

Financial Statements and Independent
Auditor's Report

“Artsakhbank” Closed Joint Stock
Company

31 December 2016



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Independent auditor's report

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To the Shareholders and Board of Directors of Closed Joint Stock Company “Artsakhbank”:

Opinion

We have audited the financial statements of “Artsakhbank” Closed Joint Stock Company (the “Bank”), which comprise the statement of financial position as of 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 of 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.

Statement of profit or loss and other comprehensive income

In thousand Armenian drams	Notes	Year ended 31 December 2016	Year ended 31 December 2015
Interest and similar income	6	10,864,006	10,312,436
Interest and similar expense	6	(6,771,863)	(6,615,340)
Net interest income		4,092,143	3,697,096
Fee and commission income	7	359,536	418,983
Fee and commission expense	7	(91,961)	(93,077)
Net fee and commission income		267,575	325,906
Net trading income	8	619,473	523,576
Other income	9	614,932	549,925
Impairment (charge)/reversal	10	865,600	(5,903,641)
Net loss from investments available-for-sale		-	(292)
Foreign currency translation net losses on non-trading assets and liabilities		(94,716)	(29,659)
Staff costs	11	(1,897,859)	(1,914,344)
Depreciation of property plant and equipment	20	(311,419)	(460,097)
Amortization of intangible assets	21	(27,618)	(22,666)
Other expenses	12	(1,674,142)	(948,108)
Profit/(loss) before income tax		2,453,969	(4,182,304)
Income tax (expense)/compensation	13	425,999	7,955
Profit/(loss) for the year		2,879,968	(4,174,349)
Other comprehensive income:			
<i>Items that will be reclassified subsequently to profit or loss</i>			
Net unrealized loss from changes in fair value of available-for-sale financial assets		(350)	-
Other comprehensive income for the year		(350)	-
Total comprehensive loss for the year		2,879,618	(4,174,349)

The accompanying notes on pages 8 to 58 are an integral part of these financial statements.

Statement of financial position

In thousand Armenian drams	Notes	As of 31 December 2016	As of 31 December 2015
ASSETS			
Cash and cash equivalents	14	10,993,034	12,781,907
Amounts due from other financial institutions	15	3,065,140	2,257,793
Derivative financial assets		-	3,416
Investments available for sale	16	54,589	29,964
Investments held to maturity	17	14,789,086	61,368
Securities pledged under repurchase agreements	18	2,802,317	8,691,709
Loans and advances to customers	19	64,509,658	63,510,814
Property, plant and equipment	20	3,368,553	3,616,649
Intangible assets	21	56,652	77,927
Repossessed assets	22	2,077,390	2,257,733
Prepaid income taxes		271,013	271,013
Deferred tax assets	13	351,124	-
Other assets	23	1,136,235	437,915
TOTAL ASSETS		103,474,791	93,998,208
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to other financial institutions	24	10,322,069	26,455,300
Amounts due to customers	25	59,138,224	50,079,670
Trading liabilities	15	-	844,308
Derivative financial liabilities		-	3,214
Deferred income tax liabilities	13	-	74,875
Subordinated debt	26	7,729,539	5,305,313
Other liabilities	27	188,990	219,177
Total liabilities		77,378,822	82,981,857
Equity			
Share capital	28	23,261,150	11,061,150
Statutory general reserve		657,233	657,233
Revaluation reserve of financial assets available for sale		(350)	-
Other reserves		1,541,289	1,541,289
Retained earnings/(accumulated loss)		636,647	(2,243,321)
Total equity		26,095,969	11,016,351
TOTAL LIABILITIES AND EQUITY		103,474,791	93,998,208

The financial statements from pages 4 to 58 were signed by the Bank's Executive Director and Chief Accountant on 14 April, 2017.

Arthur Mkhitarian
 Executive Director



Ruzan Khachatryan
 Chief Accountant

The accompanying notes on pages 8 to 58 are an integral part of these financial statements.

Statement of changes in equity

In thousand Armenian drams

	Share capital	Statutory general reserve	Revaluation reserve of PPE	Revaluation reserve of financial assets available for sale	Retained earnings/ (accumulated loss)	Total
Balance as of January 1, 2015	6,561,150	657,233	1,541,289	-	1,931,028	10,690,700
Increase in share capital	4,500,000	-	-	-	-	4,500,000
Transactions with owners	4,500,000	-	-	-	-	4,500,000
Loss for the year	-	-	-	-	(4,174,349)	(4,174,349)
Other comprehensive income:	-	-	-	-	-	-
Total comprehensive income for the year	-	-	-	-	(4,174,349)	(4,174,349)
As of 31 December 2015	11,061,150	657,233	1,541,289	-	(2,243,321)	11,016,351
Increase in share capital	12,200,000	-	-	-	-	12,200,000
Transactions with owners	12,200,000	-	-	-	-	12,200,000
Profit for the year	-	-	-	-	2,879,968	2,879,968
Other comprehensive income:						
Net unrealized loss from changes in fair value	-	-	-	(350)	-	(350)
Total comprehensive loss for the year	-	-	-	(350)	2,879,968	2,879,618
Balance as of 31 December 2016	23,261,150	657,233	1,541,289	(350)	636,647	26,095,969

The accompanying notes on pages 8 to 58 are an integral part of these financial statements.

Statement of cash flows

In thousand Armenian drams	Year ended 31 December 2016	Year ended 31 December 2015
Cash flows from operating activities		
Profit/(loss) before tax	2,453,969	(4,182,304)
<i>Adjustments for</i>		
Amortization and depreciation allowances	339,037	482,763
(Gain)/loss from disposal of PPE and intangible assets	(6,633)	3,203
Impairment charge/(reversal)	(865,600)	5,903,641
Foreign currency translation net losses of non-trading assets and liabilities	94,716	29,659
Interests receivable	(562,713)	(1,408)
Interests payable	70,999	86,554
Net loss from sale and impairment of other assets	625,826	-
Net gains from changes in fair value of derivative instruments	(129,072)	(34,312)
Cash flows from operating activities before changes in operating assets and liabilities	2,020,529	2,287,796
<i>Increase/(decrease) in operating assets</i>		
Amounts due from other financial institutions	(805,262)	(1,656,547)
Purchase of investment securities	(9,453,805)	(1,387,498)
Loans and advances to customers	(825,804)	(5,678,100)
Repossessed assets	(162,834)	558,468
Other assets	9,196	151,942
<i>Increase/(decrease) in operating liabilities</i>		
Amounts due to financial institutions	(16,025,713)	7,091,024
Amounts due to customers	8,942,135	(3,176,374)
Derivative instruments	129,274	34,110
Other liabilities	(27,398)	(287,116)
Net cash used in operating activities before income tax	(16,199,682)	(2,062,295)
Income tax paid	-	(38,716)
Net cash used in operating activities	(16,199,682)	(2,101,011)
Cash flows from investing activities		
Purchase of property, plant and equipment	(91,639)	(155,070)
Disposal of property, plant and equipment	38,063	-
Purchase of intangible assets	(9,457)	(7,732)
Net cash used in investing activities	(63,033)	(162,802)
Cash flow from financing activities		
Subordinated debt	2,424,226	1,380,911
Long term loans	(158,972)	(310,241)
Increase in share capital	12,200,000	4,500,000
Net cash from financing activities	14,465,254	5,570,670
Net increase/(decrease) in cash and cash equivalents	(1,797,461)	3,306,857
Cash and cash equivalents at the beginning of the year	12,781,907	9,488,360
Effect of exchange rate changes on cash and cash equivalents	8,588	(13,310)
Cash and cash equivalents at the end of the year (Note 14)	10,993,034	12,781,907
Supplementary information:		
Interest received	10,301,293	10,311,028
Interest paid	(6,700,864)	(6,528,786)

The accompanying notes on pages 8 to 58 are an integral part of these financial statements.

Accompanying notes to the financial statements

1 Principal activities

“Artsakhbank”(the “Bank”) is a Closed Joint Stock Company incorporated in the Republic of Armenia in 1996. The Bank is regulated by the legislation of RA and conducts its business under license number 75, granted on 14 August 1996 by the Central Bank of Armenia (the “CBA”).

