



Financial Statements and Independent Auditor's  
Report

*Aregak Universal Credit Organization closed joint  
stock company*

31 December 2007

# Contents

	<b>Page</b>
Independent auditor's report	1
Income statement	3
Balance Sheet	4
Statement of changes in equity	5
Statement of cash flows	6
Accompanying notes to the financial statements	7



## Independent auditor's report

Գրանտ Թորնթոն Ամյոտ ՍՊԸ  
ԳՅ, ք. Երևան 0012  
Վարդանշատ 8/1

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

Grant Thornton Amyot LLC  
8/1 Vaghanshyan Str  
0012 Yerevan, Armenia  
T +374 10 260 964  
F +374 10 260 961  
www.gta.am

To the Shareholder of Closed Joint Stock Company Aregak UCO:

We have audited the accompanying financial statements of Aregak UCO CJSC (the "Organization"), which comprise the balance sheet as at December 31, 2007, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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

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

### *Auditor's responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Organization's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control.



An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

*Opinion*

In our opinion, the financial statements give a true and fair view of the financial position of the Organization as of December 31, 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

23 May 2008  
Yerevan  
Grant Thornton Amyot LLC

*Grant Thornton Amyot LLC*



## Income statement

In thousand Armenian drams

	Notes	Year ended December 31, 2007 (audited)	8 months ended December 31, 2006 (audited)
Interest and similar income	6	1,442,603	353,539
Interest and similar expense	6	(232,056)	(63,955)
<b>Net interest income</b>		<b>1,210,547</b>	<b>289,584</b>
Fee and commission income	7	44,130	350,720
Fee and commission expense	7	(14,733)	(9,935)
<b>Net fee and commission income</b>		<b>29,397</b>	<b>340,785</b>
Other income	8	106,726	6,726
Impairment charge for credit losses	9	(30,087)	(33,319)
Staff costs	10	(641,448)	(388,752)
Depreciation of property and equipment	16	(19,999)	(1,443)
Amortization of intangible assets	17	(910)	(8)
Other expenses	11	(332,192)	(149,235)
<b>Profit before income tax</b>		<b>322,034</b>	<b>64,338</b>
Income tax expense	12	(98,041)	(23,919)
<b>Profit for the year</b>		<b>223,993</b>	<b>40,419</b>

The accompanying notes on pages 7 to 31 are an integral part of these financial statements.



## Statement of changes in equity

In thousand Armenian drams	Share capital	Statutory general reserve	Fair value reserve	Retained earnings	Total
<b>Balance as of May 1, 2006</b>	-	-	-	-	-
Increase in capital as a result of borrowing received from the related party at below market interest rate (Note 19)	-	-	530,758	-	530,758
Total income and expense recognized directly in equity	-	-	530,758	-	530,758
Profit for the period	-	-	-	40,419	40,419
Total income and expense for the year	-	-	530,758	40,419	571,177
Issue of share capital	200,000	-	-	-	200,000
<b>Balance as of December 31, 2006 (audited)</b>	<b>200,000</b>	<b>-</b>	<b>530,758</b>	<b>40,419</b>	<b>771,177</b>
Increase in capital as a result of borrowing received from the related party at below market interest rate (Note 19)	-	-	270,270	-	270,270
Total income and expense recognized directly in equity	-	-	270,270	-	270,270
Profit for the year	-	-	-	223,993	223,993
Total income and expense for the year	-	-	270,270	223,993	494,263
Distribution to reserve	-	3,892	-	(3,892)	-
Dividends to shareholders	-	-	-	(19,460)	(19,460)
<b>Balance as of December 31, 2007 (audited)</b>	<b>200,000</b>	<b>3,892</b>	<b>801,028</b>	<b>241,060</b>	<b>1,245,980</b>

