Financial Statements and Independent Auditor's Report

"EVOCABANK" CLOSED JOINT STOCK COMPANY

31 December 2017

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Independent auditor’s report

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To the shareholders of "EVOCABANK" CLOSED JOINT STOCK COMPANY

Opinion

We have audited the financial statements of "EVOCABANK" CLOSED JOINT STOCK COMPANY (the “Bank”), which comprise the statement of financial position as of 31 December 2017, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as of 31 December 2017 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (“IFRSs”).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (“ISAs”). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (the “IESBA Code”) together with the ethical requirements that are relevant to our audit of the financial statements in the Republic of Armenia, and we have fulfilled our other ethical responsibilities in accordance with those ethical requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

Management is responsible for the other information. The other information comprises the information included in the annual report of the Bank for the year ended 31 December 2017, but does not include the financial statements and our auditor’s report thereon. The annual report is expected to be made available to us after the date of this auditor’s report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Gagik Gyulbudaghyan	Armen Hovhannisyan
Managing Partner	Engagement Partner

26 April 2018

Statement of profit or loss and other comprehensive income

In thousand Armenian drams	Notes	Year ended 31 December 2017	Year ended 31 December 2016
Interest and similar income	6	6,912,868	6,147,170
Interest and similar expense	6	(3,396,390)	(3,221,281)
Net interest income		3,516,478	2,925,889
Fee and commission income	7	494,461	334,083
Fee and commission expense	7	(526,011)	(327,794)
Net fee and commission income/(expense)		(31,550)	6,289
Net trading income	8	722,412	526,188
Gains less losses on securities available for sale		54,049	335,156
Other income	9	99,584	111,740
Impairment charge	10	(73,111)	(546,211)
Staff costs	11	(1,445,188)	(1,107,379)
Depreciation of property and equipment and amortization of intangible assets	19	(264,703)	(204,615)
Other expenses	12	(1,801,265)	(787,633)
Profit before income tax		776,706	1,259,424
Income tax expense	13	(276,996)	(301,130)
Profit for the year		499,710	958,294
Other comprehensive income:			
Items that will be reclassified subsequently to profit or loss			
Net unrealized gains from changes in fair value from available-for-sale financial securities		157,651	1,637,499
Net gains realized to statement of profit or loss on disposal of available-for-sale securities		(55,269)	(331,567)
Income tax relating to items that will be reclassified		(20,476)	(261,186)
Total other comprehensive income for the year, net of tax		81,906	1,044,746
Total comprehensive income for the year		581,616	2,003,040

The accompanying notes on pages 10 to 59 are an integral part of these financial statements.

Statement of financial position

In thousand Armenian drams	Notes	As of 31 December 2017	As of 31 December 2016
Assets			
Cash and cash equivalents	14	18,812,252	16,049,033
Amounts due from financial institutions	15	8,620,732	7,166,968
Derivative financial assets	16	852	1,810
Loans to customers	17	56,834,306	46,537,338
Investment securities	18		
- Securities available for sale		5,976,769	6,599,191
- Securities held to maturity		499,366	501,835
Securities pledged under repurchase agreements	27	5,536,417	3,865,633
Property, plant and equipment and intangible assets	19	5,555,956	4,524,362
Repossessed assets	20	2,921,907	4,093,996
Other assets	21	446,564	155,266
Total asstes		105,205,121	89,495,432
Liabilities and equity			
Liabilities			
Amounts due to financial institutions	22	13,531,924	7,504,485
Financial liabilities held for trading		-	1,076,462
Amounts due to customers	23	49,830,715	39,776,356
Derivative financial liabilities	16	20,400	19,633
Other liabilities	24	26,719	273,267
Subordinated liabilities	25	10,735,989	10,048,198
Current income tax liabilities		65,373	218,450
Deferred income tax liabilities	13	689,399	711,646
Other liabilities	26	807,525	517,304
Total liabilities		75,708,044	60,145,801
Equity			
Share capital	28	17,950,000	17,950,000
Statutory general reserve		52,075	52,075
Other reserves		2,373,774	2,298,030
Retained earnings		9,121,228	9,049,526
Total equity		29,497,077	29,349,631
Total liabilities and equity		105,205,121	89,495,432

The financial statements from pages 5 to 59 were signed by the Bank's Chairman of Management Board and Chief Accountant on 26 April 2018.

Emil Soghomonyan
Chairman of Management Board

Alvard Mkrtumyan
Chief accountant

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The accompanying notes on pages 10 to 59 are an integral part of these financial statements.

Statement of changes in equity

In thousand Armenian drams	Share capital	Statutory general reserve	Revaluation reserve of securities available for sale	Revaluation reserve of PPE	Retained earnings	Total
Balance as of 1 January 2016	14,400,000	52,075	(303,688)	1,556,972	8,161,259	23,866,618
Increase in share capital	3,550,000	-	-	-	-	3,550,000
Dividends to shareholders	-	-	-	-	(70,027)	(70,027)
Total transactions with owners	3,550,000	-	-	-	(70,027)	3,479,973
Profit for the year	-	-	-	-	958,294	958,294
Other comprehensive income:						
Adjustment to reserve on amortization or disposal of PPE	-	-	-	-	-	-
Net unrealized gains from changes in fair value	-	-	1,637,499	-	-	1,637,499
Net gains realized to statement of profit or loss on disposal of available-for-sale investments	-	-	(331,567)	-	-	(331,567)
Income tax relating to components of other comprehensive income	-	-	(261,186)	-	-	(261,186)
Total comprehensive income for the year	-	-	1,044,746	-	958,294	2,003,040
Balance As of 31 December 2016	17,950,000	52,075	741,058	1,556,972	9,049,526	29,349,631
Dividends to shareholders					(434,170)	(434,170)
Total transactions with owners	-	-	-	-	(434,170)	(434,170)
Profit for the year	-	-	-	-	499,710	499,710
Other comprehensive income:						
Adjustment to reserve on amortization or disposal of PPE	-	-	-	(6,162)	6,162	-
Net unrealized gains from changes in fair value			157,651			157,651
Net gains realized to statement of profit or loss on disposal of available-for-sale investments	-	-	(55,269)	-	-	(55,269)
Income tax relating to components of other comprehensive income	-	-	(20,476)	-	-	(20,476)
Total comprehensive income for the year	-	-	81,906	(6,162)	505,872	581,616
Balance as of 31 December 2017	17,950,000	52,075	822,964	1,550,810	9,121,228	29,497,077

The accompanying notes on pages 10 to 59 are an integral part of these financial statements.

Statement of cash flows

In thousand Armenian drams	Year ended 31 December 2017	Year ended 31 December 2016
Cash flows from operating activities		
Profit before tax	776,706	1,259,424
Adjustments for		
Amortization and depreciation allowances	264,703	204,615
Net gains from sale of PPE	(2,057)	(7,690)
Net loss on disposal of other assets	447,854	83,976
Impairment charge	73,111	546,211
Net loss from revaluation of derivative financial instruments	4,163	34,527
Net loss from revaluation of non-trading assets and liabilities	40,659	61,234
Interest receivable	(24,729)	(7,703)
Interest payable	394,311	80,445
Cash flows from operating activities before changes in operating assets and liabilities	1,974,721	2,255,039
(Increase)/decrease in operating assets		
Amounts due from other financial institutions	(1,403,378)	1,771,346
Securities available for sale	742,536	(4,802,265)
Securities pledged under repurchase agreements	(2,747,246)	3,927,260
Derivative financial assets	(4,163)	(16,704)
Loans to customers	(9,499,188)	(10,073,291)
Repossessed assets	216,949	158,860
Other assets	(279,745)	(180,587)
Increase/(decrease) in operating liabilities		
Amounts due to financial institutions	5,565,761	(2,317,709)
Amounts due to customers	9,411,007	6,597,619
Derivative financial liabilities	1,725	-
Other liabilities	(52,900)	113,993
Net cash flow from/(used in) operating activities before income tax	3,926,079	(2,566,439)
Income tax paid	(472,796)	(130,570)
Net cash from/(used in) operating activities	3,453,283	(2,697,009)
Cash flows from investing activities		
Purchase/(sale) of investment securities	2,627	(486,894)
Purchase of property, plant and equipment and intangible assets	(806,320)	(728,575)
Sale of property, plant and equipment	19,184	8,065
Net cash used in investing activities	(784,509)	(1,207,404)

Statement of cash flows

In thousand Armenian drams	Year ended 31 December 2017	Year ended 31 December 2016
Cash flow from financing activities		
Proceeds from issue of share capital	-	3,550,000
Subordinated debt	-	4,762,728
Dividends paid	(78,197)	-
Other long term loans	(246,548)	(3,313,696)
Net cash from/ (used in) financing activities	(324,745)	4,999,032
Net increase in cash and cash equivalents	2,344,029	1,094,619
Cash and cash equivalents at the beginning of the year	16,049,033	14,559,127
Exchange differences on cash and cash equivalents	419,190	395,287
Cash and cash equivalents at the end of the year (Note 14)	18,812,252	16,049,033
Supplementary information:		
Interest received	6,888,139	6,139,467
Interest paid	(3,002,079)	(3,140,836)

The accompanying notes on pages 10 to 59 are an integral part of these financial statements.

Notes to the financial statements

1 Principal activities

"EVOCABANK" CJSC (the "Bank") is the renamed "Prometey Bank" CJSC is a Closed Join Stock Company, which was incorporated on 01.06.1990. The Bank is regulated by the legislation of RA and conducts its business under license number 27, granted on 02.10.1991 by the Central Bank of Armenia (the "CBA").

The Bank is a member of Individuals deposit compensation guarantee state system of RA , as well as member of Union of Banks of Armenia, ArCa, MasterCard payment systems.

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

The head office of the Bank and its 11 branches are located in Yerevan; one branch is located in Gyumri, one branch in Abovyan and another branch is located in Vanadzor.

The registered office of the Bank is located at: 44/2 Hanrapetutyan str. Yerevan 0010, Republic of Armenia.

2 Armenian business environment

Armenia continues to undergo political and economic changes. The stability and development of the Armenian economy largely depends on these changes, as well as developments in the Eurasian Economic Union with which the integration of the Armenian economy continues.