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

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

The Bank has 22 branches through which implements its activity. The main office of the Bank is in Yerevan, 1b, Charents Str..

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 are stated at amortized cost and non-financial assets and liabilities are stated at 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, 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 consolidated financial statements of the Bank.

- *Defined Benefit Plans: Employee Contributions (Amendments to IAS 19).*
- *Disclosure Initiative (Amendments to IAS 1)*
- *Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)*
- *Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)*
- *Equity Method in Separate Financial Statements (Amendments to IAS 27)*
- *IFRS 14 Regulatory Deferral Accounts.*
- *Annual Improvements to IFRSs 2012–2014 Cycle.*

3.5 Standards and interpretations not yet applied by the Bank

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

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

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 2017. The Bank's management have not yet assessed the impact of IFRS 15 on these financial statements.

IFRS 16 Leases

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

IFRS 16 also:

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

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided IFRS 15 Revenue from Contracts with Customers is also applied. The 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.

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 recognized in the statement of income in other income or other expense. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date.

Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the

amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount are recognised in equity.

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

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

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

	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 the statement of profit or loss and other comprehensive income except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

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

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

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized

or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

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 and which are subject to an insignificant risk of changes in value.

Cash and cash equivalents are carried at amortised cost.

4.5 Precious metals

Gold and other precious metals are recorded at CBA prices which approximate fair values and are quoted according to London Bullion Market rates. Precious metals are included in other assets in the statement of financial position.

Changes in the bid prices are recorded in net gain/loss on operations with precious metals in other income/expense.

4.6 Amounts due from other financial institutions

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

4.7 Financial instruments

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

When financial assets and liabilities are recognised initially, they are measured at cost, 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, receivables and loans, available-for-sale financial instruments and held-to-maturity investments. The classification of investments between the categories is determined at acquisition based on the guidelines established by the management. The Bank determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end.

Financial assets at fair value through profit or loss

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

In the normal course of business, the Bank enters into various derivative financial instruments including futures, forwards, swaps and options in the foreign exchange and capital markets. Such financial instruments are held for trading and are initially 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.

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

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

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

Held-to-maturity investments

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

Loans and receivables

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

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

Available-for-sale financial assets

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

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

4.8 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.

Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the comprehensive statement on income, is transferred from equity to the statement of profit or loss and other comprehensive income.

Reversals in respect of equity instruments classified as available-for-sale are not recognised in the statement of profit or loss and other comprehensive income. 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.

4.9 Derecognition of financial assets and liabilities

Financial assets

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

- the rights to receive cash flows from the asset have expired;
- the 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.

4.10 Repurchase and reverse repurchase agreements

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the statement of financial position and, in case the transferee has the right by contract or custom to sell or repledge them, reclassified as securities pledged under sale and repurchase agreements and faced as the separate 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.

4.11 Leases

Operating - Bank as leasee

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

4.12 Property, plant and equipment

Property, plant and equipment ("PPE") are recorded at historical cost less accumulated depreciation except land and buildings, which are stated at fair values.

The buildings are stated at fair value less accumulated depreciation. If the recoverable value of PPE is lower than its carrying amount, due to circumstances not considered to be temporary, the respective asset is written down to its recoverable value. 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	30	3.33
Computers	3	33.3
ATMs	10	10
Equipmet	5	20
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.

Land and buildings are revalued on a regular basis approximately after 3-5 years. The frequency of revaluation depends on changes in fair value of assets. In case of significant divergences between

fair value of revalued assets and their carrying amounts further revaluation is conducted. Revaluation is conducted for the whole class of property, plant and equipment.

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

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 of 1 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end.

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

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

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

Retained earnings

Include 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 (Refer to note 31).

Classification of investment securities

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

Related party transactions

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

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

Impairment of available-for-sale equity investments

The 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	8,984,443	9,184,882
Debt securities available-for-sale	1,097,858	788,192
Amounts due from other financial institutions	21,135	22,368
Reverse repurchase transactions	242,554	117,557
Interest accrued on impaired financial assets	518,016	199,437
Total interest and similar income	10,864,006	10,312,436
Amounts due to customers	4,455,851	4,334,649
Amounts due to financial institutions	1,188,285	1,086,180
Repurchase transactions	513,879	722,335
Subordinated debt	613,848	472,176
Total interest and similar expense	6,771,863	6,615,340

7 Fee and commission income and expense

In thousand Armenian drams	2016	2015
Payment, transfer and other services	208,282	259,482
Plastic cards operations	144,762	140,789
Guarantees and letters of credit	6,492	18,712
Total fee and commission income	359,536	418,983
Payment, transfer and other services	11,169	14,797
Plastic cards operations	80,792	78,280
Total fee and commission expense	91,961	93,077

8 Net trading income

In thousand Armenian drams	2016	2015
Gains less losses from foreign currency transactions	323,241	428,276
Net gain from changes in fair value of trading assets and liabilities	-	7,826
Net gain on derivative instruments	167,160	53,161
Net gains from changes in fair value of derivative instruments	129,072	34,313
Total net trading income	619,473	523,576

9 Other income

In thousand Armenian drams	2016	2015
Fines and penalties received	568,389	513,271
Net income from operations with precious metals	17,952	-
Net income from disposal of property, plant and equipment	9,747	-
Net income from sale of other assets	-	7,607
Income from grants (Note 27)	476	1,138
Other income	18,368	27,909
Total other income	614,932	549,925

10 Impairment charge/(reversal)

In thousand Armenian drams	2016	2015
Loans and advances to customers (Note 19)	(3,148,883)	5,818,320
Other assets (Note 23)	2,283,283	46,366
Amounts due from other financial institutions (Note 15)	-	40,969
Instruments available for sale (Note 16)	-	(2,014)
Total impairment charge/(reversal) for credit losses	(865,600)	5,903,641

11 Staff costs

In thousand Armenian drams	2016	2015
Compensations of employees	1,896,193	1,913,754
Other expenses	1,666	590
Total staff costs	1,897,859	1,914,344

12 Other expenses

In thousand Armenian drams	2016	2015
Operating lease	195,704	165,192
Fixed assets maintenance	174,007	176,662
Taxes, other than income tax, duties	140,994	132,287
Security	119,503	83,831
Net loss from disposal and remission of other assets	590,198	-
Impairment loss on deferred collaterals	35,628	-
Deposit Insurance expenses	76,040	57,287
Communications	70,292	73,437
Consulting and other services	34,649	26,861
Advertising costs	32,954	46,563
Losses from operations with precious metals	-	12,886
Payment system services	32,260	25,155
Office supplies	22,135	34,999
Charitable distributions	23,644	5,836
Business trip expenses	9,907	8,624
Loan extension expenses	17,297	17,589
Cash collection expenses	16,966	16,912
Penalties paid	10,593	6,577
Net loss from disposal of property, plant and equipment	3,114	3,203
Other expenses	68,257	54,207
Total other expense	1,674,142	948,108

13 Income tax compensation

In thousand Armenian drams	2016	2015
Deferred tax	(425,999)	(7,955)
Total income tax compensation	(425,999)	(7,955)

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 compensation and accounting profit/(loss) is provided below:

In thousand Armenian drams	2016	Effective rate (%)	2015	Effective rate (%)
Profit/(loss) before tax	2,453,969		(4,182,304)	
Income tax at the rate of 20%	490,794	20	(836,461)	20
Taxable income	-	-	16,959	(0.4)
Non-deductible expenses	128,679	5	13,633	(0.4)
Foreign exchange losses	18,943	1	5,932	-
Non-taxable income	-	-	(2,471)	-
Use of accumulated tax loss	(1,210,588)	(49)	(416,135)	10
Effect of unrecognized net deferred tax assets	146,173	6	1,210,588	(29)
Income tax compensation	(425,999)	(17)	(7,955)	0.2

The Company can use the tax loss during the period from 2017 to 2018. The Company's predictions concerning the taxable income were revised in comparison with the previous year, in the result of which the tax assets in amount of AMD 380,000 thousand were derecognised as of December 31, 2015, and were recognised as of December 31, 2016.

