

**CLOSED JOINT STOCK  
COMPANY  
UNIVERSAL CREDIT  
ORGANIZATION "FINCA"**

**Financial Statements**  
For the Year Ended December 31, 2012

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**CLOSED JOINT-STOCK COMPANY UNIVERSAL CREDIT  
ORGANIZATION "FINCA"**

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**CLOSED JOINT-STOCK COMPANY UNIVERSAL CREDIT ORGANIZATION "FINCA"**

**STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2012**

Management is responsible for the preparation of the financial statements that present fairly the financial position of Closed Joint Stock Company Universal Credit Organization "FINCA" (the "Company") as at December 31, 2012, the results of its operations, cash flows and changes in shareholders' equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

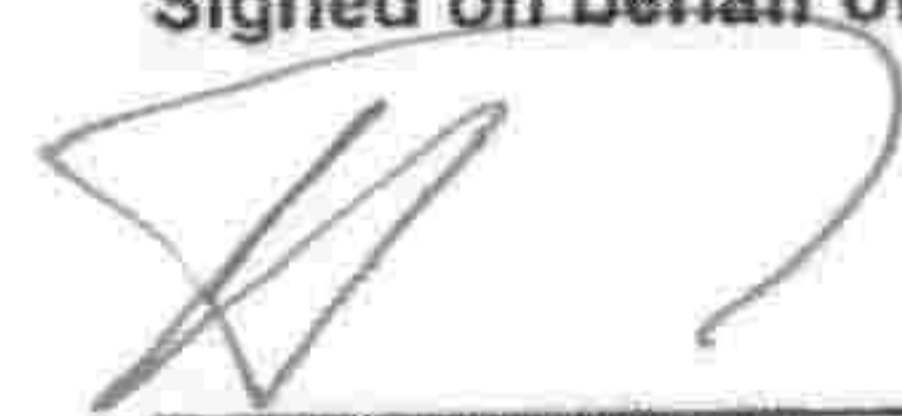
- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance; and
- Making an assessment of the Company's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Company;
- Maintaining adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company, and which enable them to ensure that the financial statements of the Company comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Armenia;
- Taking such steps that are reasonably available to them to safeguard the assets of the Company; and
- Preventing and detecting fraud and other irregularities.

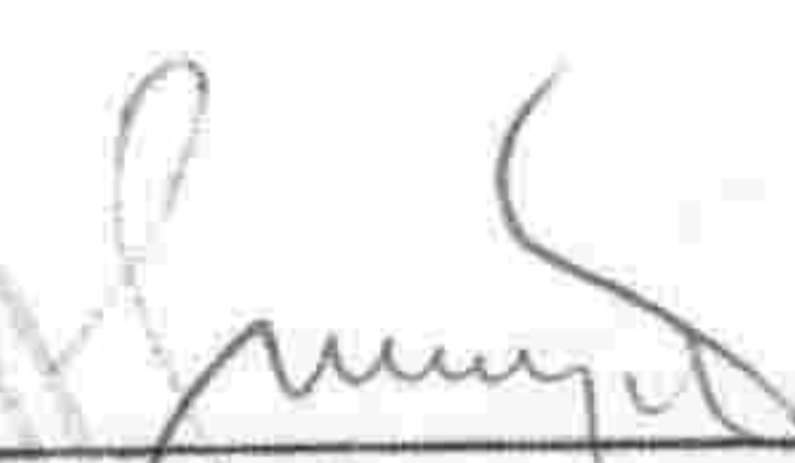
The financial statements for the year ended December 31, 2012 were authorized for issue on March 15, 2013.

Signed on behalf of the management of the Company:



General Director  
Y. Barseghyan

March 15, 2013  
Yerevan, Republic of Armenia



Chief Accountant  
A. Khachatryan

March 15, 2013  
Yerevan, Republic of Armenia

The notes on pages 8-50 form an integral part of these financial statements.





CJSC "Deloitte Armenia"

4/6 Amiryán street  
Yerevan, 0010, Armenia

Tel: +37410526520  
Fax: +37410527520

## INDEPENDENT AUDITORS' REPORT

To the Shareholders and the Board of Directors of Closed Joint-Stock Company Universal Credit Organization "FINCA":

### Report on the financial statements

We have audited the accompanying financial statements of Closed Joint-Stock Company Universal Credit Organization "FINCA" (the "Company"), which comprise the statement of financial position as at December 31, 2012, and the statement of profit or loss, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

### Management's responsibility for the financial statements

Management of the Company is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards 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.

### Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company'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 present fairly, in all material respects, the financial position of the Company as at December 31, 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

**Emphasis of matter**

We draw attention to Note 4 to the financial statements which describes the restatement of corresponding figures in the statement of financial position and the statement of cash flows as at December 31, 2011 and for the year then ended. Our opinion is not qualified in respect of this matter.

**Other matters**

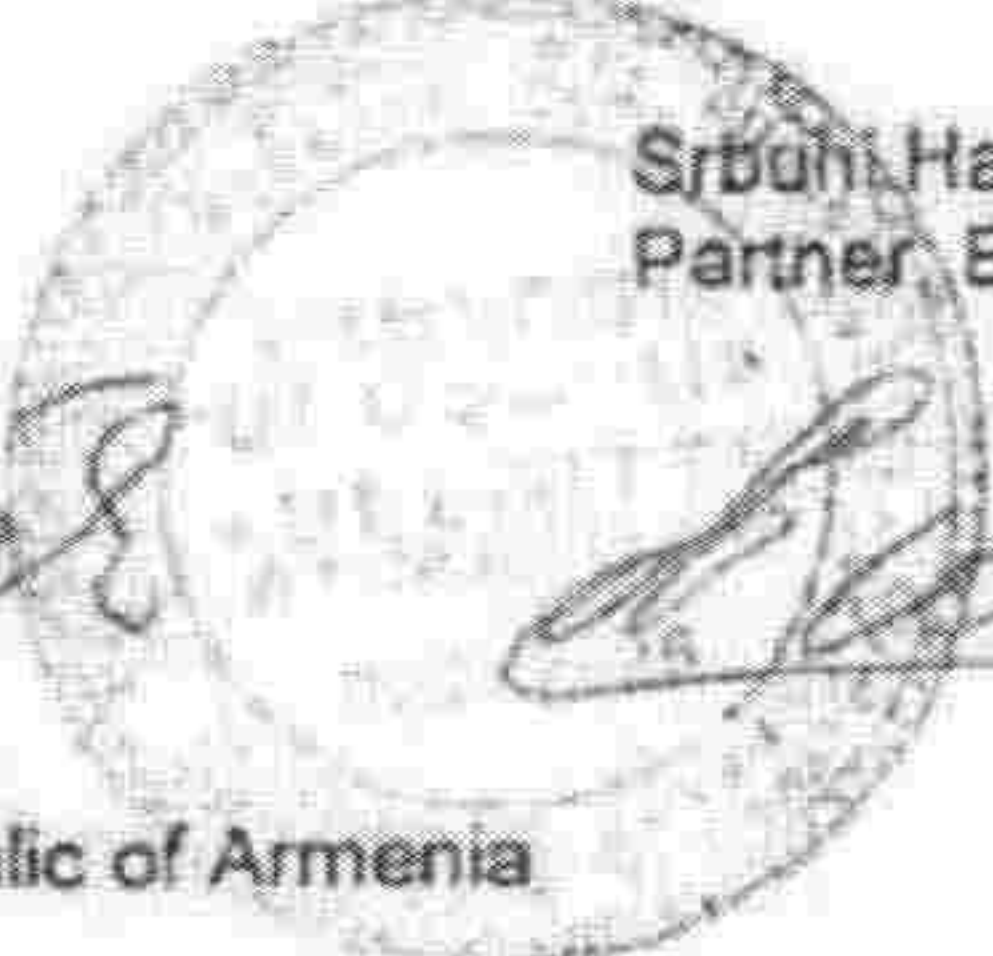
The financial statements of Closed Joint Stock Company Universal Credit Organization "FINCA" for the year ended December 31, 2011 were audited by another auditor who expressed an unmodified opinion on those statements on March 23, 2012.

As part of our audit of the 2012 financial statements, we also audited the adjustments described in Note 4 that were applied to amend the 2011 corresponding figures. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2011 financial statements of the Company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2011 financial statements taken as a whole.

*Deloitte Armenia CJSC*

Ara Kurazyan  
Audit Manager

Srbuhi Hakobyan  
Partner, Executive Director

*A. Kurazyan*  *Srbuhi Hakobyan*

March 15, 2013  
Yerevan, Republic of Armenia

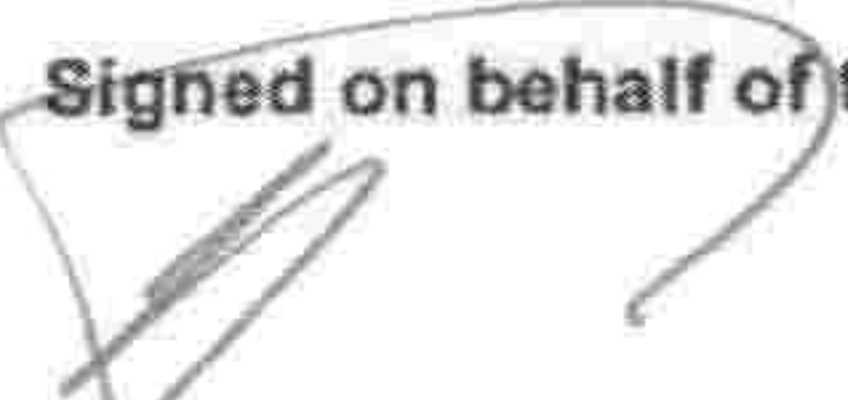


**CLOSED JOINT-STOCK COMPANY UNIVERSAL CREDIT ORGANIZATION "FINCA"**


**STATEMENT OF PROFIT OR LOSS  
FOR THE YEAR ENDED DECEMBER 31, 2012  
(in United States Dollars)**

	Notes	Year ended December 31, 2012	Year ended December 31, 2011
Interest income	5	13,674,819	11,302,537
Interest expense	5, 23	<u>(4,207,912)</u>	<u>(3,077,759)</u>
<b>NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST BEARING ASSETS</b>		9,466,907	8,224,778
Provision for impairment losses on interest bearing assets	6	<u>(41,860)</u>	<u>(37,901)</u>
<b>NET INTEREST INCOME</b>		<u>9,425,047</u>	<u>8,186,877</u>
Net (loss)/gain on financial assets and liabilities at fair value through profit or loss	12	(9,717)	10,121
Net gain on foreign exchange operations	7	21,395	9,617
Fee and commission expense		<u>(27,762)</u>	<u>(33,583)</u>
Other income		<u>17,857</u>	<u>305,854</u>
<b>NET NON-INTEREST INCOME</b>		<u>1,773</u>	<u>292,009</u>
<b>OPERATING INCOME</b>		9,426,820	8,478,886
Staff costs	8	(4,859,246)	(4,232,976)
Depreciation and amortization	14, 15	(242,295)	(195,701)
Other operating expenses	9, 23	<u>(2,634,597)</u>	<u>(1,944,385)</u>
Total operating expenses		<u>(7,736,138)</u>	<u>(6,373,062)</u>
<b>PROFIT BEFORE INCOME TAX</b>		1,690,682	2,105,824
Income tax expense	10	<u>(331,924)</u>	<u>(424,781)</u>
<b>NET PROFIT FOR THE PERIOD</b>		<u>1,358,758</u>	<u>1,681,043</u>
Foreign currency translation difference		<u>(204,121)</u>	<u>(409,315)</u>
<b>OTHER COMPREHENSIVE INCOME</b>		<u>(204,121)</u>	<u>(409,315)</u>
<b>TOTAL COMPREHENSIVE INCOME</b>		<u>1,154,637</u>	<u>1,271,728</u>

Signed on behalf of the management of the Company:

