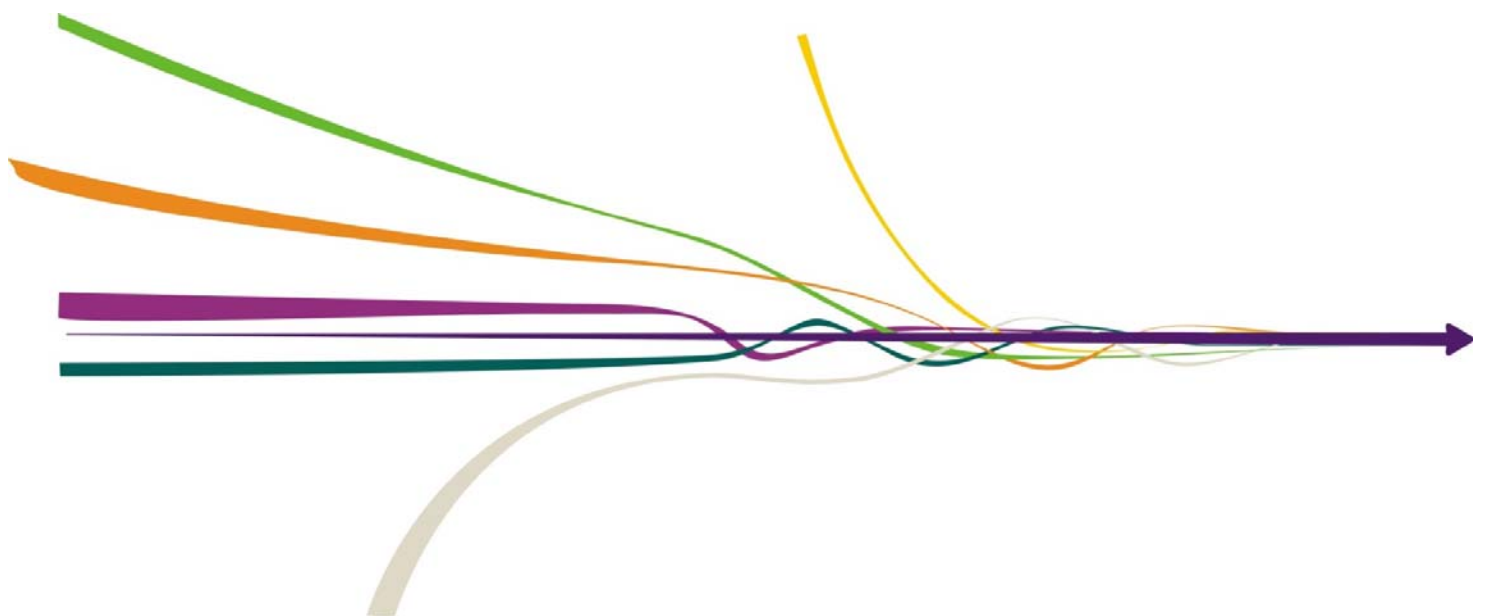


Financial Statements and Independent Auditor's Report

“Prometey Bank” Closed Joint Stock
Company

31 December 2016



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Independent auditor's report

Գրանթ Թորնթոն ՓԲԸ
ՀՀ, ք. Երեւան 0012
Վաղարշյան 8/1

Հ. + 374 10 260 964
Ֆ. + 374 10 260 961

Grant Thornton CJSC
8/1 Vagharshyan str.
0012 Yerevan, Armenia

T + 374 10 260 964
F + 374 10 260 961

www.grantthornton.am

To the shareholders of “Prometey Bank” Closed Joint Stock Company:

Opinion

We have audited the financial statements of “Prometey Bank” Closed Joint Stock Company (the “Bank”), which comprise the statement of financial position as at 31 December 2016, 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 at 31 December 2016, 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.

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

Marine Musheghyan

Managing Partner

Auditor

05 April 2017



Statement of profit or loss and other comprehensive income

In thousand Armenian drams	Notes	Year ended December 31, 2016	Year ended December 31, 2015
Interest and similar income	6	6,147,170	5,878,744
Interest and similar expense	6	(3,221,281)	(3,419,373)
Net interest income		2,925,889	2,459,371
Fee and commission income	7	334,083	358,047
Fee and commission expense	7	(327,794)	(320,352)
Net fee and commission income		6,289	37,695
Net trading income	8	526,188	596,551
Net gains on investments available for sale		335,156	21,238
Other income	9	111,740	120,007
Impairment charge	10	(546,211)	(66,637)
Staff costs	11	(1,107,379)	(994,721)
Depreciation of property, plant and equipment and amortization of intangible assets	19	(204,615)	(267,881)
Other expenses	12	(787,633)	(715,712)
Profit before income tax		1,259,424	1,189,911
Income tax expense	13	(301,130)	(283,258)
Profit for the year		958,294	906,653
Other comprehensive income:			
<i>Items that will be reclassified subsequently to profit or loss</i>			
Net unrealized gains/(losses) from changes in fair value of available-for-sale financial assets		1,637,499	(195,091)
Net gains realized to net profit on disposal of available for sale investments		(331,567)	(70,134)
Income tax relating to items that will be reclassified		(261,186)	53,045
Other comprehensive income for the year, net of tax		1,044,746	(212,180)
Total comprehensive income for the year		2,003,040	694,473

The accompanying notes on pages 8 to 56 are an integral part of these financial statements.

Statement of financial position

In thousand Armenian drams	Notes	As of December 31, 2016	As of December 31, 2015
ASSETS			
Cash and cash equivalents	14	16,049,033	14,559,127
Amounts due from financial institutions	15	7,166,968	8,923,705
Derivative financial assets	16	1,810	-
Loans and advances to customers	17	46,537,338	36,748,049
Investment securities			
-Investments available for sale	18	6,599,191	488,387
-Investments held to maturity	18	501,835	-
Securities pledged under repurchase agreements	27	3,865,633	8,587,674
Property, plant and equipment and intangible assets	19	4,524,362	4,000,777
Reposessed assets	20	4,093,996	4,640,976
Other assets	21	155,266	61,889
TOTAL ASSETS		89,495,432	78,010,584
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to financial institutions	22	7,504,485	10,520,133
Trading financial liabilities	15	1,076,462	794,781
Amounts due to customers	23	39,776,356	33,120,887
Derivative financial liabilities	16	19,633	-
Other borrowings	24	273,267	493,680
Subordinated debts	25	10,048,198	8,413,023
Current income tax liabilities		218,450	772
Deferred income tax liabilities	13	711,646	497,578
Other liabilities	26	517,304	303,112
Total liabilities		60,145,801	54,143,966
Equity			
Charter capital	28	17,950,000	14,400,000
General reserve		52,075	52,075
Other reserves		2,298,030	1,253,284
Retained earnings		9,049,526	8,161,259
Total equity		29,349,631	23,866,618
TOTAL LIABILITIES AND EQUITY		89,495,432	78,010,584

The financial statements from pages 4 to 56 were signed by the Bank's General Manager and Chief Accountant on 05 April 2017.



