

**HSBC Bank Armenia cjsc**

**Financial Statements**  
**for the year ended 31 December 2006**

## **Contents**

Independent Auditor's Report	2
Income Statement	3
Balance Sheet	4
Statement of Cash Flows	5
Statement of Changes in Shareholders' Equity	6
Notes to the Financial Statements	7-38



**KPMG Armenia cjsc**  
 8 Hanrapetutian Street  
 Yerevan 0010  
 Republic of Armenia

Telephone + 374 (10) 566 762  
 Fax + 374 (10) 566 762  
 Internet www.kpmg.am

## Independent Auditor's Report

Board of Directors  
 HSBC Bank Armenia cjsc

We have audited the accompanying balance sheet of the HSBC Bank Armenia cjsc (the "Bank") as of 31 December 2006, and the related statements of income, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the Armenian Auditing Standards. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position of the Company as of 31 December 2006, and of the results of its operations and its cash flows for the year then ended in accordance with Accounting Regulation of the Republic of Armenia.

Andrew Coxshall  
 Managing Director

Tigran Gasparyan  
 Manager, Audit Department

KPMG Armenia cjsc  
 Licensed auditors  
 4 April 2007



### Note to translation

The financial statements of HSBC Bank Armenia cjsc for the year ended 31 December 2006 were prepared in accordance with the accounting regulation of the Republic of Armenia and the related auditor's report were prepared in English language. In case of a discrepancy between the English and Armenian texts, the English text shall prevail.

		('000 AMD)	
	Notes	01/01/06-31/12/06	01/01/05-31/12/05
Interest income	3	5,024,423	3,352,637
Interest expense	4	(371,892)	(200,624)
<b>Net interest income</b>		<b>4,652,531</b>	<b>3,152,013</b>
Dividend income		-	-
Fee and commission income		1,415,070	1,201,143
Fee and commission expense		(110,851)	(95,424)
Net gain/(loss) from investments held for trading	5	(7,423)	3,356
Net gain/(loss) from investments available-for-sale	6	17,527	-
Net gain/(loss) from investments held-to-maturity		-	-
Net foreign exchange gain	7	1,179,237	1,161,044
Other operating income	8	165,838	99,624
<b>Operating income</b>		<b>7,311,929</b>	<b>5,521,756</b>
Impairment losses	9	(2,515)	77,212
General administrative expenses	10	(2,901,137)	(2,049,336)
Other operating expenses	11	(378,722)	(374,865)
Profit/(loss) on investments accounted for under the equity method		-	-
<b>Profit before taxes</b>		<b>4,029,555</b>	<b>3,174,767</b>
Income tax	12	(874,226)	(330,674)
<b>Profit after taxes</b>		<b>3,155,329</b>	<b>2,844,093</b>
Interim dividends of current year , of which		500,000	-
<i>on preference shares</i>		-	-
<i>on ordinary shares</i>		500,000	-
Basic earning per share		-	-
Diluted earnings per share		-	-
Retained earnings of current year after interim dividends		<b>2,655,329</b>	<b>2,844,093</b>

Anthony Turner  
 Chief Executive Officer

Ruzanna Shahinyan  
 Chief Accountant

4 April 2007



		('000 AMD)	
	Notes	31/12/2006	31/12/2005
<b>Assets</b>			
Cash and balances with the Central Bank of Armenia	13	10,350,753	13,469,171
Other balances with the Central Bank of Armenia	14	161,900	32,747
Precious metals bullions		-	-
Accounts and deposits in precious metals		-	-
Financial investments held for trading	15	1,332,679	1,173,243
Placements with other banks	16	16,798,471	26,800,923
Other placements	17	21	-
Loans and other advances to customers	18	30,539,372	16,377,079
Investments available-for-sale	19	14,842,253	6,828,431
Amounts receivable from banking operations	20	263,211	330,386
Lease receivables	21	-	-
Investments held-to-maturity	22	3,398,425	5,350,155
Investments in share capital of other entities	22/1	-	-
Capital investments in property, plant and equipment and intangible assets of the Bank	23	65,628	279
Property, plant and equipment and intangible assets	24	941,682	544,836
Deferred tax asset		-	-
Interest receivable	25	526,634	309,246
Other assets	26	1,237,120	333,715
<b>Total assets</b>		<b><u>80,458,149</u></b>	<b><u>71,550,211</u></b>
<b>Liabilities</b>			
Due to the Central Bank of Armenia	27	-	-
Due to other banks	28	259,272	101,501
Other borrowings	29	922,523	397,382
Current accounts and deposits from customers	30	66,404,180	60,812,358
Due to the Government of the Republic of Armenia	30/1	1,797,910	1,079,362
Lease payables	31	-	-
Deposit certificates issued by the Bank		-	-
Securities issued by the Bank	32	-	-
Provisions	9	-	-
Amounts payable	33	207,181	16,149
Deferred tax liability	33/1	38,401	3,359
Interest payable		97,396	39,768
Other liabilities	34	2,555,412	2,160,097
<b>Total liabilities</b>		<b><u>72,282,275</u></b>	<b><u>64,609,976</u></b>
<b>Equity</b>			
Share capital	35	2,437,600	2,437,600
Reserves			
<i>General reserve</i>		365,640	365,640
<i>Revaluation reserves</i>	36	(96,160)	(76,470)
Accumulated profit	36/1	5,468,794	4,213,465
<b>Total equity</b>		<b><u>8,175,874</u></b>	<b><u>6,940,235</u></b>
<b>Total equity and liabilities</b>		<b><u>80,458,149</u></b>	<b><u>71,550,211</u></b>

Anthony Turner  
 Chief Executive Officer

Ruzanna Shahinyan  
 Chief Accountant

4 April 2007



('000 AMD)

Notes	<u>01/01/06-31/12/06</u>	<u>01/01/05-31/12/05</u>
<b>Net cash flows from operating activities</b>	<b>(3,760,513)</b>	<b>(8,001,964)</b>
<i>Net cash flows before changes in operating assets and liabilities</i>	<b>3,897,081</b>	<b>3,024,234</b>
Interest receipts	4,776,513	3,346,763
Interest payments	(305,289)	(199,912)
Loss recovery	108,157	629
Dividends received	-	-
Net commissions received	1,485,356	1,218,776
Salary paid and other related payments	(1,419,016)	(1,032,297)
Taxes paid	(748,639)	(309,725)
<b>Net cash flows from changes in operating assets and liabilities</b>	<b>(7,657,594)</b>	<b>(11,026,198)</b>
Decrease/(increase) of allocated funds	(15,915,405)	(6,711,777)
Increase/(decrease) of attracted resources	17,134,972	2,540,600
Decrease/(increase) of investments held for trading and available-for-sale	(8,023,418)	(7,828,239)
Decrease/(increase) of finance lease receivables	-	-
Net cash flows from other operating activities	(853,743)	973,218
<b>Net cash flows from investing activities</b>	<b>1,353,306</b>	<b>1,824,789</b>
Decrease/(increase) of investments held-to-maturity	1,946,364	2,036,738
Decrease/(increase) of investments in share capital of other entities	-	-
Decrease/(increase) of capital investments in property, plant and equipment and intangible assets	(67,743)	(335)
Purchase of property, plant and equipment and intangible assets	(525,142)	(214,411)
Disposal of property, plant and equipment and intangible assets	(173)	2,797
Net cash flows from other investing activities	-	-
<b>Net cash flows from financing activities</b>	<b>(1,814,010)</b>	<b>(1,798,668)</b>
Dividends paid	(1,900,000)	(1,800,000)
Increase/(decrease) of borrowings received from the Central Bank of Armenia	-	-
Increase/(decrease) of borrowings received from banks	85,990	1,332
Increase/(decrease) of other borrowings received	-	-
Increase/(decrease) of other securities issued by the Bank	-	-
Investments of shareholders in share capital	-	-
Increase/(decrease) of finance lease payables	-	-
Net cash flows from other financing activities	-	-
Effect of changes in exchange rates on cash and cash equivalents	(5,817,467)	(4,602)
<b>Net cash flows</b>	<b>(10,038,684)</b>	<b>(7,980,445)</b>
Cash and cash equivalents at the beginning of the period	36,504,516	44,484,961
Cash and cash equivalents at the end of the period	44 <b>26,465,832</b>	<b>36,504,516</b>