  
General Director  
Y. Barseghyan

March 15, 2013  
Yerevan, Republic of Armenia

  
Chief Accountant  
A. Khachatryan

March 15, 2013  
Yerevan, Republic of Armenia

The notes on pages 8-50 form an integral part of these financial statements

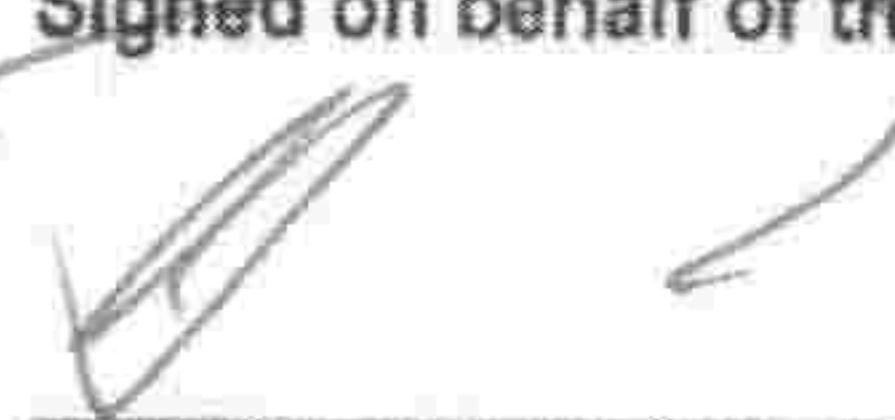


**CLOSED JOINT-STOCK COMPANY UNIVERSAL CREDIT ORGANIZATION "FINCA"**


**STATEMENT OF FINANCIAL POSITION  
AS AT DECEMBER 31, 2012  
(in United States Dollars)**

	Notes	December 31, 2012	December 31, 2011 (As restated, Note 4)	December 31, 2010 (As restated, Note 4)
<b>ASSETS:</b>				
Cash and cash equivalents	11	6,077,913	3,198,437	1,539,515
Financial assets at fair value through profit or loss	12	-	10,121	-
Loans to customers	13	43,854,619	35,278,329	25,359,619
Property, plant and equipment	14	1,035,312	713,847	614,983
Current income tax assets		1,048	-	164,392
Deferred income tax assets	10	7,904	23,172	-
Intangible assets	15	236,875	151,685	-
Other assets	16	505,218	125,173	90,162
Assets classified held for sale		12,862	13,456	-
<b>TOTAL ASSETS</b>		<b>51,731,751</b>	<b>39,514,220</b>	<b>27,768,671</b>
<b>LIABILITIES AND EQUITY</b>				
<b>LIABILITIES:</b>				
Borrowed funds	17	35,512,696	29,097,314	18,164,828
Current income tax liabilities		-	225,230	94,915
Deferred income tax liabilities		-	-	9,837
Other liabilities	18	737,834	577,958	605,420
Subordinated debt	19	2,533,686	2,531,856	2,528,285
<b>Total liabilities</b>		<b>38,784,216</b>	<b>32,432,358</b>	<b>21,403,285</b>
<b>EQUITY:</b>				
Share capital	20	10,815,575	3,251,918	3,251,918
Foreign currency translation difference		(167,582)	36,539	445,854
Retained earnings	21	2,299,542	3,793,405	2,667,614
<b>Total equity</b>		<b>12,947,535</b>	<b>7,081,862</b>	<b>6,365,386</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>51,731,751</b>	<b>39,514,220</b>	<b>27,768,671</b>

Signed on behalf of the management of the Company:

  
General Director  
Y. Barseghyan

March 15, 2013  
Yerevan, Republic of Armenia

  
Chief Accountant  
A. Khachatryan

March 15, 2013  
Yerevan, Republic of Armenia


The notes on pages 8-50 form an integral part of these financial statements



**CLOSED JOINT-STOCK COMPANY UNIVERSAL CREDIT ORGANIZATION "FINCA"**  
**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED DECEMBER 31, 2012**  
*(in United States Dollars)*

	Notes	Share capital	Foreign currency translation difference	Retained earnings	Total equity
January 1, 2011		3,251,918	445,854	2,667,614	6,365,386
Total comprehensive income for the year	21	-	(409,315)	1,681,043	1,271,728
Dividends declared	20	-	-	(555,252)	(555,252)
<b>December 31, 2011</b>		<b>3,251,918</b>	<b>36,539</b>	<b>3,793,405</b>	<b>7,081,862</b>
Total comprehensive income for the year	21	-	(204,121)	1,358,758	1,154,637
Issue of ordinary shares	20	5,500,000	-	-	5,500,000
Transfer from retained earnings	20	2,063,657	-	(2,063,657)	-
Dividends declared	20	-	-	(788,964)	(788,964)
<b>December 31, 2012</b>		<b>10,815,575</b>	<b>(167,582)</b>	<b>2,299,542</b>	<b>12,947,535</b>

Signed on behalf of the management of the Company:

  
 General Director  
 Y. Barseghyan

March 15, 2013  
 Yerevan, Republic of Armenia

  
 Chief Accountant  
 A. Khachatryan

March 15, 2013  
 Yerevan, Republic of Armenia

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**CLOSED JOINT-STOCK COMPANY UNIVERSAL CREDIT ORGANIZATION "FINCA"**

**STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2012**  
*(in United States Dollars)*

	Notes	Year ended December 31, 2012	Year ended December 31, 2011 (As restated, Note 4)
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net profit for the year		1,358,758	1,681,043
Adjustments for non-cash items:			
Provision for impairment losses on interest bearing assets		41,860	37,901
Loss from disposal of property and equipment and intangible assets		1,864	4,681
Translation differences, net and net (loss)/ gain on financial assets and liabilities at fair value through profit or loss		63,783	(9,065)
Net change in accrued interest		626,560	462,313
Depreciation and amortization		242,295	195,701
Income tax expense recognized in profit and loss		331,924	424,781
Cash inflow from operating activities before changes in operating assets and liabilities		2,667,044	2,797,355
Changes in operating assets and liabilities			
(Increase)/decrease in operating assets:			
Loans to customers		(9,810,222)	(11,271,521)
Other assets		(388,444)	(53,365)
Increase/(decrease) in operating liabilities:			
Other liabilities		156,731	(17,284)
Cash outflow from operating activities before taxation and interest		(7,374,891)	(8,544,815)
Income tax paid		(533,875)	(317,706)
Net cash outflow from operating activities		(7,908,766)	(8,862,521)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Payments for property and equipment		(592,033)	(325,874)
Proceeds on disposal of property and equipment		-	1,332
Payments for intangible assets		(98,975)	(16,081)
Net cash outflow from investing activities		(691,008)	(340,623)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from issue of ordinary shares		5,500,000	-
Dividends paid on ordinary shares		(788,964)	(555,252)
Proceeds from borrowed funds		17,168,248	20,532,976
Repayment of borrowed funds		(10,404,179)	(9,110,206)
Net cash inflow from financing activities		11,475,105	10,867,518
Effect of exchange rate changes on the balance of cash held in foreign currencies		4,145	(5,451)
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>		2,879,476	1,658,923
CASH AND CASH EQUIVALENTS, beginning of period	11	3,198,437	1,539,514
CASH AND CASH EQUIVALENTS, end of period	11	6,077,913	3,198,437

Interest paid and received by the Company during the year ended December 31, 2012 amounted to USD 3,433 thousand and USD 13,527 thousand, respectively.

Interest paid and received by the Company during the year ended December 31, 2011 amounted to USD 2,735 thousand and USD 11,422 thousand, respectively.

Signed on behalf of the management of the Company:

\_\_\_\_\_  
**General Director**  
**Y. Barseghyan**

\_\_\_\_\_  
**Chief Accountant**  
**A. Khachatryan**

March 15, 2013  
 Yerevan, Republic of Armenia

March 15, 2013  
 Yerevan, Republic of Armenia

The notes on pages 8-50 form an integral part of these financial statements



## CLOSED JOINT-STOCK COMPANY UNIVERSAL CREDIT ORGANIZATION "FINCA"

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2012 (in United States Dollars)

#### 1. ORGANIZATION

CJSC Universal Credit Organization "FINCA" (the "Company") is a closed joint stock company - 100% subsidiary of FINCA Microfinance Coöperatief U.A. The Company is regulated by the legislation of Republic of Armenia and conducts its business under license number 13, granted on 28 March 2006 by the Central Bank of Armenia (the CBA).

The Company is involved in microfinance and provides individual business loans, solidarity group-based general and group-based agricultural micro loans. The loans are disbursed both in local and foreign currencies. The Company serves over 54,000 clients and represents one of the largest microfinance organizations throughout the country.

The founder of the Company is FINCA International Inc., a network of microfinance institutions based in Washington, D.C., with affiliates/subsidiaries operating in 21 countries around the world. In 2011 FINCA INTERNATIONAL, INC. transferred 100% of issued shares (136,472 shares) of Closed Joint Stock Company Universal Credit Organization "FINCA" (Armenia) to FINCA Microfinance Coöperatief U.A. (a cooperative with exclusion on liability, having its official seat in Amsterdam, the Netherlands) as a member contribution to the Cooperative.

As of December 31, 2012, the members of the Cooperative were:

1. FINCA MICROFINANCE HOLDING COMPANY LLC, a limited liability company registered under the laws of the State of Delaware, United States of America and having its registered address at 2711 Centerville Road, Suite 400, Wilmington, Delaware 19808, United States of America. FINCA MICROFINANCE HOLDING COMPANY LLC holds 99 voting rights as a Member A and 1 voting right as a Member B of the Cooperative.
2. FINCA INTERNATIONAL LLC, a limited liability company registered under the laws of the State of Maryland, United States of America and having its registered address at 11 East Chase Street, Baltimore, Maryland 21202, United States of America. FINCA INTERNATIONAL LLC holds 1 voting right as a Member B of the Cooperative.

As at December 31, 2012 and 2011 the following shareholders owned FINCA MICROFINANCE HOLDING COMPANY LLC:

	December 31, 2012, %	December 31, 2011, %
<b>First level shareholders/holders of the issued share capital:</b>		
FINCA International, Inc.	66.33%	66.33%
International Finance Corporation	14.99%	14.99%
KfW	7.19%	7.19%
Nederlandse Financierings Maatschappij voor Ontwikkelingslanden N.V.	6.71%	6.71%
Credit Suisse Microfinance Fund Management Company	2.39%	2.39%
ASN-NOVIB FONDS	2.39%	2.39%
<b>Total</b>	<b>100%</b>	<b>100%</b>

FINCA International, Inc. is a not-for-profit corporation under the laws of the United State of America and as such, its Members hold no ownership in the Company and have no economic rights. As at December 31, 2012 the Members of FINCA International, Inc. are as follows: Rupert Scofield, John Hatch, Robert Hatch, Richard Williamson.



The purpose of FINCA is to "Help the poor help themselves". FINCA believes that world hunger and poverty cannot be cured simply by food handouts and grants but can be permanently affected by self-help and self-sufficiency of the poor.

FINCA provides self-help opportunity by establishing community revolving loan funds, or "village banks", in impoverished communities through affiliated organizations ("affiliates").

The affiliates are typically separate legal entities that enter into affiliate agreements with FINCA. Small loans support investment in individual or community productive micro enterprises. Participants build self-reliance, self-esteem, and a savings fund that remains within the community as a permanent source of capital for continued investment.

Currently CJSC UCO "FINCA" is undergoing transformation into microfinance bank, which is planned to be accomplished in 2013 and has been performed in full conformity with Republic of Armenia Central Bank's regulatory normatives.

From the perspective of future growth, development and competitiveness, CJSC UCO "FINCA" has launched the course of actions on restructuring into a microfinance bank, both as strategic need and essential step from the perspective of the Company's mission. Currently CJSC UCO "FINCA" has reached to such stage of development, that transforming to the microfinance bank become only way to support the increasing volume and complexity of its operations, to provide complete financial services to its customers, to have access to more affordable and long term borrowings to support grow of client's portfolio. The Company has rapidly expanded the network of its operating offices and by the end of 2012 had 25 branches. The number of branches is planned to reach 40 by the end of 2016. After transformation into a bank each branch will offer wider range of services to the Republic of Armenia's urban and rural communities through strengthening and enhancing marketing and advertising policies.

As part of planned transformation process, in June 2012 on the general meeting of shareholders was approved increase of the charter capital by means of additional issue of 312,699 shares of USD 7,563,657 from which USD 2,063,657 from retained earnings and USD 5,500,000 from the cash contribution provided by the shareholder.

The Company headquarters in Yerevan, has 25 branches located throughout Armenia.  
The Company's head office is located in Yerevan, Republic of Armenia.  
The Company's legal and mailing address is at: 2a, Agatangeghos str., Yerevan, Republic of Armenia.  
The average number of the Company's employees in 2012 was 537 (2011: 436).

These financial statements were authorized for issue on *March 15, 2013* by the Board of Directors of the Company.



## **2. SIGNIFICANT ACCOUNTING POLICIES**

### **Statement of Compliance**

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

### **Other basis of presentation criteria**

These financial statements have been prepared on the assumption that the Company is a going concern and will continue in operation for the foreseeable future. Cash flows from operating activities for the years ended December 31, 2012 and 2011 are negative however we do not consider this as a trigger since this is common situation within micro finance organizations. The management and shareholder have the intention to further develop the Company and as noted in Note 1 the Company has increased its share capital.

These financial statements are presented in United States Dollars ("*USD*"), unless otherwise indicated.

These financial statements have been prepared on the historical cost basis except for certain financial instruments that are measured at revalued amounts or fair values, as explained in the accounting policies below. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

The Company presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the statement of financial position date (current) and more than 12 months after the statement of financial position date (non-current) is presented in Note 26.

### **Functional currency**

Items included in the financial statements are measured using the currency of the primary of the economic environment in which the entity operates ("the functional currency"). The functional currency of the Company is the Armenian Drams ("*AMD*"). The presentational currency of the financial statements of the Company is the *USD*.

Translation of financial statements denominated in functional currency into presentation currency is performed as follow:

- Assets and liabilities are translated at the exchange rate at the reporting date,
- Income and expense are translated at the average annual rate
- Share capital and other reserve items of capital are translated at the historical rate
- The resulting differences are recognized directly into equity and are presented as a component of comprehensive income referred as the "Foreign Currency Translation Difference".

### **Offsetting**

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liability simultaneously. Income and expense is not offset in the statement of profit or loss unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Company.

The principal accounting policies are set out below.

### **Recognition of Interest income and expense**

Interest income from a financial asset is recognized when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.