## Statement of cash flows

In thousand Armenian drams	Year ended December 31, 2007 (audited)	8 months ended December 31, 2006 (audited)
<b>Cash flows from operating activities</b>		
Interest received	1,415,460	321,775
Interest paid	(64,693)	-
Fees and commissions received	70,895	323,955
Salaries and benefits paid	(485,886)	(273,939)
Other taxes paid	(235,399)	(100,275)
Other operating expenses paid	-	(91)
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>	<b>700,377</b>	<b>271,425</b>
<i>Net (increase)/decrease in operating assets</i>		
Loans and advances to customers	(1,225,511)	(3,148,775)
Net cash outflows from other assets and other liabilities	(180,754)	(144,851)
<b>Net cash flow used in operating activities before income tax</b>	<b>(705,888)</b>	<b>(3,022,201)</b>
Income tax paid	(42,394)	(6,015)
<b>Net cash used in operating activities</b>	<b>(748,282)</b>	<b>(3,028,216)</b>
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	(137,269)	(80,317)
<b>Net cash used in investing activities</b>	<b>(137,269)</b>	<b>(80,317)</b>
<b>Cash flow from financing activities</b>		
Proceeds from issue of share capital	-	200,000
Loans received from shareholder	1,360,000	3,150,000
Dividends paid to shareholders	(19,460)	-
<b>Net cash flow from financing activities</b>	<b>1,340,540</b>	<b>3,350,000</b>
<b>Net increase in cash and cash equivalents</b>	<b>454,989</b>	<b>241,467</b>
Cash and cash equivalents at the beginning of the year	241,467	-
<b>Cash and cash equivalents at the end of the year (Note 13)</b>	<b>696,456</b>	<b>241,467</b>

# Accompanying notes to the financial statements

## 1 Principal activities

Aregak Universal Credit Organization CJSC (the “Organization”) is a closed joint-stock company, which was incorporated in the Republic of Armenia in 2006. The Organization is regulated by the legislation of RA and conducts its business under license number 11, granted on 28 March 2006 by the Central Bank of Armenia (the “CBA”) and has started its activities on 1 May 2006.

The Organization is involved in microfinance and provides solidarity group-based micro credits, individual business and consumption loans and modified version of the group micro-loan, as well as other loans for the purchase of agricultural equipment in Armenia and Nagorno Karabakh. AREGAK UCO, headquarters in Yerevan, has 24 branches and 3 representative offices located throughout the twelve regions of Armenia and Nagorno Karabakh.

The registered office of the Organization is located at: 42/1 Arami str., Yerevan, Armenia, 0010.

## 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. Consequently, operations carried out in Armenia involve certain risks that are not typically associated with those in developed countries.

The Organization could be affected, for the foreseeable future, by these risks and their consequences. The accompanying financial statements do not include any adjustments that may result from the future clarification of these uncertainties. Such adjustments, if any, will be reported in the Organization’s financial statements in the period when they become known and estimable.

In addition, economic conditions continue to limit the volume of activity in the financial markets. Market quotations in generally illiquid markets may not be reflective of the values for financial instruments, which would be determined in an efficient, active market involving many willing buyers and willing sellers.

## 3 Basis of preparation

### 3.1 Statement of compliance

The financial statements of the Organization 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”). As 2006 is the first year of operations of the Organization, comparative information and financial statements include the results of the Organization’s financial performance and cash flow for the eight month period ended 31.12.06.

### 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.

### 3.3 Functional and presentation currency

Functional currency of the Organization is the currency of the primary economic environment in which the Organization operates. The Organization's functional currency and the Organization's presentation currency is Armenian Drams ("AMD"), since this currency best reflects the economic substance of the underlying events and transactions of the Organization. The Organization prepares statements for regulatory purposes in accordance with legislative requirements and Accounting Standards of the Republic of Armenia. These financial statements are based on the Organization's books and records as adjusted and reclassified in order to comply with IFRS. The financial statements are presented in thousands of AMD, which is not convertible outside Armenia.

### 3.4 Reclassifications

Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year.

### 3.5 New standards and interpretations

Certain new IFRSs became effective for the Organization from 1 January 2007. Listed below are those new or amended standards or interpretations which are or in the future could be relevant to the Organization's operations and the nature of their impact on the Organization's accounting policies.

#### ***IFRS 7, Financial Instruments: Disclosures and a complementary Amendment to IAS 1 Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007).***

The IFRS 7 introduced new disclosures to improve the information about financial instruments, including about quantitative aspects of risk exposures and the methods of risk management. The new quantitative disclosures provide information about the extent of exposure to risk, based on information provided internally to the entity's key management personnel. Qualitative and quantitative disclosures cover exposure to credit risk, liquidity risk and market risk including sensitivity analysis to market risk. IFRS 7 replaced IAS 30, Disclosures in the Financial Statements of Organizations and Similar Financial Institutions, and some of the requirements in IAS 32, Financial Instruments: Disclosure and Presentation. The Amendment to IAS 1 introduced disclosures about the level of an entity's capital and how it manages capital. The adoption of IFRS 7 and the amendment to IAS 1 had no impact on the reported profits or financial position of the Organization. The new disclosures are made in these financial statements and in accordance with the transitional requirements of the standards, the Organization has provided full comparative information.