Deferred tax calculation in respect of temporary differences:

In thousand Armenian drams	As of 31 December 2015	Recognized in profit or loss	As of 31 December 2016
Loans and advances to customers	71,245	25,812	97,057
Repossessed assets	55,740	7,126	62,866
Amounts due to customers	-	1,461	1,461
Other liabilities	18,860	(1,906)	16,954
Transferred tax losses	1,210,588	(684,415)	526,173
Total deferred tax assets	1,356,433	(651,922)	704,511
Tax asset evaluation	(1,210,588)	1,064,415	(146,173)
Total deferred tax assets	145,845	412,493	558,338
Amounts due from other financial institutions	(1,631)	329	(1,302)
Property, plant and equipment	(219,089)	13,177	(205,912)
Total deferred tax liability	(220,720)	13,506	(207,214)
Net deferred tax (assets)/liability	(74,875)	425,999	351,124

In thousand Armenian drams

	As of 31 December 2014	Recognized in profit or loss	As of 31 December 2015
Trading securities	1,301	(1,301)	-
Loans and advances to customers	82,322	(11,077)	71,245
Reposessed assets	55,740	-	55,740
Other liabilities	43,153	(24,293)	18,860
Transferred tax losses	416,135	794,453	1,210,588
Total deferred tax assets	598,651	757,782	1,356,433
Valuation of tax asset	(416,135)	(794,453)	(1,210,588)
Total deferred tax assets	182,516	(36,671)	145,845
Amounts due from other financial institutions	(969)	(662)	(1,631)
Property, plant and equipment	(253,167)	34,078	(219,089)
Amounts due to customers	(1,282)	1,282	-
Other assets	(9,928)	9,928	-
Total deferred tax liability	(265,346)	44,626	(220,720)
Net deferred tax liability	(82,830)	7,955	(74,875)

14 Cash and cash equivalents

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Cash on hand	1,440,888	1,648,181
Correspondent accounts with the CBA	8,946,057	10,369,404
Correspondent accounts with other banks	606,089	764,322
Total cash and cash equivalents	10,993,034	12,781,907

As of 31 December 2016 correspondent account with Central Bank of Armenia includes the obligatory minimum reserve deposits with the CBA, which 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 (2015: 2% of obligations denominated in Armenian drams and 20% of obligations of the Bank, denominated in foreign currency) and amounts to AMD 7,042,145 thousand (2015: AMD 5,855,878 thousand). There are no restrictions on the withdrawal of funds from the CBA, however, if minimum average requirement is not met, the Bank could be subject to penalties. Mandatory reserve deposits are non-interest bearing.

Non-cash transactions performed by the Bank during 2016 represent the repayment of the loans in the amount of AMD 307,549 thousand by confiscation of collateral (2015: AMD 234,289 thousand).

15 Amounts due from other financial institutions

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Deposited funds with CBA	220,000	220,000
Loans and deposits to financial institutions	-	4,838
Reverse repurchase agreements	2,735,249	1,916,400
Payment and settlement systems	44,804	13,265
Other	65,087	103,290
Total amounts due from other financial institutions	3,065,140	2,257,793

As of 31 December 2016 other accounts include guaranteed deposit for the Bank's membership to MasterCard payment system in the amount of AMD 65,087 thousand (2015: AMD 65,062 thousand).

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

Fair value of assets pledged and carrying value of loans and securities under 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 state bonds pledged under repurchase agreements	2,851,505	2,735,249	1,977,574	1,916,400
Total assets pledged under repurchase agreements	2,851,505	2,735,249	1,977,574	1,916,400

At 31 December 2015 securities pledged under repurchase agreements in the amount of AMD 844,308 thousand were repledged for the Bank's liabilities for repurchase agreements. The return of these securities was recognised as "Trading liability" and is measured at fair value.

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

In thousand Armenian drams	Total
At January 1, 2015	-
Charge for the year	40,969
Amounts written off	(40,969)
At 31 December 2015	-
Charge for the year	-
Amounts written off	-
At 31 December 2016	-

16 Investments available for sale

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
RA equity shares-unquoted	31,457	31,457
RA equity shares-quoted	24,625	-
Allowance for impairment for available for sale investments	(1,493)	(1,493)
Total investments available for sale	54,589	29,964

All unquoted RA equity shares are recorded at cost less allowances for impairment since their fair value cannot be reliably estimated.

The movement in allowance for impairment losses on investments available for sale was as follows:

In thousand Armenian drams	Total
At January 1, 2015	3,507
Reversal	(2,014)
At 31 December 2015	1,493
Reversal	-
At 31 December 2016	1,493

17 Held-to-maturity investments

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Unquoted investments		
RA state bonds	4,826,249	42,006
Corporate bonds	9,962,837	19,362
Total investments held to maturity	14,789,086	61,368

As of 31 December 2016, the RA non-government bonds in the amount of AMD 9,590,261 thousand has been issued by the Bank's related parties and the parties related to them.

All debt securities have fixed coupons.

Held-to-maturity investments by nominal interest rates and maturity date comprise:

In thousand Armenian drams	2016		2015	
	%	Maturity	%	Maturity
RA state bonds	8.00-13.00	2017-2032	10.00-13.09	2016-2020
RA corporate bonds	7.50-12.00	2017-2021	15.00	2016

As at 31 December 2016 RA state bonds in the amount of AMD 2,802,317 thousand (2015: AMD 6,335,310 thousand) and RA corporate bonds in the amount of AMD 2,356,399 thousand were pledged for the Bank's liabilities of repurchase agreements (Note 18).

18 Securities pledged under repurchase agreements

In thousand Armenian drams	As of 31 December 2016	Asset As of 31 December 2015
Unquoted investments		
RA state bonds (Note 17)	2,802,317	6,335,310
RA corporate securities (Note 17)	-	2,356,399
Total investments	2,802,317	8,691,709

Borrowings with securities pledged under reverse repurchase agreements amounted to AMD 2,992,276 thousand as at 31 December 2016 (2015: AMD 7,765,981 thousand) (Note 24).

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

These transactions are conducted under terms that are usual and customary to standard lending and securities borrowing and lending activities.

19 Loans and advances to customers

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Loans to customers	60,765,070	55,876,700
Factoring	446,595	1,010,422
Overdrafts	5,842,364	9,110,357
	67,054,029	65,997,479
Less allowance for loan impairment	(2,544,371)	(2,486,665)
Total loans and advances to customers	64,509,658	63,510,814

As of 31 December 2016 the weighted average effective interest rates on loans and advances to customers was 16.01% for loans in AMD (2015: 17.77%) and 12.99% for loans in USD, EUR and other freely convertible currencies (2015: 13.21%).

During the year ended at 31 December 2016 the Bank obtained assets by taking possession of collateral for loans to customers. The carrying amount of such assets amounted to AMD 2,077,390 thousand (2015: AMD 2,257,733 thousand) (See Note 22). The Bank intends to sell these assets in a short period.

As at 31 December 2016 the Bank has three borrowers (2015: four), whose loan balances exceed 10% of equity. The gross value of these loans as at 31 December 2016 amounts to AMD 44,811,502 thousand (2015: 35,776,738 thousand). Moreover AMD 36,689,551 thousand or 54.7% of the gross loan portfolio is concentrated to single borrower related to the Bank and parties related to them (2015: AMD 26,900,397 thousand or 40% of the gross loan portfolio).

Loans and advances to customers by industries of economy may be specified as follows:

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Manufacture	2,179,197	3,229,267
Agriculture	222,753	601,326
Construction	3,961,868	4,095,165
Trading	2,088,154	3,064,278
Services	1,928,554	2,467,687
Consumer	6,835,372	10,723,754
Mortgage	9,384,616	11,074,438
Other sectors	40,453,515	30,741,564
	67,054,029	65,997,479
Less allowance for loan impairment	(2,544,371)	(2,486,665)
Total loans and advances to customers	64,509,658	63,510,814

* In 2016 the financing for state institutions in the amount of AMD 36,689,551 thousand were included in other sectors (as of 31 December 2015 AMD 25,901,418 thousand).