The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Once a financial asset or a group of similar financial assets has been written down (partly written down) as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest earned on assets at fair value is classified within interest income.

#### **Recognition of revenue – other**

##### ***Recognition of fee and commission income***

Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in profit or loss over the remaining period of the loan commitment. Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in profit or loss on expiry. Loan servicing fees are recognized as revenue as the services are provided. All other commissions are recognized when services are provided.

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

Cash and cash equivalents consist of cash on hand, unrestricted balances on corresponded accounts and term deposits with original maturity of less or equal to 90 days and are free from contractual encumbrances.

##### **Financial instruments**

The Company recognizes financial assets and liabilities in its statement of financial position when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognized 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.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

##### **Financial assets**

Financial assets are classified into the following specified categories: financial assets 'at fair value through profit or loss' ("FVTPL"), 'held to maturity' ("HTM") investments, 'available-for-sale' ("AFS") financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

##### ***Financial assets at fair value through profit or loss***

Derivative financial instruments including foreign exchange contracts, currency and interest rate swaps, as well as other derivative financial instruments with positive fair value other than derivative instruments designated and effective as hedges are initially recorded in the statement of financial position at cost (including transaction costs) and subsequently remeasured at their fair value. Fair values are obtained



from quoted market prices, cash flow discounting models or option/swap price models at year end, depending on the type of transaction.

Changes in the fair value of derivative financial instruments are included in gains less losses from dealing in foreign currency.

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

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market (including due from banks, loans to customers and other financial assets) are classified as 'loans and receivables'. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

#### ***Impairment of financial assets***

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For all other financial assets, objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty; or
- Breach of contract, such as default or delinquency in interest or principal payments; or
- Default or delinquency in interest or principal payments; or
- It becoming probable that the borrower will enter bankruptcy or financial re-organization; or
- Disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial asset, such as loans and receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of loans and receivables could include the Company's past experience of collecting payments, an increase in the number of delayed payments in the portfolio, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans and receivables, where the carrying amount is reduced through the use of an allowance account. When a loan or a receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

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

Where possible, the Company 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 any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually 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.



#### ***Write off of loans and advances***

Loans and advances are written off against the allowance for impairment losses when deemed uncollectible. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Company and after the Company has sold all available collateral. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the statement of comprehensive income in the period of recovery.

#### ***Derecognition of financial assets***

The Company derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another party. If the Company neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Company recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Company retains substantially all the risks and rewards of ownership of a transferred financial asset, the Company continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

On derecognition of a financial asset other than in its entirety (e.g. when the Group retains an option to repurchase part of a transferred asset), the Company allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognizes on the basis of the relative fair values of those parts on the date of the transfer. The difference between the carrying amount allocated to the part that is no longer recognized and the sum of the consideration received for the part no longer recognized and any cumulative gain or loss allocated to it that had been recognized in other comprehensive income is recognized in profit or loss. A cumulative gain or loss that had been recognized in other comprehensive income is allocated between the part that continues to be recognized and the part that is no longer recognized on the basis of the relative fair values of those parts.

#### ***Financial liabilities***

Financial liabilities, including other borrowed funds, subordinated debt and other financial liabilities are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

#### ***Derecognition of financial liabilities***

The Company derecognizes financial liabilities when, and only when, the Company's obligations are discharged, cancelled or they expire. 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. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss.



### ***Derivative financial instruments***

In the normal course of business the Company enters into various derivative financial instruments including, currency swaps and currency exchange contracts. Such financial instruments are held for trading and are initially recognized 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. Gains and losses from transactions in the above instruments are reported in the statement of comprehensive income as gains less losses arising from transactions in financial assets (liabilities) at fair value through profit or loss. Changes in the fair value of derivative instruments are included in gain/loss.

### ***Leases***

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

### ***The Company as lessee***

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are incurred.

### ***Property and equipment***

Property and equipment is carried at historical cost less accumulated depreciation and any recognized impairment loss, if any.

Depreciation is charged on the carrying value of property and equipment and is designed to write off assets over their useful economic lives. Depreciation is calculated on a straight line basis at the following useful lives:

- Communication devices and computers — 3 years;
- Office equipment — 5 years;
- Vehicles — 5 years;
- Other fixed assets — 5 years.

Leasehold improvements are capitalized and depreciated over the period of ten years on a straight-line basis. Assets under the course of construction are not depreciated.

The carrying amounts of property and equipment are reviewed at each reporting date to assess whether they are recorded in excess of their recoverable amounts. The recoverable amount is the higher of fair value less cost to sell and value in use. Where carrying values exceeded the estimated recoverable amount, assets are written down to their recoverable amount; impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation charge for property and equipment is adjusted in future periods to allocate the assets revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

### ***Intangible assets***

#### ***Intangible assets acquired separately***

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives. The estimated useful life and amortization method are reviewed at the end of



each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives that are acquired separately are carried at cost less accumulated impairment losses. Intangible assets are assessed for impairment whether there is an indication that the intangible assets may be impaired

#### ***Derecognition of intangible assets***

An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, and are recognized in profit or loss when the asset is derecognized.

#### **Impairment of tangible and intangible assets other than goodwill**

At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

#### **Taxation**

Income tax expense represents the sum of the tax currently payable and deferred tax.

#### ***Current tax***

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.



### **Operating taxes**

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

### **Deferred tax**

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognized for taxable temporary differences associated with property and equipment and loans to customers, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the liability is settled or the assets realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

### **Current and deferred tax for the year**

Current and deferred tax are recognized in profit or loss, except when they relate to items that are recognized in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognized in other comprehensive income or directly in equity respectively.

### **Provisions**

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

### **Contingencies**

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



### Foreign currencies

In preparing the financial statements, transactions in currencies other than the Company's functional currency are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

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

	December 31, 2012	December 31, 2011	December 31, 2010
AMD/1 US Dollar	403.58	385.77	363.44
AMD/1 Eur	532.24	498.72	481.16

### Collateral

The Company obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Company a claim on these assets for both existing and future customer liabilities.

### Share Capital

Contributions to share capital are recognized at cost. Costs directly attributable to the issue of new shares, other than on a business combination, are deducted from equity net of any income taxes.

### Critical accounting judgments and key sources of estimation uncertainty

In the application of the Company's accounting policies the Company management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

### Key sources of estimation uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

### Impairment of loans and receivables

The Company regularly reviews its loans and receivables to assess for impairment. The Company's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Company considers accounting estimates related to allowance for impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Company's estimated losses and actual losses would require the Company to record provisions which could have a material impact on its financial statements in future periods.



The Company uses a combination of individual assessment and group assessment in determining the allowance for impairment required at any reporting date. Individual assessment is performed on loans and receivables that are considered individually significant. Loans and receivables with outstanding balance greater than 0.5% of equity capital are considered to be individually significant.

Individually significant loans and receivables that are not impaired, as well as all other loans and receivables that have not been individually assessed are then included in the group of loans and receivables that are collectively assessed for impairment. The collectively assessed loans and receivables are grouped based on similar credit risk characteristics and on their past-due status and assessed accordingly. The collectively assessed methodology strives to ensure the allowance for impairment reflects the loss events that have occurred, but have not yet been identified on an individual basis.

The process uses a combination of historical data and current observable data that reflects the existing economic and political conditions and how it may affect the current loans and receivables portfolio. The Company is not in a position to predict what changes in conditions will take place in Armenia and what effect such changes might have on the adequacy of the allowances for impairment of financial assets in future periods.

As at December 31, 2012 and 2011 the gross loans and receivables totaled USD 44,065,467 and USD 35,497,571, respectively, and allowance for impairment losses amounted to USD 210,848 and USD 219,242, respectively.

#### ***Related Parties***

Identification of related parties requires exercise of significant management judgment in determining related party relationships.

#### ***Useful lives of property, plant and equipment***

Items of property and equipment are stated at cost less accumulated depreciation and less any accumulated depreciation losses. The estimation of the useful life of an item of property and equipment is a matter of management judgment based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any one of these conditions or estimates may result in adjustments to future depreciation rates.

#### ***Recoverability of deferred tax assets***

The management of the Company is confident that no valuation allowance against deferred tax assets at the reporting date is considered necessary, because it is more likely than the deferred tax asset will be fully realized. The carrying value of deferred tax assets amounted to USD 7,904 and USD 23,172 as at December 31, 2012 and 2011, respectively.

### **3. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSs)**

The Company has adopted the following new or revised standards and interpretations issued by IASB and the IFRIC of IASB that became effective for the Company's annual financial statement for the year ended December 31, 2012:

#### **Amendments to IFRSs affecting presentation and disclosure only**

##### **Amendments to IAS 1 *Presentation of Items of Other Comprehensive Income***

The Company has applied the amendments to IAS 1 *Presentation of Items of Other Comprehensive Income* in advance of the effective date (annual periods beginning on or after July 1, 2012). The amendments introduce new terminology for the statement of comprehensive income and income statement. Under the amendments to IAS 1 *Presentation of Items of Other Comprehensive Income*, the 'statement of comprehensive income' is renamed the 'statement of profit or loss and other comprehensive income' and the 'income statement' is renamed the 'statement of profit or loss'.



The amendments to IAS 1 *Presentation of Items of Other Comprehensive Income* retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements. However, the amendments to IAS 1 require items of other comprehensive income to be grouped into two categories in the other comprehensive income section: (a) items that will not be reclassified subsequently to profit or loss and (b) items that may be reclassified subsequently to profit or loss when specific conditions are met. Income tax on items of other comprehensive income is required to be allocated on the same basis – the amendments do not change the option to present items of other comprehensive income either before tax or net of tax. The amendments have been applied retrospectively, and hence the presentation of items of other comprehensive income has been modified to reflect the changes. Other than the above mentioned presentation changes, the application of the amendments to IAS 1 *Presentation of Items of Other Comprehensive Income* does not result in any impact on profit or loss, other comprehensive income and total comprehensive income.

**Amendments to IAS 1 *Presentation of Financial Statements***  
(as part of the Annual Improvements to IFRSs 2009-2011 Cycle issued in May 2012)

The Company has applied the amendments to IAS 1 as part of the *Annual Improvements to IFRSs 2009-2011 Cycle* in advance of the effective date (annual periods beginning on or after January 1, 2013).

IAS 1 *Presentation of Financial Statements* requires an entity that changes accounting policies retrospectively, or makes a retrospective restatement or reclassification to present a statement of financial position as at the beginning of the preceding period (third statement of financial position). The amendments to IAS 1 *Presentation of Financial Statements* clarify that an entity is required to present a third statement of financial position only when the retrospective application, restatement or reclassification has a material effect on the information in the third statement of financial position and that related notes are not required to accompany the third statement of financial position.

**Amendments to IAS 12 *Income Taxes* "Deferred tax: Recovery of Underlying Assets"**

The Company has applied the amendments to IAS 12 *Income taxes* "Deferred tax: Recovery of Underlying Assets" in the current year. Under the amendments, investment properties that are measured using the fair value model in accordance with IAS 40 *Investment Property* are presumed to be recovered entirely through sale for the purposes of measuring deferred taxes unless the presumption is rebutted. An application of the amendments to IAS 12 *Income taxes* "Deferred tax: Recovery of Underlying Assets" did not have an effect on the Company's financial statements.

**3.1 New and revised IFRSs in issue but not yet effective**

The Company has not applied the following new and revised IFRSs that have been issued but are not yet effective:

- IFRS 9 *Financial Instruments*<sup>3</sup>;
- IFRS 13 *Fair Value Measurement*<sup>1</sup>;
- Amendments to IFRS 7 *Financial Instruments: Disclosures* – "Disclosures – Offsetting Financial Assets and Financial Liabilities"<sup>1</sup>;
- Amendments to IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures* – "Mandatory Effective Date of IFRS 9 and Transition Disclosures"<sup>3</sup>;
- IAS 19 (as revised in 2011) *Employee Benefits*<sup>1</sup>;
- IAS 27 (as revised in 2011) *Separate Financial Statements*<sup>2</sup>;
- Amendments to IAS 32 *Financial Instruments: Presentation* – "Offsetting Financial Assets and Financial Liabilities"<sup>4</sup>;
- Amendments to IFRSs – Annual Improvements to IFRSs 2009-2011 cycle except for the amendment to IAS 1 (see above)<sup>1</sup>.

<sup>1</sup> Effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

<sup>2</sup> Each of the five standards becomes effective for annual periods beginning on or after January 1, 2013, with earlier application permitted if all the other standards in the 'package of five' are also early applied (except for IFRS 12 that can be applied earlier on its own).

<sup>3</sup> Effective for annual periods beginning on or after January 1, 2015, with earlier application permitted.



<sup>4</sup> Effective for annual periods beginning on or after January 1, 2014, with earlier application permitted.

#### **IFRS 9 Financial Instruments**

IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, introduces new requirements for the classification and measurement of financial assets and financial liabilities and for derecognition.

Key requirements of IFRS 9:

- All recognized financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* to be subsequently measured at amortized cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods. In addition, under IFRS 9 *Financial Instruments*, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognized in profit or loss.
- With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 *Financial Instruments* requires that the amount of change in the fair value of the financial liability, that is attributable to changes in the credit risk of that liability, is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Previously, under IAS 39 *Financial Instruments: Recognition and Measurement*, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit or loss was recognized in profit or loss.