Anthony Turner  
 Chief Executive Officer

Ruzanna Shahinyan  
 Chief Accountant

4 April 2007



*HSBC Bank Armenia cjsc*  
*Statement of Changes in Shareholders' Equity for the year ended 31 December 2006*  
*Address: 66 Teryan Street, Yerevan 0009, Republic of Armenia*

	<b>Share capital</b>	<b>General reserve</b>	<b>Revaluation reserve</b>	<b>Accumulated profit</b>	<b>('000 AMD) Total</b>
<b>Balance as at 31 December 2004</b>	2,437,600	365,640	-	3,169,372	5,972,612
Result of changes in accounting policies and adjustment of fundamental errors	-	-	-	-	-
<b>Restated balance</b>	2,437,600	365,640	-	3,169,372	5,972,612
Profit and loss recognised directly in equity	-	-	(76,470)	-	(76,470)
Investments in share capital	-	-	-	-	-
2004 annual dividends	-	-	-	(1,800,000)	(1,800,000)
Profit after taxes	-	-	-	2,844,093	2,844,093
<b>Balance as at 31 December 2005</b>	<u>2,437,600</u>	<u>365,640</u>	<u>(76,470)</u>	<u>4,213,465</u>	<u>6,940,235</u>
<b>Balance as at 31 December 2005</b>	2,437,600	365,640	(76,470)	4,213,465	6,940,235
Result of changes in accounting policies and adjustment of fundamental errors	-	-	-	-	-
<b>Restated balance</b>	2,437,600	365,640	(76,470)	4,213,465	6,940,235
Profit and loss recognised directly in equity	-	-	(19,690)	-	(19,690)
Investments in share capital	-	-	-	-	-
2005 annual dividends	-	-	-	(1,400,000)	(1,400,000)
Profit after taxes	-	-	-	3,155,329	3,155,329
2006 interim dividends	-	-	-	(500,000)	(500,000)
<b>Balance as at 31 December 2006</b>	<u>2,437,600</u>	<u>365,640</u>	<u>(96,160)</u>	<u>5,468,794</u>	<u>8,175,874</u>

Anthony Turner  
Chief Executive Officer

Ruzanna Shahinyan  
Chief Accountant

4 April 2007 



# **1 Background**

## **Principal activities of the Bank**

HSBC Bank Armenia cjsc (“the Bank”) was registered as a closed joint stock company in Armenia in 1995. The Bank provides a wide spectrum of financial and banking services and operates from its head office and branches located in the capital of Armenia. The average number of persons employed by the Bank during the year was 168 (2005: 140).

## **Shareholders**

The bank’s shareholders structure is the following: HSBC Europe B.V. (70%) and Wings Establishment (30%).

## **Armenian business environment**

In the current stage of economic development a certain level of instability is characteristic to the political and economic environment of the Republic of Armenia, which may affect the activities of enterprises operating in this environment. Consequently, operations in the Republic of Armenia involve risks, which do not typically exist in other markets. The accompanying financial statements reflect management’s assessment of the impact of the Armenian business environment on the operations and the financial position of the Bank. The future business environment may differ from management’s assessment.

# **2 Accounting standards**

## **Basis of preparation**

### **Statement of compliance**

The accompanying financial statements have been prepared in accordance with Accounting Regulation of Republic of Armenia (“ARRA”).

### **Basis of measurement**

The financial statements are prepared on the historical cost basis except that financial instruments held for trading and available for sale financial assets are stated at fair value, and land and buildings are revalued periodically.

### **Functional and presentation currency**

The national currency of the Republic of Armenia is the Armenian Dram (“AMD”). Management has determined the Bank’s measurement currency to be the AMD as it reflects the economic substance of the underlying events and circumstances of the Bank. The AMD is also the Bank’s presentation currency for the purposes of these financial statements.

### **Use of estimates and judgments**

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with ARRA. Actual results could differ from those estimates.

In particular, information about significant areas of estimation uncertainty and critical judgments in applying accounting policies are described in the following note:

Loan impairment estimates - Note 18

## **Significant accounting policies**

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

### **Foreign currency transactions**

Transactions in foreign currencies are translated to the appropriate functional currency at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the functional currency at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated to the functional currency at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities that are stated at fair value and whose appraised value is denominated in foreign currencies are translated to the functional currency at the foreign exchange rate ruling at the dates the fair values were determined. Foreign exchange differences arising on translation are recognised in the income statement.

The official rate of exchange prevailing at the year end was AMD 363.50 = USD 1 (2005: AMD 450.19 = USD 1).

### **Cash and cash equivalents**

The Bank considers cash, balances with the Central Bank of Armenia (CBA), except for deposits with the CBA, which are blocked as collateral for bank cards settlement activities, and nostro accounts with correspondent banks to be cash and cash equivalents. The minimum reserve deposit with the CBA is considered to be a cash equivalent due to the absence of any restrictions on its withdrawability.

### **Financial instruments**

#### ***Classification***

*Held-for-trading instruments* are those that the Bank principally holds for the purpose of short-term profit taking.

*Originated loans and receivables* are loans and receivables created by the Bank providing money to a debtor other than those created with the intention of short-term profit taking. Originated loans and receivables comprise loans and advances to banks and customers other than purchased loans.

*Held-to-maturity investments* are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intention and ability to hold to maturity, other than those that:

- the Bank holds for the purpose of short-term profit taking;
- the Bank designates as available-for-sale; or
- meet the definition of loans and receivables.

*Available-for-sale assets* are those financial assets that are designated as available for sale or are not classified as loans and receivables, held to maturity investments or trading instruments.

#### ***Recognition***

Financial assets and liabilities are recognised in the balance sheet when the Bank becomes a party to the contractual provisions of the instrument. All regular way purchases of financial assets are accounted for at the settlement date.

### **Measurement**

A financial asset or liability is initially measured at cost plus, in the case of a financial asset or liability not being trading instrument, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

Subsequent to initial recognition, financial assets, including derivatives that are assets, are measured at their fair values, without any deduction for transaction costs that may be incurred on sale or other disposal, except for:

- originated loans and receivables which are measured at amortised cost using the effective interest method;
- held to maturity investments which are measured at amortised cost using the effective interest method; and
- investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured which are measured at cost.

All financial liabilities, other than trading liabilities and financial liabilities that arise when a transfer of a financial asset carried at fair value does not qualify for derecognition, are measured at amortised cost. Amortised cost is calculated using the effective interest method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

### **Fair value measurement principles**

The fair value of financial instruments is based on their quoted market price at the balance sheet date without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument is estimated using pricing models or discounted cash flow techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate at the balance sheet date for an instrument with similar terms and conditions. Where pricing models are used, inputs are based on market related measures at the balance sheet date.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Bank would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties.

### **Gains and losses on subsequent measurement**

A gain or loss arising from a change in the fair value of a financial asset or liability is recognised as follows:

- a gain or loss on a financial instrument classified as held for trading is recognised in the income statement
- a gain or loss on an available-for-sale financial asset is recognised directly in equity through the statement of changes in shareholders' equity (except for impairment losses and foreign exchange gains and losses) until the asset is derecognised, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement. Interest in relation to an available-for-sale financial asset is recognised as earned in the income statement calculated using the effective interest method.

