may enter into various derivative financial instruments including forwards and swaps in the foreign exchange markets. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the income statement as net gains/(losses) from trading securities or net gains/(losses) from foreign currencies dealing, depending on the nature of the instrument.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair on the trading portfolio with changes in fair value recognised in the income statement.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to the Central bank and Government, amounts due to credit institutions, amounts due to customers and debt securities issued. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the borrowings are derecognised as well as through the amortisation process.

Operating leases - Bank 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.

Impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation 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.

Amounts due from credit institutions and loans to customers

For amounts due from credit institutions and loans to customers carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them 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.

(Thousands of Armenian drams)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the income statement.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. 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 foreclosure is probable.

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

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of 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 years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Held-to-maturity financial investments

For held-to-maturity investments the Bank assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss 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. The carrying amount of the asset is reduced and the amount of the loss is recognised in the income statement.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, any amounts formerly charged are credited to the income statement.

Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the income statement – is reclassified from other comprehensive income to the income statement. Impairment losses on equity investments are not reversed through the income statement; increases in their fair value after impairment are recognised in other comprehensive income.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in the income statement. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement.

(Thousands of Armenian drams)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

Renegotiated loans

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

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

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

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

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

Financial liabilities

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

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

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the income statement. The premium received is recognised in the income statement on a straight-line basis over the life of the guarantee.

(Thousands of Armenian drams)

3. Summary of accounting policies (continued)

Taxation

The current income tax expense is calculated in accordance with the regulations of the Republic of Armenia

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 utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting 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.

Armenia also has various operating taxes, that are assessed on the Bank 's activities. These taxes are included as a component of other operating expenses.

Property and equipment

Property and equipment are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	<u>Years</u>
Buildings	50
Furniture and fixtures	10
Computers and office equipment	5-10
Motor vehicles	10
Leasehold improvements	10

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

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

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. 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 20 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 indefinite useful lives are reviewed at least at each financial year-end.

(Thousands of Armenian drams)

3. Summary of accounting policies (continued)

Provisions

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

Retirement and other employee benefit obligations

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

Share capital

Share capital

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

Treasury shares

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

Dividends

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

Contingencies

Contingent liabilities are not recognised in the statement of financial position but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognised in the statement of financial position but disclosed when an inflow of economic benefits is probable.

Recognition of income and expenses

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

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

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 recognised using the original effective interest rate applied to the new carrying amount.

(Thousands of Armenian drams)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Fee and commission income

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

- ▶ *Fee income earned from services that are provided over a certain period of time*

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

- ▶ *Fee income from providing transaction services*

Fees arising from negotiating or participating in the negotiation of a transaction for a third party – such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

Dividend income

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

Foreign currency translation

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

Differences between the contractual exchange rate of a transaction in a foreign currency and the Central Bank exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The average market exchange rates declared by the CBA at 31 December, 2009 and 31 December, 2008, were 377.89 and 306.73 Armenian drams to 1 USD, respectively.

Future changes in accounting policies

Standards and interpretations issued but not yet effective

Amendment to IAS 39 "Financial Instruments: recognition and measurement" - Eligible Hedged Items

The amendment to IAS 39 was issued in August 2008, and becomes effective for annual periods beginning on or after 1 July 2009. The amendment addresses the designation of a one-sided risk in a hedged item, and designation of inflation as a hedged risk or portion in particular situations. It clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item. Management does not expect the amendment to IAS 39 to affect the Bank's financial statements as the Bank has not entered into any such hedges.

IFRS 3 "Business Combinations" (revised in January 2008) and IAS 27 "Separate Financial Statements" (revised in January 2008)

The revised standards were issued in January 2008 and become effective for financial years beginning on or after 1 July 2009. Revised IFRS 3 introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. Revised IAS 27 requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore, the revised standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by the revised Standards must be applied prospectively and will affect only future acquisitions and transactions with minority interests.

(Thousands of Armenian drams)

3. Summary of accounting policies (continued)

Future changes in accounting policies (continued)

IFRS 2 Share-based Payment: Group Cash-settled Share-based Payment Transactions

The amendment to IFRS 2 was issued in June 2009 and become effective for financial years beginning on or after 1 January 2010. The amendment clarifies the scope and the accounting for group cash-settled share-based payment transactions. This amendment also supersedes IFRIC 8 and IFRIC 11. The Bank expects that this amendment will have no impact on the Bank's financial statements.

IFRIC 17 "Distribution of Non-Cash Assets to Owners"

IFRIC Interpretation 17 was issued on 27 November 2008 and is effective for annual periods beginning on or after 1 July 2009. IFRIC 17 applies to pro rata distributions of non-cash assets except for common control transactions and requires that a dividend payable should be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity; an entity should measure the dividend payable at the fair value of the net assets to be distributed; an entity should recognise the difference between the dividend paid and the carrying amount of the net assets distributed in profit or loss. The Interpretation also requires an entity to provide additional disclosures if the net assets being held for distribution to owners meet the definition of a discontinued operation. The Bank expects that this interpretation will have no impact on the Bank's financial statements.

Improvements to IFRSs

In April 2009 the IASB issued the second omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. Most of the amendments are effective for annual periods beginning on or after 1 January 2010. There are separate transitional provisions for each standard. Amendments included in April 2009 "Improvements to IFRS" will have no impact on the accounting policies, financial position or performance of the Bank, except the following amendments resulting in changes to accounting policies, as described below.

- ▶ IFRS 5 Non-current Assets Held for Sale and Discontinued Operations: clarifies that the disclosures required in respect of non-current assets and disposal groups classified as held for sale or discontinued operations are only those set out in IFRS 5. The disclosure requirements of other IFRSs only apply if specifically required for such non-current assets or discontinued operations. The Bank expects that this amendment will have no impact on the Bank's financial statements.
- ▶ IFRS 8 Operating Segment Information: clarifies that segment assets and liabilities need only be reported when those assets and liabilities are included in measures that are used by the chief operating decision maker. As the Bank's chief operating decision maker does review segment assets and liabilities, the Bank will continue to disclose this information.
- ▶ IAS 7 Statement of Cash Flows: Explicitly states that only expenditure that results in recognising an asset can be classified as a cash flow from investing activities.
- ▶ IAS 36 Impairment of Assets: The amendment clarifies that the largest unit permitted for allocating goodwill, acquired in a business combination, is the operating segment as defined in IFRS 8 before aggregation for reporting purposes. The amendment will have no impact on the Bank as the annual impairment test is performed before aggregation.