Management of the Bank believes that in the current conditions appropriate measures are implemented in order to ensure economic stability of the Group/Bank.

3 Basis of preparation

3.1 Statement of compliance

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

The Bank prepares statements for regulatory purposes in accordance with legislative requirements of the Republic of Armenia. These financial statements are based on the Bank's books and records as adjusted and reclassified in order to comply with IFRS.

3.2 Basis of measurement

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

3.3 Functional and presentation currency

Functional currency of the Bank is the currency of the primary economic environment in which the Bank operates. The Bank's functional currency and the Bank's presentation currency is Armenian Dram ("AMD"), since this currency best reflects the economic substance of the underlying events and transactions of the Bank. The financial statements are presented in thousands of AMD, unless otherwise stated, which is not convertible outside Armenia.

3.4 Changes in accounting policies

The Group applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2017. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective. Although the new standards and amendments described below and applied for the first time in 2017, did not have a material impact on the annual consolidated financial statements of the Bank.

- *Disclosure Initiative (Amendments to IAS 7)*
- *Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12)*
- *Annual Improvements to IFRSs 2014-2016 Cycle – various standards (Amendments to IFRS 12.*

3.5 Standards and interpretations not yet applied by the Bank

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

Management anticipates that all of the pronouncements will be adopted in the Bank's accounting policy for the first period beginning after the effective date of the pronouncement.

IFRS 9 Financial Instruments **(2014)**

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. It replaces IAS 39 Financial Instruments: Recognition and Measurement.

In October 2017, the IASB issued Prepayment Features with Negative Compensation (Amendments to IFRS 9). The amendments are effective for annual periods beginning on or after 1 January 2019, with early adoption permitted.

The Bank will apply IFRS 9 as issued in July 2014 initially on 1 January 2018 and will early adopt the amendments to IFRS 9 on the same date.

The adoption of the new standard may have a material impact on the opening balance of the Bank's equity as of 1 January 1 2018.

The above assessment is preliminary because not all transition work has been finalised. Especially, The Bank has not yet completed to revise its accounting processes and internal controls changes in accordance with IFRS 9, the refining and finalising its models for ECL calculations and the new accounting policies, assumptions, judgements and estimation techniques employed are subject to change until the Bank finalises its first financial statements that include the date of initial application.

Classification – Financial assets and Financial liabilities

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

IFRS 9 includes three principal classification categories for financial assets: measured at amortised cost, FVOCI and FVTPL.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by- investment basis.

A financial asset is classified into one of these categories on initial recognition.

It eliminates the existing IAS 39 categories of held to maturity, loans and receivables, available for sale and financial assets at fair value through profit or loss.

The standard will affect the classification and measurement of financial assets held as at 1 January 2018 as follows.

– Trading assets and derivative assets held for risk management, which are classified as held-for-trading and measured at FVTPL under IAS 39, will also be measured at FVTPL under IFRS 9.

– Loans to banks and to customers that are classified as loans and receivables and measured at amortised cost under IAS 39 will in general also be measured at amortised cost under IFRS 9.

– Held-to-maturity investment securities measured at amortised cost under IAS 39 will in general also be measured at amortised cost under IFRS 9.

– Debt investment securities that are classified as available-for-sale under IAS 39 may, under IFRS 9, be measured at amortised cost, FVOCI or FVTPL, depending on the particular circumstances.

The classification and measurement assessment as at 31 December 2016 may not necessarily represent the impact on the Bank's financial statements as at 1 January 2018 because IFRS 9 requires the business model assessment to be undertaken based on the facts and circumstances that exist at the date of initial application, which will be 1 January 2018 for the Bank.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities.

However, under IAS 39 all fair value changes of financial liabilities designated as at FVTPL are recognised in profit or loss, whereas under IFRS 9 these fair value changes will generally be presented as follows:

– the amount of the change in the fair value that is attributable to changes in the credit risk of the liability will be presented in OCI; and

– the remaining amount of the change in the fair value will be presented in profit or loss

Impairment – Financial assets, loan commitments and financial guarantee contracts

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' model. This will require considerable judgement over how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis.

The Bank will recognize loss allowances for Expected Credit Losses (ECL) on the following financial instruments that are not measured at FVTPL:

– financial assets measured at amortised cost
– financial assets measured at fair value through other comprehensive income
– contract assets
– loan commitments
– financial guarantee contracts

Under IFRS 9, no impairment loss is recognised on equity investments.

The impairment requirements of IFRS 9 are complex and require management judgements, estimates and assumptions, particularly in the following areas,

– assessing whether the credit risk of an instrument has increased significantly since initial recognition; and

– incorporating forward-looking information into the measurement of ECLs;

– Definition of default.

The key inputs into the measurement of ECLs are likely to be the term structures of the following variables:

– Probability (PD);

– loss given default (LGD); and

– exposure at default (EAD).

These parameters will be derived from internally developed statistical models and other historical data that leverage regulatory models. They will be adjusted to reflect forward-looking information as described below.

The most significant impact on the Bank's financial statements from the implementation of IFRS 9 is expected to result from the new impairment requirements. Impairment losses will increase and become more volatile for financial instruments in the scope of the IFRS 9 impairment model. Loss allowances on unsecured products with longer expected lives such as overdrafts and credit cards will be most affected by the new impairment requirements.

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 will generally be applied retrospectively, except as described below.

– The Bank will take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes.

Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 will generally be recognised in retained earnings and reserves as at 1 January 2018.

– The following assessments have to be made on the basis of the facts and circumstances that exist at the date of initial application.

- The determination of the business model within which a financial asset is held.
- For a financial liability designated as at FVTPL, the determination of whether presenting the effects of changes in the financial liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss.

If a debt investment security has low credit risk at 1 January 2018, then the Bank will determine that the credit risk on the asset has not increased significantly since initial recognition.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 presents new requirements for the recognition of revenue, replacing *IAS 18 Revenue*, *IAS 11 Construction Contracts*, and several revenue-related Interpretations. The new standard establishes a control-based revenue recognition model and provides additional guidance in many areas not covered in detail under existing IFRSs, including how to account for arrangements with multiple performance obligations, variable pricing, customer refund rights, supplier repurchase options, and other common complexities.

IFRS 15 is effective for reporting periods beginning on or after 1 January 2018. The Bank's management have not yet assessed the impact of IFRS 15 on these financial statements.

IFRS 16 Leases

IFRS 16 presents new requirements and amendments to the accounting of leases. IFRS 16 will require lessees to account for leases 'on-balance sheet' by recognizing a 'right-of-use' asset and a lease liability.

IFRS 16 also:

- changes the definition of a lease;
- sets requirements on how to account for the asset and liability, including complexities such as non-lease elements, variable lease payments and option periods;
- provides exemptions for short-term leases and leases of low value assets;
- changes the accounting for sale and leaseback arrangements;
- largely retains IAS 17's approach to lessor accounting;
- introduces new disclosure requirements.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided IFRS 15 Revenue from Contracts with Customers is also applied. The [Group/Banks]'s management have not yet assessed the impact of IFRS 16 on these financial statements.

Other standards

The following amended standards and interpretations are not expected to have significant impact on the Bank's financial statements.

- Annual Improvements to IFRSs 2014-2016 Cycle – Amendments to IFRS 1 and IAS 28 (effective from 1 January 2018).
- IFRIC 22 Foreign Currency Transactions and Advance Consideration (effective from 1 January 2018).
- IFRIC 23 Uncertainty over Income Tax Treatments (effective from 1 January 2019).

4 Summary of significant accounting policies

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

4.1 Recognition of income and expenses

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

Interest income and expense

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

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

Fee and commission income

Loan origination fees for loans issued to customers are deferred (together with related direct costs) and recognised as an adjustment to the effective yield of the loans. Fees, commissions and other income and expense items are generally recorded on an accrual basis when the service has been provided. Portfolio and other management advisory and service fees are recorded based on the applicable service contracts. Asset management fees related to investment funds are recorded over the period the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time.

Dividend income

Revenue is recognized when the Bank’s right to receive the payment is established. According to the Tax Legislation of Republic of Armenia dividend income is non-taxable.

Net trading income

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realized and unrealized fair value changes, interest, dividends and foreign exchange differences related to trading assets and liabilities. Net trading income also includes gains less losses from trading in foreign currencies and is recognized in profit or loss when the corresponding service is provided.

4.2 Foreign currency

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

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

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

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

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

	31 December 2017	31 December 2016
AMD/1 US Dollar	484.10	483.94
AMD/1 EUR	580.10	512.20

4.3 Taxation

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

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

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

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

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

4.4 Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, balances on correspondent accounts with the Central Bank of Armenia (excluding those funds deposited for the settlement of ArCa payment cards), and amounts due from other banks, which can be converted into cash at short notice, including highly liquid investments maturing within 90 days from the date of acquisition that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash and cash equivalents are carried at amortised cost.

4.5 Amounts due from other financial institutions

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

4.6 Financial instruments

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

When financial assets and liabilities are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

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

The Bank classified its financial assets into the following categories:

- financial instruments at fair value through profit or loss,
- held-to-maturity investments,
- loans and receivables,
- available for sale financial instruments.

The classification of investments between the categories is determined at acquisition based on the guidelines established by the management. The Bank determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end.

Financial assets at fair value through profit or loss

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

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

To the extent that the hedge is effective, changes in the fair value of derivatives designated as hedging instruments in cash flow hedges are recognised in other comprehensive income and included within the cash flow hedge reserve in equity. Any ineffectiveness in the hedge relationship is recognised immediately in profit or loss.

At the time the hedged item affects profit or loss, any gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss and presented as a reclassification adjustment within other comprehensive income. However, if a non-financial asset or liability is recognised as a result of the hedged transaction, the gains and losses previously recognised in other comprehensive income are included in the initial measurement of the hedged item.

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

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

- Doing so significantly reduces measurement inconsistencies that would arise if the related derivatives were treated as held for trading and the underlying financial instruments were carried at amortised cost for such as loans and advances to customers or banks and debt securities in issue;

- Certain investments, such as equity investments, that are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis are designated at fair value through profit and loss; and
- Financial instruments, such as debt securities held, containing one or more embedded derivatives significantly modify the cash flows, are designated at fair value through profit and loss.