For financial assets and liabilities carried at amortised cost, a gain or loss is recognised in the income statement when the financial asset or liability is derecognised or impaired, and through the amortization process.

### ***Derecognition***

A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire or when the Bank transfers substantially all of the risks and rewards of ownership of the financial asset. Any rights or obligations created or retained in the transfer are recognised separately as assets or liabilities. A financial liability is derecognised when it is extinguished.

### **Repurchase and reverse repurchase agreements**

Securities sold under sale and repurchase (“repo”) agreements are accounted for as secured financing transactions, with the securities retained in the balance sheet and the counterparty liability included in amounts due to other banks or to customers, as appropriate. The difference between the sale and repurchase price represents interest expense and is recognised in the income statement over the terms of the repo agreement.

Securities purchased under agreements to resell (“reverse repo”) are recorded as due from banks or customers as appropriate. In addition securities purchased are recorded on balance sheet with the corresponding liability. The differences between the sale and repurchase prices are treated as interest and accrued over the life of the reverse repo agreement using the effective interest method.

### **Offsetting**

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

### **Property and equipment**

#### ***Owned assets***

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses, except for land and buildings which are stated at revalued amounts as described below.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

#### ***Leased assets***

Operating leases, under the terms of which the Bank does not assume substantially all the risks and rewards of ownership, are expensed.

#### ***Revaluation***

Land and buildings of the Bank are subject to revaluation on a regular basis. The frequency of revaluation depends upon the movements in the fair values of the land and buildings being revalued. A revaluation increase on an item of land and building is recognised directly in equity except to the extent that it reverses a previous revaluation decrease recognised in the statement of income, in which case it is recognised in the statement of income. A revaluation decrease on an item of land or buildings is recognised in the statement of income except to the extent that it reverses a previous revaluation increase recognised directly in equity, in which case it is recognised directly in equity.

The revaluation surplus included in equity in respect of an item of property, plant and equipment is transferred directly to retained earnings when the asset is derecognized.

## **Depreciation**

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Land is not depreciated. Leasehold improvements are depreciated over the shorter of the asset useful life and lease term. The estimated useful lives are as follows:

Buildings	20 years
Leasehold improvements	up to 10 years
Vehicles	5 years
Computer equipment	3 to 5 years
Other	5 years

## **Intangible assets**

Intangible assets, which are acquired by the Bank, are stated at cost less accumulated amortisation and impairment losses.

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives are as follows:

Computer software	3 years
Other	10 years

## **Impairment**

### ***Financial assets carried at amortised cost***

Financial assets carried at amortised cost consist principally of loans and other receivables (“loans and receivables”). The Bank reviews its loans and receivables, to assess impairment on a regular basis. A loan or receivable is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the loan or receivable and that event (or events) has an impact on the estimated future cash flows of the loan that can be reliably estimated.

The Bank first assesses whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for loans and receivables that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed loan or receivable, whether significant or not, it includes the loan in a group of loans and receivables with similar credit risk characteristics and collectively assesses them for impairment. Loans and receivables that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on a loan or receivable has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan or receivable and the present value of estimated future cash flows including amounts recoverable from guarantees and collateral discounted at the loan or receivable’s original effective interest rate. Contractual cash flows and historical loss experience adjusted on the basis of relevant observable data that reflect current economic conditions provide the basis for estimating expected cash flows.

In some cases the observable data required to estimate the amount of an impairment loss on a loan or receivable may be limited or no longer fully relevant to current circumstances. This may be the case when a borrower is in financial difficulties and there are few available historical data relating to similar borrowers. In such cases, the Bank uses its experience and judgement to estimate the amount of any impairment loss.

All impairment losses in respect of loans and receivables are recognised in the income statement and are only reversed if a subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

### ***Financial assets carried at cost***

Financial assets carried at cost include unquoted equity instruments included in available-for-sale assets that are not carried at fair value because their fair value can not be reliably measured. If there is objective evidence that such investments are impaired the impairment loss is calculated as the difference between the carrying amount of the investment and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset.

All impairment losses in respect of these investments are recognised in the income statement.

### ***Non financial assets***

Other non financial assets, other than deferred taxes, are assessed at each reporting date for any indications of impairment. The recoverable amount of non financial assets is the greater of their 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 an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is recognised when the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

All impairment losses in respect of non financial assets are recognised in the income statement and reversed only if there has been a change in the estimates used to determine the recoverable amount. Any impairment loss reversed is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

### **Provisions**

A provision is recognised in the balance sheet when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

### **Dividends**

The ability of the Bank to declare and pay dividends is subject to the rules and regulations of the Armenian legislation.

Dividends in relation to ordinary shares are reflected as an appropriation of retained earnings in the period when they are declared.

## **Taxation**

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

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The temporary differences for the initial recognition of assets or liabilities that affect neither accounting nor taxable profit are not provided for. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences, unused tax losses and credits can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

## **Interest income and expenses and fee and commission income**

Interest income and expense are recognised in the income statement as they accrue, taking into account the effective interest rate of the asset/liability or an applicable floating rate. Interest income and expense include the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

Loan organization fees, loan servicing fees and other fees that are considered to be integral to the overall profitability of a loan, together with the related direct costs, are deferred and amortised to interest income over the estimated life of the financial instrument using the effective interest rate method.

Other fee and commission income is recognised when the corresponding service is provided.

### 3 Interest income

	<b>01/01/06- 31/12/06</b>	<b>(‘000 AMD) 01/01/05- 31/12/05</b>
Interest income on correspondent account with the CBA	-	27
Interest income on other placements with the CBA	11,426	23,875
Interest income on correspondent accounts with resident banks	-	-
Interest income on placements with resident banks and other financial institutions	17,630	4,544
Interest income on correspondent accounts with non-resident banks	293,824	170,773
Interest income on placements with non-resident banks and other financial institutions	740,985	712,186
Interest income on loans and advances to resident legal entities and institutions	1,816,213	1,274,245
Interest income on loans and advances to non-resident legal entities and institutions	53	42
Interest income on loans and advances to resident individuals	1,086,883	399,752
Interest income on loans and advances to non-resident individuals	28,603	14,850
Interest income on loans and advances to the employees of the Bank	24,130	17,095
Interest income on loans and advances to the related parties	27,099	19,464
Interest income on investments in treasury bills	975,466	715,784
Interest income on investments in other securities	2,111	-
Other interest income	-	-
	<b><u>5,024,423</u></b>	<b><u>3,352,637</u></b>

## 4 Interest expense

	<b>01/01/06- 31/12/06</b>	<b>(‘000 AMD) 01/01/05- 31/12/05</b>
Interest expense on resources from the CBA by repurchase agreements	-	-
Interest expense on other resources from the CBA	-	-
Interest expense on correspondent accounts with resident banks	-	-
Interest expense on other resources from resident banks and other financial institutions	2,338	86
Interest expense on correspondent accounts with non-resident banks	-	-
Interest expense on other resources from non-resident banks and other financial institutions	1,263	2,986
Interest expense on bank accounts and demand deposits of resident legal entities and institutions	43,940	38,104
Interest expense on bank accounts and demand deposits of resident individuals	10,209	15,776
Interest expense on bank accounts and demand deposits of non-resident legal entities and institutions	384	138
Interest expense on bank accounts and demand deposits of non-resident individuals	789	2,105
Interest expense on demand deposits of other non-residents	-	-
Interest expense on term deposits of resident legal entities and institutions	92,419	43,354
Interest expense on term deposits of resident individuals	115,676	19,818
Interest expense on term deposits of non-resident legal entities and institutions	5,322	1,365
Interest expense on term deposits of non-resident individuals	18,333	7,544
Interest expense on term deposits of other non-residents	-	-
Interest expense on repurchase and swap agreements signed with resident legal entities and institutions	-	-
Interest expense on repurchase and swap agreements signed with resident individuals	-	-
Interest expense on repurchase and swap agreements signed with non-resident legal entities and institutions	-	-
Interest expense on repurchase and swap agreements signed with non-resident individuals	-	-
Interest expense on due to the RA Government	12	15
Interest expense on accrued but non-collected interest from non-performing assets	-	-
Other interest expense	81,207	69,333
	<b>371,892</b>	<b>200,624</b>

Included in other interest expenses are amounts payable to the Deposit Guarantee Fund of AMD 71,074 thousand (2005: AMD 65,997 thousand), which are calculated on the accounts of individual customers, at 0.05% per quarter.