The Company management anticipates that IFRS 9 *Financial Instruments* in the future may have a significant impact on amounts reported in respect of the Company's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 *Financial Instruments* until a detailed review has been completed.

#### **IFRS 13 Fair Value Measurement**

IFRS 13 *Fair Value Measurement* establishes a single source of guidance for fair value measurements and disclosures about fair value measurements. The Standard defines fair value, establishes a framework for measuring fair value, and requires disclosures about fair value measurements. The scope of IFRS 13 *Fair Value Measurement* is broad; it applies to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures amount fair value measurements, except in specified circumstances. In general, the disclosure requirements in IFRS 13 *Fair Value Measurement* are more extensive than those required in the current standards. For example, quantitative and qualitative disclosures based on the three-level fair value hierarchy currently required for financial instruments only under IFRS 7 *Financial Instruments: Disclosures* will be extended by IFRS 13 *Fair Value Measurement* to cover all assets and liabilities within its scope.

The Company management anticipates that the application of the new Standard may affect certain amounts reported in the financial statements and result in more extensive disclosures in the financial statements.

#### **Amendments to IFRS 7 *Financial Instruments: Disclosures* and IAS 32 *Financial Instruments: Presentation* – "Offsetting Financial Assets and Financial Liabilities and the related disclosures"**

The amendments to IAS 32 *Financial Instruments: Presentation* clarify existing application issues relating to the offset of financial assets and financial liabilities requirements. Specifically, the amendments clarify the meaning of 'currently has a legally enforceable right of set-off' and 'simultaneous realization and settlement'.



The amendments to IFRS 7 *Financial Instruments: Disclosures* require entities to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreement or similar arrangement.

The disclosures should be provided retrospectively for all comparative periods.

The Company management anticipates that the application of these amendments to IAS 32 and IFRS 7 may result in more disclosures being made with regards to offsetting financial assets and financial liabilities in the future.

#### **IAS 19 Employee Benefits**

The amendments to IAS 19 *Employee Benefits* change the accounting for defined benefit plans and termination benefits and a definition of short-term benefits. The most significant change relates to the accounting for changes in defined benefit obligations and plan assets. The amendments require the recognition of changes in defined benefit obligations and in fair value of plan assets when they occur and hence eliminate the 'corridor approach' permitted under the previous version of IAS 19 *Employee Benefits* and accelerate the recognition of past service costs. The amendments require all actuarial gains and losses to be recognized immediately through other comprehensive income in order for the net pension asset or liability recognized in the statement of financial position to reflect the full value of the plan deficit or surplus. Furthermore, the interest cost and expected return on plan assets used in the previous version of IAS 19 *Employee Benefits* are replaced with a 'net-interest' amount, which is calculated by applying the discount rate to the net defined benefit liability or asset.

The amendments to IAS 19 *Employee Benefits* require retrospective application. The Company management does not anticipate that the revision of IAS 19 *Employee Benefits* will have a significant effect on the Company's financial statements as the Company has not defined benefit plans.

#### **Annual Improvements to IFRSs 2009-2011 Cycle issued in May 2012**

The *Annual Improvements to IFRSs 2009-2011 Cycle* include a number of amendments to various IFRSs. Amendments to IFRSs include:

##### **Amendments to IAS 32 *Financial Instruments: Presentation***

The amendments to IAS 32 *Financial Instruments: Presentation* clarify that income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction should be accounted for in accordance with IAS 12 *Income Taxes*. The Company management anticipates that the amendments to IAS 32 *Financial Instruments: Presentation* will have no effect on the Company's financial statements as the Company has already adopted this treatment.

#### **4. RESTATEMENTS AND RECLASSIFICATIONS**

##### **Restatements**

In 2012 the management discovered errors in the presentation of financial statements for the years ended December 31, 2011 and 2010. Unrestricted time deposit accounts with original maturities within 90 days were recorded as due from banks in the statement of financial position and in the statement of cash flows. The reclassification was made in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" and detailed in the following paragraph.

Unrestricted time deposit accounts with original maturities within 90 days, which may be converted to cash within a short period of time and thus are considered liquid were reclassified from due from banks to cash and cash equivalents in the statement of financial position. This restatement resulted in elimination of change in due from banks from cash flows from operating activities in the statement of cash flows for the year ended December 31, 2011, besides that other insignificant reclassifications were made to conform with the presentation of the statement of cash flows for the year ended December 31, 2012.



### Reclassifications

Certain reclassification has been made to the Statement of Financial Position as at December 31, 2011 to conform with the presentation as at December 31, 2012. Assets classified held for sale were presented separately from the other assets in compliance with disclosure requirements of IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations".

The effect on every financial statement line restated for the years ended December 31, 2011 and 2010 is presented in the table below:

### Statement of financial position

	As previously reported		Amount of adjustment,		As restated	
	December 31, 2011	December 31, 2010	December 31, 2011	December 31, 2010	December 31, 2011	December 31, 2010
<b>ASSETS:</b>						
Cash and cash equivalents	319,001	372,785	2,879,436	1,166,730	3,198,437	1,539,515
Due from banks	2,879,436	1,166,730	(2,879,436)	(1,166,730)	-	-
Other assets	138,629	90,162	(13,456)	-	125,173	90,162
Assets classified held for sale	-	-	13,456	-	13,456	-

### Statement of cash flows

	As previously reported Year ended December 31, 2012	Amount of adjustment, Year ended December 31, 2011	As restated Year ended December 31, 2011
Loss from disposal of property and equipment and intangible assets	9,301	(4,620)	4,681
Translation differences, net and net (loss)/ gain on financial assets and liabilities at fair value through profit or loss	(9,065)	-	(9,065)
Net change in accrued interest	462,376	(63)	462,313
Depreciation and amortization	195,347	354	195,701
Due from banks	(1,761,323)	1,761,323	-
Effect of exchange rate changes on the balance of cash held in foreign currencies	38,836	(44,287)	(5,452)
<b>CASH AND CASH EQUIVALENTS, beginning of period</b>	<b>372,785</b>	<b>1,166,729</b>	<b>1,539,515</b>
<b>CASH AND CASH EQUIVALENTS, end of period</b>	<b>319,001</b>	<b>2,879,436</b>	<b>3,198,437</b>



**5. NET INTEREST INCOME**

	Year ended December 31, 2012	Year ended December 31, 2011
<b>Interest income comprises:</b>		
Interest income on financial assets recorded at amortized cost:		
- interest income on impaired financial assets	13,227,558	11,159,712
- interest income on unimpaired financial assets	<u>447,261</u>	<u>142,825</u>
<b>Total interest income</b>	<u><b>13,674,819</b></u>	<u><b>11,302,537</b></u>
Interest income on financial assets recorded at amortized cost comprises:		
Interest on loans to customers	13,227,558	11,159,712
Interest on placements with banks with original maturities of less than three month	<u>447,261</u>	<u>142,825</u>
Total interest income on financial assets recorded at amortized cost	<u>13,674,819</u>	<u>11,302,537</u>
<b>Interest expense comprises:</b>		
Interest expense on financial liabilities recorded at amortized cost	4,145,682	3,070,721
Interest expense on financial assets at fair value through profit or loss	<u>62,230</u>	<u>7,038</u>
<b>Total interest expense</b>	<u><b>4,207,912</b></u>	<u><b>3,077,759</b></u>
Interest expense on financial liabilities recorded at amortized cost comprise:		
Interest on borrowed funds	3,805,831	2,711,291
Interest on subordinated debt	<u>339,851</u>	<u>359,430</u>
Total interest expense on financial liabilities recorded at amortized cost	<u>4,145,682</u>	<u>3,070,721</u>
<b>Net interest income before provision for impairment losses on interest bearing financial assets</b>	<u><b>9,466,907</b></u>	<u><b>8,224,778</b></u>



## 6. ALLOWANCE FOR IMPAIRMENT LOSSES

The movements in allowance for impairment losses on interest bearing assets were as follows:

	Trade	Agri- culture	Produc- tion	Transport	Construc- tion	Other	Total
December 31, 2011	64,418	54,583	10,813	8,078	4,202	30,362	172,456
Additional provisions recognized	21,970	11,970	(39,268)	29,698	3,179	10,352	37,901
Write-off of assets	-	(20,423)	(54,737)	(62,113)	(2,409)	-	(139,682)
Recoveries of assets previously written off	-	27,064	97,691	35,170	661	-	160,586
Effect of foreign currency exchange difference	(4,489)	(3,806)	(752)	(563)	(293)	(2,116)	(12,019)
December 31, 2011	81,899	69,388	13,747	10,270	5,340	38,598	219,242
Additional provisions recognized	2,496	1,635	6,110	35,304	869	(4,554)	41,860
Write-off of assets	-	(42,592)	(61,510)	(123,610)	(7,303)	(6,583)	(241,598)
Recoveries of assets previously written off	95	44,749	60,378	87,433	5,804	2,566	201,025
Effect of foreign currency exchange difference	(3,626)	(3,077)	(629)	(450)	(233)	(1,666)	(9,681)
December 31, 2012	80,864	70,103	18,096	8,947	4,477	28,361	210,848

## 7. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprises:

	Year ended December 31, 2012	Year ended December 31, 2011
Dealing, net	75,461	10,673
Translation differences, net	(54,066)	(1,056)
Total net gain on foreign exchange operations	21,395	9,617

## 8. STAFF COSTS

Staff costs comprise:

	Year ended December 31, 2012	Year ended December 31, 2011
Salaries, bonuses and other employee benefits	4,377,266	3,811,028
Social security costs	432,596	379,564
Training costs	49,384	42,384
Total staff cost	4,859,246	4,232,976



## 9. OTHER OPERATING EXPENSES

Other operating expenses comprise:

	Year ended December 31, 2012	Year ended December 31, 2011
Royalty and management fee	799,938	507,780
Operating leases	422,702	326,438
Taxes, other than income tax	388,780	270,291
Property and equipment maintenance	225,250	191,049
Business trip expenses	157,346	89,300
Office supplies	144,555	106,533
Professional services	100,495	51,133
Communications	80,967	93,652
Security expenses	72,270	60,416
Representative expenses	62,401	57,403
Insurance	6,006	3,550
Advertising costs	1,966	19,537
Loss on disposal of property and equipment	1,864	4,681
Penalties	804	2,215
Other expenses	169,253	160,407
<b>Total other operating expenses</b>	<b>2,634,597</b>	<b>1,944,385</b>

## 10. INCOME TAXES

The Company measures and records its current income tax payable and its tax bases in its assets and liabilities in accordance with the tax regulations of the Republic of Armenia, which differ from IFRS.

The Company is subject to certain permanent tax differences due to the non-tax deductibility of certain expenses and certain income being treated as non-taxable for tax purposes.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at December 31, 2012 and 2011 relate mostly to different methods/timing of income and expense recognition as well as to temporary differences generated by tax – book bases' differences for certain assets.

The tax rate used for the reconciliations below is the corporate tax rate of 20% payable by corporate entities in the Republic of Armenia on taxable profits (as defined) under tax law of the Republic of Armenia.

Temporary differences as at December 31, 2012 and 2011 comprise:

	December 31, 2012	December 31, 2011
<i>Deferred tax assets/ liabilities in relation to:</i>		
Placements with banks with original maturities of less than three month	(13,199)	(1,001)
Loans to customers	(53,516)	(53,845)
Borrowed funds	(15,294)	
Other liabilities	89,913	78,018
<b>Net deferred tax asset</b>	<b>7,904</b>	<b>23,172</b>



The effective tax rate reconciliation is as follows for the years ended December 31, 2012 and 2011:

	Year ended December 31, 2012	Year ended December 31, 2011
Profit before income tax	<u>1,690,682</u>	<u>2,105,824</u>
Tax at the statutory tax rate (20%)	338,136	421,165
Tax effect of permanent differences	<u>(6,212)</u>	<u>3,616</u>
<b>Income tax expense</b>	<b><u>331,924</u></b>	<b><u>424,781</u></b>
Current income tax expense	316,656	457,790
Deferred tax expense/(benefit) recognized in the current year	14,309	(33,603)
Effect of foreign currency exchange difference	<u>959</u>	<u>594</u>
<b>Income tax expense</b>	<b><u>331,924</u></b>	<b><u>424,781</u></b>
<b>Deferred income tax assets</b>	<b>2012</b>	<b>2011</b>
As at January 1 – deferred tax assets/(liability)	23,172	(9,837)
Changes in deferred income tax balances recognized in comprehensive income	(14,309)	33,603
Effect of foreign currency exchange difference	<u>(959)</u>	<u>(594)</u>
<b>As at December 31- deferred tax assets</b>	<b><u>7,904</u></b>	<b><u>23,172</u></b>

#### 11. CASH AND CASH EQUIVALENTS

	December 31, 2012	December 31, 2011 (As restated, Note 4)	December 31, 2010 (As restated, Note 4)
Cash on hand	17,905	9,965	3,954
Correspondent accounts with banks	223,854	309,036	368,831
Placements with banks with original maturities of less than three months	<u>5,836,154</u>	<u>2,879,436</u>	<u>1,166,730</u>
<b>Total cash and cash equivalents</b>	<b><u>6,077,913</u></b>	<b><u>3,198,437</u></b>	<b><u>1,539,515</u></b>

As at December 31, 2012 and 2011 accrued interest included in cash and cash equivalents amounted to USD 6,489 and USD 3,717, respectively.