Emil Soghomonyan
General manager

Alvard Mkrtumyan
Chief accountant

The accompanying notes on pages 8 to 56 are an integral part of these financial statements.

Statement of changes in equity

In thousand Armenian drams

	Charter capital	General reserve	Revaluation reserve of securities available for sale	Revaluation reserve of PPE	Retained earnings	Total
Balance as of January 1, 2015	14,400,000	52,075	(91,508)	1,616,628	7,194,950	23,172,145
Profit for the year	-	-	-	-	906,653	906,653
Other comprehensive income:						
Adjustment to reserve on amortization or disposal of PPE	-	-	-	(59,656)	59,656	-
Net unrealized losses from changes in fair value	-	-	(195,091)	-	-	(195,091)
Net gains realized to net profit on available for sale investments	-	-	(70,134)	-	-	(70,134)
Income tax relating to components of other comprehensive income	-	-	53,045	-	-	53,045
Total comprehensive income for the year	-	-	(212,180)	(59,656)	966,309	694,473
Balance as of December 31, 2015	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:						
Net gains from changes in fair value	-	-	1,637,499	-	-	1,637,499
Net gains realized to net profit 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 December 31, 2016	17,950,000	52,075	741,058	1,556,972	9,049,526	29,349,631

The accompanying notes on pages 8 to 56 are an integral part of these financial statements.

Statement of cash flows

In thousand Armenian drams	Year ended December 31, 2016	Year ended December 31, 2015
Cash flows from operating activities		
Profit before tax	1,259,424	1,189,911
<i>Adjustments for</i>		
Amortization and depreciation allowances	204,615	267,881
Net gains on disposal of PPE	(7,690)	-
Net loss from impairment of other assets	83,976	-
Impairment charge	546,211	66,637
Net loss from revaluation of derivative financial instruments	34,527	2,081
Net loss from revaluation of non-trading assets and liabilities	61,234	64,786
Interest receivable	(7,703)	(167,060)
Interest payable	80,445	6,448
Cash flows from operating activities before changes in operating assets and liabilities	2,255,039	1,430,684
<i>(Increase)/decrease in operating assets</i>		
Amounts due from financial institutions	1,771,346	(3,191,259)
Investments available for sale	(4,802,265)	(604,560)
Securities pledged under repurchase agreements	3,927,260	(800,298)
Derivative financial assets	16,704	24,945
Loans and advances to customers	(10,073,291)	(242,370)
Repossessioned assets	158,860	173,054
Other assets	(180,587)	34,907
<i>Increase/(decrease) in operating liabilities</i>		
Amounts due to financial institutions	(2,317,709)	(590,166)
Amounts due to customers	6,597,619	3,528,677
Other liabilities	113,993	52,121
Net cash used in operating activities before income tax	(2,566,439)	(184,265)
Income tax paid	(130,570)	(65,563)
Net cash from used in operating activities	(2,697,009)	(249,828)
Cash flows from investing activities		
Purchase of investing securities	(486,894)	-
Purchase of property and equipment and intangible assets	(728,575)	(97,281)
Proceeds from sale of property, plant and equipment	8,065	-
Net cash used in investing activities	(1,207,404)	(97,281)
Cash flows from financing activities		
Issue of share capital	3,550,000	-
Issue/(repayment) of debt securities	-	(5,452,455)
Subordinated debt	4,762,728	-
Other long term loans	(3,313,696)	4,552,733
Net cash from/(used in) financing activities	4,999,032	(899,722)
Net increase/(decrease) in cash and cash equivalents	1,094,619	(1,246,831)
Cash and cash equivalents at the beginning of the year	14,559,127	15,895,791
Exchange differences on cash and cash equivalents	395,287	(89,833)
Cash and cash equivalents at the end of the year (Note 14)	16,049,033	14,559,127
Supplementary information:		
Interest received	6,139,467	5,711,684
Interest paid	(3,140,836)	(3,606,608)

The accompanying notes on pages 8 to 56 are an integral part of these financial statements.

Accompanying notes to the financial statements

1 Principal activities

“Prometey Bank” OJSC (the “Bank”) is a Closed Joint Stock Company, which was incorporated in the Republic of Armenia 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”). On 22 July 2016 at an extraordinary meeting of the participants Prometey Bank Limited Liability Company changed its organizational structure, reorganizing onto closed joint stock company.

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

Management of the Bank believes that in the current conditions appropriate measures are implemented in order to ensure economic stability of the 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, as well as non-financial assets and liabilities are stated at amortized or historical cost, with the exception of land and 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 Bank applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2016. The Bank 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 2016, did not have a material impact on the annual financial statements of the Bank.

- *Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)*
- *Annual Improvements to IFRSs 2012–2014 Cycle.*

In 2016 the Bank has made a change in its accounting policy according to which revaluation model is applied for the accounting of land and buildings instead of the previously applied cost model. Management believes that the new accounting policy allows to provide more relevant information.

3.5 Standards, amendments 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.

Management does not anticipate a material impact on the Bank's financial statements from these Amendments, they are presented below.

Amendments to IAS 12 Income Taxes

The IASB has issued *Recognition of Deferred Tax Assets for Unrealised Losses*, which makes narrow-scope amendments to IAS 12 *Income Taxes*. The focus of these amendments is to clarify how to account for deferred tax assets related to debt instruments measured at fair value, particularly where changes in the market interest rate decrease the fair value of a debt instrument below cost.

These amendments clarify the following aspects:

- unrealized losses on debt instruments measured at fair value and measured at cost for tax purposes give rise to a deductible temporary difference regardless of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use;
- the carrying amount of an asset does not limit the estimation of probable future taxable profits;

- estimates for future taxable profits exclude tax deductions resulting from the reversal of deductible temporary differences;
- an entity should consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of the deductible temporary difference. If tax law imposes no such restrictions, an entity assesses a deductible temporary difference in combination with all of its other deductible temporary differences.

The Amendments are effective for annual periods beginning on or after January 1, 2017 and are required to be applied retrospectively. Management does not anticipate a material impact on the Bank's financial statements from these Amendments.

IFRS 9 Financial Instruments (2014)

The IASB recently released *IFRS 9 Financial Instruments* (2014), representing the completion of its project to replace *IAS 39 Financial Instruments: Recognition and Measurement*. The new standard introduces extensive changes to IAS 39's guidance on the classification and measurement of financial assets and introduces a new 'expected credit loss' model for the impairment of financial assets. IFRS 9 also provides new guidance on the application of hedge accounting.