Amendments to IAS 32 "Financial Instruments: Presentation": Classification of Rights Issues"

In October 2009, the IASB issued amendment to IAS 32. Entities shall apply that amendment for annual periods beginning on or after 1 February 2010. Earlier application is permitted. The amendment alters the definition of a financial liability in IAS 32 to classify rights issues and certain options or warrants as equity instruments. This is applicable if the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, in order to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. The Bank expects that this amendment will have no impact on the Bank's financial statements.

IFRS 9 "Financial Instruments"

In November 2009 the IASB issued the first phase of IFRS 9 Financial instruments. This Standard will eventually replace IAS 39 Financial Instrument: Recognition and Measurement. IFRS 9 becomes effective for financial years beginning on or after 1 January 2013. Entities may adopt the first phase for reporting periods ending on or after 31 December 2009. The first phase of IFRS 9 introduces new requirements on classification and measurement of financial assets. In particular, for subsequent measurement all financial assets are to be classified at amortised cost or at fair value through profit or loss with the irrevocable option for equity instruments not held for trading to be measured at fair value through other comprehensive income. The Bank now evaluates the impact of the adoption of new Standard and considers the initial application date.

(Thousands of Armenian drams)

4. Significant accounting judgments and estimates

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgments and estimates are as follows:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

Allowance for loan impairment

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

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2009	2008 (restated)	2007 (restated)
Cash on hand	429,705	258,115	423,331
Current accounts with the Central Bank	513,067	1,020,324	1,259,257
Current accounts with other credit institutions	433,412	3,887,524	170,329
Reverse repurchase agreements up to 90 days	847,094	421,607	223,165
Cash and cash equivalents	2,223,278	5,587,570	2,076,082

The Bank had entered into reverse repurchase agreements with three Armenian non-bank financial organizations. The subject of these agreements is State treasury bonds issued by Ministry of Finance of Armenia with a fair value of AMD 844,954 AMD (2008 – AMD 428,646).

Current accounts with the Central Bank include the obligatory reserve deposits with the CBA. Banks are required to maintain obligatory reserves with the CBA that 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. 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. These current accounts are non-interest bearing.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2009	2008 (restated)	2007 (restated)
Deposits with the Central Bank	20,370	20,248	17,978
Time deposits for more than 90 days	–	–	225,873
Deposits with the OECD bank	47,194	41,184	–
Other amounts	3,496	–	8,925
Amounts due from credit institutions	71,060	61,432	252,776

(Thousands of Armenian drams)

7. Loans to customers

Loans to customers comprise:

	2009	2008
Corporate lending	899,201	1,054,675
Small business lending	489,717	978,043
Consumer lending	1,784,186	2,329,034
Residential mortgages	1,064,092	1,279,992
Gross loans to customers	4,237,196	5,641,744
Less – Allowance for impairment	(326,197)	(623,729)
Loans to customers	3,910,999	5,018,015

Allowance for impairment of loans to customers

A reconciliation of the allowance for impairment of loans to customers by class is as follows:

	Corporate lending 2009	Small business lending 2009	Consumer lending 2009	Residential mortgages 2009	Total 2009
At 1 January 2009	237,078	118,678	164,403	103,570	623,729
Charge for the year (recoveries)	(88,882)	72,941	(24,699)	37,905	(2,735)
Amounts written off	–	(137,026)	(71,908)	(85,863)	(294,797)
At 31 December 2009	148,196	54,593	67,796	55,612	326,197
Individual impairment	83,921	24,549	31,237	19,545	159,252
Collective impairment	64,275	30,044	36,559	36,067	166,945
	148,196	54,593	67,796	55,612	326,197
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	139,410	114,460	51,867	96,753	402,490

	Corporate lending 2008	Small business lending 2008	Consumer lending 2008	Residential mortgages 2008	Total 2008
At 1 January 2008	79,491	27,804	20,635	17,575	145,505
Charge for the year (recoveries)	157,587	118,492	149,675	99,284	525,038
Amounts written off	–	(27,618)	(5,907)	(13,289)	(46,814)
At 31 December 2008	237,078	118,678	164,403	103,570	623,729
Individual impairment	217,305	77,682	14,620	72,316	381,923
Collective impairment	19,773	40,996	149,783	31,254	241,806
	237,078	118,678	164,403	103,570	623,729
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	673,398	187,576	19,982	104,985	985,941

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2009, comprised AMD 9,158 (2008 – AMD 13,574).

The fair value of collateral that the Bank holds relating to loans individually determined to be impaired at 31 December 2009 amounts to AMD 1,680,865 (2008 - AMD 1,274,566).

(Thousands of Armenian drams)

7. Loans to customers (continued)

Collateral and other credit enhancements

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- ▶ For securities lending and reverse repurchase transactions, cash or securities,
- ▶ For commercial lending, charges over real estate properties, inventory and trade receivables,
- ▶ For residential mortgages, mortgages over residential properties.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

Derecognition of a loan portfolio

In February 2009, the Bank sold the rights to 100% of the cash flows arising on a portfolio of fixed rate loans carried at AMD 163,252 to a related party for a payment of AMD 146,927. In December 2008, the Bank sold the rights to 100% of the cash flows arising on a portfolio of fixed rate loans carried at AMD 4,729,317 to a related party for a payment of AMD 3,565,216.

According to the transaction agreements substantially all the risks and rewards of the portfolio have been transferred. Active trading of loans is not available in Armenia at present. The Bank believes that the payment for the loans disposed is adequate to their fair value.