***Other new standards or interpretations.*** The Organization has adopted the following other new standards or interpretations:

- IFRIC 7, *Applying the Restatement Approach under IAS 29* (effective for periods beginning on or after 1 March 2006);
- IFRIC 8, *Scope of IFRS 2* (effective for periods beginning on or after 1 May 2006);
- IFRIC 9, *Reassessment of Embedded Derivatives* (effective for annual periods beginning on or after 1 June 2006);
- IFRIC 10, *Interim Financial Reporting and Impairment* (effective for annual periods beginning on or after 1 November 2006).

The effect of these changes on the financial statements of the Organization is not significant.

At the date of authorization of these financial statements, the following Standards and Interpretations to the Organization were issued but not yet effective:

- IFRIC 12 *Service Concession Arrangement* (effective January 1, 2008)
- IFRIC 13 *Customer Loyalty Programmes* (effective July 1,2008)
- IFRIC 14 *IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (effective January 1,2008)
- IAS 23 *Borrowing Costs (revised 2007)* (effective January 1,2009)
- IFRS 8 *Operating Segments* (effective January 1,2009)

#### **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 Organization 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 Organization 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 income statement using the effective interest method.

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

###### ***Fee and commission income and expense***

Loan origination fees for loans issued to customers are deferred (together with related direct costs) and recognised as an adjustment to the effective yield of the loans. Fees, commissions and other income and expense items are generally recorded on an accrual basis when the service has been provided. Portfolio and other management advisory and service fees are recorded based on the applicable service contracts.

##### **4.2 Taxation**

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

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a

transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

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

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

The Republic of Armenia also has various operating taxes, which are assessed on the Organization's activities. These taxes are included as a component of other expenses in the statement of income.

#### **4.3 Cash and cash equivalents**

Cash and cash equivalents comprise cash on hand and amounts due from 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.

#### **4.4 Financial instruments**

The Organization 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 fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

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

The Organization classified its financial assets into the following categories: loans and receivables, financial instruments at fair value through profit or loss, available-for-sale financial instruments and held-to-maturity investments. The classification of investments between the categories is determined at acquisition based on the guidelines established by the management. The Organization determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end.

##### ***Loans and receivables***

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

Loans granted by the Organization 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 income statement 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.

#### 4.5 Impairment of financial assets

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

##### *Assets carried at amortised 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 Organization 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 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 Organization 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 Organization'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 Organization 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 Organization. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If future write-off is later recovered, the recovery is credited to the allowance account.

#### ***Renegotiated loans***

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

## **4.6 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 Organization 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 Organization 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 Organization 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 Organization'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 Organization 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 Organization's continuing involvement is the amount of the transferred asset that the Organization 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 Organization'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 income.

### **4.7 Leases**

#### **Operating - Organization as lessee**

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

### **4.8 Property, plant and equipment**

Property, plant and equipment ("PPE") are recorded at historical cost less accumulated depreciation. If the recoverable value of PPE is lower than its carrying amount, due to circumstances not considered to be temporary, the respective asset is written down to its recoverable value.

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

	<b>Useful life (years)</b>	<b>Rate (%)</b>
Buildings	20	5
Office equipment	5	20
Computers	3	33
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 not depreciated.

Repairs and maintenance are charged to the income statement during the period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits in excess of the originally assessed standard of performance

of the existing asset will flow to the Organization. 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.

#### **4.9 Intangible assets**

Intangible assets include computer software.

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 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.

#### **4.10 Borrowings**

Borrowings, which include amounts due to shareholder 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 income when the liabilities are derecognised as well as through the amortisation process.

#### **4.11 Pensions**

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

#### **4.12 Provisions**

Provisions are recognised when the Organization 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.

#### **4.13 Share capital**

##### ***Share capital***

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

### *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.

#### **4.14 Offsetting**

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

## **5 Critical accounting estimates and judgements**

The preparation of 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:

### *Related party transactions*

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

### *Allowance for impairment of loans and receivables*

The Organization reviews its problem loans and advances at each reporting date to assess whether an allowance for impairment should be recorded in the income statement. 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 Organization 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 22.