As at December 31, 2012 and 2011, the Company had a concentration of placements with banks with original maturities of less than three month in the amount of USD 5,836,154 and USD 2,879,436, respectively from two resident commercial banks.

Interest rate analysis of cash and cash equivalents is disclosed in Note 26.



## 12. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial assets at fair value through profit or loss recognized in the statement of financial position as at December 31, 2011 are represented by currency swap transactions concluded in December 2011 between the Company and ArmSwissbank. The contractual maturity of the instrument is finished in June 2012. The table below represents outstanding transactions at the year end. The amounts of these transactions are shown on a gross basis before the offset of positions for each counterparty.

	December 31, 2012		December 31, 2011	
	Notional principal amount	Fair value of assets	Notional principal amount	Fair value of assets
Buy USD	-	-	1,600,000	10,121
Sell AMD	-	-	1,589,879	

## 13. LOANS TO CUSTOMERS

Loans to customers comprise:

	December 31, 2012	December 31, 2011
Loans to customers	44,065,467	35,497,571
Less: allowance for impairment losses	(210,848)	(219,242)
<b>Total loans to customers</b>	<b>43,854,619</b>	<b>35,278,329</b>

Movements in the allowance for impairment losses for the years ended December 31, 2012 and 2011 are disclosed in Note 6.

	December 31, 2012	December 31, 2011
Analysis by sector:		
Agriculture	15,989,687	11,935,894
Trade	15,631,406	12,854,634
Production	3,803,268	2,513,708
Transport	1,899,447	1,582,567
Construction	1,013,398	977,691
Other	5,728,261	5,633,077
Less: allowance for impairment losses	(210,848)	(219,242)
<b>Total loans to customers</b>	<b>43,854,619</b>	<b>35,278,329</b>



The table below summarizes carrying value of loans to customers analysed by type of collateral obtained by the Company at December 31, 2012:

	Trade	Agriculture	Production	Transport	Construction	Other	Total
Loans collateralized by movable property	11,022,915	95,208	2,310,270	317,075	19,131	1,648,384	15,412,983
Loans collateralized by personal guarantees of individuals	4,387,088	15,874,570	1,391,224	1,582,372	994,267	4,058,704	28,288,225
Loans collateralized by pledge of real estate	221,403	19,909	101,774	-	-	21,173	364,259
Less: allowance for impairment losses	(80,884)	(70,103)	(18,096)	(8,947)	(4,477)	(28,361)	(210,848)
<b>Total loans to customers</b>	<b>15,550,542</b>	<b>15,919,584</b>	<b>3,785,172</b>	<b>1,890,500</b>	<b>1,008,921</b>	<b>5,699,900</b>	<b>43,854,619</b>

The table below summarizes carrying value of loans to customers analysed by type of collateral obtained by the Company at December 31, 2011:

	Trade	Agriculture	Production	Transport	Construction	Other	Total
Loans collateralized by personal guarantees of individuals	8,530,676	69,544	1,321,459	167,564	51,518	2,311,367	12,452,128
Loans collateralized by movable property	4,223,535	11,866,350	1,192,249	1,415,003	908,761	3,261,334	22,867,232
Loans collateralized by pledge of real estate	100,423	-	-	-	17,412	60,376	178,211
Less: allowance for impairment losses	(81,899)	(69,388)	(13,747)	(10,270)	(5,340)	(38,598)	(219,242)
<b>Total loans to customers</b>	<b>12,772,735</b>	<b>11,866,506</b>	<b>2,499,961</b>	<b>1,572,297</b>	<b>972,351</b>	<b>5,594,479</b>	<b>35,278,329</b>



Loans to customers comprise the following products:

	December 31, 2012	December 31, 2011
Individual loans	20,167,320	15,932,081
Group loans*	15,841,947	11,830,710
Rural loans	8,056,200	7,734,780
Less allowance for loan impairment	<u>(210,848)</u>	<u>(219,242)</u>
<b>Total loans to customers</b>	<b><u>43,854,619</u></b>	<b><u>35,278,329</u></b>

\*One of the products categories the Company is offering to its' customers is so-called group loan category, which includes Group Rural and Solidary Credit Group loans. The main characteristic of these loans is that, they can be issued only to the group of individuals who agree to be legally obliged to cover other partners' inability to pay should the need arise.

At December 31, 2012 the Company had 71 borrowers (2011: 55 borrowers) with maximum loan amounts of USD 35,000. The total aggregate amount of these loans was USD 1,627,731 (2011: USD 1,372,356) or 4 % of the gross loan portfolio (2011: 4 %).

As at December 31, 2012 and 2011 all loans to customers (100% of total portfolio) are granted to individuals and companies operating in Republic of Armenia, which represents a significant geographical concentration in one region.

As at December 31, 2012 and 2011 the Company did not have renegotiated loans except of loans reassigned to another business partner due to the death of the borrower, which amounted to USD 31,225 and USD 12,835 respectively.

Analysis by credit quality of loans outstanding at December 31, 2012 is as follows:

	Trade	Agricul- ture	Produc- tion	Trans- port	Const- ruction	Other	Total
Loans collectively determined to be impaired							
- not overdue	15,508,724	15,943,930	3,789,731	1,891,677	1,010,796	5,694,120	43,818,978
- 1 to 30 days overdue	39,666	25,494	26,998	1,536	1,083	13,962	108,939
- 31 to 60 days overdue	23,601	13,415	6,195	694	431	124	44,480
- 61 to 90 days overdue	39,930	5,617	-	5,540	999	8,289	58,375
- 91 to 180 days overdue	19,285	1,231	344	-	89	13,766	34,715
<b>Total loans to customers (before impairment)</b>	<b><u>15,631,406</u></b>	<b><u>15,989,687</u></b>	<b><u>3,803,268</u></b>	<b><u>1,899,447</u></b>	<b><u>1,013,398</u></b>	<b><u>5,728,261</u></b>	<b><u>44,065,467</u></b>
Less: allowance for impairment losses	<u>(80,864)</u>	<u>(70,103)</u>	<u>(18,096)</u>	<u>(8,947)</u>	<u>(4,477)</u>	<u>(28,361)</u>	<u>(210,848)</u>
<b>Total loans to customers</b>	<b><u>15,550,542</u></b>	<b><u>15,919,584</u></b>	<b><u>3,785,172</u></b>	<b><u>1,890,500</u></b>	<b><u>1,008,921</u></b>	<b><u>5,699,900</u></b>	<b><u>43,854,619</u></b>



Analysis by credit quality of loans outstanding at December 31, 2011 is as follows:

	Trade	Agriculture	Production	Transport	Construction	Other	Total
Loans collectively determined to be impaired							
- not overdue	12,785,334	11,912,063	2,511,598	1,576,475	976,109	5,594,162	35,355,741
- 1 to 30 days overdue	39,534	8,819	31	1,060	959	16,479	66,882
- 31 to 60 days overdue	12,533	3,834	1,698	86	594	5,700	24,445
- 61 to 90 days overdue	2,740	1,786	347	700	-	8,456	14,029
- 91 to 180 days overdue	14,493	9,392	34	4,246	29	8,280	36,474
<b>Total loans to customers (before impairment)</b>	<b>12,854,634</b>	<b>11,935,894</b>	<b>2,513,708</b>	<b>1,582,567</b>	<b>977,691</b>	<b>5,633,077</b>	<b>35,497,571</b>
Less: allowance for impairment losses	(81,699)	(69,388)	(13,747)	(10,270)	(5,340)	(38,598)	(219,242)
<b>Total loans to customers</b>	<b>12,772,935</b>	<b>11,866,506</b>	<b>2,499,961</b>	<b>1,572,297</b>	<b>972,351</b>	<b>5,594,479</b>	<b>35,278,329</b>



#### 14. PROPERTY AND EQUIPMENT

Property and equipment comprise:

	Leasehold improvements	Communication devices and computers	Office equipment	Vehicles	Other fixed assets	Total
<b>At initial cost</b>						
January 1, 2011	372,071	239,500	162,797	82,671	91,824	948,863
Additions	85,645	84,746	83,527	-	71,956	325,874
Disposals	(7,140)	(1,415)	-	-	-	(8,555)
Currency translation difference	(24,254)	(16,747)	(12,314)	(4,785)	(7,806)	(65,906)
<b>December 31, 2011</b>	<b>426,322</b>	<b>306,084</b>	<b>234,010</b>	<b>77,886</b>	<b>155,974</b>	<b>1,200,276</b>
Additions	112,084	99,420	174,675	127,294	78,562	592,035
Disposals	(1,697)	-	-	-	(5,349)	(7,046)
Currency translation difference	(19,309)	(13,953)	(11,111)	(4,008)	(7,211)	(55,592)
<b>December 31, 2012</b>	<b>517,400</b>	<b>391,551</b>	<b>397,574</b>	<b>201,172</b>	<b>221,976</b>	<b>1,729,673</b>
<b>Accumulated depreciation</b>						
January 1, 2011	61,256	135,989	64,652	31,312	40,671	333,880
Depreciation charge	38,676	66,495	38,634	16,135	20,638	180,578
Disposals	(2,239)	(303)	-	-	-	(2,542)
Currency translation difference	(4,807)	(10,162)	(5,079)	(2,371)	(3,068)	(25,487)
<b>December 31, 2011</b>	<b>92,886</b>	<b>192,019</b>	<b>98,207</b>	<b>45,076</b>	<b>58,241</b>	<b>486,429</b>
Depreciation charge	46,159	70,466	54,474	31,224	33,293	235,616
Disposals	(600)	-	-	-	(4,582)	(5,182)
Currency translation difference	(4,304)	(8,791)	(4,579)	(2,129)	(2,699)	(22,502)
<b>December 31, 2012</b>	<b>134,141</b>	<b>253,694</b>	<b>148,102</b>	<b>74,171</b>	<b>84,253</b>	<b>694,361</b>
<b>Net book value</b>						
As at December 31, 2012	383,259	137,857	249,472	127,001	137,723	1,035,312
As at December 31, 2011	333,436	114,065	135,803	32,810	97,733	713,847

Depreciation and amortization charge presented on the face of the statement of comprehensive income includes depreciation and amortization charge of property and equipment, and intangible assets.

As at December 31, 2012 and 2011 the Company did not have any pledged property and equipment.

As at December 31, 2012 and 2011 gross carrying amount of fully depreciated assets that are still in use comprised USD 223,472 and USD 139,257 respectively.



## 15. INTANGIBLE ASSETS

Intangible assets are presented by investments in the software:

	Software	Capital investments in software	Total
<b>At initial cost</b>			
January 1, 2011	39,864	135,424	175,288
Additions	16,081	-	16,081
Disposals	(4,264)	-	(4,264)
Currency translation difference	(2,716)	(7,839)	(10,555)
<b>December 31, 2011</b>	<b>48,965</b>	<b>127,585</b>	<b>176,550</b>
Additions	98,975	-	98,975
Disposals	-	-	-
Currency translation difference	(2,605)	(5,630)	(8,235)
<b>December 31, 2012</b>	<b>145,335</b>	<b>121,955</b>	<b>267,290</b>
<b>Accumulated depreciation</b>			
January 1, 2011	10,896	-	10,896
Depreciation charge	15,123	-	15,123
Disposals	-	-	-
Currency translation difference	(1,154)	-	(1,154)
<b>December 31, 2011</b>	<b>24,865</b>	<b>-</b>	<b>24,865</b>
Depreciation charge	6,679	-	6,679
Disposals	-	-	-
Currency translation difference	(1,129)	-	(1,129)
<b>December 31, 2012</b>	<b>30,415</b>	<b>-</b>	<b>30,415</b>
Net book value			
As at December 31, 2012	<u>114,920</u>	<u>121,955</u>	<u>236,875</u>
As at December 31, 2011	<u>24,100</u>	<u>127,585</u>	<u>151,685</u>

Capital investments in software represent banking software purchased in 2010 in the course of transformation of the Company into a microfinance bank. This software is expected to be launched in 2014 and, accordingly, will be amortized from the date of use.

## 16. OTHER ASSETS

Other assets comprise:

	December 31, 2012	December 31, 2011
<b>Other non-financial assets</b>		
Prepayments	222,768	39,787
Prepaid Rent	217,702	51,715
Inventory	64,024	32,403
Advances to employees	476	1,268
Other	248	-
<b>Total other assets</b>	<u>505,218</u>	<u>125,173</u>



## 17. BORROWED FUNDS

	Currency	Maturity	Nominal interest rate %	December 31, 2012	Nominal interest rate %	December 31, 2011
Loans and borrowings from other organization	AMD, USD	1-4 years	6.11%-17.78%	27,405,258	6.11%-17.78%	24,690,743
Loans from banks and financial institutions	AMD	1-4 years	12.66%-16%	8,107,438	14.16%-14.46%	4,406,571
				<u>35,512,696</u>		<u>29,097,314</u>

The Company is obligated to comply with financial covenants in relation to borrowed funds. These covenants include stipulated ratios, debt to equity ratios and various other financial performance ratios. The Company has not breached any of these covenants during the years ended December 31, 2012 and 2011.