## 5 Net gain/(loss) from investments held for trading

	<b>01/01/06- 31/12/06</b>	<b>(‘000 AMD) 01/01/05- 31/12/05</b>
Net gain from sale of investments held for trading	22,345	506
Net gain/(loss) from revaluation of investments held for trading	(29,768)	2,850
	<b>(7,423)</b>	<b>3,356</b>

## 6 Net gain/(loss) from investments available-for-sale

	01/01/06- 31/12/06	(‘000 AMD) 01/01/05- 31/12/05
Net gain from sale of investments available-for-sale	14,691	-
Net gain from revaluation of investments available for sale	2,836	-
	<u>17,527</u>	<u>-</u>

## 7 Net foreign exchange gain

	01/01/06- 31/12/06	(‘000 AMD) 01/01/05- 31/12/05
Net gain/(loss) from sale of foreign exchange	1,143,092	1,165,646
Net gain/(loss) from revaluation of foreign exchange	36,145	(4,602)
	<u>1,179,237</u>	<u>1,161,044</u>

## 8 Other operating income

	01/01/06- 31/12/06	(‘000 AMD) 01/01/05- 31/12/05
Income from operations with guarantees, letters of acceptance and credit and trustee management	108,561	64,242
Net income from derivatives		
Net income from disposal of property, plant and equipment	(8,731)	(3,809)
Net income from revaluation of property, plant and equipment and intangible assets	48,689	-
Income on penalties and fines received	4,298	2,020
Income from factoring	-	-
Net income received from operations with precious metals bullions and commemorative coins	-	-
Extraordinary income	-	29,274
Other income	13,021	7,897
	<u>165,838</u>	<u>99,624</u>

Net income from revaluation of property, plant and equipment and intangible assets represent reversal of previous negative revaluation on property and equipment.

## 9 Impairment losses

	01/01/06- 31/12/06	('000 AMD) 01/01/05- 31/12/05
<b>Provision on correspondent accounts and deposits</b>		
Opening balance	-	-
Provision charge	-	-
Reversal of provision	-	-
Net provision charge	-	-
Closing balance	-	-
<b>Provision on loans provided</b>		
Opening balance	<b>(416)</b>	<b>(94,515)</b>
Provision charge	(2,735)	(1,072)
Reversal of provision	220	95,144
Net provision charge	(2,515)	94,072
Loans written off to off-balance sheet	3,151	656
Repayment of loans written off to off-balance sheet	(220)	(629)
Closing balance	-	<b>(416)</b>
<b>Provision on investments held-to-maturity</b>		
Opening balance	-	<b>(4,962)</b>
Provision charge	-	-
Reversal of provision	-	4,962
Net provision charge	-	4,962
Investments written-off	-	-
Closing balance	-	-
<b>Provision on receivables and other assets</b>		
Opening balance	-	-
Provision charge	-	(21,822)
Reversal of provision	-	-
Net provision charge	-	(21,822)
Receivables written off to off-balance sheet	-	21,822
Repayment of receivables written off to off-balance sheet	-	-
Closing balance	-	-
<b>Total provision on assets</b>		
Opening balance	<b>(416)</b>	<b>(99,477)</b>
Provision charge	(2,735)	(22,894)
Reversal of provision	220	100,106
Net provision charge	(2,515)	77,212
Assets written off to off-balance sheet	3,151	22,478
Repayment of assets written off to off-balance sheet	(220)	(629)
Closing balance	-	<b>(416)</b>
<b>Provision on off-balance sheet contingencies</b>		
Opening balance	-	-
Provision charge	-	-
Reversal of provision	-	-
Net provision charge	-	-
Closing balance	-	-
<b>Total provision on assets and off-balance sheet contingencies</b>		
Opening balance	<b>(416)</b>	<b>(99,477)</b>
Provision charge	(2,735)	(22,894)
Reversal of provision	220	100,106
Net provision charge	(2,515)	77,212
Assets written off to off-balance sheet	3,151	22,478
Repayment of assets written off to off-balance sheet	(220)	(629)
Closing balance	-	<b>(416)</b>

## 10 General administrative expenses

	<b>01/01/06- 31/12/06</b>	<b>(‘000 AMD) 01/01/05- 31/12/05</b>
Salary and equivalent payments	1,531,639	1,066,410
Expenses on contributions to the state social security fund	90,587	60,892
Training	19,850	23,305
Business trip expenses	12,812	3,795
Rent of the Bank’s building and other property, plant and equipment	143,460	84,777
Insurance expenses	151,207	139,532
Maintenance expenses on the Bank’s equipment	29,680	15,881
Maintenance and security expenses on the Bank’s buildings	61,457	60,243
Audit and consulting services	37,481	30,094
Communication	104,618	34,849
Transport	11,903	8,233
Taxes, duties and other mandatory payments	7,130	5,311
Office and organisational expenses	63,623	57,396
Expenses on provision and repayment of loans	31,419	-
Other administrative expenses	604,271	458,618
	<b><u>2,901,137</u></b>	<b><u>2,049,336</u></b>

## 11 Other operating expenses

	<b>01/01/06- 31/12/06</b>	<b>(‘000 AMD) 01/01/05- 31/12/05</b>
Penalties and fines paid	15,570	2,783
Advertising and representation expenses	102,911	29,520
Expenses on factoring	-	-
Amortization expenses on property, plant and equipment and intangible assets	170,244	253,386
Expenses on acceptance of guarantees and promissory notes, and operations with letters of credit and powers of attorney	-	-
Extraordinary expenses	-	-
Other operating expenses	89,997	89,176
	<b><u>378,722</u></b>	<b><u>374,865</u></b>

## 12 Income tax

	<b>01/01/06- 31/12/06</b>	<b>(‘000 AMD) 01/01/05- 31/12/05</b>
<b>Current tax expense</b>		
Current year	800,093	343,596
Under/(over) provided in prior years	23,547	(7,848)
	<b>823,640</b>	<b>335,748</b>
<b>Deferred tax expense</b>		
Origination and reversal of temporary differences	38,731	(5,074)
Increase in tax rate	11,855	-
	<b>50,586</b>	<b>(5,074)</b>
<b>Total income tax expense in the income statement</b>	<b>874,226</b>	<b>330,674</b>

The profits tax in Armenia is 20% (2005: 20%). However, the Bank was granted favourable profit tax status and paid profits tax at 50% of the standard rate until 15 January 2006.