Concentration of loans to customers

As of 31 December 2009, the Bank had a concentration of loans represented by AMD 1,152,168 due from the ten largest third party borrowers (27.2% of gross loan portfolio) (2008 – AMD 1,419,500 or 25.20 %). An allowance of AMD 163,444 (2008 – AMD 280,891) was recognised against these loans.

Loans have been extended to the following types of customers:

	<u>2009</u>	<u>2008</u>
Individuals	2,848,277	3,609,026
Private companies	1,388,919	2,032,718
	<u>4,237,196</u>	<u>5,641,744</u>

Loans are made principally within Armenia in the following industry sectors:

	<u>2009</u>	<u>2008</u>
Individuals	2,848,277	3,609,026
Trading enterprises	734,323	912,766
Manufacturing	330,462	463,443
Services	263,645	399,292
Agriculture	30,229	41,535
Transport and telecommunication	3,567	174,123
Construction	–	5,649
Other	26,693	35,910
	<u>4,237,196</u>	<u>5,641,744</u>

(Thousands of Armenian drams)

8. Investment securities

Available-for-sale securities comprise:

	2009	2008	2007
State treasury bonds of Ministry of Finance of Armenia	1,538,236	7,997	259,129
Bonds issued by the Central Bank of Armenia	–	–	248,896
Corporate shares	32,876	32,876	33,131
Investment securities available- for -sale, gross	1,571,112	40,873	541,156
Impairment reserve	(12,047)	–	(271)
Available-for-sale securities	1,559,065	40,873	540,885
	2009	2008	2007
State treasury bonds of Ministry of Finance of Armenia	99,675	909,198	422,942
Bonds issued by the Central Bank of Armenia	–	99,642	97,966
Available-for-sale securities pledged under repurchase agreements	99,675	1,008,840	520,908

As of 31 December 2009, the Bank held State treasury bonds of the Ministry of Finance of Armenia (2008 - State treasury bonds of the Ministry of Finance of Armenia and bonds issued by the CBA) maturing in 2010-2018 (2008 – in 2010-2012) with interest ranging from 8.5% to 12.5% (2008 – from 8.04% to 8.66%).

As of 31 December 2009 and 31 December 2008, the Bank held corporate shares of “Armenian Card” (payment system), “Armenian Credit Reporting Agency” (credit bureau) and SWIFT. As of December 31, 2009 Bank recognised impairment loss on assets available for sale in total amount of AMD 12,047 (2008 - 0).

9. Property and equipment

The movements in property and equipment were as follows:

	Buildings	Furniture and fixtures	Computers and office equipment	Motor vehicles	Leasehold improvements	Total
Cost						
31-Dec-08	166,315	222,047	128,783	48,616	35,602	601,363
Additions	859	15,359	3,587	–	3,975	23,780
Disposals	–	(7,665)	–	–	(6,971)	(14,636)
Transfers	(34,933)	1,562	–	–	(1,562)	(34,933)
31-Dec-09	132,241	231,303	132,370	48,616	31,044	575,574
Accumulated depreciation						
31-Dec-08	19,313	63,781	66,795	28,318	14,339	192,546
Depreciation charge	2,596	20,226	18,585	2,663	1,195	45,265
Disposals	–	(3,975)	(1,507)	–	(1,080)	(6,562)
31-Dec-09	21,909	80,032	83,873	30,981	14,454	231,249
Net book value:						
31-Dec-08	147,002	158,266	61,988	20,298	21,263	408,817
31-Dec-09	110,332	151,271	48,497	17,635	16,590	344,325

(Thousands of Armenian drams)

9. Property and equipment (continued)

	<i>Buildings</i>	<i>Furniture and fixtures</i>	<i>Computers and office equipment</i>	<i>Motor vehicles</i>	<i>Leasehold improvements</i>	<i>Total</i>
Cost						
31-Dec-07	197,598	157,911	110,976	48,616	29,591	544,692
Additions	149	67,169	22,776	–	6,011	96,105
Disposals	(31,432)	(3,033)	(4,969)	–	–	(39,434)
31-Dec-08	166,315	222,047	128,783	48,616	35,602	601,363
Accumulated depreciation						
31-Dec-07	21,689	50,054	56,043	25,653	13,267	166,706
Depreciation charge	3,379	16,700	15,674	2,665	1,072	39,490
Disposals	(5,755)	(2,973)	(4,922)	–	–	(13,650)
31-Dec-08	19,313	63,781	66,795	28,318	14,339	192,546
Net book value:						
31-Dec-07	175,909	107,857	54,933	22,963	16,324	377,986
31-Dec-08	147,002	158,266	61,988	20,298	21,263	408,817

10. Intangible assets

The movements in intangible assets were as follows:

	<i>Licenses</i>	<i>Computer software</i>	<i>Total</i>
Cost			
31-Dec-08	65,103	19,458	84,561
Additions	–	48,175	48,175
Disposals	–	–	–
31-Dec-09	65,103	67,633	132,736
Accumulated depreciation			
31-Dec-08	14,781	5,321	20,102
Amortization charge	3,111	1,725	4,836
Disposals	–	–	–
31-Dec-09	17,892	7,046	24,938
Net book value:			
31-Dec-08	50,322	14,137	64,459
31-Dec-09	47,211	60,587	107,798

	<i>Licenses</i>	<i>Computer software</i>	<i>Total</i>
Cost			
31-Dec-07	50,602	14,691	65,293
Additions	14,501	4,767	19,268
Disposals	–	–	–
31-Dec-08	65,103	19,458	84,561
Accumulated depreciation			
31-Dec-07	11,694	4,610	16,304
Amortization charge	3,087	711	3,798
Disposals	–	–	–
31-Dec-08	14,781	5,321	20,102
Net book value:			
31-Dec-07	38,908	10,081	48,989
31-Dec-08	50,322	14,137	64,459

(Thousands of Armenian drams)

11. Taxation

The corporate income tax expense comprises:

	<u>2009</u>	<u>2008</u>
Current tax charge/(credit)	–	
Deferred tax charge/(credit) – origination and reversal of temporary differences	63,630	(78,544)
Less: deferred tax recognised in other comprehensive income	(13,106)	1,557
Less: unrecognized deferred tax (expense) benefit	(63,630)	81,671
Income tax expense	<u>(13,106)</u>	<u>4,684</u>

Deferred tax related to items charged or credited to other comprehensive income during the year is as follows:

	<u>2009</u>	<u>2008</u>
Net gains /(losses) on investment securities available for sale	13,106	(1,557)
Less: unrecognized deferred tax (expense) benefit	(13,106)	1,557
Income tax charged to other comprehensive income	<u>–</u>	<u>–</u>

Armenian legal entities must file individual tax declarations. The tax rate for banks for profits other than on state securities was 20% for 2009 and 2008. The tax rate for companies other than banks was also 20% for 2009 and 2008.