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

Held-to-maturity investments

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

Loans and receivables

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

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

Available-for-sale financial assets

Investments available for sale represent debt and equity investments that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. After initial recognition available-for sale financial assets are measured at fair value with gains or losses being recognised as a separate component of 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 equity is included in the statement of profit or loss and other comprehensive income. However, interest calculated using the effective interest method is recognised in the statement of profit or loss and other comprehensive income. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Bank's right to receive payment is established.

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

4.7 Impairment of financial assets

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

Assets carried at amortized cost

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

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

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

If there is objective evidence that an impairment loss on financial assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced through use of an allowance account. The amount of the loss shall be recognised in the statement of profit or loss and other comprehensive income. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. The Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

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

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

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

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

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

Impairment allowances of financial assets have been established in the financial statements on the basis of existing economic conditions. Bank is not able to predict how conditions may change in Armenia, and what impact these changes may have on the adequacy of the impairment allowance of financial assets in future periods.

Renegotiated loans

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

Available-for-sale financial assets

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

4.8 Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

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

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

4.9 Repurchase and reverse repurchase agreements

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the statement of financial position and, in case the transferee has the right by contract or custom to sell or repledge them, reclassified as securities pledged under sale and repurchase agreements and faced as the separate balance sheet item. The corresponding liability is presented within amounts due to financial institutions or customers.

Securities purchased under agreements to resell ("reverse repo") are recorded as amounts due from other financial institutions or loans and advances to customers as appropriate and are not recognized in the statement of financial position. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

If assets purchased under an agreement to resell are sold to third parties, the obligation to return the securities is recorded as a trading liability and measured at fair value.

4.10 Securities lending and borrowing

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

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

4.11 Leases

Operating - 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 in other operating expenses.

4.12 Property, plant and equipment

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

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

	Useful life (years)	Rate (%)
Buildings	40	2.5
Computers	3	33.3
Vehicles	5	20
Other fixed assets	5	20

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

Repairs and maintenance are charged to the statement of profit or loss and other comprehensive income during the period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is incurred and when it satisfies the criteria for asset recognition. Major renovations are depreciated over the remaining useful life of the related asset.

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

The frequency of revaluation depends on changes in fair value of assets. In case of significant divergences between fair value of revalued assets and their carrying amounts further revaluation is conducted. Revaluation is conducted for the whole class of property, plant and equipment *(if applicable).*

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

Along with the usage of fixed assets, the difference of the calculated depreciation based on the revalued amount of the asset and calculated depreciation based on the cost of the asset is transferred to retained earnings.

In case of sale or write-off of fixed assets the balance relating to revaluation reserve of that fixed assets is totally transferred to retained earnings.

4.13 Intangible assets

Intangible assets include computer software and licences.

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

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

4.14 Repossessed assets

In certain circumstances, assets are repossessed following the foreclosure on loans that are in default. Repossessed assets are measured at the lower of cost and fair value less costs to sell.

4.15 Grants

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

4.16 Borrowings

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

If the Bank purchases its own debt, it is removed from the balance sheet and the difference between the carrying amount of the liability and the consideration paid is recognised in the statement of income.

4.17 Financial guarantees

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

Financial guarantees are initially recognized in the financial statements at fair value, in “Other liabilities”, being the premium received. Following 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 settling any financial obligation arising as a result of the guarantee.

4.18 Provisions

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

4.19 Equity

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.

Retained earnings

Include accumulated earnings of current and previous periods.

Dividends

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

Property revaluation surplus

The property revaluation surplus is used to record increases in the fair value of buildings and decreases to the extent that such decrease relates to an increase on the same asset previously recognised in equity.

Revaluation reserve for available-for-sale investments

This reserve records fair value changes in available for sale investments.

4.20 Offsetting

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

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions such as in the Bank’s trading activity.

5 Critical accounting estimates and judgements

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

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

Measurement of fair values

Management uses valuation techniques to determine the fair value of financial instruments (where active market quotes are not available) and non-financial assets. This involves developing estimates and assumptions consistent with how market participants would price the instrument. Management bases its assumptions on observable data as far as possible but this is not always available. In that case management uses the best information available. Estimated fair values may vary from the actual prices that would be achieved in an arm's length transaction at the reporting date (see Note 31).

Classification of investment securities

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

Useful Life of PPE

Useful life evaluation of PPE is the result of judgement, based on the experience with similar assets. Future economic benefits are embodied in assets and mainly consumed along with usage. However, such factors as operational, technical or commercial depreciation often lead to decrease of asset's economic benefit. Management evaluates the remaining useful life according to the asset's current technical condition and estimated period, during which the Bank expects to receive benefits. For the evaluation of remaining useful life are considered the following main factors: expectable usage of assets, depending on the operational factors and maintenance program, that is depreciation and technical and commercial depreciation arising from the changes in the market conditions.

Fair value of derivatives

The fair values of financial derivatives that are not quoted in active markets are determined by using valuation techniques. Valuation of financial derivatives is applied to single currency interest rate swap transactions, cross currency interest swap transactions and foreign exchange forward contracts. The fair value of these transactions is determined as the difference between the present value of fixed receivable and the present value of floating obligation or vice versa. The present value of floating obligation is determined using discount factors derived from the zero coupon curve. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require Management to make estimates. Changes in assumptions about these factors could affect reported fair values. Any over or under estimation of these future cash flows could require a material adjustment to the carrying value of these derivatives.

Related party transactions

In the normal course of business the Bank enters into transactions with its related parties. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis (Refer to Note 30)

Impairment of loans

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

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

Tax legislation

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

The Management of the Bank has not reviewed its previous estimations, i.e. has not derecognized previously estimated deferred tax liability related to the fixed assets and continues its tax accounting as before*(add if applicable)*.

Impairment of available-for-sale equity investments

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

6 Interest and similar income and expense

In thousand Armenian drams	2017	2016
Loans to customers	4,978,311	4,127,278
Debt securities available-for-sale	1,290,509	1,228,572
Reverse repurchase transactions	389,197	411,956
Amounts due from financial institutions	216,339	267,125
Securities held-to maturity	26,334	12,314
Interest accrued on individually impaired financial assets	12,178	99,925
Total interest and similar income	6,912,868	6,147,170
Customer accounts	1,887,606	1,739,610
Repurchase transactions	313,403	723,953
Subordinated debt	437,028	187,987
Debt securities issued	299,832	293,316
Financial institutions accounts	448,564	245,061
Other borrowings	9,957	31,354
Total interest and similar expense	3,396,390	3,221,281

7 Fee and commission income and expense

In thousand Armenian drams	2017	2016
Settlement operations/transfers	276,807	184,046
Plastic cards operations	131,101	81,433
Cash operations	47,516	30,676
Other fees and commissions	39,037	37,928
Total fee and commission income	494,461	334,083
Cash/non-cash currency translation	237,548	124,119
Settlement operations/transfers	131,409	81,515
Plastic cards operations	104,228	74,080
Correspondent accounts maintenance	50,539	46,876
Other expenses	2,287	1,204
Total fee and commission expense	526,011	327,794

8 Net trading income

In thousand Armenian drams	2017	2016
Gains less losses from trading in foreign currencies	728,192	602,332
Net losses from disposal of derivative instruments	(1,617)	(41,617)
Net losses from revaluation of derivative instruments	(4,163)	(34,527)
Total net trading income	722,412	526,188

9 Other income

In thousand Armenian drams	2017	2016
Fines and penalties received	52,458	74,976
Income from issue of guarantees and letters of credit	26,116	8,384
Net income from disposal of PPE	2,057	7,690
Gains from grants relating to assets	2,074	2,074
Income from dividends	1,510	-
Other income	15,369	18,616
Total other income	99,584	111,740

10 Impairment charge/(reversal)

In thousand Armenian drams	2017	2016
Cash and cash equivalents (Note 14)	7,310	-
Loans to customers (Note 17)	79,156	541,530
Other assets (Note 21)	(13,355)	4,681
Total impairment charge	73,111	546,211

11 Staff costs

In thousand Armenian drams	2017	2016
Compensations of employees, related taxes included	1,416,855	1,096,389
Staff training expenses	10,515	2,872
Other staff costs	17,818	8,118
Total staff costs	1,445,188	1,107,379

12 Other expenses

In thousand Armenian drams	2017	2016
Communications	159,126	106,688
Operating lease	104,137	106,505
Net loss from disposal of other assets	447,854	83,976
Repair and maintenance expenses of tangible assets	125,667	71,246
Security	71,460	66,497
Advertising costs	305,811	63,264
Foreign currency translation net losses of non-trading assets and liabilities	40,659	61,234
Deposit guarantee fund expenses	86,586	56,918
Office supplies	65,981	40,484
Representative and organizational expenses	183,250	27,182
Cash collection expenses	22,476	20,826
Taxes, other than income tax, duties	92,045	20,493
Consulting and other services	32,156	16,920
Business trip expenses	20,120	9,991
Financial system mediator expenses	9,215	7,727
Other expenses	34,722	27,682
Total other expense	1,801,265	787,633

13 Income tax expense

In thousand Armenian drams	2017	2016
Current tax expense	319,719	348,248
Deferred tax	(42,723)	(47,118)
Total income tax expense	276,996	301,130

The corporate income tax within the Republic of Armenia is levied at the rate of 20% (2016: 20%). Differences between IFRS and RA statutory tax regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profit tax purposes. Deferred income tax is calculated using the principal tax rate of 20%.