The Bank's management has yet to assess the impact of IFRS 9 on these financial statements. The new standard is required to be applied for annual reporting periods beginning on or after 1 January 2018.

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 January 1, 2019. Early application is permitted provided IFRS 15 Revenue from Contracts with Customers is also applied. The Bank's management has not yet assessed the impact of IFRS 16 on these financial statements.

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 currencies

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 2016	31 December 2015
AMD/1 US Dollar	483.94	483.75
AMD/1 EUR	512.20	528.69

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.

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

The Republic of Armenia 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 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 and.

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.

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 financial results. 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 instruments

Investments available for sale represent debt and equity investments that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. After initial recognition available-for sale financial assets are measured at fair value with gains or losses being recognised as a separate component of 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 in the financial income on a straight-line basis over the lease term and included into other operating expenses.

4.12 Property, plant and equipment

Property, plant and equipment ("PPE") are recorded at historical cost less accumulated depreciation. 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 of land and buildings depend 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.

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

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

4.13 Intangible assets

Intangible assets include computer software, licences and other.

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

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

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

4.14 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 and Government, amounts due to 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.

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

Retained earnings

Include retained 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 securities

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 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 financial assets recognition of changes in fair value through equity.

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 and receivables

The Bank reviews its problem loans and advances 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.

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	2016	2015
Loans and advances to customers	4,127,278	4,104,519
Securities available for sale	1,228,572	920,351
Reverse repurchase transactions	411,956	499,496
Amounts due from other financial institutions	267,125	284,466
Investments held to maturity	12,314	-
Accrued interest on individually impaired assets	99,925	69,912
Total interest and similar income	6,147,170	5,878,744
Amounts due to customers	1,739,610	1,684,793
Repurchase transactions	723,953	1,029,171
Subordinate debt	187,987	286,537
Debt securities issued	293,316	292,586
Amounts due to financial institutions	245,061	76,622
Other borrowings	31,354	49,664
Total interest and similar expense	3,221,281	3,419,373

7 Fee and commission income and expense

In thousand Armenian drams	2016	2015
Wire transfer fees	184,046	214,263
Plastic cards operations	81,433	73,148
Cash operations	30,676	29,114
Other fees and commissions	37,928	41,522
Total fee and commission income	334,083	358,047
Wire transfer fees	171,362	212,594
Plastic cards operations	74,080	63,041
Correspondent accounts maintenance	46,876	44,253
Cash/non-cash currency translation	34,272	-
Other expenses	1,204	464
Total fee and commission expense	327,794	320,352

8 Net trading income

In thousand Armenian drams	2016	2015
Gains less losses from trading in foreign currencies	602,332	655,968
Net loss from disposal of derivative instruments	(41,617)	(57,336)
Net loss from revaluation of derivative instruments	(34,527)	(2,081)
Total net trading income	526,188	596,551

9 Other income

In thousand Armenian drams	2016	2015
Fines and penalties received	74,976	92,912
Income from issue of guarantees and letters of credit	8,384	6,055
Net income from disposal of PPE	7,690	-
Gains from grants relating to assets	2,074	2,074
Income from dividends	-	1,916
Other income	18,616	17,050
Total other income	111,740	120,007

10 Impairment charge

In thousand Armenian drams	2016	2015
Loans and advances to customers (Note 17)	541,530	57,661
Other assets (Note 21)	4,681	8,976
Total impairment charge	546,211	66,637

11 Staff costs

In thousand Armenian drams	2016	2015
Compensations of employees, related taxes included	1,096,389	986,485
Staff training costs	2,872	1,319
Other staff expenses	8,118	6,917
Total staff costs	1,107,379	994,721

12 Other expenses

In thousand Armenian drams	2016	2015
Communications	106,688	94,749
Operating lease	106,505	107,817
Other assets impairment loss	83,976	-
Repair and maintenance expenses of tangible assets	71,246	64,743
Security	66,497	59,930
Advertising costs	63,264	43,621
Foreign currency translation net losses of non-trading assets and liabilities	61,234	64,786
Deposit guarantee fund expenses	56,918	46,433
Office supplies	40,484	30,444
Representative expenses	27,182	33,503
Incasation expenses	20,826	21,602
Taxes, other than income tax, duties	20,493	52,369
Consulting and other services	16,920	30,333
Business trip expenses	9,991	5,186
Financial system mediator expenses	7,727	16,248
Other expenses	27,682	43,948
Total other expense	787,633	715,712

13 Income tax expense

In thousand Armenian drams	2016	2015
Current tax expense	348,248	178,922
Adjustments of current income tax of previous years	-	(5,515)
Deferred tax	(47,118)	109,851
Total income tax expense	301,130	283,258

The corporate income tax within the Republic of Armenia is levied at the rate of 20% (2015: 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	2016	Effective rate (%)	2015	Effective rate (%)
Profit before tax	1,259,424		1,189,911	
Income tax at the rate of 20%	251,885	20	237,982	20
Non-deductible expenses	30,093	2	37,418	3
Foreign exchange losses	12,247	1	12,957	1
Net loss from revaluation of derivative instruments	6,905	1	416	-
Adjustments of current income tax of previous years	-	-	(5,515)	-
Income tax expense	301,130	24	283,258	24

Deferred tax calculation in respect of temporary differences:

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

In thousand Armenian drams	As of 31 December 2014	Recognized in profit or loss	Recognized in other comprehensive income	As of 31 December 2015
Available for sale investments	22,878	-	53,045	75,923
Other liabilities	18,182	(7,054)	-	11,128
Total deferred tax assets	41,060	(7,054)	53,045	87,051
Amounts due from financial institutions	(6,337)	(919)	-	(7,256)
Property, plant and equipment	(400,544)	19,765	-	(380,779)
Loans and advances to customers	(66,888)	(117,368)	-	(184,256)
Other assets	(8,063)	(4,275)	-	(12,338)
Total deferred tax liabilities	(481,832)	(102,797)	-	(584,629)
Net deferred tax liability	(440,772)	(109,851)	53,045	(497,578)

14 Cash and cash equivalents

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Correspondent account with the CBA	8,832,340	7,949,660
Cash on hand	6,310,177	6,054,842
Correspondent accounts with banks	744,396	554,625
Demand deposits with banks	162,120	-
Total cash and cash equivalents	16,049,033	14,559,127

As at 31 December 2016 correspondent account with Central Bank of Armenia represents the obligatory minimum reserve deposits with the CBA, which as at 31 December 2016 is computed at 2% of certain obligations of the Bank denominated in Armenian drams and 18% of certain obligations of the Bank, denominated in foreign currency and amounts to AMD 6,598,341 thousand (2015: AMD 6,164,719 thousand). There are no restrictions on the withdrawal of funds from the CBA, however, if minimum average requirement is not met, the Bank could be subject to penalties. Mandatory reserve deposits in the CBA are non-interest bearing.