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

	<u>2009</u>	<u>2008</u>
Loss before tax	(74,858)	(1,391,641)
Statutory tax rate	20%	20%
Theoretical income tax expense/(benefit) at the statutory rate	<u>(14,972)</u>	<u>(278,328)</u>
Non taxable foreign currency translation differences	(7,856)	7,886
Non-deductible expenses	4,016	4,592
Other permanent differences	4,243	1,123
Less: unrecognized current income tax benefit	65,093	187,740
Less: unrecognized deferred income tax benefit	(63,630)	81,671
Income tax expense	<u>(13,106)</u>	<u>4,684</u>

(Thousands of Armenian drams)

11. Taxation (continued)

Deferred tax assets and liabilities as of 31 December and their movements for the respective years comprise:

	<i>Origination and reversal of temporary differences</i>			<i>Origination and reversal of temporary differences</i>			
	<i>2007</i>	<i>In the income statement</i>	<i>In other compre- hensive income</i>	<i>2008</i>	<i>In the income statement</i>	<i>In other compre- hensive income</i>	<i>2009</i>
Tax effect of deductible temporary differences:							
Allowance for loan impairment	–	80,505		80,505	(60,326)		20,179
Securities	1,247		1,557	2,804		(2,804)	–
Property and equipment	–	474		474	333		807
Other assets	–	–		–	1,891		1,891
Other liabilities	4,936	5,035		9,971	(2,448)		7,523
Gross deferred tax asset	6,183	86,014	1,557	93,754	(60,550)	(2,804)	30,400
Tax effect of taxable temporary differences:							
Cash and cash equivalents	(360)	(7,497)		(7,857)	6,888		(969)
Allowance for loan impairment	(1,319)	1,319		–	–		–
Securities	–	(3,717)		(3,717)	2,630	(10,303)	(11,390)
Other assets	(1,377)	869		(508)	508		–
Other liabilities	–	–		–	–		–
Deferred tax liability	(3,056)	(9,026)	–	(12,082)	10,026	(10,303)	(12,359)
Deferred tax asset accrued	3,127	76,988	1,557	81,672	(50,524)	(13,106)	18,041
Unrecognized Deferred tax asset		(81,671)	–	(81,672)	63,630	–	(18,041)
Deferred tax asset, net	3,127	(4,684)	1,557	–	13,106	(13,106)	–

12. Other assets and liabilities

Other assets comprise:

	2009	2008 (restated)	2007 (restated)
Current tax assets	63,391	44,185	–
Building for sale	34,933	–	–
Settlements on payment operations	12,983	–	14,125
Accounts receivable	8,779	2,237	19,605
Prepayment for real estate rent	5,428	122,083	367
Prepayments to suppliers	3,749	24,107	6,787
Prepaid operating taxes	2	–	107,522
Settlements on currency swap operations	–	985	138,683
Deferred tax assets	–	–	3,127
Other	4,892	4,366	9,817
Other assets, gross	134,157	197,963	300,033
Less – Allowance for impairment of other assets	(7,733)	–	–
Other assets	126,424	197,963	300,033

(Thousands of Armenian drams)

12. Other assets and liabilities (continued)

Other liabilities comprise:

	2009	2008 (restated)	2007 (restated)
Liabilities to personnel	24,051	22,882	21,062
Liabilities to distributors	18,795	27,364	8,659
Settlements on payment operations	15,361	18,849	16,268
Liabilities to budget	2,018	8,603	9,648
Current tax liabilities	–	–	22,771
Other	1,325	846	4,338
Other liabilities	61,550	78,544	82,746

The movements in other impairment allowances were as follows:

	Other assets
31 December 2007	–
31 December 2008	–
Charge	(1,237)
Write-offs	7,991
Recoveries	(14,487)
31 December 2009	(7,733)

Allowance for impairment of assets is deducted from the carrying amounts of the related assets.

13. Amounts due to the Central Bank

Amounts due to Central Bank consist of amounts due to the CBA under repurchase agreements. The subjects of these agreements are State treasury bonds of Ministry of Finance of Armenia (2008 - State treasury bonds of Ministry of Finance of Armenia and bonds issued by the CBA) with a fair value of AMD 235,182 (2008 – AMD 1,223,778).

14. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2009	2008
Current accounts	720	720
Time deposits and loans	1,256,081	4,953,712
Amounts due to credit institutions	1,256,801	4,954,432

Included in time deposits and loans are a short-term USD denominated funds received from BTA Bank JSC (Kazakhstan) maturing in 2010 (2008 – in 2009) with interest rate of 12.00% (2008 - from 8.37% to 12.00%), as well as short-term deposits denominated in Armenian dram attracted from Armenian Development Bank, maturing in 2010, with interest rate of 4.00%.

15. Amounts due to customers

The amounts due to customers include the following:

	2009	2008
Current accounts	778,037	317,635
Time deposits	982,584	687,220
Amounts due to customers	1,760,621	1,004,855
Held as security against guarantees	2,000	2,063

(Thousands of Armenian drams)

15. Amounts due to customers (continued)

At 31 December 2009, amounts due to customers of AMD 867,803 (49%) were due to the ten largest customers (2008 – AMD 304,668 (30%)).