Refer to Note 25 for the disclosure of the fair value of borrowed funds. Interest rate analysis of borrowed funds is disclosed in Note 27. Information on related party balances is disclosed in Note 23.

## 18. OTHER LIABILITIES

Other liabilities comprise:

	December 31, 2012	December 31, 2011
<b>Other financial liabilities:</b>		
Payables to employees	394,143	350,735
Payables for services	101,514	66,656
	<u>495,657</u>	<u>417,391</u>
<b>Other non-financial liabilities</b>		
Taxes payable, other than income tax	242,177	159,388
Other	-	1,179
	<u>242,177</u>	<u>160,567</u>
<b>Total other liabilities</b>	<u>737,834</u>	<u>577,958</u>

## 19. SUBORDINATED DEBT

At December 31, 2012 subordinated debt comprised the following:

In 2009 the Company received subordinated loan from FINCA Microfinance Fund B.V. in the amount of USD 2,500,000. The Fund is owned by a Dutch Foundation called "Stichting Holding Microfinance Fund", the founder of which is Deutsche Bank. The loan is provided for 7 years, at 12.63% interest rate p.a. As at December 31, 2012 subordinated debt provided by the legal entity amounted to USD 2,533,686 (2011: USD 2,531,856) and included accrued interest of USD 49,115 (2011: USD 31,856).

In the event of bankruptcy or liquidation of the Company, repayment of this debt is subordinate to the repayments of the Company's liabilities to all other creditors.

The Company is obligated to comply with financial covenants in relation to subordinated debt disclosed above. These covenants include stipulated ratios, debt to equity ratios and various other financial performance ratios. The Company has not breached any of these covenants during the years ended December 31, 2012 and 2011.

Refer to Note 24 for the disclosure of the fair value of subordinated debt.



## 20. SHARE CAPITAL

As at December 31, 2012 and 2011 share capital authorized and issued consisted of 449,171 and 136,472 ordinary shares. All ordinary shares have a nominal value of AMD 10,000 per share and carry one vote.

In June 2012 at the general meeting of shareholders an approval was given for the increase of the charter capital by means of additional issue of 312,699 shares of AMD 3,126,990,000 (equivalent of USD 7,563,657), from which AMD 850,000,000 (USD 2,063,657) from retained earnings and AMD 2,276,990,000 (USD 5,500,000) from the cash contribution provided by the shareholder.

As at December 31, 2012 and 2011 the Company did not possess any of its own shares.

The share capital of the Company was contributed by the shareholders in AMD and they are entitled to dividends and any capital distribution in AMD.

In 2012 the Company declared dividends in respect of the year ended December 31, 2011 totalling USD 788,962. In 2011 dividends declared in respect of the year ended December 31, 2010 were USD 555,252.

Reserves distributable among shareholders 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 Company's statutes that provide for the creation of a reserve for these purposes of 15% of the Company's share capital reported in statutory books.

## 21. RETAINED EARNINGS

According to the Armenian legislation only accumulated retained earnings reflected in the Company's statutory financial statements may be distributed as dividends among the Company's shareholders. As at December 31, 2012, the Company's retained earnings amounted to USD 2,299,542 (2011: USD 3,793,405).

The retained earnings reflected in the Company's statutory records include a reserve fund in the amount of USD 263,159 (2011: 188,209) to cover possible losses. According to Armenian legislation the Company shall create a reserve fund out of profit of prior years or current expenses. The amount of this reserve may not be distributed among the Company's shareholders and is only used in case of liquidation of the Company.

## 22. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company 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.

The Company's uses the same credit control and management policies in undertaking off-balance sheet commitments as it does for on-balance operations.

The company has no provision for losses on contingent liabilities as at December 31, 2012 and 2011.

**Capital commitments** – No material capital commitments were outstanding as at December 31, 2012 and 2011.

**Operating lease commitments** – the Company leases a number of offices under operating leases. The leases typically run for a period of 3-5 years, with an option to renew the lease after that date. Lease payments are increased every 2-3 years to reflect market rentals. Some leases provide for additional rent payments that are based on changes in a local price index.



Where the Company is the lessee, the future minimum lease payments under non-cancelable operating leases of rented offices are as follows:

	December 31, 2012	December 31, 2011
Less than 1 year	659,805	371,343
Later than 1 year and not later than 5 years	2,308,544	914,042
Later than 5 years	548,454	2,590,082
Total operating lease commitments	<u>3,516,803</u>	<u>3,875,467</u>

**Legal proceedings** – In the ordinary course of business, the Company is subject to legal actions and complaints. Management believes that the ultimate liability arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Company, accordingly no provision has been made in these financial statements.

**Taxation** – Commercial legislation of the Republic of Armenia, including tax legislation, may allow more than one interpretation. In addition, there is a risk of tax authorities making arbitrary judgments of business activities. If a particular treatment, based on management's judgment of the Company's business activities, was to be challenged by the tax authorities, the Company may be assessed additional taxes, penalties and interest.

Such uncertainty may relate to the valuation of financial instruments, valuation of provision for impairment losses and the market pricing of deals. Additionally such uncertainty may relate to the valuation of temporary differences on the provision and recovery of the provision for impairment losses on loans to customers and receivables, as an underestimation of the taxable profit. The management of the Company believes that it has accrued all tax amounts due and therefore no allowance has been made in the financial statements.

**Operating Environment** – Emerging markets such as Republic of Armenia are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. Laws and regulations affecting businesses in the Republic of Armenia continue to change rapidly, tax and regulatory frameworks are subject to varying interpretations. The future economic direction of the country is heavily influenced by the fiscal and monetary policies adopted by the government, together with developments in the legal, regulatory, and political environment.

Laws and regulations affecting businesses in the Republic of Armenia continue to change rapidly. Tax, currency and customs legislation within the Republic of Armenia are subject to varying interpretations, and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in the Republic of Armenia. The future economic direction of the Republic of Armenia is heavily influenced by the economic, fiscal and monetary policies adopted by the government, together with legal, regulatory, and political developments.

The global financial turmoil that has negatively affected the Republic of Armenia's financial and capital markets in 2009 and 2010 has receded and the Republic of Armenia's economy returned to growth in 2011 and 2012. However significant economic uncertainties remain. Adverse changes arising from systemic risks in global financial systems, including any tightening of the credit environment could slow or disrupt the Republic of Armenia's economy, adversely affect the Company's access to capital and cost of capital for the Company and, more generally, its business, results of operations, financial condition and prospects.

### 23. TRANSACTIONS WITH RELATED PARTIES

Related parties or transactions with related parties, as defined by IAS 24 "Related party disclosures", represent:

- (a) Parties that directly, or indirectly through one or more intermediaries; control, or are controlled by, or are under common control with, the Company (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Company that gives them significant influence over the Company; and that have joint control over the Company;
- (b) Members of key management personnel of the Company or its parent;
- (c) Close member of the family of any individuals referred to in (a) or (b);



- (d) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (b) or (c). In considering each possible related party relationship, attention is directly to the substance of the relationship, and not merely the legal form. Details of transactions between the Company and other related parties are disclosed below:

	Note	December 31, 2012		December 31, 2011	
		Related party balances	Total category as per the financial statements caption	Related party balances	Total category as per the financial statements caption
Borrowed funds					
- entities with joint control or significant influence over the Company	18	-	27,405,258	200,700	24,690,743
Other liabilities					
- the parent		1,898	737,834	-	577,958

Included in the statement of comprehensive income for the years ended December 31, 2012 and 2011 are the following amounts which were recognized in transactions with related parties:

	Note	Year ended December 31, 2012		Year ended December 31, 2011	
		Related party transactions	Total category as per the financial statements caption	Related party transactions	Total category as per the financial statements caption
Interest expense					
- entities with joint control or significant influence over the Company	5	15,598	4,145,682	36,397	3,070,721
Other operating expenses					
- the parent		834,017	2,634,597	526,583	1,944,385

The remuneration of the Company's key management personnel was as follows:

	Note	Year ended December 31, 2012		Year ended December 31, 2011	
		Related party transactions	Total category as per the financial statements caption	Related party transactions	Total category as per the financial statements caption
<b>Key management personnel compensation:</b>					
Short-term employee benefits	9	528,435	4,377,266	449,066	3,811,028
Social security costs	9	28,010	432,596	24,301	379,564
		<b>556,445</b>	<b>4,809,862</b>	<b>473,367</b>	<b>4,190,592</b>

#### 24. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments are made in accordance with the requirements of IFRS 7 "Financial Instruments: Disclosures" and IAS 39 "Financial Instruments: Recognition and Measurement". Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. The estimates presented herein are not



necessarily indicative of the amounts the Company could realize in a market exchange from the sale of its full holdings of a particular instrument.

The estimated fair values of financial instruments have been determined by the Company using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. Republic of Armenia continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distress sale transactions and therefore not represent fair values of financial instruments. Management has used all available market information in estimating the fair value of financial instruments.

**Cash and cash equivalents** – Cash and cash equivalents are carried at amortized cost which approximates their current fair value.

**Loans and receivables carried at amortized cost** – 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 of new instruments with similar credit risk and remaining maturity. Discount rates depend on currency, maturity of the instrument and credit risk of the counterparty.

**Liabilities carried at amortized cost** – The estimated fair value of fixed interest rate instruments with stated maturity was estimated based on expected future cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Discounted rates used were consistent with the Company's credit risk and also depend on currency and maturity of the instrument. For the liabilities carried at amortized cost and issued at variable rates management believes that carrying rate may be assumed to be fair value.

The fair value of financial assets and liabilities compared with the corresponding carrying amount in the statement of financial position of the Company is presented below:

	December 31, 2012		December 31, 2011		December 31, 2010	
	Carrying value	Fair value	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	6,077,913	6,077,913	3,198,437	3,198,437	1,539,515	1,539,515
Loans to customers	43,854,619	43,854,619	35,278,329	35,278,329	25,359,619	25,359,619
Other financial assets	-	-	10,121	10,121	-	-
<b>Total financial assets</b>	<b>49,932,532</b>	<b>49,932,532</b>	<b>38,486,887</b>	<b>38,486,887</b>	<b>26,899,134</b>	<b>26,899,134</b>

	December 31, 2012		December 31, 2011		December 31, 2010	
	Carrying value	Fair value	Carrying value	Fair value	Carrying value	Fair value
Other borrowed funds	35,512,696	35,512,696	29,097,314	29,097,314	18,164,828	18,164,828
Subordinated debt	2,533,686	2,533,686	2,531,856	2,531,856	2,528,285	2,528,285
Other financial liabilities	495,657	495,657	417,391	417,391	378,230	378,230
<b>Total financial liabilities</b>	<b>38,542,039</b>	<b>38,542,039</b>	<b>32,046,561</b>	<b>32,046,561</b>	<b>21,071,343</b>	<b>21,071,343</b>

## 25. CAPITAL RISK MANAGEMENT

The Company manages its capital to ensure that entities in the Company will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance.



The capital structure of the Company consists of equity attributable to equity holders of the parent, comprising issued capital and retained earnings as disclosed in statement of changes in equity.

The Management Board reviews the capital structure on a semi-annual basis. As a part of this review, the Board considers the cost of capital and the risks associated with each class of capital. Based on recommendations of the Board, the Company balances its overall capital structure through payment of dividends, new share issues as well as the issue of new debt or the redemption of existing debt.

The following table analyzes the Company's capital resources for capital adequacy purposes in accordance with the principles employed by the Basle Committee:

	Year ended December 31, 2012	Year ended December 31, 2011
Movement in tier 1 capital:		
At 1 January	7,081,862	6,365,386
Issue of ordinary shares	5,500,000	-
Dividends declared	(788,964)	(555,252)
Total comprehensive income	1,154,637	1,271,728
<b>At December 31</b>	<b>12,947,535</b>	<b>7,081,862</b>
	December 31, 2012	December 31, 2011
Composition of regulatory capital:		
Tier 1 capital:		
Share capital	10,815,575	3,251,918
Retained earnings	2,299,542	3,793,405
Effect of foreign currency translation difference	(167,582)	36,539
<b>Total qualifying tier 1 capital</b>	<b>12,947,535</b>	<b>7,081,862</b>
Subordinated debt	2,533,686	2,531,856
<b>Total regulatory capital</b>	<b>15,481,221</b>	<b>9,613,718</b>

As at December 31, 2012 and 2011, the Company included in the computation of total capital for Capital adequacy purposes the subordinated debt received. In the event of bankruptcy or liquidation of the Company, repayment of this debt is subordinate to the repayments of the Company's liabilities to all other creditors.

## 26. RISK MANAGEMENT POLICIES

Management of risk is fundamental to the Company's business and is an essential element of the Company's operations. The main risks inherent to the Company's operations are those related to:

- Credit exposures;
- Liquidity risk;
- Market risk.

The Company recognizes that it is essential to have efficient and effective risk management processes in place. To enable this, the Company has established a risk management framework, whose main purpose is to protect the Company from risk and allow it to achieve its performance objectives.

The Board of Directors has overall responsibility for the determination of the Company's risk management objectives and policies and, whilst retaining ultimate responsibility for them, it has delegated the authority for designing and operating processes that ensure the effective implementation of the objectives and policies to the organizations finance function.