At 31 December 2016 the Bank had no nostro accounts (2015: either), the balances of which exceeded 10% of equity.

The following non-cash transaction took place during 2016:

- Repayment of loans through collaterals in the amount of AMD 388,120 thousand (2015: AMD 161,867 thousand).

15 Amounts due from financial institutions

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Reverse repurchase agreements	4,266,994	5,351,696
Loans to banks	251,460	1,741,662
Loans to other financial institutions	2,183,787	1,066,736
Deposited funds in the CBA	252,500	312,500
Deposits in banks	-	264,816
Amounts due from other financial institutions	132,621	121,233
Short-term receivables	14,518	-
Other accounts	65,088	65,062
Total amounts due from financial institutions	7,166,968	8,923,705

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

As of 31 December 2016 included in other accounts is AMD 65,088 thousand (2015: AMD 65,062 thousand) which represents a blocked deposit for membership in Master Card payment system.

Fair value of assets pledged and carrying value of loans under reverse repurchase agreements as of 31 December 2016 are presented as follows:

In thousand Armenian drams	As of 31 December 2016		As of 31 December 2015	
	Fair value of collateral	Carrying value of loans	Fair value of collateral	Carrying value of loans
RA Government bonds	4,424,915	4,266,994	5,536,265	5,351,696
Total assets pledged under reverse repurchase agreements	4,424,915	4,266,994	5,536,265	5,351,696

As at 31 December 2016 out of securities acquired under repurchase agreements securities in the amount of AMD 1,076,462 thousand (2015: AMD 794,781 thousand) were resold to third parties and their liability is accounted in “Trading liabilities” on the face of the statement of financial position.

16 Derivative financial instruments

In thousand Armenian drams	As of 31 December 2016			As of 31 December 2015		
	Notional amount	Fair value of assets	Fair value of liabilities	Notional amount	Fair value of assets	Fair value of liabilities
Derivatives held for trading						
Spot transactions-currency	203,255	1,810	-	-	-	-
Forward foreign exchange contracts	2,001,092	-	19,633	-	-	-
Total derivative financial instruments	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 2016	As of 31 December 2015
Loans	42,139,631	32,522,585
Credit lines and overdrafts	4,133,966	3,590,352
Credit cards	565,976	705,025
Reverse repurchase agreements	412,269	490,810
	47,251,842	37,308,772
Less allowance for loan impairment	(714,504)	(560,723)
Total loans and advances to customers	46,537,338	36,748,049

As of 31 December 2016 accrued interest income included in loans and advances to customers amounted to AMD 365,348 thousand (2015: AMD 462,088 thousand).

As of 31 December 2016 the weighted average effective interest rates on loans and advances to customers was 15.34% for loans in AMD (2015: 14.22%) and 9.95 % for loans in USD, EUR and other freely convertible currencies (2015: 11.8%).

As at 31 December 2016 the Bank has three borrowers (2015: two), whose loan balances exceed 10% of equity. The gross value of these loans as at 31 December 2016 amounts to AMD 12,595,218 thousand (2015: AMD 5,765,521 thousand).

As of 31 December 2016, loans to customers in amount of AMD 1,777,572 thousand (2015: AMD 442,385 thousand) serve as collateral for other borrowings.

Fair value of assets pledged and carrying value of loans under reverse repurchase agreements as of 31 December 2016 are presented as follows:

In thousand Armenian drams	As of December 31, 2016		As of December 31, 2015	
	Fair value of collateral	Carrying value of loans	Fair value of collateral	Carrying value of loans
RA Government bonds	430,901	412,269	519,919	490,810
Total assets pledged and loans under reverse repurchase agreements	430,901	412,269	519,919	490,810

Reconciliation of loans and advances by industry sectors is as follows:

In thousand Armenian drams	As of 31 December 2016							Total
	Industry	Construction	Trading	Consumer	Mortgage	Service	Other	
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	<u>6,693,106</u>	<u>1,460,314</u>	<u>20,152,054</u>	<u>5,193,642</u>	<u>4,144,417</u>	<u>4,022,808</u>	<u>4,870,997</u>	<u>46,537,338</u>

In thousand Armenian drams	As of 31 December 2015							Total
	Industry	Construction	Trading	Consumer	Mortgage	Service	Other	
Loans	9,688,156	1,442,477	11,840,018	5,232,931	3,137,168	3,746,117	2,221,905	37,308,772
Less allowance for loan impairment	(83,881)	(77,470)	(187,440)	(70,527)	(50,824)	(78,463)	(12,118)	(560,723)
Net loans	<u>9,604,275</u>	<u>1,365,007</u>	<u>11,652,578</u>	<u>5,162,404</u>	<u>3,086,344</u>	<u>3,667,654</u>	<u>2,209,787</u>	<u>36,748,049</u>

Reconciliation of allowance account for losses on loans and advances by industry sectors and the collective impairment is as follows:

In thousand Armenian drams	As of 31 December 2016							Total
	Industry	Construction	Trading	Consumer	Mortgage	Service	Other	
At 1 January 2016	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
Net amounts written off	(56,509)	(16,368)	(21,275)	(44,844)	(20,819)	(216,176)	(11,758)	(387,749)
At 31 December 2016	<u>77,320</u>	<u>36,937</u>	<u>259,210</u>	<u>69,858</u>	<u>76,217</u>	<u>109,381</u>	<u>85,581</u>	<u>714,504</u>
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
	<u>77,320</u>	<u>36,937</u>	<u>259,210</u>	<u>69,858</u>	<u>76,217</u>	<u>109,381</u>	<u>85,581</u>	<u>714,504</u>
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	<u>187,338</u>	<u>205,996</u>	<u>792,289</u>	<u>-</u>	<u>107,526</u>	<u>340,950</u>	<u>496,819</u>	<u>2,130,918</u>

In thousand Armenian drams	As of 31 December 2015							
	Industry	Construction	Trading	Consumer	Mortgage	Service	Other	Total
At 1 January 2015	99,567	80,249	249,331	44,179	25,033	35,669	30,767	564,795
Charge/(reversal) for the year	(23,924)	(2,779)	(72,950)	107,586	25,583	42,794	(18,649)	57,661
Net (write off)/recovery	8,238	-	11,059	(81,238)	208	-	-	(61,733)
At 31 December 2015	83,881	77,470	187,440	70,527	50,824	78,463	12,118	560,723
Individual impairment	16,759	69,394	106,101	19,016	29,398	53,278	-	293,946
Collective impairment	67,122	8,076	81,339	51,511	21,426	25,185	12,118	266,777
	83,881	77,470	187,440	70,527	50,824	78,463	12,118	560,723
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	99,297	288,729	220,231	81,844	76,309	148,205	-	914,615

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

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Privately held companies	34,041,634	25,604,353
Individuals	9,429,441	8,758,055
Sole proprietors	3,294,476	2,943,479
Non-commercial institutions	486,291	2,885
	47,251,842	37,308,772
Less allowance for loan impairment	(714,504)	(560,723)
Total loans and advances to customers	46,537,338	36,748,049

Loans to individuals comprise the following products:

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Mortgage loans	4,220,634	3,137,168
Consumer loans	2,617,313	2,999,633
Car loans	564,521	811,027
Gold-backed loans	707,741	-
Other	1,319,232	1,810,227
Total loans and advances to individuals (gross)	9,429,441	8,758,055

At 31 December 2016 and 2015 the estimated fair value of loans and advances to customers approximates its carrying value, as stated in Note 31.