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

In thousand Armenian drams	2017	Effective rate (%)	2016	Effective rate (%)
Profit before tax	776,706		1,259,424	
Income tax at the rate of 20%	155,341	20	251,885	20
Non-taxable income	(302)	-	-	-
Non-deductible expenses	113,825	14	36,998	3
Foreign exchange losses	8,132	1	12,247	1
Income tax expense	276,996	35	301,130	24

Deferred tax calculation in respect of temporary differences:

In thousand Armenian drams	As of 31 December 2016	Recognized in profit or loss	Recognized in other comprehensive income	As of 31 December 2017
Other liabilities	10,773	(2,215)	-	8,558
Total deferred tax asset	10,773	(2,215)	-	8,558
Amounts due from financial institutions	(7,091)	170	-	(6,921)
Securities available-for-sale	(185,263)	-	(20,476)	(205,739)
Property, plant and equipment	(380,714)	635	-	(380,079)
Loans to customers	(140,000)	49,811	-	(90,189)
Other assets	(9,351)	(5,678)	-	(15,029)
Total deferred tax liability	(722,419)	44,938	(20,476)	(697,957)
Net deferred tax liability	(711,646)	42,723	(20,476)	(689,399)

In thousand Armenian drams	As of 31 December 2015	Recognized in profit or loss	Recognized in other comprehensive income	As of 31 December 2016
Securities available-for-sale	75,923	-	(75,923)	-
Other liabilities	11,128	(355)	-	10,773
Total deferred tax asset	87,051	(355)	(75,923)	10,773
Amounts due from financial institutions	(7,256)	165	-	(7,091)
Securities available-for-sale	-	-	(185,263)	(185,263)
Property, plant and equipment	(380,779)	65	-	(380,714)
Loans to cutomers	(184,256)	44,256	-	(140,000)
Other assets	(12,338)	2,987	-	(9,351)
Total deferred tax liability	(584,629)	47,473	(185,263)	(722,419)
Net deferred tax liability	(497,578)	47,118	(261,186)	(711,646)

14 Cash and cash equivalents

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Correspondent account with the CBA	8,970,461	8,832,340
Cash on hand	7,704,022	6,310,177
Correspondent accounts with banks	637,214	744,396
Deposits for less than 90 days with the CBA	1,500,555	-
Demand deposits with banks	-	162,120
Total cash and cash equivalents	18,812,252	16,049,033

Correspondent account with Central Bank of Armenia represents the obligatory minimum reserve deposits with the CBA, which as of 31 December 2017 is computed at 2% (2016: 2%) of certain obligations of the Bank denominated in Armenian drams and 18% (2016: 18%) of certain obligations of the Bank, denominated in foreign currency and amounts to AMD 8,088,892 thousand (2016: AMD 6,598,341 thousand). There are no restrictions on the withdrawal of funds from the CBA, however, if mini mum average requirement is not met, the Bank could be subject to penalties. Mandatory reserve deposits in the CBA are non-interest bearing.

At 31 December 2017 the Bank had no nostro accounts (2016: either), the balances of which exceeded 10% of equity.

Non-cash transactions performed by the Bank during 2017 are represented by:

- repayment of loans through collaterals in the amount of AMD 182 thousand (2016: AMD 388,120 thousand).

The movement in allowance for impairment losses on cash and cash equivalents was as follows:

In thousand Armenian drams	Total
At 1 January 2017	-
Net charge for the year	7,310
Amounts written off	(7,310)
At 31 December 2017	-

15 Amounts due from other financial institutions

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Reverse repurchase agreements	5,885,446	4,266,994
Loans to financial institutins	2,076,366	2,183,787
Deposited funds with CBA	362,500	252,500
Loans to banks	-	251,460
Deposited funds in other financial institutions	70,821	65,088
Other proceeds from financial institutions	225,599	147,139
Total amounts due from other financial institutions	8,620,732	7,166,968

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

Blocked deposits with financial institutions represent a blocked deposit for membership in Master Card payment system.

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

In thousand Armenian drams	As of 31 December 2017		As of 31 December 2016	
	Fair value of collateral	Carrying value of loans	Fair value of collateral	Carrying value of loans
RA state securities	6,056,948	5,885,446	4,424,915	4,266,994

As of 31 December 2017 the Bank has not possess securities acquired under repurchase agreements (2016: AMD 1,076,462 thousand and their liability is accounted in “Trading liabilities” on the face of the statement of financial position) which were resold to third parties.

16 Derivative financial instruments

In thousand Armenian drams	As of 31 December 2017			As of 31 December 2016		
	Notional amount	Fair value of assets	Fair value of liabilities	Notional amount	Fair value of assets	Fair value of liabilities
Derivatives held for trading						
Swaps – foreign	745,109	852	-	203,255	1,810	-
Forwards - domestic	1,916,000	-	20,400	2,001,092	-	19,633
Total derivative financial instruments	2,661,109	852	20,400	2,204,347	1,810	19,633

The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time.

17 Loans and advances to customers

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Loans	51,508,700	42,139,631
Credit lines and overdrafts	4,229,263	4,133,966
Credit cards	966,599	565,976
Reverse repurchase agreements	887,014	412,269
	57,591,576	47,251,842
Less allowance for loan impairment	(757,270)	(714,504)
Total loans to customers	56,834,306	46,537,338

As of 31 December 2017 the weighted average effective interest rates on loans and advances to customers was 15.80% for loans in AMD (2016: 15.34%) and 9.18 % for loans in USD, EUR and other freely convertible currencies (2016: 9.95%).

As at 31 December 2017 the Bank had four borrowers and groups of related parties (2016: three), whose loan balances exceed 10% of equity. The gross value of these loans as at 31 December 2017 amounts to AMD 19,446,703 thousand (2016: AMD 12,595,218 thousand).

As of 31 December 2017, loans to customers in amount of AMD 2,836,193 thousand (2016: AMD 1,777,572 thousand) serve as collateral for loans dur to financial institutions (Refer to note 22).

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

								2017
In thousand Armenian drams	Industry	Construction	Trading	Consumer	Mortgage	Service	Other	Total
Loans	8,056,239	2,266,614	20,883,533	8,090,445	6,284,298	8,717,070	3,293,377	57,591,576
Less allowance for loan impairment	(62,601)	(8,067)	(248,726)	(102,559)	(26,238)	(302,489)	(6,590)	(757,270)
Net loans	7,993,638	2,258,547	20,634,807	7,987,886	6,258,060	8,414,581	3,286,787	56,834,306

In thousand Armenian drams	Industry	Construction	Trading	Consumer	Mortgage	Service	Other	Total
								2016
Loans	6,770,426	1,497,251	20,411,264	5,263,500	4,220,634	4,132,189	4,956,578	47,251,842
Less allowance for loan impairment	(77,320)	(36,937)	(259,210)	(69,858)	(76,217)	(109,381)	(85,581)	(714,504)
Net loans	6,693,106	1,460,314	20,152,054	5,193,642	4,144,417	4,022,808	4,870,997	46,537,338

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

In thousand Armenian drams	Industry	Agriculture	Trading	Consumer	Mortgage	Service	Other	Total
								2017
As of 1 January 2017	77,320	36,937	259,210	69,858	76,217	109,381	85,581	714,504
Charge/(Reversal) for the year	29,471	(28,870)	20,988	61,422	(32,138)	94,899	(66,616)	79,156
Amounts (written off)/recovery	(44,190)	-	(31,472)	(28,721)	(17,841)	98,209	(12,375)	(36,390)
As of 31 December 2017	62,601	8,067	248,726	102,559	26,238	302,489	6,590	757,270
Individual impairment	28,489	-	238,500	33,972	9,982	186,928	-	497,871
Collective impairment	34,112	8,067	10,226	68,587	16,256	115,561	6,590	259,399
	62,601	8,067	248,726	102,559	26,238	302,489	6,590	757,270
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	123,301	-	432,026	58,953	32,054	271,464	-	917,798

In thousand Armenian drams								2016
	Industry	Agriculture	Trading	Consumer	Mortgage	Service	Other	Total
As of 1 January 2017	83,881	77,470	187,440	70,527	50,824	78,463	12,118	560,723
Charge/(Reversal) for the year	49,948	(24,165)	93,045	44,175	46,212	247,094	85,221	541,530
Amounts (written off)/recovery	(56,509)	(16,368)	(21,275)	(44,844)	(20,819)	(216,176)	(11,758)	(387,749)
As of 31 December 2017	77,320	36,937	259,210	69,858	76,217	109,381	85,581	714,504
Individual impairment	36,505	28,931	139,612	-	50,716	69,952	57,930	383,646
Collective impairment	40,815	8,006	119,598	69,858	25,501	39,429	27,651	330,858
	77,320	36,937	259,210	69,858	76,217	109,381	85,581	714,504
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	187,338	205,996	792,289	-	107,526	340,950	496,819	2,130,918

Loans by customer profile may be specified as follows:

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Privately held companies	38,581,873	34,041,634
Individuals	14,371,201	9,429,441
Sole proprietors	4,341,341	3,294,476
Non-commercial institutions	297,161	486,291
	57,591,576	47,251,842
Less allowance for loan impairment	(757,270)	(714,504)
Total loans	56,834,306	46,537,338

Loans to individuals comprise the following products:

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Mortgage loans	6,284,298	4,220,634
Consumer loans	3,010,604	2,617,313
Car loans	412,359	564,521
Gold secured	909,345	707,741
Other	3,754,595	1,319,232
Total loans and advances to individuals (gross)	14,371,201	9,429,441

At 31 December 2017 and 2016 the estimated fair value of loans to customers approximates its carrying value, as stated in Note 31.

Maturity analysis of loans to customers are disclosed in Note 33.

Other risks analyses of loans to customers are disclosed in Note 34. Information on related parties is disclosed in Note 30

18 Investment securities

In thousand Armenian drams	As of 31 December 2017			As of 31 December 2016		
	Available-for-sale	Held-to-maturity	Total	Available-for-sale	Held-to-maturity	Total
Shares of Armenian companies	42,825	-	42,825	42,825	-	42,825
RA state bonds	4,496,050	499,366	4,995,416	6,161,527	501,835	6,663,362
Corporate bonds	1,437,894	-	1,437,894	394,839	-	394,839
Total investments	5,976,769	499,366	6,476,135	6,599,191	501,835	7,101,026

All debt securities have fixed coupons.

The Bank has not reclassified any financial assets measured at amortised cost rather than fair value during the year (2016: either).