### Reconciliation of effective tax rate:

<b>(‘000 AMD)</b>	<b>01/01/06- 31/12/06</b>	<b>%</b>	<b>01/01/05- 31/12/05</b>	<b>%</b>
Income before tax	4,029,555		3,174,767	
Income tax at the applicable tax rate	805,911	20.0	317,477	10.0
Non-deductible costs/(non-taxable income)	32,913	0.8	21,045	0.7
Under/(over) provided in prior years	23,547	0.6	(7,848)	(0.3)
Change in estimate related to change in statutory tax rate	11,855	0.3	-	-
	<b>874,226</b>	<b>21.7</b>	<b>330,674</b>	<b>10.4</b>

## 13 Cash and balances with the Central Bank of Armenia

	<b>31/12/06</b>	<b>(‘000 AMD) 31/12/05</b>
Cash and equivalent payment documents	4,457,544	4,009,572
Correspondent accounts with the CBA	5,893,209	5,159,599
Deposits in the CBA	-	4,300,000
Provision on receivables and other assets	-	-
	<b>10,350,753</b>	<b>13,469,171</b>

The correspondent account with the Central Bank of Armenia includes a reserve amounting to AMD 5,668,254 thousand (2005: AMD 5,099,673 thousand), which is calculated in accordance with regulations promulgated by the Central Bank of Armenia. As at 31 December 2006 the interest rate on correspondent accounts was 0% per annum (2005: 0%). Withdrawal of such reserves is not restricted, however, the Bank is subject to penalties if the required balance is not maintained in average for 14 days period.

## 14 Other balances with the Central Bank of Armenia

	31/12/06	('000 AMD) 31/12/05
Repurchase and swap agreements with the CBA	-	-
Due from the CBA	161,900	32,747
	<b>161,900</b>	<b>32,747</b>

As of 31 December 2006 the Bank maintained a balance of AMD 161,900 thousand (2005: AMD 32,747 thousand) on the correspondent account with the CBA, which was frozen for settlement activities through the ArCa payment system.

## 15 Financial investments held for trading

	31/12/06	('000 AMD) 31/12/05
Government securities of the Republic of Armenia	1,332,576	1,172,045
Government securities of other countries	-	-
Non-government securities of the Republic of Armenia	-	-
Non-government securities of other countries	-	-
Receivables on factoring	-	-
Derivative instruments	103	1,198
Provision on receivables and other assets	-	-
	<b>1,332,679</b>	<b>1,173,243</b>

## 16 Placements with other banks

	31/12/06	('000 AMD) 31/12/05
Correspondent accounts and demand deposits with resident banks	-	-
Correspondent accounts and demand deposits with non-resident banks	16,115,079	23,035,345
Term deposits in resident banks	-	-
Term deposits in non-resident banks	-	3,600,397
Loans to resident banks	448,500	112,548
Loans to non-resident banks	-	-
Repurchase and swap agreements with resident banks	190,313	-
Repurchase and swap agreements with non-resident banks	-	-
Due from resident banks	-	-
Due from non-resident banks	44,579	52,633
Provision on deposits, correspondent accounts and loans	-	-
	<b>16,798,471</b>	<b>26,800,923</b>

### Concentration of placements with banks

As at 31 December 2006 and 2005 the Bank had three and five banks, respectively, whose balances exceeded 10% of total placements with banks. The gross value of these balances as of 31 December 2006 and 2005 were AMD 15,026,077 thousand and AMD 22,758,682 thousand, respectively.

## 17 Other placements

	31/12/06	('000 AMD) 31/12/05
Demand deposits in other non-resident financial organisations	-	-
Term deposits in other non-resident financial organisations	-	-
Loans to other resident financial organisations	-	-
Loans to other non-resident financial organisations	21	-
Repurchase and swap agreements with other resident financial organizations	-	-
Repurchase and swap agreements with other non-resident financial organizations	-	-
Provision on deposits and loans	-	-
	<u>21</u>	<u>-</u>

## 18 Loans and other advances to customers

	31/12/06	('000 AMD) 31/12/05
Loans to resident legal entities and institutions	15,429,829	10,625,341
Loans to non-resident legal entities and institutions	877	1,098
Loans to resident individuals	13,442,537	4,527,581
Loans to non-resident individuals	258,338	218,067
Loans to employees of the Bank	683,350	517,237
Loans to related parties	724,441	488,171
Repurchase and swap agreements with resident legal entities and institutions	-	-
Repurchase and swap agreements with non-resident legal entities and institutions	-	-
Repurchase agreements with resident individuals	-	-
Repurchase agreements with non-resident individuals	-	-
Provision on loans provided	-	(416)
	<u>30,539,372</u>	<u>16,377,079</u>

### Significant credit exposures

As at 31 December 2006 and 2005 the Bank did not have any borrowers or groups of related borrowers, whose loan balances exceeded more than 10% of loans to customers.

### Contractually overdue loans

Information in relation to loans with contractually overdue principal or interest as at 31 December 2006 and 2005, is summarised as follows:

	31/12/06	('000 AMD) 31/12/05
Overdue loans principal and interest	1,151	238
Provision for impairment	-	(182)
Net contractually overdue loans recorded in the balance sheet	<u>1,151</u>	<u>56</u>

The Bank has reviewed its current commercial and consumers loan portfolios and has identified no impaired loans.

The Bank did not create collective provision for the consumer and commercial loan portfolio as the Bank has no material historical losses on its commercial and consumer loans.

## 19 Investments available-for-sale

	<u>31/12/06</u>	<u>(’000 AMD)</u> <u>31/12/05</u>
Government securities of the Republic of Armenia	14,708,039	6,815,509
Government securities of other countries	-	-
Non-government securities of the Republic of Armenia	124,031	12,143
Non-government securities of other countries	10,183	779
Receivables on factoring	-	-
Provision on investments in securities	-	-
	<u><u>14,842,253</u></u>	<u><u>6,828,431</u></u>

Included in non-government securities AMD 22,326 thousand represent unquoted equity instruments classified as available-for-sale.

The above instruments are stated at cost and comprise unquoted equity securities in the financial services industry. There is no market for these investments and there have not been any recent transactions that provide evidence of the current fair values. In addition, discounted cash flow techniques yield a wide range of fair values due to the uncertainty regarding future cash flows.

## 20 Amounts receivable from banking operations

	<u>31/12/06</u>	<u>(’000 AMD)</u> <u>31/12/05</u>
Dividends receivable	-	-
Receivables on trustee management	-	-
Letters of credit and bank guarantees	260,836	319,193
Hedging derivative instruments	-	-
Other receivables	2,375	11,193
Provision on receivables and other assets	-	-
	<u><u>263,211</u></u>	<u><u>330,386</u></u>

## 21 Lease receivables

	<u>31/12/06</u>	<u>(’000 AMD)</u> <u>31/12/05</u>
Lease receivables	-	-
Financial income not received	-	-
Provision on receivables and other assets	-	-
	<u><u>-</u></u>	<u><u>-</u></u>

## 22 Investments held-to-maturity

	<u>31/12/06</u>	<u>(’000 AMD)</u> <u>31/12/05</u>
Government securities of the Republic of Armenia	3,398,425	5,350,155
Government securities of other countries	-	-
Non-government securities of the Republic of Armenia	-	-
Non-government securities of other countries	-	-
Receivables on factoring	-	-
Provision on impairment of investments held to maturity	-	-
Provision on receivables and other assets	-	-
	<u><u>3,398,425</u></u>	<u><u>5,350,155</u></u>

## 22/1 Investments in share capital of other entities

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
Investments in share capital of other entities accounted for under the equity method	-	-
Investments in share capital of other entities accounted for by cost method	-	-
Provision on impairment of investments in share capital of other entities	-	-
	<u>-</u>	<u>-</u>

## 23 Capital investments in property, plant and equipment and intangible assets of the Bank

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
Capital investments in property, plant and equipment	-	-
Capital investments in intangible assets	-	-
Capital investments in leased property, plant and equipment	65,628	279
	<u>65,628</u>	<u>279</u>