Credit, currency and interest rate analyses of loans and advances to customers are disclosed in Note 34. Information on related parties is disclosed in Note 30.

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

18 Investment securities

In thousand Armenian drams	As of 31 December 2016			As of 31 December 2015		
	Available-for-sale	Held-to-maturity	Total	Available-for-sale	Held-to-maturity	Total
Unquoted investments						
Shares of Armenian companies	42,825	-	42,825	42,825	-	42,825
RA state bonds	6,161,527	501,835	6,663,362	346,256	-	346,256
Corporate bonds	394,839	-	394,839	99,306	-	99,306
Total investments	6,599,191	501,835	7,101,026	488,387	-	488,387

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 (2015: nil).

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.

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.

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

In thousand Armenian drams	2016		2015	
	%	Maturity	%	Maturity
RA state bonds	10.3-16.95	2017-2036	10.68-14.85	2016-2020
Corporate bonds	10.7	2019	4.1	2025

Securities available for sale at fair value of 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 statement of financial position.

Held-to-maturity investments

In thousand Armenian drams	2016	2015
RA state bonds	501,835	-
Total investments held to maturity	501,835	-

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

In thousand Armenian drams	2016		2015	
	%	Maturity	%	Maturity
RA state bonds	5.42	2020	-	-

19 Property, plant and equipment and intangible assets

In thousand Armenian drams	Land and buildings	Leasehold improvements	Computer equipment	Vehicles	Office equipment	PPE capital investments	Intangible assets	Total
COST OR REVALUED AMOUNT								
At January 1, 2015	3,742,403	117,589	474,079	106,229	473,440	-	108,330	5,022,070
Additions	1,614	-	57,779	1,118	10,102	-	26,668	97,281
Disposals	-	-	(795)	-	-	-	-	(795)
At December 31, 2015	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 December 31, 2016	4,098,684	109,623	714,707	132,487	491,386	79,642	154,996	5,781,525
ACCUMULATED DEPRECIATION								
At January 1, 2015	2,247	79,014	241,133	68,519	372,489	-	87,291	850,693
Charge for the year	128,832	12,690	74,238	10,112	34,191	-	7,818	267,881
Disposals	-	-	(795)	-	-	-	-	(795)
At December 31, 2015	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 December 31, 2016	190,181	95,414	389,086	55,898	423,329	-	103,255	1,257,163
CARRYING VALUE								
At December 31, 2016	3,908,503	14,209	325,621	76,589	68,057	79,642	51,741	4,524,362
At December 31, 2015	3,612,938	25,885	216,487	28,716	76,862	-	39,889	4,000,777

Revaluation of assets

The lands and buildings owned by the Bank were evaluated 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.

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

Fully depreciated items

As at 31 December 2016 fixed assets and intangible assets included fully depreciated assets in amount of AMD 624,925 thousand (2015: AMD 557,153 thousand).

Restrictions on title of fixed assets and intangible assets

As at 31 December 2016, the Bank does not possess any fixed assets and intangible assets pledged as security for liabilities or whose title is otherwise restricted.

Contractual commitments

As at 31 December 2016 the Bank had contractual commitments of making investments in the intangible assets in 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 2016	As of 31 December 2015
Real estate	4,052,972	4,616,075
Vehicles	16,123	-
Other	24,901	24,901
Total repossessed assets	4,093,996	4,640,976

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 2016	As of 31 December 2015
Debtors and other receivables	97,563	32,250
Receivables on cash transfers	25,143	61
	122,706	32,311
Less allowance for assets impairment	(9,632)	(3,040)
Total other financial assets	113,074	29,271
Other prepaid taxes	16	-
Materials	14,484	15,423
Other	27,692	17,195
Total other non-financial assets	42,192	32,618
Total other assets	155,266	61,889

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

In thousand Armenian drams	Total
At January 1, 2015	-
Charge for the year	8,976
Amounts written off	(8,896)
Recoveries	2,960
At December 31, 2015	3,040
Charge for the year	4,681
Amounts written off	(7,878)
Recoveries	9,789
At December 31, 2016	9,632

22 Amounts due to financial institutions

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Repurchase agreements with the CBA	-	6,509,610
Loans from banks and other financial institutions	3,076,965	1,745,069
Deposits from financial institutions	238,823	208,521
Current accounts of banks and other financial institutions	442,085	203,650
Repurchase agreements with banks	3,746,612	1,853,283
Total amounts due to financial institutions	7,504,485	10,520,133

All deposits from financial institutions have fixed interest rates.

As of 31 December 2016 the weighted average effective interest rates on amounts due to financial institutions were 6.53% for borrowings in AMD (2015: 9.74%), and 6.94% for loans in USD, EUR and other freely convertible currencies (2015: 5.56%).

The Bank has not had any defaults of principal, interest or other breaches with respect to its liabilities during the period (2015: nil).

23 Amounts due to customers

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Corporate customers		
Current/settlement accounts	11,527,923	7,399,718
Time deposits	945,581	996,393
	12,473,504	8,396,111
Retail customers		
Current/demand accounts	3,824,266	3,628,329
Time deposits	23,478,586	21,096,447
	27,302,852	24,724,776
Total amounts due to customers	39,776,356	33,120,887

As at 31 December 2016 included in amounts due to customers are deposits amounting to AMD 1,373,413 thousand (2015: AMD 864,740 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 at 31 December 2016 the Bank has two groups of related customers (2015: two), whose loan balances exceed 10% of equity. The gross value of these loans as at 31 December 2016 amounts to AMD 11,577,198 thousand (2015: AMD 10,108,405 thousand).

As of 31 December 2016 the weighted average effective interest rates on amounts due to customers was 12.5% for borrowings in AMD (2015: 12.9%) and 7.7% for borrowings in USD, EUR and other freely convertible currencies (2015: 8.1%).

24 Other borrowings

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Loans from the CBA	26,408	-
Loans from RA Government	246,859	493,680
Total other borrowings	273,267	493,680

Loans from the RA Government 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 9.2% at 31 December 2016 (2015: 9.2%).