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

In thousand Armenian drams	2016								
	Manufacture	Agriculture	Construction	Trading	Services	Consumer	Mortgage	Other sectors	Total
As of January 1, 2016	193,590	93,760	1,150,168	158,711	201,709	414,526	216,999	57,202	2,486,665
Charge/(reversal) for the year	(12,823)	(82,736)	(1,767,263)	82,933	(661,507)	(1,393,974)	668,688	17,799	(3,148,883)
Amounts written off	(78,852)	(21,688)	(6,238)	(282,943)	(21,134)	(604,137)	(817,582)	(28,430)	(1,861,004)
Recovery	81,943	14,674	2,259,640	177,029	558,667	1,667,564	297,648	10,428	5,067,593
As of 31 December 2016	183,858	4,010	1,636,307	135,730	77,735	83,979	365,753	56,999	2,544,371
Individual impairment	18,206	-	1,633,014	-	3,125	2,214	64,130	-	1,720,689
Collective impairment	165,652	4,010	3,293	135,730	74,610	81,765	301,623	56,999	823,682
	183,858	4,010	1,636,307	135,730	77,735	83,979	365,753	56,999	2,544,371
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	108,544	-	3,632,597	-	15,468	14,491	244,538	-	4,015,638

2015

In thousand Armenian drams	Manufacture	Agriculture	Construction	Trading	Services	Consumer	Mortgage	Other sectors	Total
As of January 1, 2015	186,229	237,298	1,509,631	169,381	16,594	1,224,290	125,756	320,021	3,789,200
Charge/(reversal) for the year	1,005,789	(121,201)	2,301,816	320,261	943,804	851,220	718,735	(202,104)	5,818,320
Amounts written off	(1,275,501)	(109,521)	(2,809,772)	(482,899)	(808,936)	(2,012,006)	(804,892)	(66,507)	(8,370,034)
Recovery	277,073	87,184	148,493	151,968	50,247	351,022	177,400	5,792	1,249,179
As of 31 December 2015	<u>193,590</u>	<u>93,760</u>	<u>1,150,168</u>	<u>158,711</u>	<u>201,709</u>	<u>414,526</u>	<u>216,999</u>	<u>57,202</u>	<u>2,486,665</u>
Individual impairment	-	18,673	1,064,199	25,540	-	-	41,172	2,052	1,151,636
Collective impairment	193,590	75,087	85,969	133,171	201,709	414,526	175,827	55,150	1,335,029
	<u>193,590</u>	<u>93,760</u>	<u>1,150,168</u>	<u>158,711</u>	<u>201,709</u>	<u>414,526</u>	<u>216,999</u>	<u>57,202</u>	<u>2,486,665</u>
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	-	57,810	3,108,749	187,351	-	-	131,812	27,562	3,513,284

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
Individuals	16,425,381	22,257,019
Privately held companies	13,604,448	15,102,036
Sole proprietors	505,673	1,008,910
State owned enterprises	36,518,527	27,629,514
	<u>67,054,029</u>	<u>65,997,479</u>
Less allowance for loan impairment	(2,544,371)	(2,486,665)
Total loans and advances to customers	<u>64,509,658</u>	<u>63,510,814</u>

Loans to individuals comprise the following products:

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Mortgage loans	9,384,616	11,074,438
Credit card loans	2,791,971	3,361,309
Consumer loans	1,734,268	4,345,339
Gold loans	2,289,213	2,982,714
Car loans	12,779	34,392
Agricultural	188,978	432,358
Other	23,556	26,469
Total loans and advances to individuals (gross)	<u>16,425,381</u>	<u>22,257,019</u>

As of 31 December 2016 and 31 December 2015 the estimated fair value of loans and advances to customers approximates their carrying value. Refer to Note 31.

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

Credit, currency, liquidity risk analyses of loans and advances to customers are disclosed in Note 34. The information on related party balances is disclosed in Note 30.

20 Property, plant and equipment

In thousand Armenian drams	Land and buildings	Leasehold improvements	Computer equipment	Vehicles	Equipment	Capital Investments	Total
COST OR REVALUED AMOUNT							
As of January 1, 2015	4,719,829	137,178	1,086,358	197,698	628,241	241,633	7,010,937
Additions	35,843	8,198	34,314	44,353	12,500	19,862	155,070
Disposals	-	(18,241)	(61,360)	(14,207)	(29,856)	-	(123,664)
Reclassification	59,177	-	(6,357)	-	6,357	(59,177)	-
Adjustments	(147,523)	-	-	-	-	-	(147,523)
As of 31 December 2015	4,667,326	127,135	1,052,955	227,844	617,242	202,318	6,894,820
Additions	-	2,368	13,464	47,984	22,875	4,948	91,639
Disposals	-	(28,258)	(40,349)	(106,954)	(95,475)	(4,511)	(275,547)
Reclassification	163,473	-	-	-	39,282	(202,755)	-
As of 31 December 2016	4,830,799	101,245	1,026,070	168,874	583,924	-	6,710,912
ACCUMULATED DEPRECIATION							
As of January 1, 2015	1,556,183	40,944	821,932	138,025	381,451	-	2,938,535
Depreciation charge	217,699	8,357	130,752	22,844	80,445	-	460,097
Disposals	-	(18,241)	(61,360)	(11,026)	(29,834)	-	(120,461)
Reclassification	-	-	(6,357)	-	6,357	-	-
As of 31 December 2015	1,773,882	31,060	884,967	149,843	438,419	-	3,278,171
Depreciation charge	137,197	14,015	33,385	27,024	99,798	-	311,419
Disposals	-	(28,256)	(39,510)	(84,148)	(95,317)	-	(247,231)
As of 31 December 2016	1,911,079	16,819	878,842	92,719	442,900	-	3,342,359
CARRYING VALUE							
As of 31 December 2016	2,919,720	84,426	147,228	76,155	141,024	-	3,368,553
As of 31 December 2015	2,893,444	96,075	167,988	78,001	178,823	202,318	3,616,649

Revaluation of assets

The buildings and land owned by the Bank were revalued by an independent appraiser as of 31 December 2011 using comparative, cost and income methods resulting in a revaluation of AMD 1,926,611 thousand. Management has based its estimate of the fair value of the buildings and land on the results of the independent appraisal.

For the fair value hierarchy of PPE see note 31.3

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

Fully depreciated items

As at 31 December 2016 fixed assets included fully depreciated assets in amount of AMD 490,916 thousand (2015: AMD 598,366 thousand).

Fixed assets in the phase of installation

As of 31 December 2016 fixed assets included assets in the phase of installation in amount of AMD 92,520 thousand (2015: AMD 141,841 thousand).

Restrictions on title of fixed assets

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

Contractual commitments

As of 31 December 2016 the Bank did not have contractual commitments (2015: AMD 990 thousand).

21 Intangible assets

In thousand Armenian drams	Licenses	Computer software	Other	Total
COST				
As of January 1, 2015	34,396	128,835	3,375	166,606
Additions	7,732	-	-	7,732
Disposals	(23,263)	(337)	-	(23,600)
As of 31 December 2015	18,865	128,498	3,375	150,738
Additions	8,457	1,000	-	9,457
Disposals	(7,997)	(4,172)	(2,295)	(14,464)
Reclassification	23,161	(23,161)	-	-
As of 31 December 2016	42,486	102,165	1,080	145,731
ACCUMULATED AMORTISATION				
As of January 1, 2015	23,257	49,756	732	73,745
Amortisation charge	6,885	15,673	108	22,666
Disposal	(23,263)	(337)	-	(23,600)
As of 31 December 2015	6,879	65,092	840	72,811
Amortisation charge	10,330	17,180	108	27,618
Disposals	(7,997)	(3,353)	-	(11,350)
Reclassification	12,733	(12,733)	-	-
As of 31 December 2016	21,945	66,186	948	89,079
CARRYING VALUE				
As of 31 December 2016	20,541	35,979	132	56,652
As of 31 December 2015	11,986	63,406	2,535	77,927

Fully amortized items

As of 31 December 2016 the Bank did not possess intangible assets included fully amortized assets (2015: AMD 2,510 thousand).

Restrictions on title of intangible assets

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

Contractual commitments

As of 31 December 2016 the Bank had no contractual commitments (2015: nil).

22 Repossessed assets

Details of financial and non-financial assets obtained by the Bank during the year by taking possession of collateral held as security against loans and advances as of December 31 are shown below:

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Property	2,007,948	2,179,467
Vehicles	7,253	10,751
Other	62,189	67,515
Total	2,077,390	2,257,733

The Bank's policy is to pursue timely realisation of the collateral in an orderly manner. The Bank generally does not use the non-cash collateral for its own operations. The assets are measured at the lower of their carrying amount and fair value less costs to sell.