## 24 Property, plant and equipment and intangible assets

01/01/06-31/12/06	('000 AMD)				
Assets in use	Land, buildings, fixtures and fittings	Computer equipment	Motor vehicles	Other property, plant and equipment and intangible assets	Total
<b>Cost</b>					
At the end of the prior year	608,350	408,995	60,649	282,319	1,360,313
Additions	10,841	96,402	46,914	60,512	214,669
Disposals	(4,344)	(18,610)	(62)	(29,144)	52,160)
At the end of the current year	614,847	486,787	107,501	313,687	1,522,822
<b>Depreciation and impairment losses</b>					
Opening balance	378,475	281,298	39,601	216,747	916,121
Depreciation charge	25,092	21,728	14,510	18,326	79,656
Disposals	(4,344)	(17,939)	(38)	(29,048)	51,369)
Reversal of previously recognised impairment losses	(48,689)				(48,689)
Closing balance	350,534	285,087	54,073	206,025	895,719
<b>Net carrying value</b>					
At the end of the prior year	229,875	127,697	21,048	65,572	444,192
At the end of the current year	264,313	201,700	53,428	107,662	627,103
<b>Assets not in use</b>					
<b>Cost</b>					
At the end of the prior year	3,520	165,625	837	23,321	193,303
Additions	69,916	202,527	-	38,030	310,473
Disposals	(179)	(81,975)	-	(5,686)	(87,840)
At the end of the current year	73,257	286,177	837	55,665	415,936
<b>Depreciation and impairment losses</b>					
Opening balance	2,532	76,791	399	12,937	92,659
Depreciation charge	1,025	73,902	-	13,269	88,196
Disposals	(169)	(74,067)	-	(5,262)	(79,498)
Closing balance	3,388	76,626	399	20,944	101,357
<b>Net carrying value</b>					
At the end of the prior year	988	88,834	438	10,384	100,644
At the end of the current year	69,869	209,551	438	34,721	314,579
<b>Total net carrying value</b>					
At the end of the prior year	230,863	216,531	21,486	75,956	544,836
At the end of the current year	334,182	411,251	53,866	142,383	941,682
<b>Carrying value had no revaluations/(impairment) taken place</b>					
At the end of the current year	411,617	411,251	53,866	142,383	1,019,117

### Revalued assets

At 31 December 2006 the buildings were revalued by Management based on the results of an independent appraisal performed by "AV Bursa" Ltd. The basis used for the appraisals was the market approach, which was based upon an analysis of the results of comparable sales of similar buildings. As a result of this appraisal AMD 48,689 thousand of previously recognised impairment losses were reversed.

## 25 Interest receivable

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
Accrued interest	526,634	309,246
Interest income not recognised	-	-
	<u><b>526,634</b></u>	<u><b>309,246</b></u>

## 26 Other assets

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
Receivables	63,159	68,160
Advances to employees and suppliers	916,653	13,617
Advances to the budget and with respect to mandatory social security payments	-	-
Provision on receivables and other assets	-	-
Expenses of future periods	102,124	89,620
Small value items	55,372	44,593
Securities sold under repurchase agreements	-	-
Securities sold under swap agreements	-	-
Other assets	99,812	117,725
	<u><b>1,237,120</b></u>	<u><b>333,715</b></u>

## 27 Due to the Central Bank of Armenia

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
Loans received from the CBA	-	-
Repurchase and swap agreements with the CBA	-	-
	<u><b>-</b></u>	<u><b>-</b></u>

## 28 Due to other banks

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
Correspondent accounts and demand deposits of resident banks	51,597	16,151
Correspondent accounts and demand deposits of non-resident banks	121,504	84,018
Term deposits of resident banks	-	-
Term deposits of non-resident banks	-	-
Loans from resident banks	-	-
Loans from non-resident banks	86,171	1,332
Repurchase and swap agreements with resident banks	-	-
Repurchase and swap agreements with non-resident banks	-	-
Other amounts due to resident banks	-	-
Other amounts due to non-resident banks	-	-
	<u><b>259,272</b></u>	<u><b>101,501</b></u>

## 29 Other borrowings

	<u>31/12/06</u>	<u>(’000 AMD)</u> <u>31/12/05</u>
Bank accounts and demand deposits of other resident financial organisations	780,119	346,211
Bank accounts and demand deposits of other non-resident financial organisations	66,069	37,483
Term deposits of other resident financial organisations	76,335	13,688
Term deposits of other non-resident financial organisations	-	-
Loans from other resident financial organisations	-	-
Loans from other non-resident financial organisations	-	-
Repurchase and swap agreements with other resident financial organisations	-	-
Repurchase and swap agreements with other non-resident financial organisations	-	-
	<u><b>922,523</b></u>	<u><b>397,382</b></u>

## 30 Current accounts and deposits from customers

	<u>31/12/06</u>	<u>(’000 AMD)</u> <u>31/12/05</u>
Bank accounts and demand deposits of resident legal entities and institutions	17,797,595	15,678,476
Bank accounts and demand deposits of non-resident legal entities and institutions	5,264,676	6,673,173
Bank accounts and demand deposits of resident individuals	21,400,315	21,288,476
Bank accounts and demand deposits of non-resident individuals	5,866,730	7,241,574
Demand deposits of other non-residents	-	-
Term deposits of resident legal entities and institutions	5,642,686	2,193,438
Term deposits of non-resident legal entities and institutions	104,454	19,397
Term deposits of resident individuals	9,224,100	6,231,488
Term deposits of non-resident individuals	1,103,624	1,486,336
Term deposits of other non-residents	-	-
Repurchase and swap agreements with resident legal entities and institutions	-	-
Repurchase and swap agreements with non-resident legal entities and institutions	-	-
Repurchase and swap agreements with resident individuals	-	-
Repurchase and swap agreements with non-resident individuals	-	-
	<u><b>66,404,180</b></u>	<u><b>60,812,358</b></u>

### Concentrations of current accounts and deposits from customer

As of 31 December 2006 and 2005 the Bank had no customer, whose balance exceeded 10% of total current accounts and deposits from customers.

## 30/1 Due to the Government of the Republic of Armenia

	<u>31/12/06</u>	<u>(’000 AMD)</u> <u>31/12/05</u>
Bank accounts and deposits of Project Implementation Units	1,797,910	1,079,362
Other liabilities to the Government	-	-
	<u><b>1,797,910</b></u>	<u><b>1,079,362</b></u>

### 31 Lease payables

	<b>31/12/06</b>	<b>(’000 AMD) 31/12/05</b>
Lease payables	-	-
Financial expenses not incurred	-	-
	-	-

### 32 Securities issued by the Bank

	<b>31/12/06</b>	<b>(’000 AMD) 31/12/05</b>
Interest bearing securities	-	-
Non-interest bearing securities	-	-
Other securities issued	-	-
	-	-

### 33 Amounts payable

	<b>31/12/06</b>	<b>(’000 AMD) 31/12/05</b>
Dividends payable	-	-
Payables on trustee management agreements	-	-
Liabilities on deposits insurance	16,868	16,149
Other payables	190,313	-
	<b>207,181</b>	<b>16,149</b>

### 33/1 Deferred tax liability

Temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes give rise to net deferred tax liabilities as of 31 December 2006 and 2005. These deferred tax liabilities have been recognised in these financial statements.