The Bank has not had any defaults of principal, interest or other breaches with respect to its liabilities during the period (2015: nil).

25 Subordinated debts

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Subordinated debt from the CBA	-	3,106,286
Bonds issued	5,141,995	5,306,737
Subordinated debt from individuals	4,906,203	-
Total other borrowings	10,048,198	8,413,023

The debt provided by the CBA is subordinated debt issued in 2011 in the amount of AMD 3,600,000 thousand at 8% per annum with contractual maturity up to 31 December 2016.

During 2015 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 2016	As of 31 December 2015
Due to personnel	66,032	66,602
Accounts payables	123,740	98,583
Dividend liabilities	70,027	-
Total other financial liabilities	259,799	165,185
Tax payable, other than income tax	188,300	81,704
Grants related to assets	51,854	53,928
Other	17,351	2,295
Total other non financial liabilities	257,505	137,927
Total other liabilities	517,304	303,112
Grants related to assets		
In thousand Armenian drams	2016	2015
At January 1	53,928	56,002
Recognition of income (Note 9)	(2,074)	(2,074)
At December 31	51,854	53,928

27 Securities pledged under repurchase agreements

In thousand Armenian drams	Asset		Liability	
	As of 31 December 2016	As of 31 December 2015	As of 31 December 2016	As of 31 December 2015
Investments available for sale (Note 18, 22)	3,865,633	8,587,674	3,746,612	8,362,893
Total securities pledged under repurchase agreements	3,865,633	8,587,674	3,746,612	8,362,893

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 statutes, 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 participants as at 31 December 2016 and 2015 may be specified as follows:

In thousand Armenian drams	As of 31 December 2016		As of 31 December 2015	
	Paid-in charter capital	% of total paid-in capital	Paid-in charter capital	% of total paid-in capital
“ZakNefteGazStroy Prometey” OJSC	6,642,000	37.0	6,642,000	46.125
Vazgen Gevorgyan	561,600	3.13	561,600	3.9
“Prometey City” LLC	10,746,400	59.87	7,196,400	49.975
	17,950,000	100	14,400,000	100

As at 31 December 2016, the Bank did not possess any of its own shares.

In 2016 the shareholders of the Bank increased its share capital by AMD 3,550,000 thousand issuing preference shares.

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

During 2016 the Bank has not paid dividends.

The amount of cumulative preference dividends recognized in the financial statements as at 31 December 2016 amounted to AMD 70,027 thousand (2015: nil).

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 2016	As of 31 December 2015
Undrawn loan commitments	1,580,210	670,412
Guarantees	208,102	861,757
Total commitments and contingent liabilities	1,788,312	1,532,169

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 equipment, central office and branch facilities.

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

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Not later than 1 year	89,586	94,950
Later than 1 year and not later than 5 years	147,263	175,001
Later than 5 years	30,222	30,450
Total operating lease commitments	267,071	300,401

Capital commitments

Information on capital 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 include loans, deposits and other transactions. 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	2016		2015	
	Participants and parties related with them	Key management personnel and parties related with them	Participants and parties related with them	Key management personnel and parties related with them
STATEMENT OF FINANCIAL POSITION				
Loans and advances to customers				
Loans outstanding at January 1	151,675	363,911	347,555	326,695
Loans issued during the year	185,163	998,136	261,675	921,398
Loan repayments during the year	(237,242)	(999,376)	(457,555)	(884,182)
Loans outstanding at December 31	99,596	362,671	151,675	363,911
Less: allowance for loan impairment	(996)	(3,627)	(1,062)	(2,547)
Loans outstanding at December 31	98,600	359,044	150,613	361,364
Amounts due to customers				
Deposits at January 1	1,150,637	1,031,294	1,127,954	986,060
Deposits received during the year	11,076,910	3,337,145	1,910,380	4,290,276
Deposits repaid during the year	(11,055,125)	(3,291,259)	(1,887,697)	(4,245,042)
Deposits at December 31	1,172,422	1,077,180	1,150,637	1,031,294
Subordinated debt				
Deposits at January 1	-	-	-	-
Deposits received during the year	5,157,612	-	-	-
Deposits repaid during the year	(251,409)	-	-	-
Deposits at December 31	4,906,203	-	-	-
Statement of profit or loss and other comprehensive income				
Interest income on loans	20,883	39,869	25,165	34,190
Impairment (charge)/reversal	66	(1,080)	2,414	720
Interest expense on deposits	(207,888)	(81,738)	(100,350)	(81,697)
Commission income	897	2,209	1,037	1,730
Net loss from derivative instruments	(18,392)	-	-	-
Other income	1,669	807	1,738	1,711
Other operating expenses	(107)	(4,146)	(1,692)	(2,162)

Compensation of key management personnel was comprised of the following:

In thousand Armenian drams	2016	2015
Salaries and other bonuses	331,845	264,562
Total key management compensation	331,845	264,562

The loans issued to parties related with the Bank are repayable over 1-15 years and have effective interest rates of 9.33-26.83% (2015: 10.10-26.83%).

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.

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 each fair value measurement is categorised.

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 and advances to customers	-	46,537,338	-	46,537,338	46,537,338
Investments held to maturity	-	510,194	-	510,194	501,835
Other assets	-	113,074	-	113,074	113,074
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

In thousand Armenian drams

As of 31 December 2015

	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
FINANCIAL ASSETS					
Cash and cash equivalents	-	14,559,127	-	14,559,127	14,559,127
Amounts due from financial institutions	-	8,923,705	-	8,923,705	8,923,705
Loans and advances to customers	-	36,748,049	-	36,748,049	36,748,049
Other assets	-	29,271	-	29,271	29,271
FINANCIAL LIABILITIES					
Amounts due to financial institutions	-	10,520,133	-	10,520,133	10,520,133
Amounts due to customers	-	33,120,887	-	33,120,887	33,120,887
Subordinated debt	-	8,413,023	-	8,413,023	8,413,023
Other borrowings	-	493,680	-	493,680	493,680
Other liabilities	-	165,185	-	165,185	165,185

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 and advances to customers

The fair value of floating rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discount rates used depend on credit risk of the counterparty and ranged from 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 2016			
	Level 1	Level 2	Level 3	Total
FINANCIAL ASSETS				
Derivative financial assets	-	1,810	-	1,810
Available for sale investments	-	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

In thousand Armenian drams	As of 31 December 2015			
	Level 1	Level 2	Level 3	Total
FINANCIAL ASSETS				
Securities available for sale	99,306	346,256	-	445,562
Securities pledged under repurchase agreements	-	8,587,674	-	8,587,674
Total	99,306	8,933,930	-	9,033,236
FINANCIAL LIABILITIES				
Trading financial liabilities	-	794,781	-	794,781
Total	-	794,781	-	794,781
NET FAIR VALUE	99,306	8,139,149	-	8,238,455

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

Listed equity investments.