## 6 Interest and similar income and expense

In thousand Armenian drams	2007	8 months ended 31 December 2006
Loans and advances to customers	1,435,984	352,574
Amounts due from other financial institutions	6,530	965
Interest accrued on impaired financial assets	89	-
<b>Total interest and similar income</b>	<b>1,442,603</b>	<b>353,539</b>

In thousand Armenian drams	2007	8 months ended 31 December 2006
Borrowings	232,056	63,955
<b>Total interest and similar expense</b>	<b>232,056</b>	<b>63,955</b>

## 7 Fee and commission income and expense

In thousand Armenian drams	2007	8 months ended 31 December 2006
Portfolio service commission fees	44,130	348,924
Other fees and commissions	-	1,796
<b>Total fee and commission income</b>	<b>44,130</b>	<b>350,720</b>

In thousand Armenian drams	2007	8 months ended 31 December 2006
Bank service fees	14,733	9,935
<b>Total fee and commission expense</b>	<b>14,733</b>	<b>9,935</b>

## 8 Other income

In thousand Armenian drams	2007	8 months ended 31 December 2006
Fines and penalties received	104,851	6,421
Other income	1,875	305
<b>Total other income</b>	<b>106,726</b>	<b>6,726</b>

## 9 Impairment charge for credit losses

In thousand Armenian drams	2007	8 months ended 31 December 2006
Loans and advances to customers (Note 15)	30,087	33,319
<b>Total impairment charge/reversal of impairment for credit losses</b>	<b>30,087</b>	<b>33,319</b>

## 10 Staff costs

In thousand Armenian drams	2007	8 months ended 31 December 2006
Wages and salaries	577,954	352,800
Social security contributions	63,494	35,952
<b>Total staff costs</b>	<b>641,448</b>	<b>388,752</b>

## 11 Other expenses

In thousand Armenian drams	2007	8 months ended 31 December 2006
Fixed assets maintenance	83,580	36,661
Advertising costs and representative expenses	9,552	7,183
Business trip expenses	17,205	6,407
Communications	35,178	9,363
Operating lease	56,443	26,709
Taxes, other than income tax, duties	39,779	21,118
Consulting and other services	16,915	8,398
Security	42,705	18,392
Office supplies	13,207	5,020
Penalties paid	1,298	-
Other expenses	16,330	9,984
<b>Total other expense</b>	<b>332,192</b>	<b>149,235</b>

## 12 Income tax expense

In thousand Armenian drams	2007	8 months ended 31 December 2006
Current tax expense	94,549	27,520
Deferred tax	3,492	(3,601)
<b>Total income tax expense</b>	<b>98,041</b>	<b>23,919</b>

The corporate income tax within the Republic of Armenia is levied at the rate of 20% (2006: 20%). Differences between IFRS and RA statutory tax regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profit tax purposes. Deferred income tax is calculated using the principal tax rate of 20%.

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

In thousand Armenian drams	2007	Effective rate (%)	2006	Effective rate (%)
<b>Profit before tax</b>	<b>322,034</b>		64,338	
Income tax at the rate of 20%	<b>64,407</b>	<b>20</b>	12,868	20
Non-deductible expenses	<b>33,634</b>	<b>10</b>	11,051	17
<b>Income tax expense</b>	<b>98,041</b>	<b>30</b>	23,919	37

Deferred tax calculation in respect of temporary differences:

In thousand Armenian drams	2006	Recognized in income statement	2007
Accrued expenses and other liabilities	<b>4,138</b>	<b>(2,162)</b>	<b>1,976</b>
<b>Total deferred tax assets</b>	<b>4,138</b>	<b>(2,162)</b>	<b>1,976</b>
Allowances for impairment of other losses	<b>(537)</b>	<b>(871)</b>	<b>(1,408)</b>
Accrued interest on loans	-	<b>(459)</b>	<b>(459)</b>
<b>Total deferred tax liability</b>	<b>(537)</b>	<b>(1,330)</b>	<b>(1,867)</b>
<b>Net deferred tax asset</b>	<b>3,601</b>	<b>(3,492)</b>	<b>109</b>

In thousand Armenian drams	2005	Recognized in income statement	2006
Accrued expenses and other liabilities	-	4,138	4,138
<b>Total deferred tax assets</b>	-	4,138	4,138
Allowances for impairment of other assets	-	(537)	(537)
<b>Total deferred tax liability</b>	-	(537)	(537)
<b>Net deferred tax asset</b>	-	3,601	3,601

### 13 Cash and cash equivalents

In thousand Armenian drams	2007	2006
Cash on hand	9,544	3,570
<b>Included in cash on hand</b>	<b>9,544</b>	<b>3,570</b>
Placements with banks (Note 14)	686,912	237,897
<b>Total cash and cash equivalents</b>	<b>696,456</b>	<b>241,467</b>

### 14 Amounts due from other financial institutions

In thousand Armenian drams	2007	2006
Correspondent accounts with financial institutions	175,436	237,897
Deposits for less than 90 days	511,476	-
<b>Included in cash and cash equivalents</b>	<b>686,912</b>	<b>237,897</b>
<b>Total amounts due from other financial institutions</b>	<b>686,912</b>	<b>237,897</b>

### 15 Loans and advances to customers

In thousand Armenian drams	2007	2006
Loans to customers	4,417,893	3,182,167
Less allowance for loan impairment	(63,406)	(33,319)
<b>Total loans and advances to customers</b>	<b>4,354,487</b>	<b>3,148,848</b>

The loans to customers represent small loans to individuals involved in developing agriculture. The maximum limit of loans granted to an individual amounts to AMD 10,000 thousand.