23 Other assets

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Debtors and other receivables	981,939	290,517
Total other financial assets	981,939	290,517
Less allowance for impairment of financial assets	(45,096)	(29,387)
Total net other financial assets	936,843	261,130
Prepayments to suppliers	14,034	11,257
Precious metals	127,104	121,616
Materials	25,691	20,062
Other	32,563	23,850
Total non-financial assets	199,392	176,785
Total other assets	1,136,235	437,915

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

In thousand Armenian drams	Total
As of January 1, 2015	10,397
Charge for the year	46,366
Amounts written off	(167,399)
Recoveries	140,023
As of 31 December 2015	29,387
Charge for the year	2,283,283
Amounts written off	(2,322,902)
Recoveries	55,328
As of 31 December 2016	45,096

AMD 2,249,422 thousand included in the total amount of other assets written-off in 2016 is the amount receivable on the remitted loans (recognized as impaired on the day of the signature of the transaction) in accordance with the remittance contract with the right of demand from one person.

24 Amounts due to financial institutions

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Repurchase agreements from the CBA	-	7,765,981
Repurchase agreements from the other banks	2,992,276	-
Loans from banks	-	13,133,456
Correspondent accounts of banks	166,268	1,683,470
Deposits from other financial institutions	4,367,359	1,001,746
Bank accounts of other financial institutions	13,042	32,424
Loans from other financial institutions	2,781,547	2,802,842
Other amounts	1,577	35,381
Total amounts due to financial institutions	10,322,069	26,455,300

As at 31 December 2015 the loans from banks in amounts of AMD 10,512,415 thousand (80%) due from four financial institutions.

As of 31 December 2016 the Bank has single borrower, whose deposit balances exceed 10% of the Bank's equity. The gross value of these deposits as of 31 December 2016 amounts to AMD 3,910,941 thousand (2015: nil).

As at 31 December 2016 loans from other financial institutions in the amount of AMD 2,781,547 thousand (100%) (2015: AMD 2,802,842 thousand were due from two financial institutions (100%)) were due from two financial institutions.

All deposits and loans from banks and financial institutions have fixed interest rates.

As of 31 December 2016 the average effective interest rates on amounts due to the financial institutions was 9.23% for borrowings in AMD (2015: 8.16%) and 8.38% for borrowings in USD, EUR and other freely convertible currencies (2015: 7.43%).

The Bank did not have any defaults of principal, interest or other breaches with respect to its borrowings during the year (2015: nil).

25 Amounts due to customers

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Government of the RA		
Current/Settlement accounts	714,233	529,122
Received loans	68,900	227,872
	<u>783,133</u>	<u>756,994</u>
Corporate customers		
Current/Settlement accounts	3,490,695	4,342,483
Time deposits	17,081,663	9,895,431
	<u>20,572,358</u>	<u>14,237,914</u>
Retail customers		
Current/Settlement accounts	6,495,392	5,213,222
Time deposits	31,287,341	29,871,540
	<u>37,782,733</u>	<u>35,084,762</u>
Total amounts due to customers	<u><u>59,138,224</u></u>	<u><u>50,079,670</u></u>

Customer deposits carry fixed rates.

As of 31 December 2016 included in payables to Government are loans in the amount of AMD 67,715 thousand (2015: AMD 158,257 thousand) attracted under the World Bank PIU on “Agriculture Finance Support Facility”, as well as loans received within the scope of “Small and Medium business loan project” of German-Armenian fund in the amount of AMD 1,185 thousand (2015: AMD 69,615 thousand).

As of 31 December 2016 included in amounts due to customers are deposits amounting to AMD 6,382,468 thousand (2015: AMD 3,231,114 thousand) held as security against loans, letters of credit issued, guarantees issued and other transaction related to contingent liabilities. The fair value of those deposits approximates the carrying amount.

As of 31 December 2016 the aggregate balance of top two customers of the Bank (including related parties, see Note 30) amounts to AMD 23,418,549 thousand (2015: 13,188,102 thousand) or 35.44% of total customer accounts and subordinated debt (2015: 24.14%). The amount of top two customers does not include amounts due to RA Government.

As of 31 December 2016 the average effective interest rates on amounts due to customers was 12.41% for amounts attracted in AMD (2015: 11.74%) and 7.90% for amounts attracted in USD, EUR and other freely convertible currencies (2015: 9.03%).

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

26 Subordinate debt

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Subordinate debt from other organizations	7,729,539	5,305,313
Total subordinate debt	<u><u>7,729,539</u></u>	<u><u>5,305,313</u></u>

Subordinate debt represents a long term borrowing agreement, which, in case of the Bank's default, would be secondary to the Bank's other obligations, including deposits and other debt instruments.

The maturity for subordinate debt attracted from legal entities is set until 2026.

As of 31 December 2016 average weighted interest rate of subordinated debt was 13.56% (2015: 13.48%), for borrowings in US dollar was 7.81% (2015: 5.98%).

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

27 Other liabilities

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Accounts payables	69,499	85,599
Due to personnel	52,830	48,435
Total other financial liabilities	122,329	134,034
Tax payable, other than income tax	36,625	34,225
Grants related to assets	8,040	8,516
Other	21,996	42,402
Total other non-financial liabilities	66,661	85,143
Total other liabilities	188,990	219,177

Grants related to assets

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
At January 1	8,516	9,654
Recognition of income (Note 9)	(476)	(1,138)
As of December 31	8,040	8,516

28 Equity

As of 31 December 2016 the Bank's registered and paid-in share capital was AMD 23,261,150 thousand (2015: AMD 11,061,150 thousand).

In accordance with the Bank's statutes, the share capital consists of 465,223 ordinary shares, all of which have a par value of AMD 50,000 each.

As of 31 December 2016 the Bank increased its share capital by AMD 12,200,000 thousand (2015: AMD 4,500,000 thousand).

The respective shareholders of the Bank are:

In thousand Armenian drams	As of 31 December 2016		As of 31 December 2015	
	Paid-in share capital	% of total paid-in capital	Paid-in share capital	% of total paid-in capital
Armenia Business Fund	12,030,100	51.72	4,500,000	40.7
Artsakh Investment Fund	7,500,000	32.24	-	-
Sirmakes Vartan Nazareth	-	-	2,830,150	25.6
Kaprielyan Hrach-Nerses	2,563,800	11.02	2,563,800	23.2
Nersisyan Kamo Sergey	354,750	1.53	354,750	3.2
Selefyan Arden	334,250	1.44	334,250	3.0
Gabrielyan Inna Valeri	328,100	1.41	328,100	2.9
Other (5 shareholders in total)	150,150	0.65	150,100	1.4
	23,261,150	100	11,061,150	100

As of 31 December 2016, the Bank did not repurchase any of its own shares. The holders of ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at annual and general meetings of the Bank.

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.

Distributable among shareholders reserves equal the amount of retained earnings, determined according to the Armenian legislation. Non-distributable reserves are represented by a reserve fund, which is created as required by the statutory regulations, in respect of general banking risks, including future losses and other unforeseen risks or contingencies. The reserve has been created in accordance with the Bank's statutes that provide for the creation of a reserve for these purposes of not less than 15% of the Bank's share 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 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	721,884	907,858
Guarantees	666,130	895,513
Total commitments and contingent liabilities	1,388,014	1,803,371

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 other lease agreements for buildings and premises.

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	208,365	256,570
1 - 5 years	678,014	924,630
Later than 5 years	73,775	36,442
Total operating lease commitments	960,154	1,217,642

Capital commitments

Information on the Bank's capital commitments is disclosed in notes 20, 21.

Insurance

The insurance industry in Armenia is at developing stage and many forms of insurance protection common in other parts of the world are not yet generally available. 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 shareholders, members of Bank's Management as well as other persons and enterprises related with and controlled by them respectively.

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

The ultimate controlling party of the Bank is Swiss businessman Vardan Sirmakes.

These transactions were carried out on commercial terms and at market rates.