The overall objective of the Board of Directors is to set policies that seek to reduce risks as far as possible without unduly affecting the Company's competitiveness and flexibility. Through the risk management framework, the Company manages the following risks:



### **Credit Risk**

The Company is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

The main business of the Company is to provide micro-loans. Respectively credit risk is of crucial importance in the Micro Financing Organisations (MFO) risk management. To avoid significant financial damage caused by this the Company uses various methods to identify and manage effectively the credit risks.

Risk management and monitoring is performed within set limits of authority. These processes are performed by the Credit Committees and the Company's Management Board. Before any application is made by the Credit Committee, all recommendations on credit processes (borrower's limits approved, or amendments made to loan agreements, etc.) are reviewed and approved by the Credit Department. Daily risk management is performed by the Head of Credit Departments and Internal Control Departments.

The Company's credit policy is determined by the Credit Manual, where all the related procedures and requirements, along with respective controls are clearly defined, including loan disbursement, monitoring of delinquent loans, etc.

The Credit Committee is the analytical body responsible for analysing the information in the loan applications, assessing and reducing the credit risks as far as possible. The Credit Committee is the independent body with MFO authorized to make the final decision about financing or rejecting the loan application.

Accuracy and correctness of information presented to the Credit Committee is the responsibility of the credit officer, who fills in the initial application after the due scrutiny of the applicant's business and its credit risks. Eventually the Credit Committee members assess the application against the established criteria (applicant's credit history, financial condition, competitive ability, etc.).

The Company's credit department reviews ageing analysis of outstanding loans and follows up past due balances. Management therefore considers it to be appropriate to provide ageing and other information about credit risk.

The Company structures the level 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 industry (and geographical) segments. Limits on the level of credit risk by a borrower and a product (by industry sector, by region) are approved monthly (quarterly) by the Management Board. The exposure to any one borrower including is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Credit Committee. Actual exposures against limits are monitored daily.

Where appropriate, and in the case of most loans, the Company obtains collateral and personal guarantee. However, a significant portion of loans is personal lending, where no such facilities can be obtained. Such risks are monitored on a continuous basis and subject to annual or more frequent reviews.

### **Maximum exposure of credit risk**

The Company's maximum exposure to credit risk varies significantly and is dependent on both individual risks and general market economy risks.

The following table presents the maximum exposure to credit risk of balance sheet financial assets. For financial assets in the balance sheet, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. The Company's maximum exposure to credit risk under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.



	<u>Maximum exposure</u>
<b>December 31, 2012</b>	
Placements with banks with original maturities of less than three month	5,836,154
Loans to customers	43,854,619
<b>December 31, 2011</b>	
Placements with banks with original maturities of less than three month	2,879,436
Loans to customers	35,278,329
Other financial assets	10,121
<b>December 31, 2010</b>	
Placements with banks with original maturities of less than three month	1,166,730
Loans to customers	25,359,619

**Off-balance sheet risk**

The Company applies fundamentally the same risk management policies for off-balance sheet risks as it does for its on-balance sheet risks.

The Assets and Liabilities Management Committee ("ALMC") exercises control over the risk in the legislation and regulatory arena and assesses its influence on the Company's activity. This approach allows the Company to minimize potential losses from the investment climate fluctuations in the Republic of Armenia.

The geographical concentration of assets and liabilities is set out below:

The geographical concentration of the Company's assets and liabilities as at December 31, 2012 is set out below:

	Republic of Armenia	OECD countries	December 31, 2012 Total
<b>Non-derivative financial assets</b>			
Cash and cash equivalents	6,077,913	-	6,077,913
Loans to customers	43,854,619	-	43,854,619
<b>Total non-derivative financial assets</b>	<b>49,932,532</b>	<b>-</b>	<b>49,932,532</b>
<b>Non-derivative financial liabilities</b>			
Borrowed funds	2,951,962	32,560,734	35,512,696
Other financial liabilities	495,657	-	495,657
Subordinated debt	-	2,533,686	2,533,686
<b>Total non-derivative financial liabilities</b>	<b>3,447,619</b>	<b>35,094,420</b>	<b>38,542,039</b>
<b>Net position on non-derivative financial instruments</b>	<b>46,484,913</b>	<b>(35,094,420)</b>	<b>11,390,493</b>



The geographical concentration of the Company's assets and liabilities as at December 31, 2011 is set out below:

	Republic of Armenia	OECD countries	December 31, 2011 Total
<b>Non-derivative financial assets</b>			
Cash and cash equivalents	3,198,437	-	3,198,437
Loans to customers	35,278,329	-	35,278,329
<b>Total non-derivative financial assets</b>	<b>38,476,766</b>	<b>-</b>	<b>38,476,766</b>
<b>Derivative financial assets</b>			
Financial assets at fair value through profit or loss	10,121	-	10,121
<b>Total financial assets</b>	<b>38,486,887</b>	<b>-</b>	<b>38,486,887</b>
<b>Non-derivative financial liabilities</b>			
Borrowed funds	-	29,097,314	29,097,314
Other financial liabilities	417,391	-	417,391
Subordinated debt	-	2,531,856	2,531,856
<b>Total non-derivative financial liabilities</b>	<b>417,391</b>	<b>31,629,170</b>	<b>32,046,561</b>
<b>Net position on non-derivative financial instruments</b>	<b>38,069,496</b>	<b>(31,629,170)</b>	<b>6,440,326</b>

#### Collateral

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

The main types of collateral obtained are personal guarantees, movable property and real estate. The company provides short-term loans up to 42 months with maximum amount of USD 35,000. Most loans are guaranteed by third parties and movable property.

Management monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

The following table details credit ratings of financial assets held by the Company that are neither past due nor impaired:

	AAA	AA	A	BBB	<BBB	Not rated	Total
<b>December 31, 2012</b>							
Placements with banks with original maturities of less than three month	-	-	-	-	5,047,401	788,753	5,836,154
<b>December 31, 2011</b>							
Placements with banks with original maturities of less than three month	-	-	-	1,450,766	-	1,428,670	2,879,436
Other financial assets	-	-	-	-	-	10,121	10,121
<b>December 31, 2010</b>							
Placements with banks with original maturities of less than three month	-	-	-	1,166,730	-	-	1,166,730

The Company enters into numerous transactions where the counterparties are not rated by international rating agencies. The Company has developed internal models, which allow it to determine the rating of counterparties, which are comparable to rating of international rating agencies.



The Microfinance industry is generally exposed to credit risk through its loans to customers and bank deposits. With regard to the loans to customers this risk exposure is concentrated within the Republic of Armenia. The exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the Company's risk management policy are not breached.

A model of the borrower's scoring assessment has been developed in the Company to assess and decide on loans to small and medium-sized businesses. The scoring model is developed relating to standard loan products and includes key performance indicators of borrowers: financial situation, relations with the borrower, management quality, target use, location, credit history, collateral, etc.

Financial assets other than loans to customers are graded according to the current credit rating they have been issued by an internationally regarded agency such as *Fitch, Standard & Poor's and Moody's*. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

The credit rating of the Republic of Armenia according to the international rating agencies corresponded to investment level BB-.

### **Liquidity risk**

#### ***Liquidity risk management***

Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due.

The ALMC controls these types of risks by means of maturity analysis, determining the Company's strategy for the next financial period. Current liquidity is managed by Treasurer, who deals in the money markets for current liquidity support and cash flow optimization.

In order to manage liquidity risk, the Company performs daily monitoring of future expected cash flows on clients' and banking operations, which is a part of assets/liabilities management process. The Management Board sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level on interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

An analysis of liquidity and interest rate risk is presented in the following table. The presentation below is based upon the information provided internally to key management personnel of the entity.



	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	December 31, 2012 Total
<b>NON-DERIVATIVE FINANCIAL ASSETS</b>						
<i>Fixed interest rate instruments</i>						
Placements with banks with original maturities of less than three month	7.80%	5,429,665	400,000	-	-	5,829,665
Loans to customers	35.30%	2,592,599	5,964,983	23,596,908	11,700,129	43,854,619
<b>Total fixed interest bearing financial assets</b>		<b>8,022,264</b>	<b>6,364,983</b>	<b>23,596,908</b>	<b>11,700,129</b>	<b>49,684,284</b>
<i>Non-interest bearing financial assets</i>						
Placements with banks with original maturities of less than three month		6,489	-	-	-	6,489
Cash on hand and correspondent accounts with banks		241,759	-	-	-	241,759
<b>Total non-interest bearing financial assets</b>		<b>248,248</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>248,248</b>
<b>Total non-derivative financial assets</b>		<b>8,270,512</b>	<b>6,364,983</b>	<b>23,596,908</b>	<b>11,700,129</b>	<b>49,932,532</b>
<b>NON-DERIVATIVE FINANCIAL LIABILITIES</b>						
<i>Fixed interest rate instruments</i>						
Amounts due to other financial institutions	13.29%	2,169,084	5,212,037	11,338,857	8,512,664	27,232,642
Subordinated debt	14.14%	-	-	33,686	2,500,000	2,533,686
<b>Total fixed interest bearing financial liabilities</b>		<b>2,169,084</b>	<b>5,212,037</b>	<b>11,372,543</b>	<b>11,012,664</b>	<b>29,766,328</b>
<i>Variable interest rate instruments</i>						
Amounts due to other financial institutions	14.36%	4,857	2,046,801	2,521,470	3,706,926	8,280,054
<b>Total variable interest bearing financial liabilities</b>		<b>4,857</b>	<b>2,046,801</b>	<b>2,521,470</b>	<b>3,706,926</b>	<b>8,280,054</b>
<i>Non-interest bearing financial liabilities</i>						
Other financial liabilities		495,657	-	-	-	495,657
<b>Total non-interest bearing financial liabilities</b>		<b>495,657</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>495,657</b>
<b>Total non-derivative financial liabilities</b>		<b>2,669,698</b>	<b>7,258,838</b>	<b>13,894,013</b>	<b>14,719,590</b>	<b>38,542,039</b>
Interest sensitivity gap		<b>5,848,323</b>	<b>(893,855)</b>	<b>9,702,895</b>	<b>(3,019,461)</b>	
Cumulative interest sensitivity gap		<b>5,848,323</b>	<b>4,954,468</b>	<b>14,657,363</b>	<b>11,637,902</b>	
Liquidity gap		<b>5,600,914</b>	<b>(893,855)</b>	<b>9,702,895</b>	<b>(3,019,461)</b>	
Cumulative liquidity gap		<b>5,600,914</b>	<b>4,707,059</b>	<b>14,409,954</b>	<b>11,390,493</b>	



	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	December 31, 2011 Total
<b>NON-DERIVATIVE FINANCIAL ASSETS</b>						
<i>Fixed interest rate instruments</i>						
Placements with banks with original maturities of less than three month	7.83%	2,875,719	-	-	-	2,875,719
Loans to customers	46.60%	2,225,424	4,875,716	19,907,331	8,269,858	35,278,329
<b>Total fixed interest bearing financial assets</b>		<b>5,101,143</b>	<b>4,875,716</b>	<b>19,907,331</b>	<b>8,269,858</b>	<b>38,154,048</b>
<i>Non-interest bearing financial assets</i>						
Placements with banks with original maturities of less than three month		3,717	-	-	-	3,717
Cash on hand and Correspondent accounts with banks		319,001	-	-	-	319,001
<b>Total non-interest bearing financial assets</b>		<b>322,718</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>322,718</b>
<b>Total non-derivative financial assets</b>		<b>5,423,861</b>	<b>4,875,716</b>	<b>19,907,331</b>	<b>8,269,858</b>	<b>38,476,766</b>
<b>Derivative financial instruments</b>						
Gross settled:						
- currency swaps		-	-	10,121	-	-
<b>Total derivative financial instruments</b>		<b>-</b>	<b>-</b>	<b>10,121</b>	<b>-</b>	<b>-</b>
<b>Total financial assets</b>		<b>5,423,861</b>	<b>4,875,716</b>	<b>19,917,452</b>	<b>8,269,858</b>	<b>38,486,887</b>
<b>NON-DERIVATIVE FINANCIAL LIABILITIES</b>						
<i>Fixed interest rate instruments</i>						
Amounts due to other financial institutions	12.18%	32,374	5,816,816	5,287,145	11,116,305	22,252,640
Subordinated debt	14.14%	-	-	31,856	2,500,000	2,531,856
<b>Total fixed interest bearing financial liabilities</b>		<b>32,374</b>	<b>5,816,816</b>	<b>5,319,001</b>	<b>13,616,305</b>	<b>24,784,496</b>
<i>Variable interest rate instruments</i>						
Amounts due to other financial institutions	13.84%	706,380	852,886	932,654	4,352,754	6,844,674
<b>Total variable interest bearing financial liabilities</b>		<b>706,380</b>	<b>852,886</b>	<b>932,654</b>	<b>4,352,754</b>	<b>6,844,674</b>
<i>Non-interest bearing financial liabilities</i>						
Other financial liabilities		417,391	-	-	-	417,391
<b>Total non-interest bearing financial liabilities</b>		<b>417,391</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>417,391</b>
<b>Total non-derivative financial liabilities</b>		<b>1,156,145</b>	<b>6,669,702</b>	<b>6,251,655</b>	<b>17,969,059</b>	<b>32,046,561</b>
Interest sensitivity gap		4,362,389	(1,793,986)	13,665,797	(9,699,201)	
<b>Cumulative interest sensitivity gap</b>		<b>4,362,389</b>	<b>2,568,403</b>	<b>16,234,200</b>	<b>6,524,878</b>	
Liquidity gap		4,267,716	(1,793,986)	13,665,797	(9,699,201)	
<b>Cumulative liquidity gap</b>		<b>4,267,716</b>	<b>2,473,730</b>	<b>16,139,527</b>	<b>6,450,447</b>	

In the table above, the terms to maturity correspond to the contractual terms.