Due to the small amount of individual loans there is no credit risk concentration.

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

In thousand Armenian drams	Privately held companies	Individuals	Sole proprietors	2007 Total
At 1 January 2007	121	33,153	45	33,319
Charge for the year	4,122	24,927	1,038	30,087
At 31 December 2007	<u>4,243</u>	<u>58,080</u>	<u>1,083</u>	<u>63,406</u>
Individual impairment	1,130	-	-	1,130
Collective impairment	3,113	58,080	1,083	62,276
	<u>4,243</u>	<u>58,080</u>	<u>1,083</u>	<u>63,406</u>
Gross amount of loans individually determined to be impaired, before deducting any individually assessed impairment allowance	<u>4,050</u>	-	-	<u>4,050</u>

In thousand Armenian drams	Privately held companies	Individuals	Sole proprietors	2006 Total
At 1 May 2006	-	-	-	-
Charge for the year	121	33,153	45	33,319
At 31 December 2006	<u>121</u>	<u>33,153</u>	<u>45</u>	<u>33,319</u>
Collective impairment	121	33,153	45	33,319

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

In thousand Armenian drams	2007	2006
Privately held companies	61,644	12,055
Individuals	4,205,238	3,134,744
Sole proprietors	107,795	1,977
Accrued interest	43,216	33,391
	<u>4,417,893</u>	<u>3,182,167</u>
Less allowance for loan impairment	(63,406)	(33,319)
<b>Total loans and advances to customers</b>	<u><b>4,354,487</b></u>	<u><b>3,148,848</b></u>

At 31 December 2007 and 2006 the estimated fair value of loans and advances to customers approximates its carrying value. Refer to Note 24.

Credit, liquidity and interest rate analyses of loans and advances to customers are disclosed in Note 26. The information on related party balances is disclosed in Note 23.

## 16 Property, plant and equipment

In thousand Armenian drams	Buildings	Leasehold improve ments	Communic ation devices & computers	Vehicles	Office equipment	Other PPE	Total
<b>COST</b>							
Cost at May 1, 2006	-	-	-	-	-	-	-
Additions	-	2,210	14,565	41,301	13,546	3,047	74,669
At December 31, 2006	-	2,210	14,565	41,301	13,546	3,047	74,669
Additions	7,884	-	32,907	57,106	30,055	2,901	130,853
<b>At December 31, 2007</b>	<b>7,884</b>	<b>2,210</b>	<b>47,472</b>	<b>98,407</b>	<b>43,601</b>	<b>5,948</b>	<b>205,522</b>
<b>DEPRECIATION</b>							
At May 1, 2006	-	-	-	-	-	-	-
Depreciation charge	-	16	236	207	888	96	1,443
At December 31, 2006	-	16	236	207	888	96	1,443
Depreciation charge	255	111	6,206	8,537	3,891	999	19,999
<b>At December 31, 2007</b>	<b>255</b>	<b>127</b>	<b>6,442</b>	<b>8,744</b>	<b>4,779</b>	<b>1,095</b>	<b>21,442</b>
<b>CARRYING VALUE</b>							
<b>At December 31, 2007</b>	<b>7,629</b>	<b>2,083</b>	<b>41,030</b>	<b>89,663</b>	<b>38,822</b>	<b>4,853</b>	<b>184,080</b>
At December 31, 2006	-	2,194	14,329	41,094	12,658	2,951	73,226

### *Fixed assets in the phase of installation*

As at 31 December 2007 fixed assets included assets in the phase of installation in amount of AMD 15,178 thousand (2006: AMD 8,535 thousand), which are not amortized and are classified in accordance with their type.