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

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

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

In thousand Armenian drams	As of 31 December 2017		As of 31 December 2016	
	%	Maturity	%	Maturity
RA state bonds	10.3-16.39	2018-2036	10.3-16.95	2017-2036
Corporate bonds	5.42-13.15	2018-2022	10.7	2019

Debt securities available for sale at fair value of AMD 5,536,417 thousand (2016: AMD 3,865,633 thousand) were pledged to third parties in sale and repurchase agreements for periods not exceeding six months. These have been reclassified as securities pledged under repurchase agreements on the face of the balance sheet (see Note 27).

Held-to-maturity investments

In thousand Armenian drams	As of December 2017	As of 31 December 2016
RA state bonds	499,366	501,835

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

In thousand Armenian drams	As of 31 December 2017		As of 31 December 2016	
	%	Maturity	%	Maturity
RA state bonds	5.42	2020	5.42	2020

19 Property, plant and equipment

In thousand Armenian drams	Land and buildings	Leasehold improve-ments	Computer equipment	Vehicles	Office equipment	PPE capital investments	Intangible assets	Total
Cost or revalued amount								
At 1 January 2016	3,744,017	117,589	531,063	107,347	483,542	-	134,998	5,118,556
Additions	323,815	-	193,001	59,676	21,591	110,494	19,998	728,575
Disposals	-	(7,966)	(9,357)	(34,536)	(13,747)	-	-	(65,606)
Reclassification	30,852	-	-	-	-	(30,852)	-	-
At 31 December 2016	4,098,684	109,623	714,707	132,487	491,386	79,642	154,996	5,781,525
Additions	526,698	5,325	285,286	15,862	172,064	249,417	58,772	1,313,424
Disposals	(2,652)	(49,223)	(29,153)	(8,500)	(112,605)	(2,997)	(3,636)	(208,766)
Reclassification	290,283	35,779	-	-	-	(326,062)	-	-
At 31 December 2017	4,913,013	101,504	970,840	139,849	550,845	-	210,132	6,886,183
Accumulated depreciation								
At 1 January 2016	131,079	91,704	314,576	78,631	406,680	-	95,109	1,117,779
Charge for the year	59,102	11,301	83,867	11,803	30,396	-	8,146	204,615
Disposals	-	(7,591)	(9,357)	(34,536)	(13,747)	-		(65,231)
At 31 December 2016	190,181	95,414	389,086	55,898	423,329	-	103,255	1,257,163
Charge for the year	75,054	9,529	109,823	21,849	32,698	-	15,750	264,703
Disposals	(4)	(46,624)	(20,649)	(8,500)	(112,226)	-	(3,636)	(191,639)
At 31 December 2017	265,231	58,319	478,260	69,247	343,801	-	115,369	1,330,227
Revalued amounts								
At 31 December 2016	3,908,503	14,209	325,621	76,589	68,057	79,642	51,741	4,524,362
At 31 December 2017	4,647,782	43,185	492,580	70,602	207,044	-	94,763	5,555,956

Revaluation of assets

The lands and buildings owned by the Bank were revaluated by an independent appraiser on 19 December 2014 using a combination of the market, income and cost methods resulting in a revaluation of AMD 2,022,783 thousand. Management have based their estimate on the results of the independent appraisal.

Additions to buildings included reclassified assets from repossessed assets at the amount of AMD 507,104 thousand.

The management believes that at 31 December 2016 the fair value of the buildings does not differ significantly from their revalued amounts.

For the fair value measurement and movement of PPE see note 31.3

If the net book value of revalued buildings that would have been recognised under the historic cost, the revalued amounts will be presented as follows:

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Historic cost	2,032,627	1,868,491
Accumulated amortization	(620,895)	(572,793)
Revalued amount	1,411,732	1,295,698

Fully depreciated items

As of 31 December 2017 fixed assets and intangible assets included fully depreciated assets at the amount of AMD 571,807 thousand (2016: AMD 624,925 thousand).

Restrictions on title of fixed assets and intangible assets

As of 31 December 2017, the Bank does not possess any fixed assets and intangible assets pledged as security for liabilities or whose title is otherwise restricted (2016: either).

Contractual commitments

As of 31 December 2017 the Bank had contractual commitments of making investments in fixed assets and intangible assets (2016: contractual commitments of making investments in intangible assets at the amount of AMD 16,000 thousand)

20 Repossessed assets

Details of confiscated assets serving as collateral for loans issued by the Bank at 31 December are presented below.

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Real estate	2,890,995	4,052,972
Vehicles	-	16,123
Other assets	30,912	24,901
Total repossessed assets	2,921,907	4,093,996

At the date of confiscation the collateral is measured at the lower of the carrying amount of non-repaid loan liabilities and the fair value of collateral.

It is the Bank's policy to properly and timely dispose the collateral. The Bank does not principally use non-cash collaterals for carrying out its activity. Assets are measured at the lower of carrying amount and fair value less costs to sell.

21 Other assets

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Debtors and other receivables	159,419	97,563
Receivables on cash transfers	59,784	25,143
	219,203	122,706
Less allowance for assets impairment	(22,839)	(9,632)
Total other financial assets	196,364	113,074
Prepayments	182,529	17,162
Materials	42,627	14,484
Other	25,044	10,546
Total non-financial assets	250,200	42,192
Total other assets	446,564	155,266

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

In thousand Armenian drams	Total
At 1 January 2016	3,040
Charge for the year	4,681
Net recovery	1,911
At 31 December 2016	9,632
Reversal for the year	(13,355)
Net recovery	26,562
At 31 December 2017	22,839

22 Amounts due to financial institutions

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Loans from banks and other financial institutions	4,446,962	3,076,965
Deposits from financial institutions	3,452,983	238,823
Current accounts of banks and oher financial institutions	195,975	442,085
Repurchase agreements with banks	5,436,004	3,746,612
Total amounts due to financial institutions	13,531,924	7,504,485

Loans from financial institutions have fixed interest rates.

As of 31 December 2017 the weighted average effective interest rates on amounts due to financial institutions were 8.04% for borrowings in AMD (2016: 6.53%), and 7.14% for loans in USD, EUR and other freely convertible currencies (2016: 6.94%).

As of 31 December 2017 the Bank had only one borrower (As of 31 December 2016: one), whose deposit ans loan balances exceed 10% of equity. The total amount of such loans as of 31 December 2017 was AMD 3,285,312 thousand (2016: AMD 5,147,040 thousand)

The Bank has not had any defaults of principal, interest or other breaches with respect to its liabilities during the period (2016: either).

23 Amounts due to customers

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Legal entities		
Current/Settlement accounts	9,743,148	11,527,923
Time deposits	4,714,085	945,581
	14,457,233	12,473,504
Individuals		
Current/Settlement accounts	5,963,385	3,824,266
Time deposits	29,410,097	23,478,586
	35,373,482	27,302,852
Total amounts due to customers	49,830,715	39,776,356

As of 31 December 2017 time deposits of legal entities / individuals are deposits amounting to AMD 984,255 thousand (2016: AMD 1,373,413 thousand) held as security against loans to customers, guarantees issued and other transaction related contingent obligations. The fair value of those deposits approximates the carrying amount.

Concentration of customers' current accounts and deposits

As of 31 December 2017 the Bank has three groups of related customers (2016: two), whose loan balances exceed 10% of equity. The gross value of these loans as at 31 December 2016 amounts to AMD 16,920,400 thousand (2016: AMD 11,577,198 thousand).

As of 31 December 2017 the weighted average effective interest rates on amounts due to customers was 10% for borrowings in AMD (2016: 12.5%) and 6% for borrowings in USD, EUR and other freely convertible currencies (2016: 7.7%).

24 Other borrowings

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Loans from the CBA	26,719	26,408
Loans from RA Government	-	246,859
Total other borrowings	26,719	273,267

Loans from the RA Government and the CBA include loans received within the frames of “Small and Medium Loaning program” and “Economy stabilization project” of the German Armenian fund.

The weighted average effective interest rate of the attracted loan was 7.5% at 31 December 2017 (2016: 9.2%).

The Bank has not had any defaults of principal, interest or other breaches with respect to its liabilities during the period (2016: nil).

25 Subordinated debt

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Bonds issued	5,823,655	5,141,995
Subordinated debt from individuals	4,912,334	4,906,203
Total subordinated debt	10,735,989	10,048,198

During 2016 10,000 subordinated coupon bonds have been issued with nominal value of Euro 1000, 5.5% of interest rate and maturity up to 2020.

During 2016 The Bank has received a subordinated debt in amount of US dollar 10,000 thousand maturing in 2026. The interest rate is 9% (Refer to note 30).

26 Other liabilities

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Due to personnel	97,407	66,032
Accounts payables	102,590	123,740
Dividend liabilities	426,000	70,027
Total other financial liabilities	625,997	259,799
Tax payable, other than income tax	127,133	188,300
Grants related to assets	49,780	51,854
Other	4,615	17,351
Total other non-financial liabilities	181,528	257,505
Total other liabilities	807,525	517,304

Grants related to assets

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
At 1 January	51,854	53,928
Recognition of income (Note 9)	(2,074)	(2,074)
At 31 December	49,780	51,854

27 Securities pledged under repurchase agreements

In thousand Armenian drams	Asset		Liability	
	As of 31 December 2017	As of 31 December 2016	As of 31 December 2017	As of 31 December 2016
Securities available-for-sale (refer to note 22, 27)	5,536,417	3,865,633	5,436,004	3,746,612
	5,536,417	3,865,633	5,436,004	3,746,612

The pledged securities are financial assets pledged under repurchase agreements with other banks, with the right to sell or re-pledge by the counterparty.

28 Equity

As at 31 December 2016 the Bank's registered and paid-in charter capital was AMD 17,950,000 thousand. In accordance with the Bank's statues, the share capital consists of 144,000 ordinary shares, all of which have a par value of AMD 100,000 each and 35,500 non-redeemable preference shares, all of which have a par value of AMD 100,000 each.