The amounts included above for variable interest rate instruments for both non-derivative financial assets and liabilities is subject to change if changes in variable interest rates differ to those estimates of interest rates determined at the end of the reporting period.



The following tables detail the Company's remaining contractual maturity for its non-derivative financial liabilities with agreed repayment periods. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to pay. The tables include both interest and principal cash flows. To the extent that interest flows are floating rate, the undiscounted amount is derived from interest rate curves at the end of the reporting period. The contractual maturity is based on the earliest date on which the Company may be required to pay.

	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	December 31, 2012 Total
<i>Fixed interest rate instruments</i>						
Amounts due to other financial institutions	13.29%	2,262,932	5,471,579	12,410,402	8,985,814	29,130,727
Subordinated debt	14.14%	-	-	319,258	3,467,419	3,786,677
Total fixed interest bearing financial liabilities		<u>2,262,932</u>	<u>5,471,579</u>	<u>12,729,660</u>	<u>12,453,233</u>	<u>32,917,404</u>
<i>Variable interest rate instruments</i>						
Amounts due to other financial institutions	14.36%	49,658	2,111,703	2,866,227	4,277,273	9,304,861
Total variable interest bearing financial liabilities		<u>49,658</u>	<u>2,111,703</u>	<u>2,866,227</u>	<u>4,277,273</u>	<u>9,304,861</u>
<i>Non-interest bearing instruments</i>						
Other financial liabilities		495,657	-	-	-	495,657
Total non-interest bearing financial liabilities		<u>495,657</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>495,657</u>
<b>Total financial liabilities</b>		<u><b>2,808,247</b></u>	<u><b>7,583,282</b></u>	<u><b>15,595,887</b></u>	<u><b>16,730,506</b></u>	<u><b>42,717,922</b></u>



	Weighted average effective interest rate	Up to 1 month	1 month to 3 months	3 month to 1 year	1 year to 5 years	December 31, 2011 Total
<i>Fixed interest rate instruments</i>						
Amounts due to other financial institutions	12.18%	90,650	6,442,219	6,702,064	12,565,521	25,800,454
Subordinated debt	14.14%	-	-	361,771	4,092,194	4,453,965
<b>Total fixed interest bearing financial liabilities</b>		<b>90,650</b>	<b>6,442,219</b>	<b>7,063,835</b>	<b>16,657,715</b>	<b>30,254,419</b>
<i>Variable interest rate instruments</i>						
Amounts due to other financial institutions	13.84%	-	943,050	1,530,445	6,313,122	8,786,617
<b>Total variable interest bearing financial liabilities</b>		<b>-</b>	<b>943,050</b>	<b>1,530,445</b>	<b>6,313,122</b>	<b>8,786,617</b>
<i>Non-interest bearing instruments</i>						
Other financial liabilities		417,391	-	-	-	417,391
<b>Total non-interest bearing financial liabilities</b>		<b>417,391</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>417,391</b>
<b>Total financial liabilities</b>		<b>508,041</b>	<b>7,385,269</b>	<b>8,594,280</b>	<b>22,970,837</b>	<b>39,458,427</b>

#### Financing facilities

#### Market Risk

Market risk is that the risk that the Company's earnings or capital or its ability to meet business objectives will be adversely affected by changes in the level or volatility of market rates or prices. Market risk covers interest rate risk, currency risk, credit spreads, commodity prices and equity prices that the Company is exposed to. There have been no changes as to the way the Company measures risk or to the risk it is exposed or the manner in which these risks are managed and measured.

#### Interest rate sensitivity

The Company manages fair value interest rate risk through periodic estimation of potential losses that could arise from adverse changes in market conditions. The Company's management conducts monitoring of the Company's current financial performance, estimates the Company's sensitivity to changes in fair value interest rates and its influence on the Company's profitability.

The sensitivity analyses below have been determined based on the exposure to interest rates for non-derivative instruments at the end of the reporting period. For floating rate liabilities, the analysis is prepared assuming the amount of the liability outstanding at the end of the reporting period was outstanding for the whole year.

The following table presents a sensitivity analysis of interest rate risk, which has been determined based on "reasonably possible changes in the risk variable". The level of these changes is determined by management and is contained within the risk reports provided to key management personnel.



Impact on profit before tax:

	As at December 31, 2012		As at December 31, 2011		As at December 31, 2010	
	Interest rate	Interest rate	Interest rate	Interest rate	Interest rate	Interest rate
	+2%	-2%	+2%	-2%	+2%	-2%
<b>Financial assets:</b>						
Placements with banks with original maturities of less than three month	116,723	(116,723)	57,589	(57,589)	23,335	(23,335)
Loans to customers	877,092	(877,092)	705,567	(705,567)	507,192	(507,192)
Other financial assets	-	-	202	(202)	-	-
<b>Financial liabilities:</b>						
Amounts due to other financial institutions	(710,254)	710,254	(581,946)	581,946	(363,297)	363,297
Subordinated debt	(50,674)	50,674	(50,637)	50,637	(50,566)	50,566
<b>Net impact on profit before tax</b>	<b>232,887</b>	<b>(232,887)</b>	<b>130,775</b>	<b>(130,775)</b>	<b>116,664</b>	<b>(116,664)</b>

Impact on shareholders equity:

	As at December 31, 2012		As at December 31, 2011		As at December 31, 2010	
	Interest rate	Interest rate	Interest rate	Interest rate	Interest rate	Interest rate
	+2%	-2%	+2%	-2%	+2%	-2%
<b>Financial assets:</b>						
Placements with banks with original maturities of less than three month	93,378	(93,378)	46,071	(46,071)	18,668	(18,668)
Loans to customers	701,674	(701,674)	564,453	(564,453)	405,754	(405,754)
Other financial assets	-	-	162	(162)	-	-
<b>Financial liabilities:</b>						
Amounts due to other financial institutions	(568,203)	568,203	(465,557)	465,557	(290,637)	290,637
Subordinated debt	(40,539)	40,539	(40,510)	40,510	(40,453)	40,453
<b>Net impact on shareholders equity</b>	<b>186,310</b>	<b>(186,310)</b>	<b>104,619</b>	<b>(104,619)</b>	<b>93,332</b>	<b>(93,332)</b>

**Currency risk**

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Company is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The ALMC controls currency risk by management of the open currency position on the estimated basis of USD devaluation and other macroeconomic indicators, which gives the Company an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The Treasurer performs daily monitoring of the Company's open currency position.



The Company's exposure to foreign currency exchange rate risk is presented in the table below:

	AMD	USD USD 1 = 403.58 AMD	EUR EUR 1 = 532.24 AMD	December 31, 2012 Total
<b>Non-derivative financial assets</b>				
Cash and cash equivalents	4,300,099	1,776,027	1,787	6,077,913
Loans to customers	31,276,550	12,578,069	-	43,854,619
<b>Total non-derivative financial assets</b>	<b>35,576,649</b>	<b>14,354,096</b>	<b>1,787</b>	<b>49,932,532</b>
<b>Non-derivative financial liabilities</b>				
Amounts due from other financial institutions	24,494,098	11,018,598	-	35,512,696
Subordinated debt	-	2,533,686	-	2,533,686
Other financial liabilities	493,759	1,898	-	495,657
<b>Total non-derivative financial liabilities</b>	<b>24,987,857</b>	<b>13,554,182</b>	<b>-</b>	<b>38,542,039</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>10,588,792</b>	<b>799,914</b>	<b>1,787</b>	<b>11,390,493</b>

The gross basis of currency SWAP transaction of USD 1,600,000 (Note 12) is not shown in the foreign currency exchange rate risk table below. Instead this amount was shown after the offset of positions for each counterparty as at December 31, 2011 as a financial assets at fair value through profit and loss.

	AMD	USD USD 1 = 385.77 AMD	EUR EUR 1 = 498.72 AMD	December 31, 2011 Total
<b>Non-derivative financial assets</b>				
Cash and cash equivalents	1,632,468	1,565,171	798	3,198,437
Financial assets at fair value through profit and loss	10,121	-	-	10,121
Loans to customers	23,662,955	11,615,374	-	35,278,329
<b>Total non-derivative financial assets</b>	<b>25,305,544</b>	<b>13,180,545</b>	<b>798</b>	<b>38,486,887</b>
<b>Non-derivative financial liabilities</b>				
Amounts due from other financial institutions	17,365,435	11,731,879	-	29,097,314
Subordinated debt	-	2,531,856	-	2,531,856
Other financial liabilities	417,391	-	-	417,391
<b>Total non-derivative financial liabilities</b>	<b>17,782,826</b>	<b>14,263,735</b>	<b>-</b>	<b>32,046,561</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>7,522,718</b>	<b>(1,083,190)</b>	<b>798</b>	<b>6,440,326</b>



	AMD	USD USD 1 = 363.44 AMD	EUR EUR 1 = 481.16 AMD	December 31, 2010 Total
<b>Non-derivative financial assets</b>				
Cash and cash equivalents	595,467	943,542	506	1,539,515
Loans to customers	14,080,638	11,278,981	-	25,359,619
<b>Total non-derivative financial assets</b>	<b>14,676,105</b>	<b>12,222,523</b>	<b>506</b>	<b>26,899,134</b>
<b>Non-derivative financial liabilities</b>				
Amounts due from other financial institutions	9,414,996	8,749,832	-	18,164,828
Subordinated debt	-	2,528,285	-	2,528,285
Other financial liabilities	378,230	-	-	378,230
<b>Total non-derivative financial liabilities</b>	<b>9,793,226</b>	<b>11,278,117</b>	<b>-</b>	<b>21,071,343</b>
<b>OPEN BALANCE SHEET POSITION</b>	<b>4,882,879</b>	<b>944,406</b>	<b>506</b>	<b>5,827,791</b>

#### Currency risk sensitivity

The following table details the Company's sensitivity to a 10% increase and decrease in the AMD against USD. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations with the Company where the denomination of the loan is in a currency other than the functional currency of the lender or the borrower. A positive number below indicates an increase in profit and other equity where the USD strengthens 10% against the AMD. For a 10% weakening of the AMD against the USD, there would be a comparable impact on the profit and other equity, and the balances below would be negative.

	As at December 31, 2012		As at December 31, 2011		As at December 31, 2010	
	AMD/USDD	AMD/USD	AMD/USD	AMD/USD	AMD/USDD	AMD/USD
	10%	-10%	10%	-10%	10%	-10%
Impact on profit or loss	79,991	(79,991)	(108,319)	108,319	94,441	(94,441)
Impact on equity	63,993	(63,993)	(86,655)	86,655	75,552	(75,552)

	As at December 31, 2012		As at December 31, 2011		As at December 31, 2010	
	AMD/EUR	AMD/EUR	AMD/EUR	AMD/EUR	AMD/EUR	AMD/EUR
	10%	-10%	10%	-10%	10	-
Impact on profit or	179	(179)	80	(80)	51	(51)
Impact on equity	143	(143)	64	(64)	40	(40)

#### Limitations of sensitivity analysis

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analyses do not take into consideration that the Company's assets and liabilities are actively managed. Additionally, the financial position of the Company may vary at the time that any actual market movement occurs. For example, the Company's financial risk management strategy aims to manage the exposure to market fluctuations. As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation and



taking other protective action. Consequently, the actual impact of a change in the assumptions may not have any impact on the liabilities, whereas assets are held at market value in the statement of financial position. In these circumstances, the different measurement bases for liabilities and assets may lead to volatility in shareholder equity.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Company's view of possible near-term market changes that cannot be predicted with any certainty; and the assumption that all interest rates move in an identical fashion.

#### **Price risks**

Price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market. The Company is exposed to price risks of its products which are subject to general and specific market fluctuations.

The Company manages price risk through periodic estimation of potential losses that could arise from adverse changes in market conditions and establishing and maintaining appropriate stop-loss limits and margin and collateral requirements. With respect to undrawn loan commitments the Company is potentially exposed to a loss of an amount equal to the total amount of such commitments. However, the likely amount of a loss is less than that, since most commitments are contingent upon certain conditions set out in the loan agreements.

#### **Operational Risk**

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Company cannot expect to eliminate all operational risks, but it endeavours to manage these risks through a control framework and by monitoring and responding to potential risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes.

## **27. SUBSEQUENT EVENTS**

In January 2013 the Company concluded agreements on prolongation of loans obtained from Responsibility Global Microfinance Fund of USD 750,000, Responsibility SICAV (Lux) Mikrofinanz-Fonds of USD 500,000 and Responsibility SICAV (Lux) Financial Inclusion Fund of USD 750,000. All these loans were fixed with the AMD/USD exchange rate of December 19, 2011, published by Central Bank of Armenia into equivalent of AMD. Maturity of these loans was extended from January 2013 to January 2015.