In thousand Armenian drams	2016		2015	
	Shareholders and parties related with them	Key management personnel and parties related with them	Shareholders and parties related with them	Key management personnel and parties related with them
Statement of financial position				
Investments held to maturity				
At January 1	-	-	-	-
Acquired during the year	9,590,261	-	-	-
Repayments during the year	-	-	-	-
At December 31	9,590,261	-	-	-
Loans and advances to customers				
Loans outstanding at January 1	4,392,740	24,465	4,069,057	43,017
Loans balance of new related party	36,689,551	-	-	-
Loans issued during the year	10,612,712	57,384	3,486,400	35,237
Loan repayments during the year	(10,559,340)	(54,007)	(3,162,717)	(53,789)
Loans outstanding at December 31	41,135,663	27,842	4,392,740	24,465
Less: allowance for loan impairment	(46,703)	(278)	(43,927)	(245)
At December 31	41,088,960	27,564	4,348,813	24,220
Amounts due from other financial institutions				
At January 1	383	-	699	-
Increase	6,729,092	-	5,780,459	-
Decrease	(6,724,257)	-	(5,780,775)	-
At December 31	5,218	-	383	-
Other receivables	898,289	-	48,480	-
Amounts due to other financial institutions				
At January 1	1,667,739	-	759,387	-
Increase	4,001,877	-	11,633,472	-
Decrease	(5,504,616)	-	(10,725,120)	-
At December 31	165,000	-	1,667,739	-
Amounts due to customers				
Deposits at January 1	3,633,275	665,161	4,223,271	779,173
Deposits received during the year	51,908,179	201,181	29,990,077	746,189
Deposits repaid during the year	(51,662,865)	(785,957)	(30,580,073)	(860,201)
Deposits at December 31	3,878,589	80,385	3,633,275	665,161
Subordinated debt at December 31	7,729,539	-	850,667	-
Other receivables	-	59,036	-	41,119
Guarantees issued	194,332	-	-	-

Statement of profit or loss and other comprehensive income

Interest income	910,982	1,502	624,720	2,874
Interest expense	1,224,362	7,702	415,808	50,313
Impairment (charge)/reversal	(2,776)	(33)	36,899	185
Net income on disposal of repossessed assets	98	-	-	-
Other expenses(lease)	113,734	-	41,625	-

The loans issued to directors and other key management personnel (and close family members) have maturity from 1 to 18 years (2015: from 1 to 13 years) and have interest rates of 7.5-24% (2015: 12-18%). The loans advanced to the directors are collateralised by gold, real estate, cash and other assets.

Compensation of key management personnel was comprised of the following:

In thousand Armenian drams	2016	2015
Salaries and other short-term benefits	239,419	209,677
Total key management compensation	239,419	209,677

31 Fair value measurement

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

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

At each reporting date, the Management analyses the movements in the values of assets and liabilities which are required to be re-measured or re-assessed as per the Bank's accounting policies. For this analysis, the major inputs applied in the latest valuation are verified by agreeing the information in the valuation computation to contracts and other relevant documents. The Management, in conjunction with the Bank's external valuers, also compares each the changes in the fair value of each asset and liability with relevant external sources to determine whether the change is reasonable.

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	-	10,993,034	-	10,993,034	10,993,034
Amounts due from other financial institutions	-	3,065,140	-	3,065,140	3,065,140
Investments held to maturity	-	14,226,353	-	14,226,353	14,789,086
Securities pledged under repurchase agreements	-	3,075,698	-	3,075,698	2,802,317
Loans and advances to customers	-	64,509,658	-	64,509,658	64,509,658
Other assets	-	936,843	-	936,843	936,843
FINANCIAL LIABILITIES					
Amounts due to other financial institutions	-	10,322,069	-	10,322,069	10,322,069
Amounts due to customers	-	59,138,224	-	59,138,224	59,138,224
Subordinate debt	-	7,729,539	-	7,729,539	7,729,539
Other financial liabilities	-	122,329	-	122,329	122,329

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	-	12,781,907	-	12,781,907	12,781,907
Amounts due from other financial institutions	-	2,257,793	-	2,257,793	2,257,793
Loans and advances to customers	-	61,368	-	60,228	61,368
Investments held to maturity	-	7,538,874	-	7,538,874	7,847,400
Securities pledged under repurchase agreements	-	63,510,814	-	63,510,814	63,510,814
Other assets	-	261,130	-	261,130	261,130
FINANCIAL LIABILITIES					
Amounts due to other financial institutions	-	26,455,300	-	26,455,300	26,455,300
Amounts due to customers	-	50,079,670	-	50,079,670	50,079,670
Subordinate debt	-	5,305,313	-	5,305,313	5,305,313
Other financial liabilities	-	134,034	-	134,034	134,034

Amounts due from and to other 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 6% to 24% per annum (2015: 7.5% 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.

Investment securities held to maturity

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

Due to customers

The fair value of deposits from 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.

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				
Investments available for sale	24,625	-	-	24,625
NET FAIR VALUE	24,625	-	-	24,625

In thousand Armenian drams	As of 31 December 2015			
	Level 1	Level 2	Level 3	Total
FINANCIAL ASSETS				
Derivative financial assets	-	3,416	-	3,416
Total	-	3,416	-	3,416
FINANCIAL LIABILITIES				
Derivative financial assets	-	3,214	-	3,214
Trading liabilities	-	844,308	-	844,308
Total	-	847,522	-	847,522
NET FAIR VALUE	-	(844,106)	-	(844,106)

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

Unquoted RA equity securities

The fair value of Bank's investment in unquoted RA equity securities cannot be reliably measured and is therefore excluded from this disclosure. Refer to note 16 for further information about this equity investment.

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				
Land and buildings	-	-	4,830,799	4,830,799
Total	-	-	4,830,799	4,830,799
NET FAIR VALUE	-	-	4,830,799	4,830,799

In thousand Armenian drams	As of 31 December 2015			
	Level 1	Level 2	Level 3	Total
NON FINANCIAL ASSETS				
Land and buildings	-	-	4,667,326	4,667,326
Total	-	-	4,667,326	4,667,326
NET FAIR VALUE	-	-	4,667,326	4,667,326

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	Land and buildings	Total
NON FINANCIAL ASSETS		
Balance as at 1 January 2016	4,667,326	4,667,326
Reclassification	163,473	163,473
Balance as at 31 December, 2016	4,830,799	4,830,799
NET FAIR VALUE	4,830,799	4,830,799

In thousand Armenian drams	Land and buildings	Total
NON FINANCIAL ASSETS		
Balance as at 1 January 2015	4,719,829	4,719,829
Purchases	35,843	35,843
Reclassification	59,177	59,177
Adjustments	(147,523)	(147,523)
Balance as at 31 December, 2015	4,667,326	4,667,326
NET FAIR VALUE	4,667,326	4,667,326

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 at each reporting date.

The appraisal was carried out using a comparative and income methods that reflect observed prices for recent market transactions for similar properties and incorporates adjustments for factors specific to the land in question, including plot size, location, encumbrances and current use and other.

The land and buildings were revalued on 31 December 2011.

The significant unobservable input is the adjustment for factors specific to the land in question. The extent and direction of this adjustment depends on the number and characteristics of the observable market transactions in similar properties that are used as the starting point for valuation. Although this input is a subjective judgement, management considers that the overall valuation would not be materially affected by reasonably possible alternative assumptions.