## 17 Intangible assets

In thousand Armenian drams	Acquired software
<b>COST</b>	
At May 1, 2006	-
Additions	5,648
At December 31, 2006	5,648
Additions	6,416
<b>At December 31, 2007</b>	<b>12,064</b>
<b>AMORTISATION</b>	
At May 1, 2006	-
Amortisation charge	8
At December 31, 2006	8
Amortisation charge	910
<b>At December 31, 2007</b>	<b>918</b>
<b>CARRYING VALUE</b>	
<b>At December 31, 2007</b>	<b>11,146</b>
At December 31, 2006	5,640

*Intangible assets in the phase of installation*

As at 31 December 2006 intangible assets included assets in the phase of installation in amount of AMD 5,417 thousand, which are not amortized.

**18 Other assets**

In thousand Armenian drams	2007	2006
Prepayments and other debtors	812	3,817
Settlements with employees	192	571
Receivable from UMCOR	-	24,968
Other assets	17,683	1,004
Other accounts receivable	565	169
	<u>19,252</u>	<u>30,529</u>
Materials	10,939	13,919
Other	705	416
<b>Total other assets</b>	<b><u>30,896</u></b>	<b><u>44,864</u></b>

**19 Borrowings**

In thousand Armenian drams	2007	2006
Loans	3,940,290	2,683,197
<b>Total borrowings</b>	<b><u>3,940,290</u></b>	<b><u>2,683,197</u></b>

Borrowings represent a loan received on May 1, 2006 from the sole shareholder in the amount of AMD 3,150,000 thousand. The loan has been provided at below market rates, specifically at 2% p.a. for the years 2006 and 2007 and at 4.35% p.a. for the years 2008-2011. The gain of AMD 530,758 thousand resulting from presenting the loan at fair value, calculated at 6% p.a., is included in equity as a fair value reserve. The unwinding of the gain in the year 2007 has resulted in interest expense of AMD 96,529 thousand (2006: 39,567).

During 2007 the Loan Agreement was amended to provide to the Organization additional loan in the amount of AMD 1,360,000 thousand on the same terms. The gain of AMD 270,270 thousand resulting from presenting the loan at fair value, calculated at 8% p.a., is included in equity as a fair value reserve. The unwinding of the gain in the year 2007 has resulted in interest expense of AMD 49,504 thousand (2006: nil).

Information on related party balances is disclosed in Note 23.

The Organization has not had any defaults of principal, interest or other breaches with respect to its liabilities during the period (2006: nil).

## 20 Other liabilities

In thousand Armenian drams	2007	2006
Accounts payables	9,852	13,140
Tax payable, other than income tax	798	7,854
Due to personnel	6,459	20,690
Other	135	83
<b>Total other liabilities</b>	<b>17,244</b>	<b>41,767</b>

## 21 Equity

As at 31 December 2007 the Organization's registered and paid-in share capital was AMD 200,000 thousand. In accordance with the Organization's statutes, the share capital consists of 1,000 ordinary shares, all of which have a par value of AMD 200 thousand each.

The sole shareholder of the Organization is the United Methodist Committee on Relief.

As at 31 December 2007, the Organization did not possess any of its own shares.

The share capital of the Organization 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 risks, including future losses and other unforeseen risks or contingencies. The reserve has been created in accordance with the Organization's statutes that provide for the creation of a reserve for these purposes of 15% of the Organization's share capital reported in statutory books.

## 22 Contingent liabilities and commitments

### *Tax and legal matters*

The taxation system in Armenia is characterized by frequently changing legislation, which is often unclear, contradictory and subject to interpretation. Often, differing interpretations exist among various taxation authorities and jurisdictions.

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

As of 31 December 2007 there were no legal actions and complaints taken against the Organization.

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

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

In the normal course of business the Organization enters into commercial lease agreements for office buildings and premises.

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

In thousand Armenian drams	2007	2006
Not later than 1 year	50,481	49,609
Later than 1 year and not later than 5 years	36,921	80,995
Later than 5 years	-	32
<b>Total operating lease commitments</b>	<b>87,402</b>	<b>130,636</b>

### 23 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 Organization's Management as well as other persons and enterprises related with and controlled by them respectively.

The Organization's only shareholder and its ultimate controlling party is United Methodologist Committee on Relief.

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

	2007	2006
<b><i>Borrowings</i></b>		
At the beginning of the period	2,683,197	-
Borrowings received during the year	1,257,093	2,683,197
<b>At December 31</b>	<b>3,940,290</b>	<b>2,683,197</b>
Interest expense on loans	232,056	63,954
<b><i>Accounts receivables</i></b>	-	24,968
<b><i>Income statement items</i></b>		
Fee and commission income	44,130	348,924
Other expenses	-	856

Borrowings represent the loan received from the sole shareholder. See Note 19 for more details.