The respective shareholdings as of 31 December 2017 and 2016 may be specified as follows:

In thousand Armenian drams	As of 31 December 2017		As of 31 December 2016	
	Paid-in share capital	% of total paid-in capital	Paid-in share capital	% of total paid-in capital
"ZakNefteGazStroy Prometey" OJSC	6,642,000	37.0	6,642,000	37.0
Vazgen Gevorgyan	561,600	3.13	561,600	3.13
"Prometey City" LLC	10,746,400	59.87	10,746,400	59.87
	17,950,000	100	17,950,000	100

As of 31 December 2017, the Bank did not possess any of its own shares.

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

In 2017 the shareholders of the Bank has not increased its share capital (2016: increased the share capital by AMD 3,550,000 thousand by issuing preferred shares).

In 2017 the Bank accrued dividends totaling AMD 434,170 thousand on preferred shares (As of 31 December 2016: AMD 70,027 thousand).

Distributable among participants reserves equal the amount of retained earnings, determined according to the Armenian legislation. Non-distributable reserves are represented by a reserve fund, which is created as required by the statutory regulations, in respect of general banking risks, including future losses and other unforeseen risks or contingencies. The reserve has been created in accordance with the Bank's statutes that provide for the creation of a reserve for these purposes of not less than 5 % of the Bank's charter capital reported in statutory books.

29 Contingent liabilities and commitments

Tax and legal matters

The taxation system in Armenia is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes unclear, contradictory and subject to varying interpretation. Taxes are subject to review and investigation by tax authorities, which have the authority to impose fines and penalties. In the event of a breach of tax legislation, no liabilities for additional taxes, fines or penalties may be imposed by tax authorities once three years have elapsed from the date of the breach.

These circumstances may create tax risks in Armenia that are more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Armenian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these financial statements, if the authorities were successful in enforcing their interpretations, could be significant. Management believes that the Bank has complied with all regulations and has completely settled all its tax liabilities.

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

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

Loan commitment, guarantee and other financial facilities

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

As of 31 December the nominal or contract amounts were:

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Undrawn loan commitments	3,741,993	1,580,210
Guarantees	2,136,265	208,102
Total commitments and contingent liabilities	5,878,258	1,788,312

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

Operating lease commitments – Bank as a lessee

In the normal course of business the Bank enters into commercial lease agreements for office territory.

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

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Not later than 1 year	19,471	14,798
Total operating lease commitments	19,471	14,798

Contractual commitments

Information on the Bank's capital nature contractual commitments is disclosed in note 19.

Insurance

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

30 Transactions with related parties

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

The ultimate participant of the Bank is Vazgen Gevorgyan, who is related with other shareholders of the Bank.

A number of banking transactions are entered into with related parties in the normal course of business. These transactions were carried out on commercial terms and at market rates.

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

In thousand Armenian drams	2017		2016	
	Shareholders and parties related with them	Key management personnel and parties related with them	Shareholders and parties related with them	Key management personnel and parties related with them
Statement of financial position				
Loans to customers				
Loans outstanding at 1 January	99,596	362,671	151,675	363,911
Loans issued during the year	2,552	493,690	185,163	998,136
Loan repayments during the year	(102,148)	(637,869)	(237,242)	(999,376)
Loans outstanding at 31 December	-	218,492	99,596	362,671
Less allowance for loan impairment	-	(2,185)	(996)	(3,627)
Loans outstanding at 31 December	-	216,307	98,600	359,044

In thousand Armenian drams	2017		2016	
	Shareholders and parties related with them	**Key management personnel and parties related with them**	**Shareholders and parties related with them**	**Key management personnel and parties related with them**
Amounts due to customers				
At 1 January	1,172,422	1,077,180	1,150,637	1,031,294
Received during the year	6,004,534	2,845,890	11,076,910	3,337,145
Repaid during the year	(4,037,423)	(3,205,170)	(11,055,125)	(3,291,259)
At 31 December	3,139,533	717,900	1,172,422	1,077,180
Subordinated debt				
At 1 January	4,906,203	-	-	-
Received during the year	308,031	-	5,157,612	-
Repaid during the year	(301,900)	-	(251,409)	-
At 31 December	4,912,334	-	4,906,203	-
Statement of profit or loss and other comprehensive income				
Interest income on loans	-	24,164	20,883	39,869
Impairment (charge)/reversal	996	1,442	66	(1,080)
Interest expense on deposits	(112,006)	(48,671)	(100,739)	(81,738)
Interest expense on subordinated debt	(434,377)	-	(107,149)	-
Commission income	636	530	897	2,209
Net loss from derivative instruments	(2,016)	-	(18,392)	-
Other income	377	867	1,669	807
Other operating expenses	(58)	(4,475)	(107)	(4,146)

Compensation of key management personnel was comprised of the following:

In thousand Armenian drams	2017	2016
Salaries and bonuses	393,488	331,845
Total key management compensation	393,488	331,845

The loans issued to parties related with the Bank are repayable over 1-15 years and have effective interest rates of 7-24% (2016: 9-24%).

31 Fair value measurement

The Bank’s management determines the policies and procedures for both recurring fair value measurement, such as unquoted trading and available-for-sale securities, unquoted derivatives and for non-recurring measurement, such as assets held for sale.

External valuers are involved for valuation of significant assets, such as properties and repossessed assets. Involvement of external valuers is decided upon annually by the Bank’s Board.

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

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities

- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset and liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)

- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

31.1 Financial instruments that are not measured at fair value

The table below presents the fair value of financial assets and liabilities not measured at their fair value in the statement of financial position and analyses them by the level in the fair value hierarchy into which teach fair value measurement is categorised.

In thousand Armenian drams	As of 31 December 2017				
	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
Financial assets					
Cash and cash equivalents	-	18,812,252	-	18,812,252	18,812,252
Amounts due from financial institutions	-	8,620,732	-	8,620,732	8,620,732
Loans to customers	-	56,834,306	-	56,834,306	56,834,306
Securities held to maturity	-	513,630	-	513,630	499,366
Other assets	-	196,364	-	196,364	196,364
Financial liabilities					
Amounts due to financial institutions	-	13,531,924	-	13,531,924	13,531,924
Amounts due to customers	-	49,830,715	-	49,830,715	49,830,715
Subordinated debt	-	10,735,989	-	10,735,989	10,735,989
Other borrowings	-	26,719	-	26,719	26,719
Other liabilities	-	625,997	-	625,997	625,997

In thousand Armenian drams	As of 31 December 2016				
	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
Financial assets					
Cash and cash equivalents	-	16,049,033	-	16,049,033	16,049,033
Amounts due from financial institutions	-	7,166,968	-	7,166,968	7,166,968
Loans to customers	-	46,537,338	-	46,537,338	46,537,338
Securities held to maturity	-	510,194	-	510,194	501,835
Other assets	-	113,074	-	113,074	113,074

In thousand Armenian drams	As of 31 December 2016				
	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
Financial liabilities					
Amounts due to financial institutions	-	7,504,485	-	7,504,485	7,504,485
Amounts due to customers	-	39,776,356	-	39,776,356	39,776,356
Subordinated debt	-	10,048,198	-	10,048,198	10,048,198
Other borrowings	-	273,267	-	273,267	273,267
Other liabilities	-	259,799	-	259,799	259,799

Amounts due from and to financial institutions

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

Loans to customers

The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on credit risk of the counterparty and ranged from 7% to 24% per annum (2015: 7% to 24% per annum).

The fair value of the impaired loans is calculated based on expected cash flows from the sale of collateral. The value of collateral is based on appraisals performed by independent, professionally-qualified property valuers.

Due to financial institutions and customers

The fair value of deposits from financial institutions and customers is estimated using discounted cash flow techniques, applying the rates that are offered for deposits of similar maturities and terms. The fair value of deposits payable on demand is the amount payable at the reporting date.

Issued securities, other borrowings

The fair value of borrowings with fixed and unquoted interest rates is set based on the calculation of future cash flows, which are discounted applying the rates that are offered new debt instruments of similar maturities and terms.

31.2 Financial instruments that are measured at fair value

In thousand Armenian drams	As of 31 December 2017			
	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial assets	-	852	-	852
Securities available-for-sale	-	5,976,769	-	5,976,769
Securities pledged under repurchase agreements	-	5,536,417	-	5,536,417
Total	-	11,514,038	-	11,514,038

In thousand Armenian drams				As of 31 December 2017
	Level 1	Level 2	Level 3	Total
Financial liabilities				
Derivative financial liabilities	-	20,400	-	20,400
Total	-	20,400	-	20,400
Net fair value	-	11,493,638	-	11,493,638

In thousand Armenian drams				As of 31 December 2017
	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial assets	-	1,810	-	1,810
Securities available-for-sale	-	6,599,191	-	6,599,191
Securities pledged under repurchase agreements	-	3,865,633	-	3,865,633
Total	-	10,466,634	-	10,466,634
Financial liabilities				
Derivative financial liabilities	-	19,633	-	19,633
Trading financial liabilities	-	1,076,462	-	1,076,462
Total	-	1,096,095	-	1,096,095
Net fair value		9,370,539		9,370,539

The methods and valuation techniques used for the purpose of measuring fair value are unchanged compared to the previous reporting period.

Unlisted equity investments.

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

Derivatives

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

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

31.3 Fair value measurement of non-financial assets and liabilities

In thousand Armenian drams				As of 31 December 2017
	Level 1	Level 2	Level 3	Total
Non-financial assets				
Property plant and equipment				
Buildings and land	-	-	4,913,013	4,913,013
Total	-	-	4,913,013	4,913,013

In thousand Armenian drams	As of 31 December 2016			
	3	Level 2	Level 3	Total
Non-financial assets				
Property plant and equipment				
Buildings and land	-	-	4,913,013	4,913,013
Total	-	-	4,913,013	4,913,013

Fair value measurements in Level 3

The Bank's non-financial assets and liabilities classified in Level 3 uses valuation techniques based on significant inputs that are not based on observable market data.

The non- financial assets within this level can be follows:

In thousand Armenian drams	2017	2016
Balance as of 1 January 2017	4,098,684	3,744,017
Purchases and reclassification	816,981	354,667
Sales	(2,652)	-
Net fair value as of 31 December	4,913,013	4,098,684

Fair value of the Bank's main property assets is estimated based on appraisals performed by independent, professionally-qualified property valuers. The significant inputs and assumptions are developed in close consultation with management. The valuation processes and fair value changes are reviewed by the board of directors and audit committee at each reporting date.