32 Offsetting of financial assets and financial liabilities

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

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

In thousand Armenian drams

As at 31 December 2016

	Gross amount of recognised financial assets/liabilities	Gross amount of recognised financial assets/liabilities in the statement of financial position	Net amount of financial assets/liabilities in the statement of financial position	Related amounts that are not offset in the statement of financial position		
				Financial instruments	Cash collateral received	Net
FINANCIAL ASSETS						
Reverse repurchase agreements (Note 15)	2,735,249	-	2,735,249	2,735,249	-	-
FINANCIAL LIABILITIES						
Repurchase agreements (Note 18)	2,802,317		2,802,317	2,992,276	-	(189,959)

In thousand Armenian drams

As at 31 December 2016

	Gross amount of recognised financial assets/liabilities	Gross amount of recognised financial assets/liabilities in the statement of financial position	Net amount of financial assets/liabilities in the statement of financial position	Related amounts that are not offset in the statement of financial position		
				Financial instruments	Cash collateral received	Net
FINANCIAL ASSETS						
Reverse repurchase agreements (Note 15)	1,916,400	-	1,916,400	1,916,400	-	-
FINANCIAL LIABILITIES						
Repurchase agreements (Note 18)	8,610,289	-	8,610,289	8,691,709	-	(81,420)

33 Maturity analysis of assets and liabilities

The table below shows an analysis of main financial 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 of 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	10,993,034	-	-	10,993,034	-	-	-	10,993,034
Amounts due from financial institutions	3,065,140	-	-	3,065,140	-	-	-	3,065,140
Investments available for sale	54,589	-	-	54,589	-	-	-	54,589
Investments held to maturity	156,683	752,357	1,218,810	2,127,850	12,072,154	589,082	12,661,236	14,789,086
Securities pledged under repurchase agreements	2,802,317	-	-	2,802,317	-	-	-	2,802,317
Loans and advances to customers	13,032,291	10,340,657	17,605,711	40,978,659	18,909,820	4,621,179	23,530,999	64,509,658
Other assets	259,327	96,788	435,546	791,661	145,182	-	145,182	936,843
	<u>30,363,381</u>	<u>11,189,802</u>	<u>19,260,067</u>	<u>60,813,250</u>	<u>31,127,156</u>	<u>5,210,261</u>	<u>36,337,417</u>	<u>97,150,667</u>
LIABILITIES								
Amounts due to financial institutions	6,885,017	478,396	177,782	7,541,195	873,305	1,907,569	2,780,874	10,322,069
Loans and advances to customers	12,164,682	9,425,758	18,975,441	40,565,881	12,773,770	5,798,573	18,572,343	59,138,224
Subordinate debt	-	-	-	-	-	7,729,539	7,729,539	7,729,539
Other liabilities	122,329	-	-	122,329	-	-	-	122,329
	<u>19,172,028</u>	<u>9,904,154</u>	<u>19,153,223</u>	<u>48,229,405</u>	<u>13,647,075</u>	<u>15,435,681</u>	<u>29,082,756</u>	<u>77,312,161</u>
Net position	<u>11,191,353</u>	<u>1,285,648</u>	<u>106,844</u>	<u>12,583,845</u>	<u>17,480,081</u>	<u>(10,225,420)</u>	<u>7,254,661</u>	<u>19,838,506</u>
Accumulated gap	<u>11,191,353</u>	<u>12,477,001</u>	<u>12,583,845</u>		<u>30,063,926</u>	<u>19,838,506</u>		

In thousand Armenian drams	As of 31 December 2015							Total
	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	
ASSETS								
Cash and cash equivalents	12,781,907	-	-	12,781,907	-	-	-	12,781,907
Amounts due from other financial institutions	2,257,793	-	-	2,257,793	-	-	-	2,257,793
Derivative financial assets	3,416	-	-	3,416	-	-	-	3,416
Investments available for sale	29,964	-	-	29,964	-	-	-	29,964
Investments held to maturity	24,914	-	19,363	44,277	12,742	4,349	17,091	61,368
Securities pledged under repurchase agreements	61,368	-	1,334,763	1,396,131	6,127,067	1,168,511	7,295,578	8,691,709
Loans and advances to customers	9,170,532	8,422,363	8,379,394	25,972,289	26,200,713	11,337,812	37,538,525	63,510,814
Other assets	261,130	-	-	261,130	-	-	-	261,130
	<u>24,591,024</u>	<u>8,422,363</u>	<u>9,733,520</u>	<u>42,746,907</u>	<u>32,340,522</u>	<u>12,510,672</u>	<u>44,851,194</u>	<u>87,598,101</u>
LIABILITIES								
Amounts due to other financial institutions	23,252,024	106,963	293,471	23,652,458	670,043	2,132,799	2,802,842	26,455,300
Amounts due to customers	14,198,938	5,720,367	14,422,012	34,341,317	11,088,690	4,649,663	15,738,353	50,079,670
Trading liabilities	-	-	-	-	757,772	86,536	844,308	844,308
Derivative financial liability	3,214	-	-	3,214	-	-	-	3,214
Subordinate debt	-	-	-	-	2,922,347	2,382,966	5,305,313	5,305,313
Other liabilities	134,034	-	-	134,034	-	-	-	134,034
	<u>37,588,210</u>	<u>5,827,330</u>	<u>14,715,483</u>	<u>58,131,023</u>	<u>15,438,852</u>	<u>9,251,964</u>	<u>24,690,816</u>	<u>82,821,839</u>
Net position	<u>(12,997,186)</u>	<u>2,595,033</u>	<u>(4,981,963)</u>	<u>(15,384,116)</u>	<u>16,901,670</u>	<u>3,258,708</u>	<u>20,160,378</u>	<u>4,776,262</u>
Accumulated gap	<u>(12,997,186)</u>	<u>(10,402,153)</u>	<u>(15,384,116)</u>		<u>1,517,554</u>	<u>4,776,262</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 and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to operating risks.

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

Risk management structure

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

Board of Directors

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

Management Board

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

Risk Committee

The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Internal audit

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

Risk measurement and reporting systems

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 Management Board, the Risk Committee, and the head of each business division. The report includes aggregate credit exposure, credit metric forecasts, hold limit exceptions, VaR, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Board of Directors 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.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

A daily briefing is given to the Management Board and all other relevant employees of the Bank on the utilisation of market limits, analysis of VaR, proprietary investments and liquidity, plus any other risk developments.

Risk mitigation

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

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

Excessive risk concentration

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

As of 31 December 2016, the Bank had a concentration in loan portfolio and security investments represented by AMD 36,689,551 thousand and AMD 9,590,261 thousand respectively due from single third party entities and parties related with them (45% of Bank's assets). The Bank's management believes, that these loans and bonds will be repaid according to the contractual terms and the concentrations will not cause a deterioration of the Bank's financial condition.

34.1 Credit risk

The Bank takes on exposure to credit risk, which is the risk that 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 is managed in accordance with the Bank's credit policy and the internal legal acts regulating the sphere.

The risk management division implements daily monitoring of the loan portfolio, calculation of dynamics based on the structured series and analysis of the quality of loan portfolio by products and branches, which is used for forecasting the qualitative indicators of the loan portfolio. The risk management division also conducts monitoring of different loan types in accordance with approved procedures, and monitors also other loans if it is necessary in case of worsening of the borrower's creditability. The loans issued by the Bank are also approved by the risk management division in accordance with the requirements of internal legal acts for reducing the credit risk. The credit risk management and control are centralised in Risk Management Division and reported to the Executive Board regularly.

As of 31 December 2016 and 2015 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 of the maximum exposure to credit risk

Geographical sectors

The following table breaks down the Bank’s main credit exposure at their carrying amounts, as categorized by geographical region as of December 31 2016 and 31 December 2015.

In thousand Armenian drams	Armenia	Other non-OECD countries	OECD countries	Total
Cash and cash equivalents	10,993,034	-	-	10,993,034
Amounts due from other financial institutions	2,328,994	282,803	453,343	3,065,140
Investments available for sale	54,589	-	-	54,589
Held to maturity investments	14,789,086	-	-	14,789,086
Securities pledged under reverse repurchase agreements	2,802,317	-	-	2,802,317
Loans and advances to customers	64,507,994	-	1,664	64,509,658
Other assets	128,430	-	808,413	936,843
As of 31 December 2016	95,604,444	282,803	1,263,420	97,150,667
As of 31 December 2015	86,829,526	606,604	161,971	87,598,101

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

Industry sectors

The Bank’s main credit exposure at their carrying amounts, as categorized by the industry sectors of the counterparties as of December 31 2016 and 31 December 2015 is disclosed in Note 19.

34.1.2 Risk limit control and mitigation policies

The Bank manages limits and controls concentrations of credit risk wherever they are identified – in particular, to individual counterparties and groups, and to industries and countries.

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 Credit Committee.

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

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

Some other specific control and mitigation measures are outlined below.

Collateral

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

- Mortgages over residential properties;
- Charges over business assets such as premises, inventories and receivables.

- Financial instruments, debt and equity shares.