Fee and commission income represents income from managing loan portfolio of UMCOR.

Accounts receivables represent commission receivable for managing loan portfolio of UMCOR.

Compensation of key management personnel was comprised of the following:

In thousand Armenian drams	2007	8 months ended 31 December 2006
Salaries and other short-term benefits	71,562	41,006
Social security costs	4,750	2,812
<b>Total key management compensation</b>	<b>76,312</b>	<b>43,818</b>

## 24 Fair value of financial instruments

### *Financial instruments not measured at fair value*

The fair value of financial assets and liabilities, not presented on the Organization's balance sheet at their fair value, does not differ significantly from their carrying values.

### *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.

### *Borrowings*

The estimated fair value of borrowings not quoted in an active market is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

## 25 Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities analyzed according to when they are expected to be recovered or settled. See Note 26.3 for the Organization's contractual undiscounted repayment obligations.

In thousand Armenian drams						2007
	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	Total
<b>ASSETS</b>						
Cash on hand	9,544	-	-	9,544	-	9,544
Amounts due from other financial institutions	686,912	-	-	686,912	-	686,912
Loans and advances to customers	11,983	286,751	3,628,427	3,927,161	427,326	4,354,487
	<u>708,439</u>	<u>286,751</u>	<u>3,628,427</u>	<u>4,623,617</u>	<u>427,326</u>	<u>5,050,943</u>
<b>LIABILITIES</b>						
Borrowings	-	-	-	-	3,940,290	3,940,290
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,940,290</u>	<u>3,940,290</u>
<b>Net position</b>	<u>708,439</u>	<u>286,751</u>	<u>3,628,427</u>	<u>4,623,617</u>	<u>(3,512,964)</u>	<u>1,110,563</u>
<b>Accumulated gap</b>	<u>708,439</u>	<u>995,190</u>	<u>4,623,617</u>		<u>1,110,653</u>	

In thousand Armenian drams							2006
	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	Total	
<b>ASSETS</b>							
Cash on hand	3,570	-	-	3,570	-	3,570	
Amounts due from other financial institutions	237,897	-	-	237,897	-	237,897	
Loans and advances to customers	982	37,568	3,055,170	3,093,720	55,128	3,148,848	
	<u>242,449</u>	<u>37,568</u>	<u>3,055,170</u>	<u>3,335,187</u>	<u>55,128</u>	<u>3,390,315</u>	
<b>LIABILITIES</b>							
Borrowings	-	-	24,388	24,388	2,658,809	2,683,197	
	<u>-</u>	<u>-</u>	<u>24,388</u>	<u>24,388</u>	<u>2,658,809</u>	<u>2,683,197</u>	
<b>Net position</b>	<u>242,449</u>	<u>37,568</u>	<u>3,030,782</u>	<u>3,310,799</u>	<u>(2,603,681)</u>	<u>707,118</u>	
<b>Accumulated gap</b>	<u>242,449</u>	<u>280,017</u>	<u>3,310,799</u>		<u>707,118</u>		

## 26 Risk management

The Organization's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business. The Organization's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Organization's financial performance.

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

Risk management is carried out by a Risk Management and Financial Analysis Unit under policies approved by the Shareholder. The Risk Management Financial Analysis Unit identifies, evaluates and hedges financial risks in close co-operation with the Organization's operating units. The Shareholder approves written principles for overall risk management, as well as written policies covering specific areas. In addition, internal audit is responsible for the independent review of risk management and the control environment. The most important types of risk are credit risk, liquidity risk, market risk and other operational risk. Market risk includes currency risk, interest rate and other price risk.

### 26.1 Credit risk

The Organization takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Organization by failing to discharge an obligation. Credit risk is the most important risk for the Organization'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 Organization's asset portfolio. The credit risk management and control are centralised in credit risk management team of Organization's Credit Unit and reported to the Executive Administration of the Organization and head of each business unit regularly.

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

The table below represents a worst case scenario of credit risk exposure to the Organization at 31 December 2007 and 2006, without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the balance sheet.

In thousand Armenian drams	Notes	Gross maximum exposure as of December 31, 2007	Gross maximum exposure as of December 31, 2006
Cash on hand		9,544	3,570
Amounts due from other financial institutions	14	686,912	237,897
Loans and advances to customers	15	4,354,487	3,148,848
<b>Total credit risk exposure</b>		<b>5,050,943</b>	<b>3,390,315</b>

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

#### *Geographical sectors*

All of the Organization's assets are located in Armenia.