Included in time deposits are deposits of individuals in the amount of AMD 626,528 (2008 – AMD 560,075). In accordance with the Civil Code of the Republic of Armenia, the Bank is obliged to repay such deposits upon demand of a depositor. In case a term deposit is repaid upon demand of the depositor prior to maturity, interest on it is paid based on the interest rate for on demand deposits, unless a different interest rate is specified in the agreement.

Amounts due to customers include accounts with the following types of customers:

	2009	2008
Private enterprises	901,547	379,169
Individuals	831,192	608,625
Employees	27,882	17,061
Amounts due to customers	1,760,621	1,004,855

An analysis of customer accounts by economic sector follows:

	2009	2008
Individuals	859,074	625,686
Trade	398,679	115,740
Finances and insurance	377,432	153,665
Manufacturing	101,283	37,692
Energy	9,909	6,402
Food industry	5,434	6,075
Tourism	3,769	3,792
Transport and communication	1,159	15,100
Formation, health and culture	592	5,010
Other	3,290	35,693
Amounts due to customers	1,760,621	1,004,855

16. Equity

Movements in shares outstanding, issued and fully paid were as follows:

	Number of shares		Nominal amount		Total
	Preferred	Ordinary	Preferred	Ordinary	
31-Dec-07	567	4,733	567,000	4,733,000	5,300,000
Increase in share capital		1,220		1,220,000	1,220,000
31-Dec-08	567	5,953	567,000	5,953,000	6,520,000
31-Dec-09	567	5,953	567,000	5,953,000	6,520,000

The number of authorised ordinary and preference shares is 5,953 and 567 respectively, both with a nominal value per share of AMD 1,000.

The share capital of the Bank was contributed by the shareholders in Armenian Drams and they are entitled to dividends and any capital distribution in Armenian Drams. Preference shares are voting only in cases envisaged by Armenian legislation and guarantee annual dividends of not less than 5% of their nominal amount. The Charter of the Bank doesn't allow the payment of dividends in case of accumulated deficit.

(Thousands of Armenian drams)

17. Commitments and contingencies

Operating environment

In current stage of economic development a certain level of instability is characteristic to political and economic environment of the Republic of Armenia, which may affect the activities of enterprises operating in this environment. Consequently, operations in the Republic of Armenia involve risks, which do not typically exist in other markets.

The economic reforms, legal, tax and administrative development continue in Armenia, which meets market economy requirements. Stability of the economy is mostly conditioned with afore-mentioned reforms, as well as with the efficiency of activity undertaken in the sphere of the economy, financial and credit policy.

While management believes it is taking appropriate measures to support the sustainability of the Bank's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Bank's results and financial position in a manner not currently determinable.

Legal

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

Taxation

Armenian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Often, differing interpretations exist among numerous taxation authorities. Taxes are subject to review and investigation by a number of authorities, who are enabled by law to impose severe fines, penalties and interest charges. These facts may create tax risks in the Republic of Armenia substantially more significant than in other countries.

As at 31 December 2009 management believes that its interpretation of the relevant legislation is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Commitments and contingencies

As of 31 December the Bank's commitments and contingencies comprised the following:

	<u>2009</u>	<u>2008</u>
Credit related commitments		
Undrawn loan commitments	29,060	246,557
Guarantees	2,000	2,063
	31,060	248,620
Operating lease commitments		
Not later than 1 year	4,279	259,493
Later than 1 year but not later than 5 years	301,702	982,815
Later than 5 years	–	1,181,067
	305,981	2,423,375
Commitments and contingencies (before deducting collateral)	337,041	2,671,995
Less – Cash held as security against letters of credit and guarantees	(2,000)	(2,063)
Commitments and contingencies	335,041	2,669,932

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions. Liability insurance is generally not available in Armenia at present.

(Thousands of Armenian drams)

18. Net fee and commission income

Net fee and commission income comprises:

	<u>2009</u>	<u>2008</u>
Cash and settlements operations	65,085	68,672
Plastic card operations	8,872	7,442
Guarantees and letters of credit	40	336
Fee and commission income	<u>73,997</u>	<u>76,450</u>
Cash and settlements operations	(18,557)	(4,036)
Plastic card operations	(9,195)	(8,790)
Other	(2,293)	(7,662)
Fee and commission expense	<u>(30,045)</u>	<u>(20,488)</u>
Net fee and commission income	<u><u>43,952</u></u>	<u><u>55,962</u></u>

19. Net gains / (losses) from investment securities available-for-sale

Net gains/(losses) from investment securities available-for-sale recognised in the income statement comprise:

	<u>2009</u>	<u>2008</u>
Net gains/(losses) on sale of investment securities available-for-sale	(19,654)	16,167
Losses on impairment of investment securities available-for-Sale	(12,047)	–
Net gains/(losses) from investment securities available-for-sale	<u>(31,701)</u>	<u>16,167</u>

20. Other income

	<u>2009</u>	<u>2008</u>
Fines and penalties	72,645	108,009
Gain / (loss) from sales of property	(948)	1,407
Remote terminal	1,000	1,335
Other	4,773	1,516
Total other income	<u>77,470</u>	<u>112,267</u>

21. Personnel and other operating expenses

Personnel and other operating expenses comprise:

	<u>2009</u>	<u>2008 (restated)</u>
Salaries and bonuses	446,360	417,809
Social security costs	41,835	41,204
Learning and development	1,179	5,209
Personnel expenses	<u>489,374</u>	<u>464,222</u>
Occupancy and rent	239,657	245,477
Operating taxes	55,290	71,516
Communications	33,055	30,448
Repair and maintenance of property and equipment	31,256	27,616
Security	26,532	18,610
Office supplies	21,118	26,363
Legal and consultancy	13,682	20,416
Representative expenses	12,117	18,658
Business travel and related	5,228	13,463
Membership	4,520	4,055
Marketing and advertising	4,092	52,388
Insurance	1,196	1,602
Fines and penalties	152	2,629
Other	21,690	9,913
Other operating expenses	<u>469,585</u>	<u>543,154</u>

(Thousands of Armenian drams)

22. Risk management

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification measurement and monitoring subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk. It is also subject to operating risks.