The land and building owned by the Bank were evaluated by an independent appraiser on 19 December 2014 using a combination of the market, income and cost methods.

32 Offsetting of financial assets and financial liabilities

In the ordinary course of business, the Bank performs different operations with financial instruments which may be presented in net amounts when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

The table below presents financial assets and financial liabilities that are offset in the statement of financial position or are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments, irrespective of whether they are offset in the statement of financial position.

In thousand Armenian drams	As at 31 December 2017					
				Related amounts that are not offset in the statement of financial position		
	Gross amount of recognised financial assets/ liabilities	Gross amount of recognised financial assets/ liabilities in the statement of financial position	Net amount of financial liabilities in the statement of financial position	Financial instruments in the statement of financial position	Cash collateral received	Net
Financial assets						
Reverse repurchase agreements (note 15, 17)	6,772,460	-	6,772,460	6,772,460	-	-
Financial liabilities						
Repurchase agreements (note 22)	5,436,004	-	5,436,004	5,536,417	-	(100,413)

In thousand Armenian drams	As at 31 December 2016					
				Related amounts that are not offset in the statement of financial position		
	Gross amount of recognised financial assets/ liabilities	Gross amount of recognised financial assets/ liabilities in the statement of financial position	Net amount of financial liabilities in the statement of financial position	Financial instruments in the statement of financial position	Cash collateral received	Net
Financial assets						
Reverse repurchase agreements (note 15, 17)	4,679,263	-	4,679,263	4,679,263	-	-
Financial liabilities						
Repurchase agreements (note 22)	3,746,612	-	3,746,612	3,865,633	-	(119,021)

33 Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities analyzed according to when they are expected to be recovered or settled. See Note 34.3 for the Bank's contractual undiscounted repayment obligations.

In thousand Armenian drams	As at 31 December 2017						
	Demand and less than 1 month	From 1 to 12 months	Subtotal less than 12 months	From 1 to 5 years	More than 5 years	Subtotal over 12 months	Total
Assets							
Cash and cash equivalents	18,812,252	-	18,812,252	-	-	-	18,812,252
Amounts due from financial institutions	6,372,511	1,375,174	7,747,685	785,635	87,412	873,047	8,620,732
Derivative financial assets	852	-	852	-	-	-	852
Loans to customers	3,697,309	13,196,574	16,893,883	27,014,591	12,925,832	39,940,423	56,834,306
Securities available-for-sale	-	959,819	959,819	3,979,304	1,037,646	5,016,950	5,976,769
Securities s held-to-maturity	-	7,580	7,580	491,786	-	491,786	499,366
Securities pledged under repurchase agreements	-	3,148,055	3,148,055	1,349,944	1,038,418	2,388,362	5,536,417
Other financial assets	196,364	-	196,364	-	-	-	196,364
	29,079,288	18,687,202	47,766,490	33,621,260	15,089,308	48,710,568	96,477,058
Liabilities							
Amounts due to financial institutions	7,254,146	2,538,655	9,792,801	2,250,940	1,488,183	3,739,123	13,531,924
Derivative financial liabilities	-	5,680	5,680	14,720	-	14,720	20,400
Amounts due to customers	17,331,044	16,588,526	33,919,570	15,911,145	-	15,911,145	49,830,715
Subordinated debt	21,367	72,622	93,989	5,801,000	4,841,000	10,642,000	10,735,989
Other borrowings	-	-	-	26,719	-	26,719	26,719
Other liabilities	195,997	430,000	625,997	-	-	-	625,997
	24,802,554	19,635,483	44,438,037	24,004,524	6,329,183	30,333,707	74,771,744
Net position	4,276,734	(948,281)	3,328,453	9,616,736	8,760,125	18,376,861	21,705,314
Accumulated gap	4,276,734	3,328,453		12,945,189	21,705,314		

In thousand Armenian drams	As at 31 December 2016						
	Demand and less than 1 month	From 1 to 12 months	Subtotal less than 12 months	From 1 to 5 years	More than 5 years	Subtotal over 12 months	Total
Assets							
Cash and cash equivalents	16,049,033	-	16,049,033	-	-	-	16,049,033
Amounts due from financial institutions	4,361,209	1,947,573	6,308,782	480,624	377,562	858,186	7,166,968
Derivative financial assets	1,810	-	1,810	-	-	-	1,810
Loans to customers	3,626,233	10,660,033	14,286,266	24,782,117	7,468,955	32,251,072	46,537,338
Securities available-for-sale	80,036	367,655	447,691	4,201,500	1,950,000	6,151,500	6,599,191
Securities held-to-maturity	10,435	7,460	17,895	483,940	-	483,940	501,835
Securities pledged under repurchase agreements	104,363	111,270	215,633	3,650,000	-	3,650,000	3,865,633
Other assets	112,050	1,024	113,074	-	-	-	113,074
	24,345,169	13,095,015	37,440,184	33,598,181	9,796,517	43,394,698	80,834,882
Liabilities							
Amounts due to financial institutions	5,602,061	291,921	5,893,982	722,162	888,341	1,610,503	7,504,485
Derivative financial liabilities	-	1,072	1,072	16,209	2,352	18,561	19,633
Trading financial liabilities	1,076,462	-	1,076,462	-	-	-	1,076,462
Amounts due to customers	16,310,508	15,743,138	32,053,646	7,720,871	1,839	7,722,710	39,776,356
Subordinated debt	20,992	65,806	86,798	5,122,000	4,839,400	9,961,400	10,048,198
Other borrowings	-	246,859	246,859	-	26,408	26,408	273,267
Other liabilities	253,799	6,000	259,799	-	-	-	259,799
	23,263,822	16,354,796	39,618,618	13,581,242	5,758,340	19,339,582	58,958,200
Net position	1,081,347	(3,259,781)	(2,178,434)	20,016,939	4,038,177	24,055,116	21,876,682
Accumulated gap	1,081,347	(2,178,434)		17,838,505	21,876,682		

34 Risk management

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

Risk is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability. The Bank is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to operating risks. The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's 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 is responsible for implementation, realization and control of processes, which are connected with risk management.

Risk Controlling Unit

The Risk Controlling Unit is responsible for monitoring compliance with risk principles, policies and limits across the Bank. This unit also ensures the complete capture of the risks in risk measurement and reporting systems.

Internal audit

Risk management processes throughout the Bank are audited annually by the internal audit function, which 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 Board of the Bank and the Management Board.

Risk measurement and reporting systems

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

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

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Board of the Bank and the Management Board. The report includes aggregate credit exposure, hold limit exceptions, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place by maturity. The Management receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

A daily briefing is given to the members of the Management Board, which includes Bank normative, current balance of the Bank, daily change in income and expenses and changes in off-balance sheet articles.

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's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

34.1 Credit risk

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

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

34.1.1 Risk concentrations

Geographical sectors

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

In thousand Armenian drams	Armenia	Other non-OECD countries	OECD countries	Total
Cash and cash equivalents	18,268,394	352,962	190,896	18,812,252
Amounts due from financial institutions	8,509,560	111,172	-	8,620,732
Derivative financial assets	-	852	-	852
Loans to customers	56,827,498	6,065	743	56,834,306
Securities available-for-sale	5,976,769	-	-	5,976,769
Securities held-to-maturity	499,366	-	-	499,366
Securities pledged under repurchase agreements	5,536,417	-	-	5,536,417
Other assets	141,737	44,128	10,499	196,364
As of 31 December 2017	95,759,741	515,179	202,138	96,477,058
As of 31 December 2016	79,715,630	808,196	311,056	80,834,882

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

34.1.2 Risk limit control and mitigation policies

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments.

Such risks are monitored on a revolving basis and subject to an annual or more frequent review, when considered necessary. Limits on the level of credit risk by product, industry sector and by country are approved quarterly by the Board of the Bank.

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

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

Some other specific control and mitigation measures are outlined below.

Collateral

The Bank employs a range of policies and practices to mitigate credit risk. It is common practice to take collateral for extended funs. The Bank implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Charges over business assets such as premises, other fixed assets, inventory;

- Charges over financial instruments such as debt securities and equities,
- Cash,
- Guarantees

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

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

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

In thousand Armenian drams	As of 31 December 2017	As of 31 December 2016
Loans collateralized by real estate	34,115,934	24,590,996
Loans collateralized by inventories	3,420,404	3,927,546
Loans collateralized by movable property	4,560,419	3,887,682
Loans collateralized by cash	6,078,981	5,914,321
Loans collateralized by guarantees	4,426,136	5,709,922
Loans collateralized by gold	921,245	765,657
Loans collateralized by RA state bonds	887,014	412,269
Loans collateralized by deposits	361,747	309,092
Other collateral	1,289,887	1,119,453
Unsecured loans	1,529,809	614,904
Total loans to customers (gross)	57,591,576	47,251,842

The amounts presented in the table above are carrying values of the loans, and do not necessarily represent the fair value of the collaterals. Estimates of market values of collaterals are based on valuation of the collateral at the date when loans were provided. Generally they are not updated unless loans are assessed as individually impaired.

Credit-related commitments

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

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans.

In this case, the possible amount of loss, that the Bank may bear, equals to the unused portions of loans.

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

34.1.3 Impairment and provisioning policies

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

Individually assessed allowances

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

Collectively assessed allowances

Allowances are assessed collectively for losses on loans and advances that are not significant (including residential mortgages and unsecured consumer loans) 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 not yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired.

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

Loans neither past due or impaired

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

In thousand Armenian drams	**As of 31 December 2017**	**As of 31 December 2016**
Loans to customers		
Manufacturing	**0.43%**	**0.36%**
Construction	**0.36%**	**-**
Trade	**0.05%**	**0.10%**
Consumer	**0.96%**	**1.44%**
Mortgage	**0.26%**	**-**
Service	**1.37%**	**3.13%**
Other	**0.2%**	**0.08%**

As of 31 December 2017 and 31 December 2016 the Bank has not had any losses on other financial assets bearing credit risk.