Listed bonds have been issued by publicly traded companies in Russia.

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 2016			
	Level 1	Level 2	Level 3	Total
NON FINANCIAL ASSETS				
Property plant and equipment				
<i>Land and buildings</i>	-	-	4,098,684	4,098,684
Total	-	-	4,098,684	4,098,684

In thousand Armenian drams	As of 31 December 2015			
	Level 1	Level 2	Level 3	Total
NON FINANCIAL ASSETS				
Property plant and equipment				
<i>Land and buildings</i>	-	-	3,744,017	3,744,017
Total	-	-	3,744,017	3,744,017

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 financial assets and financial liabilities within this level can be reconciled from beginning to ending balance as follows:

In thousand Armenian drams	Property plant equipment	Total
NON FINANCIAL ASSETS		
Balance as at 1 January 2015	3,742,403	3,742,403
Purchases	1,614	1,614
Balance as at 31 December, 2015	3,744,017	3,744,017
Purchases	354,667	354,667
Balance as at 31 December, 2016	4,098,684	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

In thousand Armenian drams

As at 31 December 2016

In thousand Armenian drams

As at 31 December 2015

[illegible]

The gross amounts of financial assets and financial liabilities and their net amounts as presented in the statements of financial position and disclosed in the above tables are measured in the statement of financial position on the following basis:

- repurchase agreements, securities lending and borrowing are measured at amortised cost

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 2016						
	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	Subtotal less than 12 months	From 1 to 5 years	More than 5 years	Subtotal over 12 months	Total
ASSETS								
Cash and cash equivalents	16,049,033	-	-	16,049,033	-	-	-	16,049,033
Amounts due from financial institutions	4,361,209	25,023	1,922,550	6,308,782	480,624	377,562	858,186	7,166,968
Derivative financial assets	1,810	-	-	1,810	-	-	-	1,810
Loans and advances to customers	3,626,233	2,217,182	8,442,851	14,286,266	24,782,117	7,468,955	32,251,072	46,537,338
Investments available for sale	80,036	-	367,655	447,691	4,201,500	1,950,000	6,151,500	6,599,191
Investments held to maturity	10,435	7,460	-	17,895	483,940	-	483,940	501,835
Securities pledged under repurchase agreements	104,363	80,413	30,857	215,633	3,650,000	-	3,650,000	3,865,633
Other assets	112,050	1,024	-	113,074	-	-	-	113,074
	24,345,169	2,331,102	10,763,913	37,440,184	33,598,181	9,796,517	43,394,698	80,834,882
LIABILITIES								
Amounts due to financial institutions	5,602,061	31,851	260,070	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	3,025,985	12,717,153	32,053,646	7,720,871	1,839	7,722,710	39,776,356
Subordinate debts	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	3,123,642	13,231,154	39,618,618	13,581,242	5,758,340	19,339,582	58,958,200
Net position	1,081,347	(792,540)	(2,467,241)	(2,178,434)	20,016,939	4,038,177	24,055,116	21,876,682
Accumulated gap	1,081,347	288,807	(2,178,434)		17,838,505	21,876,682		

In thousand Armenian drams		As at 31 December 2015						
	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	Subtotal less than 12 months	From 1 to 5 years	More than 5 years	Subtotal over 12 months	Total
ASSETS								
Cash and cash equivalents	14,559,127	-	-	14,559,127	-	-	-	14,559,127
Amounts due from financial institutions	6,714,218	1,231,845	252,959	8,199,022	347,121	377,562	724,683	8,923,705
Derivative financial assets	3,056,080	1,815,674	6,853,685	11,725,439	19,237,972	5,784,638	25,022,610	36,748,049
Loans and advances to customers	-	95,435	4,197	99,632	250,050	138,705	388,755	488,387
Investments available for sale	794,781	142,063	88,042	1,024,886	6,509,626	1,053,162	7,562,788	8,587,674
Securities pledged under repurchase agreements	29,271	-	-	29,271	-	-	-	29,271
Other assets	25,153,477	3,285,017	7,198,883	35,637,377	26,344,769	7,354,067	33,698,836	69,336,213

In thousand Armenian drams

As at 31 December 2015

	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	Subtotal less than 12 months	From 1 to 5 years	More than 5 years	Subtotal over 12 months	Total
LIABILITIES								
Amounts due to financial institutions	9,955,244	7,775	197,756	10,160,775	165,376	193,982	359,358	10,520,133
Trading financial liabilities	794,781	-	-	794,781	-	-	-	794,781
Amounts due to customers	12,714,207	1,563,670	11,715,058	25,992,935	7,126,984	968	7,127,952	33,120,887
Subordinated debt	278,747	919,837	1,927,539	3,126,123	5,286,900	-	5,286,900	8,413,023
Other borrowings	-	-	247,633	247,633	246,047	-	246,047	493,680
Other liabilities	91,964	73,221	-	165,185	-	-	-	165,185
	23,834,943	2,564,503	14,087,986	40,487,432	12,825,307	194,950	13,020,257	53,507,689
Net position	<u>1,318,534</u>	<u>720,514</u>	<u>(6,889,103)</u>	<u>(4,850,055)</u>	<u>13,519,462</u>	<u>7,159,117</u>	<u>20,678,579</u>	<u>15,828,524</u>
Accumulated gap	<u>1,318,534</u>	<u>2,039,048</u>	<u>(4,850,055)</u>		<u>8,669,407</u>	<u>15,828,524</u>		

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 the Bank and the Management Board are ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of the Bank

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

Management Board

The Management Board 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	Non-OECD countries	OECD countries	Total
Cash and cash equivalents	15,163,967	579,305	305,761	16,049,033
Amounts due from other financial institutions	6,977,479	189,489	-	7,166,968
Derivative financial assets	1,810	-	-	1,810
Loans and advances to customers	46,517,784	18,594	960	46,537,338
Investments available for sale	6,599,191	-	-	6,599,191
Investments held to maturity	501,835	-	-	501,835
Securities pledged under repurchase agreements	3,865,633	-	-	3,865,633
Other assets	87,931	20,808	4,335	113,074
As at 31 December 2016	79,715,630	808,196	311,056	80,834,882
As at 31 December 2015	68,328,955	666,260	340,998	69,336,213

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 funds. 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.