These deductible temporary differences, which have no expiry dates, are listed below at their tax effected accumulated values:

	Assets		Liabilities		Net	
	2006	2005	2006	2005	2006	2005
Cash and balances with the Central Bank of Armenia	-	-	128	40	128	40
Financial investments held for trading	(89)	-	-	139	(89)	139
Placements with other banks	-	-	33,216	26,801	33,216	26,801
Loans and other advances to customers	-	-	103,154	22,415	103,154	22,415
Investments available-for-sale	(27,549)	(8,496)	4,393	500	(23,156)	(7,996)
Amounts receivable from banking operations	-	-	526	864	526	864
Property, plant and equipment and intangible assets	(23,192)	(17,909)	-	-	(23,192)	(17,909)
Interest receivable	-	-	868	279	868	279
Other assets	-	-	30,220	6,542	30,220	6,542
Other liabilities	(113,064)	(33,665)	29,790	5,849	(83,274)	(27,816)
<b>Total deferred tax (assets)/liabilities</b>	<b>(163,894)</b>	<b>(60,070)</b>	<b>202,295</b>	<b>63,429</b>	<b>38,401</b>	<b>3,359</b>

#### Movement in temporary differences during the year

	Balance 1 January 2006	Recognised in income statement	Recognised in equity	(’000 AMD) Balance 31 December 2006
Cash and balances with the Central Bank of Armenia	40	88	-	128
Financial investments held for trading	139	(228)	-	(89)
Placements with other banks	26,801	6,415	-	33,216
Loans and other advances to customers	22,415	80,739	-	103,154
Investments available-for-sale	(7,996)	384	(15,544)	(23,156)
Amounts receivable from banking operations	864	(338)	-	526
Property, plant and equipment and intangible assets	(17,909)	(5,283)	-	(23,192)
Interest receivable	279	589	-	868
Other assets	6,542	23,678	-	30,220
Other liabilities	(27,816)	(54,458)	-	(83,274)
	<b>3,359</b>	<b>50,586</b>	<b>(15,544)</b>	<b>38,401</b>

### 34 Other liabilities

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
Settlement liabilities with payment documents	964,911	659,846
Payables and transit accounts	858,189	501,343
Deferred income	129,484	56,827
Other liabilities	602,828	942,081
	<u><b>2,555,412</b></u>	<u><b>2,160,097</b></u>

### 35 Share capital

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
Number of shares authorised by the Bank	609,400	609,400
Nominal value of the shares authorised by the Bank	4	4
Number of shares issued and fully paid	609,400	609,400
Nominal value of shares issued and fully paid	4	4
Number of shares issued but not allocated	-	-
Nominal value of the shares issued but not allocated	-	-
Number of shares allocated but not paid	-	-
Nominal value of shares allocated but not paid	-	-
Number of shares repurchased by the Bank	-	-
Nominal value of shares repurchased by the Bank	-	-
Number of shares outstanding at the beginning and at the end of the year	-	-

### 36 Revaluation reserves

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
Unrealised loss from revaluation of investments available-for-sale	(96,160)	(76,470)
Revaluation reserve of property, plant and equipment	-	-
Other provisions	-	-
	<u><b>(96,160)</b></u>	<u><b>(76,470)</b></u>

### 36/1 Accumulated profit

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
Profit of the current period after taxes and interim dividends	2,655,329	2,844,093
Accumulated profit of previous years	2,813,465	1,369,372
	<u><b>5,468,794</b></u>	<u><b>4,213,465</b></u>

### 37 Maturity analysis of assets and liabilities per balance sheet captions

	Demand	Up to 30 days	31 days to 90 days	91 days to 1 year	1 year to 5 years	More than 5 years	No maturity	('000 AMD) Total
<b>Assets</b>								
Cash and balances with the CBA	10,350,753	-	-	-	-	-	-	10,350,753
Other balances with the CBA	161,900	-	-	-	-	-	-	161,900
Precious metals bullions	-	-	-	-	-	-	-	-
Accounts and deposits in precious metals	-	-	-	-	-	-	-	-
Financial instruments held for trading	-	845,163	140,151	337,294	10,071	-	-	1,332,679
Placements with other banks	16,159,658	638,813	-	-	-	-	-	16,798,471
Other placements	21	-	-	-	-	-	-	21
Loans and other advances to customers	568,383	1,272,486	2,782,103	5,823,948	16,551,392	3,541,060	-	30,539,372
Investments available-for sale	-	877,119	4,090,091	4,056,846	5,795,871	-	22,326	14,842,253
Amounts receivable from banking operations	1,737	95,199	166,275	-	-	-	-	263,211
Lease receivables	-	-	-	-	-	-	-	-
Investments held-to-maturity	-	30,782	394,574	1,030,204	1,942,865	-	-	3,398,425
Investments in share capital of other entities	-	-	-	-	-	-	-	-
Capital investments in property, plant and equipment and intangible assets of the Bank	-	-	-	-	-	-	65,628	65,628
Property, plant and equipment and intangible assets	-	-	-	-	-	-	941,682	941,682
Deferred tax asset	-	-	-	-	-	-	-	-
Interest receivable	-	259,073	165,121	102,440	-	-	-	526,634
Other assets	1,048,202	20,158	113,151	55,609	-	-	-	1,237,120
<b>Total assets</b>	<b>28,290,654</b>	<b>4,038,793</b>	<b>7,851,466</b>	<b>11,406,341</b>	<b>24,300,199</b>	<b>3,541,060</b>	<b>1,029,636</b>	<b>80,458,149</b>

	Demand	Up to 30 days	31 days to 90 days	91 days to 1 year	1 year to 5 years	More than 5 years	No maturity	(’000 AMD) Total
<b>Liabilities</b>								
Due to the CBA	-	-	-	-	-	-	-	-
Due to other banks	173,101	-	-	-	86,171	-	-	259,272
Other borrowings	846,188	76,335	-	-	-	-	-	922,523
Current accounts and deposits from customers	50,329,316	7,638,762	1,853,237	6,352,481	230,384	-	-	66,404,180
Due to the Government of the Republic of Armenia	1,797,910	-	-	-	-	-	-	1,797,910
Lease payables	-	-	-	-	-	-	-	-
Deposit certificates issued by the Bank	-	-	-	-	-	-	-	-
Securities issued by the Bank	-	-	-	-	-	-	-	-
Provisions	-	-	-	-	-	-	-	-
Amounts payable	-	190,313	16,868	-	-	-	-	207,181
Deferred tax liability	-	-	-	-	-	-	38,401	38,401
Interest payable	-	19,205	11,895	64,276	2,020	-	-	97,396
Other liabilities	999,355	445,871	347,298	758,000	4,888	-	-	2,555,412
<b>Total liabilities</b>	<b>54,145,870</b>	<b>8,370,486</b>	<b>2,229,298</b>	<b>7,174,757</b>	<b>323,463</b>	<b>-</b>	<b>38,401</b>	<b>72,282,275</b>

## 38 Currency analysis

	AMD	Hard currency	Soft currency	(’000 AMD) Total
Assets	30,795,031	49,404,597	258,521	80,458,149
Liabilities	22,471,882	49,634,264	176,129	72,282,275
<b>Net foreign currency position</b>	<b>8,323,149</b>	<b>(229,667)</b>	<b>82,392</b>	<b>8,175,874</b>