Past due but not impaired loans

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

Analysis of past due loans by age and by class is provided below.

In thousand Armenian drams	As of 31 December 2017				
	Less than 30 days	31 to 60 days	61 to 90 days	More than 91 days	Total
Manufacturing	-	-	-	50,702	50,702
Construction	-	-	-	206,025	206,025
Trade	11,987	-	7,872	130,067	149,926
Consumer	-	1,012	189	64,444	65,645
Mortgage	54,108	-	-	37,930	92,038
Other	13,229	-	-	65,785	79,014
Total	79,324	1,012	8,061	554,953	643,350

In thousand Armenian drams	As of 31 December 2016				
	Less than 30 days	31 to 60 days	61 to 90 days	More than 91 days	Total
Manufacturing	-	13,187	2,195	18,923	34,305
Construction	-	-	-	408,870	408,870
Trade	-	25,976	9,703	132,740	168,419
Consumer	19,610	18,876	6,584	85,470	130,540
Mortgage	26,125	-	7,358	10,031	43,514
Service	-	-	-	9,091	9,091
Total	45,735	58,039	25,840	665,125	794,739

34.2 Market risk

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

34.2.1 Market risk – Non-trading

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Board of the Bank has established limits on the interest rate gaps for stipulated periods. Positions are monitored on a daily basis.

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

The sensitivity of the statement of profit or loss and other comprehensive income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2017. The sensitivity of equity is calculated by revaluating fixed rate available-for-sale financial assets at 31 December 2017 for the effects of the assumed changes in interest rates. The sensitivity of equity is analysed by maturity of the asset or swap. The total sensitivity of equity is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity displays the sensitivity to non-parallel changes.

In thousand Armenian drams			As of 31 December 2017				
			Sensitivity of equity				
Currency	Change in basis points	Sensitivity of net interest income	Up to 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	Total
AMD	+1	-	(7,929)		(93,500)	(149,848)	(251,277)
AMD	(1)	-	7,989		96,435	169,269	273,693

In thousand Armenian drams			As of 31 December 2016				
			Sensitivity of equity				
Currency	Change in basis points	Sensitivity of net interest income	Up to 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	Total
USD	+1	-	(486)	-	(156,147)	(133,632)	(290,265)
USD	(1)	-	4,902	-	161,295	150,569	316,766

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board of the Bank has set limits on positions by currency. Positions are monitored on a daily basis. The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2016 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculated the effect of a reasonably possible movement of the currency rate against the Armenian dram, with all other variables held constant on the statement of profit or loss and other comprehensive income (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in statement of profit or loss and other comprehensive income or equity, while a positive amount reflects a net potential increase.

In thousand Armenian drams	As of 31 December 2017		As of 31 December 2016	
Currency	Change in currency rate in %	Effect on profit before tax	Change in currency rate in %	Effect on profit before tax
USD	+5	30,173	+5	31,171
EUR	+5	1,001	+5	(573)

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

In thousand Armenian drams	Armenian Dram	Freely convertible currencies/ precious metals	Non-freely convertible currencies	Total
Assets				
Cash and cash equivalents	9,251,057	8,281,954	1,279,241	18,812,252
Amounts due from other financial institutions	7,185,994	1,305,271	129,467	8,620,732
Loans to customers	11,702,255	45,122,517	9,534	56,834,306
Securities available-for-sale	5,976,769	-	-	5,976,769
Securities held-to-maturity	-	499,366	-	499,366
Securities pledged under repurchase agreements	5,536,417	-	-	5,536,417
Other assets	40,982	115,407	39,975	196,364
	39,693,474	55,324,515	1,458,217	96,476,206
Liabilities				
Amounts due to financial institutions	12,939,116	592,802	6	13,531,924
Amounts due to customers	6,980,488	42,055,180	795,047	49,830,715
Subordinated debt	-	10,735,989	-	10,735,989
Other borrowings	26,719	-	-	26,719
Other liabilities	585,710	38,322	1,965	625,997
Total	20,532,033	53,422,293	797,018	74,751,344
Total effect of derivative financial instruments	1,916,000	(1,207,842)	(727,706)	(19,548)
Net position as of 31 December 2017	21,077,441	694,380	(66,507)	21,705,314
Commitments and contingent liabilities as of 31 December 2017	4,182,324	1,687,298	8,636	5,878,258
Total financial assets	30,828,030	49,407,434	597,608	80,833,072
Total financial liabilities	11,561,905	46,984,779	391,883	58,938,567
Total effect of derivative financial instruments	1,981,459	(1,797,837)	(201,445)	(17,823)
Net position as of 31 December 2016	21,247,584	624,818	4,280	21,876,682
Commitments and contingent liabilities As of 31 December 2016	630,763	1,157,549	-	1,788,312

Freely convertible currencies represent mainly US dollar and Euro. Non-freely convertible amounts relate to currencies of CIS countries, excluding Republic of Armenia.

34.3 Liquidity risk

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

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains an obligatory minimum reserve deposits with the Central Bank of Armenia equal to 2% of certain obligations of the Bank denominated in Armenian drams and 18% on certain obligations of the Bank denominated in foreign currency. See note 14. The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank.

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

The indicators as of 31 December is as follows:

		Not audited
As of 31 December, these ratios were as follows:	As of 31 December 2017, %	As of 31 December 2016, %
N2/1- Total liquidity ratio (Highly liquid assets/ Total assets)	29.25	32.41
N2/2- Current liquidity ratio (Highly liquid assets /liabilities on demand)	183.19	196.0

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2017 based on contractual undiscounted repayment obligations. See note 33 for the expected maturities of these liabilities. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

In thousand Armenian drams	As of 31 December 2017				
	Demand and less than 1 month	From 1 to 12 months	From 1 to 5 years	More than 5 years	Total
Non-derivative financial liabilities					
Amounts due to financial institutions	7,351,882	2,703,707	2,922,520	1,703,946	14,682,055
Amounts due to customers	17,352,970	17,127,620	17,479,437	-	51,960,027
Subordinated debt	23,396	412,294	7,567,442	6,541,265	14,544,397
Other borrowings	-	-	37,437	-	37,437
Other liabilities	195,997	430,000	-	-	625,997
Total undiscounted non-derivative financial liabilities	24,924,245	20,673,621	28,006,836	8,245,211	81,849,913

In thousand Armenian drams					As of 31 December 2017
	Demand and less than 1 month	From 1 to 12 months	From 1 to 5 years	More than 5 years	Total
Non-derivative financial liabilities					
Foreign exchange forward contracts					
Inflow	-	381,600	1,534,400	-	1,916,000
Outflow	-	(387,280)	(1,549,120)	-	(1,936,400)
Foreign exchange swap contracts					
Inflow	745,961	-	-	-	745,961
Outflow	(745,109)	-	-	-	(745,109)
Commitments and contingent liabilities	3,746,993	388,171	1,743,094	-	5,878,258

In thousand Armenian drams					As of 31 December 2016
	Demand and less than 1 month	From 1 to 12 months	From 1 to 5 years	More than 5 years	Total
Non-derivative financial liabilities					
Amounts due to financial institutions	5,618,528	448,001	1,326,606	1,399,560	8,792,695
Trading financial liabilities	1,076,462		-	-	1,076,462
Amounts due to customers	16,453,391	16,836,687	8,001,187	2,171	41,293,436
Subordinated debt	102,860	749,550	7,595,858	6,857,616	15,305,884
Other borrowings	-	252,749	-	39,659	292,408
Other liabilities	253,799	6,000	-	-	259,799
Total undiscounted non-derivative financial liabilities	23,505,040	18,292,987	16,923,651	8,299,006	67,020,684
Non-derivative financial liabilities					
Foreign exchange forward contracts					
Inflow	-	64,260	1,532,399	384,800	1,981,459
Outflow	-	(65,332)	(1,548,608)	(387,152)	(2,001,092)
Foreign exchange swap contracts					
Inflow	203,255	-	-	-	203,255
Outflow	(201,445)	-	-	-	(201,445)
Commitments and contingent liabilities	1,584,210	176,852	27,250	-	1,788,312

34.4 Operational risk

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

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

The primary responsibility for the development and implementation of controls to address operational risk is assigned to the Board. This responsibility is supported by the development of overall standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements, including the minimal requirements of the Central Bank of Armenia on internal control system;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified;
- requirements for the reporting of operational losses and proposed remedial action;
- development of contingency plans;
- training and professional development;
- ethical and business standards; and
- risk mitigation.

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

35 Reconciliation of liabilities arising from financing activities

The changes in the Bank's liabilities arising from financing activities can be classified as follows:

In thousand Armenian drams	As of 31 December 2017		
	Subordinated debt	**Other long-term borrowings**	**Total**
As of 1 January 2017	10,048,198	273,267	10,321,465
Cash-flows	-	(246,548)	(246,548)
Repayments	-	24,907	24,907
Amounts received	-	(271,455)	(271,455)
Non-cash	687,791	-	687,791
Foreign exchange loss	681,105	-	681,105
Accrued interest	6,686	-	6,686
As of 31 December 2017	10,735,989	26,719	10,762,708

36 Capital adequacy

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

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

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

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

Regulatory capital consists of Tier 1 capital, which comprises share capital, retained earnings including current year profit, and general reserve. Regulatory capital is calculated in accordance with the requirements of the Central Bank of Armenia and accounting standards of the Republic of Armenia. The other component of regulatory capital is Tier 2 capital, which includes revaluation and other reserves and subordinated debt.

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

As of 31 December 2016 and 2015 the amount of regulatory capital, risk waited assets and capital adequacy ratio calculated in accordance with the requirements of Central Bank of Armenia are provided below.

	Not audited	
In thousand Armenian drams	**2017**	**2016**
Tier 1 capital	23,690,226	22,029,559
Tier 2 capital	9,916,939	10,682,748
Total regulatory capital	33,607,165	32,712,307
Risk-weighted assets	109,042,077	83,005,092
Capital adequacy ratio	30.82%	39.41%

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

The Central Bank of Armenia has set the minimal required total capital at AMD 30,000,000 thousand as of 1 January 2017.