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

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

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

Management Board

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

Assets and Liabilities Management Committee

The committee is a collegial body responsible for the Bank's policy related to operations with assets and liabilities with regard to market and prudential risks.

Risk Management Department

The Risk Management Unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Risk Controlling

The Risk Controlling Unit is responsible for monitoring compliance with risk principles, policies and limits, across the Bank. Each business group has a decentralised unit which is responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This unit also ensures the complete capture of the risks in risk measurement and reporting systems.

Bank Treasury

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

Internal audit

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

Risk measurement and reporting systems

Risk assessment is carried out by an expert method using professional judgements of the Risk Management Department's specialists.

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

(Thousands of Armenian drams)

22. Risk management (continued)

Introduction (continued)

On a monthly basis Risk Management Department assesses the appropriateness of creating allowance for credit losses. On a quarterly basis the Board of Directors receives a comprehensive risk report which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

Periodically briefing is given to the Management Board and all other relevant employees of the Bank on the fulfilment of market limits proprietary investments and liquidity plus any other risk developments.

Risk mitigation

As part of its overall risk management, the Bank uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions.

The Bank actively uses collateral to reduce its credit risks (see below for more detail).

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risks the Bank focuses on maintaining a maximally diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties including regular collateral revisions. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the statement of financial position.

Credit-related commitments risks

The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

(Thousands of Armenian drams)

22. Risk management (continued)**Credit risk (continued)**

The table below shows the maximum exposure to credit risk for the components of the statement of financial position, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	<i>Notes</i>	<i>Maximum exposure 2009</i>	<i>Maximum exposure 2008</i>
Cash and cash equivalents (excluding cash on hand)	5	1,793,573	5,329,455
Amounts due from credit institutions	6	71,060	61,432
Loans to customers	7	4,237,196	5,641,744
Investment securities	8	1,670,787	1,049,713
Other assets	12	35,833	153,778
		7,808,449	12,236,122
Financial commitments and contingencies	17	31,060	248,620
Total credit risk exposure		7,839,509	12,484,742

Where 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.

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 7.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank internal credit ratings. The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position, based on the Bank's credit rating system.

	<i>Notes</i>	<i>Neither past due nor impaired</i>		<i>Past due but not impaired 2009</i>	<i>Individually impaired 2009</i>	<i>Total 2009</i>
		<i>Standard grade 2009</i>	<i>Sub-standard 2009</i>			
Amounts due from credit institutions	6	71,060	-	-	-	71,060
Loans to customers	7					
Corporate lending		253,161	442,354	-	55,489	751,004
Small business lending		322,647	16,081	6,486	89,911	435,125
Consumer lending		1,623,352	26,254	46,155	20,630	1,716,391
Residential mortgages		879,932	22,178	29,162	77,207	1,008,479
		3,079,092	506,867	81,803	243,237	3,910,999
Investment securities available-for-sale	8	1,651,212			7,528	1,658,740
Total		4,801,364	506,867	81,803	250,765	5,640,799

	<i>Notes</i>	<i>Neither past due nor impaired</i>		<i>Past due but not impaired 2008</i>	<i>Individually impaired 2008</i>	<i>Total 2008</i>
		<i>Standard grade 2008</i>	<i>Sub-standard 2008</i>			
Amounts due from credit institutions	6	61,432	-	-	-	61,432
Loans to customers	7					
Corporate lending		361,504	-	-	456,092	817,596
Small business lending		522,071	9,699	217,700	109,894	859,364
Consumer lending		2,039,170	42,197	78,315	5,362	2,165,044
Residential mortgages		1,125,775	13,152	4,415	32,669	1,176,011
		4,048,520	65,048	300,430	604,017	5,018,015
Investment securities available-for-sale	8	1,049,713				1,049,713
Total		5,159,665	65,048	300,430	604,017	6,129,160

(Thousands of Armenian drams)

22. Risk management (continued)

Credit risk (continued)

Past due loans to customers include those that are only past due by a few days. An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products, the rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly.

Aging analysis of past due but not impaired loans per class of financial assets

	Less than 30 days 2009	31 to 60 days 2009	61 to 90 days 2009	More than 90 days 2009	Total 2009
Loans to customers					
Corporate lending	–	–	–	–	–
Small business lending	–	6,486	–	–	6,486
Consumer lending	26,032	15,391	4,732	–	46,155
Residential mortgages	–	3,007	26,155	–	29,162
Total	26,032	24,884	30,887	–	81,803

Of the total aggregate amount of gross past due but not impaired loans to customers the fair value of collateral that the Bank held as at 31 December 2009 was AMD 291,342 (2008 - AMD 483,185). See 'Collateral and other credit enhancements' in Note 7 for the details of types of collateral held.

	Less than 30 days 2008	31 to 60 days 2008	61 to 90 days 2008	More than 90 days 2008	Total 2008
Loans to customers					
Corporate lending	–	–	–	–	–
Small business lending	7,853	43,391	12,819	153,636	217,699
Consumer lending	30,650	37,066	7,836	2,764	78,316
Residential mortgages	2,199	2,216	–	–	4,415
Total	40,702	82,673	20,655	156,400	300,430

See Note 7 for more detailed information with respect to the allowance for impairment of loans to customers.

Carrying amount per class of financial assets whose terms have been renegotiated

The table below shows the carrying amount for renegotiated financial assets, by class.