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. Generally no collaterals are required for provision of loans and advances to financial institutions, especially to Banks. The exception is collaterals obtained under repurchase agreements and securities borrowing transactions. Debt securities, treasury and other eligible bills are generally unsecured.

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

In thousand Armenian drams	As of 31 December 2016	As of 31 December 2015
Loans collateralized by real estate	19,495,450	24,460,615
Loans collateralized by gold	2,270,895	2,980,959
Loans collateralized by guarantees of enterprises	-	14,198
Loans collateralized by vehicles	299,219	263,517
Loans collateralized by cash	4,164,238	4,276,114
Loans collateralized by inventories	440,407	999,112
Loans collateralized by equipment	60,067	18,472
Loans collateralized by governmental guarantees	37,073,389	27,910,538
Unsecured loans	1,077,881	1,183,280
Other collateral	2,172,483	3,890,674
Total loans and advances to customers (gross)	67,054,029	65,997,479

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. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments.

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

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 by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank estimates impairment for loans based on an analysis of the future cash flows for impaired loans and based on its past loss experience for portfolios of loans for which no indications of impairment have been identified approaching conservatively. The Bank addresses impairment assessment into areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

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

Collectively assessed allowances

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

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

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

Loans and advances neither past due or impaired

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

In thousand Armenian drams	2016	2015
Industry	8%	6%
Agriculture	1.8%	14%
Construction	-	9%
Trading	6.5%	5%
Services	3.9%	8%
Consumer	1.2%	4%
Mortgage	3.3%	2%
Other	1.4%	1%

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 individually 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 but not impaired loans by class is provided below.

In thousand Armenian drams	As of 31 December 2016		
	Less than 90 days	91 to 270 days	Total
Loans and advances to customers			
Industry	1,436	12,396	13,832
Agriculture	34,039	-	34,039
Trading	130,994	17,092	148,086
Services	8,543	37,753	46,296
Consumer	176,653	170,410	347,063
Mortgage	187,121	195,713	382,834
Total	538,786	433,364	972,150

In thousand Armenian drams	As of 31 December 2015		
	Less than 90 days	91 to 270 days	Total
Loans and advances to customers			
Industry	51,628	57,941	109,569
Agriculture	25,979	30,840	56,819
Construction	-	8,190	8,190
Trading	48,585	172,970	221,555
Transport and communication	6,485	1,698	8,183
Services	34,714	23,366	58,080
Consumer	413,371	361,623	774,994
Mortgage	407,156	445,662	852,818
	987,918	1,102,290	2,090,208

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.

34.2.1 Market risk – Non-trading

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The currency risk is managed using the standard and VaR methodologies. The currency rates are monitored daily, based on which at the end of each month the currency rates are forecasted. The Board of Directors has set limits on positions by currency.

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 income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities) and equity (due to the change in fair value of equity instruments). A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

In thousand Armenian drams	Currency	As of 31 December 2016			As of 31 December 2015		
		Change in currency rate in %	Effect on profit before tax	Effect on equity	Change in currency rate in %	Effect on profit before tax	Effect on equity
	USD	5	10,474	10,474	5	21,440	21,440
	USD	(5)	(10,474)	(10,474)	(5)	(21,440)	(21,440)
	EUR	8	10,026	10,026	8	794	794
	EUR	(8)	(10,026)	(10,026)	(8)	(794)	(794)

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

In thousand Armenian drams	Armenian Dram	Freely convertible currencies	Non-freely convertible currencies	Total
ASSETS				
Cash and cash equivalents	7,066,447	3,835,144	91,443	10,993,034
Amounts due from financial institutions	2,961,718	97,439	5,983	3,065,140
Investments available for sale	54,589	-	-	54,589
Investments held to maturity	13,060,713	1,728,373	-	14,789,086
Securities pledged under reverse repurchase agreements	2,802,317	-	-	2,802,317
Loans and advances to customers	30,423,166	34,086,492	-	64,509,658
Other assets	212,416	724,427	-	936,843
	56,581,366	40,471,875	97,426	97,150,667
LIABILITIES				
Amounts due to financial institutions	10,175,101	146,849	119	10,322,069
Amounts due to customers	22,730,308	36,385,972	21,944	59,138,224
Subordinated debt	3,856,008	3,873,531	-	7,729,539
Other liabilities	122,159	170	-	122,329
	36,883,576	40,406,522	22,063	77,312,161
Net position as of 31 December 2016	19,697,790	65,353	75,363	19,838,506
Commitments and contingent liabilities as of 31 December 2016	1,321,663	66,351	-	1,388,014
Total financial assets	38,713,119	48,833,537	48,029	87,594,685
Total financial liabilities	36,828,648	45,984,079	5,898	82,818,625
Total effect of derivative financial instruments	3,288,386	(3,288,184)	-	202
Net position as of 31 December 2015	5,172,857	(438,726)	42,131	4,776,262
Commitments and contingent liabilities as of 31 December 2015	1,641,432	161,939	-	1,803,371

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. 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. Refer to 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)	22.21	17.6
N22- Current liquidity ratio(Highly liquid assets /liabilities on demand)	141.06	118.86

Analysis of financial liabilities by remaining contractual maturities.

The table below summarizes 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 of 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
FINANCIAL LIABILITIES						
Amounts due to other financial institutions	6,905,678	482,647	183,950	1,116,326	2,963,145	11,651,746
Amounts due to customers	12,165,379	9,517,441	20,153,499	15,312,480	10,509,814	67,658,613
Subordinated debt	68,705	137,410	618,347	3,297,850	7,715,458	11,837,770
Other liabilities	122,329	-	-	-	-	122,329
Total undiscounted financial liabilities	19,262,091	10,137,498	20,955,796	19,726,656	21,188,417	91,270,458
Commitments and contingent liabilities	1,121,884	6,990	200,104	59,036	-	1,388,014
Total undiscounted financial liabilities as of 31 December 2015	37,789,229	6,158,252	16,007,959	20,859,965	9,570,780	90,386,185
Derivative financial liabilities						
Currency swap contracts						
Inflow	1,931,786	-	-	-	-	1,931,786
Outflow	(1,935,000)	-	-	-	-	(1,935,000)
Commitments and contingent liabilities as of December, 2015	908,977	528,443	18,952	346,999	-	1,803,371

The Bank has received significant funds from its shareholder and its related parties. Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. Management believes that this level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

34.4 Operational risk

The primary responsibility for the development and implementation of controls to address operational risk is assigned to the Executive Board of the Bank. Operational risk is the risk of incompatibility of the Banks' operations and procedures to the legislation in force or their breach, the lack of information of the Bank's staff and their errors, the losses from insufficiency of the functional properties of the information technologies and systems implemented by the Bank. 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 operational risk management is conducted in a clear and documented manner for all the business processes described, through the internal legal acts regulating those business process, as well as limits for all the processes and operations, and double control mechanisms for all transactions. The more actual operational risk management is described below.

Legal risk: all the standard contract forms of the Bank are prepared by the Bank's Legal Department by cooperating with the Bank's appropriate departments and are approved by the Bank's Executive Board. In the Bank's day-to-day operations non-standard contracts between the Bank and third parties are allowed only in case of appropriate conclusion from the Banks Legal Department.

The IT risks are managed in accordance with internal legal acts.

The risk mitigation mechanisms for the process are:

- Regulation of all business processes by internal legal acts,
- Physical protection of the Bank's assets and critical documents (including loans contracts)
- Establishing and maintaining limits,
- Common preservation of property and records,
- Implementation and archiving of data journals,
- Implementation of double control mechanism in recording transactions.

The internal audit periodically assesses the internal control system effectiveness and adequacy with the Bank's risks and supervises the Bank's activity and operational risks.

The Bank's correspondence with the standards is accompanied by the internal auditor's periodic observations. The results of those observations are discussed by the Bank's management's appropriate representative to whom it concerns. The summaries of the observations are submitted to the Board.

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

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

In thousand Armenian drams	Not audited	
	As of 31 December 2016	As of 31 December 2015
Tier 1 capital	12,246,408	6,954,106
Tier 2 capital	5,617,829	3,477,053
Total regulatory capital	17,864,237	10,431,159
Risk-weighted assets	43,192,062	52,789,266
Capital adequacy ratio	41.36%	19.76%

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.

The Bank has complied with 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 and after that period.