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 at 31 December 2016	As at 31 December 2015
Loans collateralized by real estate	24,590,996	25,640,491
Loans collateralized by materials	3,927,546	5,300,299
Loans collateralized by movable property and other property, plant and equipment	3,887,682	2,260,867
Loans collateralized by cash	5,914,321	1,635,633
Loans collateralized by guarantees	5,709,922	1,036,157
Loans collateralized by gold	765,657	465,256
Loans collateralized by RA state bonds	412,269	490,810
Loans collateralized by deposits	309,092	277,857
Other collateral	1,119,453	201,402
Unsecured loans	614,904	-
Total loans and advances to customers (gross)	47,251,842	37,308,772

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

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

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

Loans and advances neither past due or impaired

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

In thousand Armenian drams	2016	2015
Loans and advances to customers		
Manufacturing	0.36%	0.10%
Trade	0.10%	0.10%
Consumer	1.44%	1.30%
Mortgage	-	0.10%
Service	3.13%	-
Other	0.08%	1.00%

As of 31 December 2016 and 2015 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 at 31 December 2016				
		Less than 30 days	31 to 60 days	61 to 90 days	More than 91 days	Total
Loans and advances to customers						
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

In thousand Armenian drams		As at 31 December 2015				
		Less than 30 days	31 to 60 days	61 to 90 days	More than 91 days	Total
Loans and advances to customers						
Manufacturing	12,670	-	14,130	20,768	47,568	
Construction	-	-	-	389,858	389,858	
Trade	30,501	251,414	-	319,416	601,331	
Consumer	11,901	18,257	23,710	56,654	110,522	
Mortgage	-	10,379	15,075	27,148	52,602	
Service	-	28,354	26,943	1,426,847	1,482,144	
Other	-	-	-	3,269	3,269	
Total		55,072	308,404	79,858	2,243,960	2,687,294

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 2016. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2016

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 2016

Currency	Change in basis points	Sensitivity of net interest income	Sensitivity of equity				Total
			Up to 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	
AMD	+1	-	(486)	-	(156,147)	(133,632)	(290,265)
EUR	(1)	-	4,902	-	161,295	150,569	316,766

In thousand Armenian drams 2015

Currency	Change in basis points	Sensitivity of net interest income	Sensitivity of equity				Total
			Up to 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	
AMD	+1	-	(160)	-	(140,650)	(37,368)	(178,178)
EUR	+10	-	-	-	-	9,931	9,931
AMD	(1)	-	161	-	144,812	39,180	184,153
EUR	(10)	-	-	-	-	(9,931)	(9,931)

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.

Currency	2016		2015	
	Change in currency rate in %	Effect on profit before tax	Change in currency rate in %	Effect on profit before tax
USD	+5	31,171	+5	14,641
EUR	+5	(573)	+5	(2,179)

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

In thousand Armenian drams	As at 31 December 2016			
	Armenian Dram	Freely convertible currencies	Non-freely convertible currencies	Total
ASSETS				
Cash and cash equivalents	7,100,628	8,456,995	491,410	16,049,033
Amounts due from other financial institutions	4,817,171	2,271,549	78,248	7,166,968
Loans and advances to customers	8,433,748	38,103,590	-	46,537,338
Investments available for sale	6,599,191	-	-	6,599,191
Investments held to maturity	-	501,835	-	501,835
Securities pledged under repurchase agreements	3,865,633	-	-	3,865,633
Other assets	11,659	73,465	27,950	113,074
	30,828,030	49,407,434	597,608	80,833,072
LIABILITIES				
Amounts due to financial institutions	7,070,161	434,321	3	7,504,485
Trading financial liabilities	1,076,462	-	-	1,076,462
Amounts due to customers	2,976,482	36,408,261	391,613	39,776,356
Subordinate debts	-	10,048,198	-	10,048,198
Other borrowings	273,267	-	-	273,267
Other liabilities	165,533	93,999	267	259,799
	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 at 31 December 2016	21,247,584	624,818	4,280	21,876,682
Commitments and contingent liabilities as at 31 December 2016	630,763	1,157,549	-	1,788,312
<hr/>				
Total financial assets	32,883,006	35,911,100	542,107	69,336,213
Total financial liabilities	17,287,722	35,663,865	556,102	53,507,689
Net position as at 31 December 2015	15,595,284	247,235	(13,995)	15,828,524
Commitments and contingent liabilities as at 31 December 2015	1,060,890	471,279	-	1,532,169

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

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.

As at 31 December, these ratios were as follows:	Not audited	
	2016,%	2015,%
N21- Total liquidity ratio (Highly liquid assets/ Total assets)	32.41	28.60
H22- Current liquidity ratio (Highly liquid assets /liabilities on demand)	196.0	173.34

Analysis of financial liabilities by remaining contractual maturities.

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2016 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 at 31 December 2016					
	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	Total
NON-DERIVATIVE FINANCIAL LIABILITIES						
Amounts due to financial institutions	5,618,528	60,075	387,926	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	3,290,099	13,546,588	8,001,187	2,171	41,293,436
Subordinate debts	102,860	207,187	542,363	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	3,557,361	14,735,626	16,923,651	8,299,006	67,020,684
Derivative financial liabilities						
<i>Foreign exchange forward contracts</i>						
Inflow	-	-	64,260	1,532,399	384,800	1,981,459
Outflow	-	-	(65,332)	(1,548,608)	(387,152)	(2,001,092)
<i>Foreign exchange swap contracts</i>						
Inflow	203,255	-	-	-	-	203,255
Outflow	(201,445)	-	-	-	-	(201,445)
	1,810	-	(1,072)	(16,209)	(2,352)	(17,823)
Credit risk related commitments	1,584,210	107,203	69,649	27,250	-	1,788,312

In thousand Armenian drams	As at 31 December 2015					Total
	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	
NON-DERIVATIVE FINANCIAL LIABILITIES						
Amounts due to financial institutions	9,956,179	12,715	231,730	280,946	230,930	10,712,500
Trading financial instruments	794,781	-	-	-	-	794,781
Amounts due to customers	12,837,411	1,636,235	12,426,636	7,626,188	1,042	34,527,512
Subordinate debt	288,263	1,026,610	2,180,851	6,334,503	-	9,830,227
Other borrowings	-	-	277,974	257,018	-	534,992
Other liabilities	91,964	73,221	-	-	-	165,185
Total undiscounted non-derivative financial liabilities	23,968,598	2,748,781	15,117,191	14,498,655	231,972	56,565,197
Credit risk related commitments	672,400	27,500	689,116	143,153	-	1,532,169

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 Risk Management department, Board of the Bank and Management 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 of the Bank.

35 Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank’s capital is monitored using, among other measures, the rules and ratios

established by the Basel Committee on Banking Supervision (“BIS rules/ratios”) and adopted by the Central Bank of Armenia in supervising the Bank.

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

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

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

Regulatory capital consists of Tier 1 capital, which comprises charter 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.

In thousand Armenian drams	Not audited	
	2016	2015
Tier 1 capital	22,029,559	17,240,699
Tier 2 capital	10,682,748	5,825,272
Total regulatory capital	32,712,307	23,065,971
Risk-weighted assets	83,005,092	66,243,454
Capital adequacy ratio	39.41%	34.82%

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.