	2009	2008
Loans to customers		
Corporate lending	578,526	–
Small business lending	88,315	–
Consumer lending	1,795	1,531
Total	668,636	1,531

Impairment assessment

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

(Thousands of Armenian drams)

22. Risk management (continued)

Credit risk (continued)

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan 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 realisable 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 to customers that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans 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 no 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 appropriate delay between the time a loss is likely to have been uncured and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

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

The geographical concentration of Bank's monetary assets and liabilities is set out below:

	2009				2008			
	Armenia	OECD	CIS and other foreign banks	Total	Armenia	OECD	CIS and other foreign banks	Total
Assets:								
Cash and cash equivalents	1,797,842	316,755	108,681	2,223,278	1,720,777	41,328	3,825,465	5,587,570
Amounts due from credit institutions	23,866	47,194	–	71,060	20,249	41,183	–	61,432
Loans to customers	3,902,567	–	8,432	3,910,999	5,011,662	–	6,353	5,018,015
Investment securities:								
- available-for-sale	1,657,582	1,158	–	1,658,740	1,048,555	1,158	–	1,049,713
Other assets	125,920	–	504	126,424	195,814	–	2,149	197,963
	7,507,777	365,107	117,617	7,990,501	7,997,057	83,669	3,833,967	11,914,693
Liabilities:								
Amounts due to the Central Bank	245,801	–	–	245,801	1,222,962	–	–	1,222,962
Amounts due to credit institutions	378,822	–	877,979	1,256,801	–	–	4,954,432	4,954,432
Amounts due to customers	1,721,907	9,815	28,899	1,760,621	992,034	–	12,821	1,004,855
Other liabilities	60,519	–	1,031	61,550	76,496	–	2,048	78,544
	2,407,049	9,815	907,909	3,324,773	2,291,492	–	4,969,301	7,260,793
Net assets / (liabilities)	5,100,728	355,292	(790,292)	4,665,728	5,705,565	83,669	(1,135,334)	4,653,900
Net assets / (liabilities) - off balance	30,044	–	1,016	31,060	248,610	–	10	248,620

(Thousands of Armenian drams)

22. Risk management (continued)

Liquidity risk and funding management

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

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can assess to meet liquidity needs. In addition, the Bank maintains a cash deposit with the CBA, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on certain liquidity ratios established by the CBA. As at 31 December, these ratios were as follows:

	2009, %	2008, %
N21 "General Liquidity Ratio" (liquid assets / total assets)	36.39%	23.07%
N22 "Current Liquidity Ratio" (liquid assets / liabilities on demand)	566.60%	579.90%

Analysis of financial liabilities by remaining contractual maturities

The tables below summarize the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations except for trading derivatives which are shown at fair value in a separate column and gross settled derivatives which are shown by contractual maturity. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

Financial liabilities

As at 31 December 2009	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Amounts due to the CBA	247,050				247,050
Amounts due to credit institutions	380,121	904,782			1,284,903
Amounts due to customers	1,504,670	238,165	37,603	8,340	1,788,778
Other liabilities	61,550				61,550
Total undiscounted financial liabilities	2,193,391	1,142,947	37,603	8,340	3,382,281

Financial liabilities

As at 31 December 2008	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Amounts due to the CBA	1,224,899	–	–	–	1,224,899
Amounts due to credit institutions	4,834,089	206,858	–	–	5,040,947
Amounts due to customers	442,829	523,992	75,453	14,542	1,056,816
Other liabilities	78,544	–	–	–	78,544
Total undiscounted financial liabilities	6,580,361	730,850	75,453	14,542	7,401,206

(Thousands of Armenian drams)

22. Risk management (continued)

Liquidity risk and funding management (continued)

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
2009	1,137	26,914	308,990	–	337,041
2008	95,539	208,938	1,181,699	1,185,819	2,671,995

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than three months in the tables above.

Included in due to customers are term deposits of individuals. In accordance with the Armenian legislation the Bank is obliged to repay such deposits upon demand of a depositor. Refer to Note 15.

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 foreign exchanges and equity prices. Except for the concentrations within foreign currency the Bank has no significant concentration of market risk.

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

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2009. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2009 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve.

Currency	Increase in basis points 2009	Sensitivity of net interest income 2009	Sensitivity of equity 2009
AMD	3.78%	–	(79,379)
Currency	Decrease in basis points 2009	Sensitivity of net interest income 2009	Sensitivity of equity 2009
AMD	(3.78%)	–	92,590
Currency	Increase in basis points 2008	Sensitivity of net interest income 2008	Sensitivity of equity 2008
AMD	2.02%	–	(57,482)
Currency	Decrease in basis points 2008	Sensitivity of net interest income 2008	Sensitivity of equity 2008
AMD	(2.02%)	–	65,502

(Thousands of Armenian drams)

22. Risk management (continued)

Market risk (continued)

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Management Board has set limits on positions by currency based on the CBA regulations. Positions are monitored on a daily basis.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December on its monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Armenian dram, with all other variables held constant on the income statement (due to the fair value of currency sensitive monetary assets and liabilities). The effect on equity does not differ from the effect on the income statement. A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

Currency	Change in	Effect on profit	Change in	Effect on profit
	currency rate in % 2009	before tax 2009	currency rate in % 2008	before tax 2008
USD	9.69%	3,389	1.17%	(27,151)
EUR	11.19%	20,515	6.32%	197
RUR	11.68%	(12,256)	3.77%	142,515

Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

The effect on profit before tax for one year and on equity, assuming 10% of repayable financial instruments were to prepay at the beginning of the year, with all other variables held constant, is as follows:

	Effect on net interest income	Effect on equity
2009	98,566	–
2008	97,038	–

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but a control framework and monitoring and responding to potential risks could be effective tools to manage the risks. Controls should include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

Operational risk is assessed by the method of Main Indicator in accordance with Regulation 2 issued by the CBA.

23. Fair values of financial instruments

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- ▶ Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- ▶ Level 2: techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- ▶ Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

(Thousands of Armenian drams)

23. Fair values of financial instruments (continued)

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

At 31 December 2009	Level 1	Level 2	Level 3	Total
Financial assets				
Investment securities – available-for-sale	-	1,637,911	20,829	1,658,740
	-	1,637,911	20,829	1,658,740
At 31 December 2008				
Financial assets				
Investment securities – available-for-sale	-	1,016,837	32,876	1,049,713
	-	1,016,837	32,876	1,049,713

The following table shows the impact on the fair value of level 3 instruments of using reasonably possible alternative assumptions:

	31 December 2009	
	Carrying amount	Effect of reasonably possible alternative assumptions
Financial assets		
Investment securities – available-for-sale	32,876	(5,436)

Fair value of State treasury bonds of Ministry of Finance of Armenia is based on valuation techniques where all the model inputs are observable in the market. Data of last transactions in interbank market is used to calculate spot and forward yields.