#### *Industry sectors*

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

In thousand Armenian drams	Financial institutions	Manufacturing	Agriculture	Construction	Trade	Other	Total
Cash on hand	9,544	-	-	-	-	-	9,544
Amounts due from other financial institutions	686,912	-	-	-	-	-	686,912
Loans and advances to customers	-	79,041	1,894,694	9,185	1,799,275	572,292	4,354,487
<b>As at 31 December 2007</b>	<b>696,456</b>	<b>79,041</b>	<b>1,894,694</b>	<b>9,185</b>	<b>1,799,275</b>	<b>572,292</b>	<b>5,050,943</b>
As at 31 December 2006	241,467	7,102	295,418	10,241	2,199,888	636,199	3,390,315

### 26.1.3 Risk limit control and mitigation policies

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

The Organization 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. 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 borrower and product are approved by the Credit Committee or Executive Body.

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 Organization 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 Organization implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation.

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

In thousand Armenian drams	2007	2006
Loans collateralized by real estate	416,648	37,002
Loans collateralized by movable property	4,510	6,618
Loans collateralized by group guarantees	3,996,735	3,138,547
<b>Total loans and advances to customers (gross)</b>	<b>4,417,893</b>	<b>3,182,167</b>

#### **26.1.4 Impairment and provisioning policies**

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

##### *Individually assessed allowances*

The Organization 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 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.

***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	2007	2006
Loans and advances to customers		
Privately held companies	5%	1%
Individuals	1%	1%
Sole proprietors	1%	2%

***Past due but not impaired loans***

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

In thousand Armenian drams					2007
	Less than 30 days	31 to 60 days	61 to 90 days	More than 91 days	Total
Loans and advances to customers					
Privately held companies	-	-	-	1,884	1,884
Individuals	26,348	6,497	2,085	9,839	44,769
<b>Total</b>	<b>26,348</b>	<b>6,497</b>	<b>2,085</b>	<b>11,723</b>	<b>46,653</b>

In thousand Armenian drams					2006
	Less than 30 days	31 to 60 days	61 to 90 days	More than 91 days	Total
Loans and advances to customers					
Individuals	10,795	2,769	461	365	14,390
<b>Total</b>	<b>10,795</b>	<b>2,769</b>	<b>461</b>	<b>365</b>	<b>14,390</b>

The fair value of collateral that the Organization holds relating to past due loans at 31 December 2007 amounts to AMD 345,077 thousand (2006: AMD 90,882 thousand). The collateral consists of group guarantees and real estate.

***Loans and advances individually impaired***

The total gross amount of individually impaired loans and advances to customers before taking into consideration the cash flows from collateral held is AMD 4,050 thousand. Refer to Note 15. The fair value of collateral that the Organization holds relating to loans individually determined to be impaired at 31 December 2007 amounts to AMD 2,238 thousand. The collateral consists of equipment and furniture.

## 26.2 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. All assets and liabilities of the Organization are denominated in AMD and the Organization is not subject to currency risk.

### *Interest rate risk*

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Organization does not have floating rate financial instruments and it does not have fixed rate available-for-sale financial assets the fair value of which would be affected by the changes in interest rates.

## 26.3 Liquidity risk

Liquidity risk is the risk that the Organization 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, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily bases.

The liquidity management of the Organization 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.

The table below summarises the maturity profile of the Organization's financial liabilities at 31 December 2007 based on contractual undiscounted repayment obligations. See note 25 for the expected maturities of these liabilities.

In thousand Armenian drams						2007
	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years		Total
<b>FINANCIAL LIABILITIES</b>						
Borrowings	-	-	-	3,940,290		3,940,290
<b>Total undiscounted financial liabilities</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,940,290</u>		<u>3,940,290</u>

In thousand Armenian drams						2006
	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years		Total
<b>FINANCIAL LIABILITIES</b>						
Borrowings	-	-	24,388	2,658,809		2,683,197
<b>Total undiscounted financial liabilities</b>	<u>-</u>	<u>-</u>	<u>24,388</u>	<u>2,658,809</u>		<u>2,683,197</u>

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

## **27 Capital adequacy**

The Organization maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Organization'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 Organization.

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

The Organization 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 Organization may adjust the amount of dividend payment to shareholder, return capital to shareholder or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Central Bank of Armenia requires minimal total capital of AMD 150,000 thousand.

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

## **28 Subsequent events**

On 31 March 2008 the Organization has increased its share capital to AMD 622,000 thousand, consisting of 3,110 shares, AMD 200 thousand each.



**Grant Thornton**

[www.gta.am](http://www.gta.am)