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2009	Fair value 2009	Unrecognised gain/(loss) 2009	Carrying value 2008	Fair value 2008	Unrecognised gain/(loss) 2008
Financial assets						
Cash and cash equivalents	2,223,278	2,223,278	-	5,587,570	5,587,570	-
Amounts due from credit institutions	71,060	71,060	-	61,432	61,432	-
Loans to customers	3,910,999	3,659,530	(251,469)	5,018,015	4,336,067	(681,948)
			(251,469)			(681,948)
Financial liabilities						
Amounts due to CBA and government	245,801	245,801	-	1,222,962	1,222,962	-
Amounts due to credit institutions	1,256,801	1,264,855	8,054	4,954,432	4,978,984	(24,552)
Amounts due to customers	1,760,621	1,764,725	4,104	1,004,855	1,012,072	(7,217)
			12,158			(31,769)
Total unrecognised change in unrealised fair value			(239,311)			(713,717)

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without a specific maturity.

(Thousands of Armenian drams)

23. Fair values of financial instruments (continued)

Fixed and variable rate financial instruments

For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

24. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 22 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2009			2008		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Cash and cash equivalents	2,223,278	–	2,223,278	5,587,570	–	5,587,570
Amounts due from credit institutions	–	71,060	71,060	–	61,432	61,432
Loans to customers	1,928,393	1,982,606	3,910,999	2,549,122	2,468,893	5,018,015
Investment securities available- for -sale	1,053,213	605,527	1,658,740	1,012,890	36,823	1,049,713
Other assets	126,424	–	126,424	197,963	–	197,963
Total	5,331,308	2,659,193	7,990,501	9,347,545	2,567,148	11,914,693
Amounts due to the Central Bank	245,801	–	245,801	1,222,962	–	1,222,962
Amounts due to credit institutions	1,256,801	–	1,256,801	4,954,432	–	4,954,432
Amounts due to customers	1,723,036	37,585	1,760,621	937,134	67,721	1,004,855
Other liabilities	61,550	–	61,550	78,544	–	78,544
Total	3,287,188	37,585	3,324,773	7,193,071	67,721	7,260,793
Net	2,044,120	2,621,608	4,665,728	2,154,474	2,499,426	4,653,900

25. Related party disclosures

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

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

(Thousands of Armenian drams)

25. Related party disclosures (continued)

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

	2009			2008		
	<i>Entities with significant influence over the Bank</i>	<i>Entities under common control</i>	<i>Key management personnel</i>	<i>Entities with significant influence over the Bank</i>	<i>Entities under common control</i>	<i>Key management personnel</i>
Loans outstanding at 1 January, gross	–	–	59,669	–	–	88,827
Loans issued during the year	–	–	138,894	–	–	129,277
Loan repayments during the year	–	–	158,352	–	–	158,436
Loans outstanding at 31 December, gross	–	–	40,211	–	–	59,668
Less: allowance for impairment at 31 December	–	–	(1,077)	–	–	(597)
Loans outstanding at 31 December, net	–	–	39,134	–	–	59,071
Losses on loan sale	–	–	(16,325)	–	(1,177,271)	–
Interest income on loans	–	–	8,247	–	–	9,183
Due from credit institutions						
Current accounts at 31 December	20,690	1,436	–	40,344	3,746,953	–
Due to credit institutions						
Loans and deposits at 1 January	4,953,712	–	8,767	6,222,274	–	6,998
Loans and deposits received during the year	12,190,049	–	39,091	16,912,551	–	29,784
Loans and deposits repaid during the year	16,266,502	–	29,178	18,181,113	–	28,015
Other movements	19	–	–	–	–	–
Loans and deposits at 31 December	877,278	–	18,680	4,953,712	–	8,767
Current accounts at 31 December	4,277	–	2,535	720	226	35,034
Interest expense on deposits	134,471	–	571	660,170	–	980
Interest expense on loans	14,934	–	–	35,720	–	–
Commitments and guarantees issued	–	–	–	–	–	63
Unused loan commitments	–	–	5,151	–	–	9,335
Fee and commission income	3	–	914	1,116	–	1,407
Fee and commission expense	484	–	5,171	414	–	4

Compensation of key management personnel was comprised of the following:

	2009	2008
Salaries and other short-term benefits	114,061	84,647
Social security costs	5,096	3,346
Total key management personnel compensation	119,157	87,993

The Bank enters into transactions with related parties in the normal course of business. These transactions were carried under the following conditions: loans were granted on market conditions, the amounts due to related parties were attracted at rates above market conditions. Significant volume of related party transactions is carried out by the Bank with BTA Bank JSC (Kazakhstan), since it is an entity with significant influence over the bank.

(Thousands of Armenian drams)

26. 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 ratios established by the CBA in supervising the Bank.

During the past year, the Bank had complied in full with all its externally imposed capital requirements.

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.

In early 2006 the CBA approved a framework strategy for the widespread adoption of Basel II standards. Armenian banks started implementing the revised standards in 2007 to evaluate basic currency, market and operational risks.

The CBA requires banks to maintain a capital adequacy ratio of 12% of credit and 25/3 of currency, interest, price and operational risks. For December 2009 and 2008, the Bank's capital adequacy ratio on this basis was as follows:

	2009	2008
Main capital	5,175,063	2,474,962
Additional capital	37,631	–
Less: deductions from capital	(55,301)	(57,167)
Total capital	5,157,393	2,417,795
Credit risk	4,852,958	6,783,375
Currency risk	103,786	484,770
Interest risk	77,795	57,622
Price risk	2,292	5,196
Operational risk	32,964	32,964
Capital adequacy ratio	77.44%	20.80%

27. Events after the reporting period

No significant events occurred after 31 December 2009.