## 39 Interest rate risk

Interest bearing assets and liabilities of the Bank by interest repricing dates

	('000 AMD)									
	Demand		Up to 1 month		1 month to 3 months		3 months 1 year		More than 1 year	
	Prior year	Current year	Prior year	Current year	Prior year	Current year	Prior year	Current year	Prior year	Current year
<b>Resources attracted</b>	<b>28,235,071</b>	<b>24,241,310</b>	<b>5,687,423</b>	<b>7,715,104</b>	<b>1,744,416</b>	<b>1,853,237</b>	<b>2,804,143</b>	<b>6,809,060</b>	-	<b>305,074</b>
In AMD	2,388,772	4,528,537	138,930	252,151	554,539	772,024	1,699,536	2,349,396	-	39,570
In foreign currency	25,846,299	19,712,773	5,548,493	7,462,953	1,189,877	1,081,213	1,104,607	4,459,664	-	265,504
<b>Resources allocated</b>	<b>19,471,509</b>	<b>15,336,804</b>	<b>9,311,633</b>	<b>3,461,204</b>	<b>2,561,222</b>	<b>8,723,409</b>	<b>11,178,136</b>	<b>11,137,565</b>	<b>13,632,467</b>	<b>26,648,239</b>
In AMD	334	111,215	4,975,208	2,067,634	796,004	5,118,266	7,923,094	7,256,737	4,787,120	9,963,078
In foreign currency	19,471,175	15,225,589	4,336,425	1,393,570	1,765,218	3,605,143	3,255,042	3,880,828	8,845,347	16,685,161

## 39/1 Credit risk

	('000 AMD)			
	<u>Standard</u>	<u>Controlled</u>	<u>Non-standard</u>	<u>Doubtful</u>
<b>Assets</b>				
Loans, including				
1 Loans to non-residents	-	-	-	-
2 Loans to residents, including:	-	-	-	-
2.1 Industry	-	-	-	-
2.2 Agriculture	-	-	-	-
2.3 Construction	-	-	-	-
2.4 Transport and communication	-	-	-	-
2.5 Trade	-	-	-	-
2.6 Public food and other areas of service	-	-	-	-
2.7 Financial sector	-	-	-	-
2.7.1 including resident banks	-	-	-	-
2.8 Consumer loans, including:	-	-	-	-
2.8.1 secured by real estate	-	-	-	-
2.8.2 secured by car	-	-	-	-
2.9 Other sectors of economy	-	-	-	-
3. Receivables	-	-	-	-
4. Investment securities	-	-	-	-

The above table is not completed since the Bank has made assessment and provisioning against assets according to ASRA 39.

## 40 Contingencies and commitments

At any time the Bank has outstanding commitments to extend credit. These commitments take the form of approved loans, credit card limits and overdraft facilities.

The Bank provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to one year.

The contractual amounts of commitments and contingent liabilities are set out in the following table by category. The amounts reflected in the table for commitments assume that amounts are fully advanced. The amounts reflected in the table for guarantees and letters of credit represent the maximum accounting loss that would be recognised at the balance sheet date if counterparties failed completely to perform as contracted.

	('000 AMD)	
	<u>31/12/06</u>	<u>31/12/05</u>
<b>Off-balance sheet items</b>		
Loan guarantees	24,900	64,827
Other guarantees	506,271	284,395
Unused part of credit lines	2,531,793	2,121,224
Unused part of credit cards	1,350,401	1,148,701
Unused part of overdrafts	8,287,969	417,078
Letters of credit	1,687,076	324,168
	<u><b>14,388,410</b></u>	<u><b>4,360,393</b></u>

The total outstanding contractual commitments to extend credit indicated above does not necessarily represent future cash requirements, as many of these commitments may expire or terminate without being funded.

Of the above listed commitments, AMD 553,666 thousand (2005: AMD 543,685 thousand) were secured by cash deposits.

The capital commitments outstanding at 31 December 2006 related to the construction of the Bank's premises is AMD 157,748 thousand.

### **Litigation**

Bank management is unaware of any significant actual, pending or threatened claims against the Bank.

### **Taxation contingencies**

The taxation system in the Republic of Armenia is relatively immature and is characterised by numerous taxes and frequently changing legislation which is often unclear, contradictory, and subject to interpretation. Often, differing interpretations exist among numerous taxation authorities. Taxes are subject to review and investigation by a number of authorities, who are enabled by law to impose severe fines, penalties and interest charges.

These facts may create tax risks in the Republic of Armenia substantially more significant than in other countries. Management believes that it has adequately provided for tax liabilities based on its interpretation of tax legislation. However, the relevant authorities may have differing interpretations.

## 41 Concentration of assets, liabilities and off-balance sheet items

	Residents	Non-residents	('000 AMD) Total
<b>Assets</b>			
Cash and balances with the CBA	10,350,753	-	10,350,753
Other balances with the CBA	161,900	-	161,900
Precious metals bullions	-	-	-
Accounts and deposits in precious metals	-	-	-
Financial instruments held for trading	1,332,601	78	1,332,679
Placements with other banks	638,813	16,159,658	16,798,471
Other placements	-	21	21
Loans and other advances to customers	30,280,157	259,215	30,539,372
Investments available-for-sale	14,832,070	10,183	14,842,253
Amounts receivable from banking operations	261,716	1,495	263,211
Lease receivables	-	-	-
Investments held-to-maturity	3,398,425	-	3,398,425
Investments in share capital of other entities	-	-	-
Capital investments in property, plant and equipment and intangible assets of the Bank	65,628	-	65,628
Property, plant and equipment and intangible assets	941,682	-	941,682
Deferred tax asset	-	-	-
Interest receivable	480,159	46,475	526,634
Other assets	1,106,708	130,412	1,237,120
<b>Total assets</b>	<b>63,850,612</b>	<b>16,607,537</b>	<b>80,458,149</b>
<b>Liabilities</b>			
Due to the CBA	-	-	-
Due to other banks	51,597	207,675	259,272
Other borrowings	856,454	66,069	922,523
Current accounts and deposits from customers	54,064,696	12,339,484	66,404,180
Due to the Government of the Republic of Armenia	1,797,910	-	1,797,910
Lease payables	-	-	-
Deposit certificates issued by the Bank	-	-	-
Securities issued by the Bank	-	-	-
Provisions	-	-	-
Amounts payable	207,181	-	207,181
Deferred tax liability	38,401	-	38,401
Interest payable	88,049	9,347	97,396
Other liabilities	2,027,799	527,613	2,555,412
<b>Total liabilities</b>	<b>59,132,087</b>	<b>13,150,188</b>	<b>72,282,275</b>
<b>Off-balance sheet items</b>			
Loan guarantees	24,900	-	24,900
Other guarantees	315,407	190,864	506,271
Unused part of credit lines	2,531,793	-	2,531,793
Unused part of credit cards	1,276,860	73,541	1,350,401
Unused part of overdrafts	287,990	7,999,979	8,287,969
Letters of credit	1,687,076	-	1,687,076
<b>Total off-balance sheet items</b>	<b>6,124,026</b>	<b>8,264,384</b>	<b>14,388,410</b>

## 42 Pledged assets

As of 31 December 2006 and 31 December 2005 the Bank did not have any pledged assets.

## 43 Related parties

The Company's Parent is HSBC Europe B.V. The party with ultimate control over the Company is HSBC Holdings PLC.

### (i) Transactions with management

The outstanding balances and average interest rates as of 31 December 2006 and 2005 with directors and executive officers are as follows:

	<u>31/12/06</u>	<u>Average interest rate</u>	<u>31/12/05</u>	<u>('000 AMD) Average interest rate</u>
<i>Balance sheet</i>				
<i>Assets</i>				
Loans and other advances to customers	724,441	4.83%	488,171	4.78%
<i>Liabilities</i>				
Current accounts and deposits from customers	133,274	0.29%	94,040	0.34%

Amounts included in the income statement in relation to related party transactions with directors and executive officers are as follows:

<i>Income statement</i>				
Interest income	26,351	-	18,998	-
Interest expense	428	-	264	-
Employee compensation	925,049	-	549,944	-

### (ii) Transactions with entities under common control

The outstanding balances and the related average interest rates as of 31 December 2006 and 2005 with entities under common control are as follows:

	<u>31/12/06</u>	<u>Average interest rate</u>	<u>31/12/05</u>	<u>('000 AMD) Average interest rate</u>
<i>Assets</i>				
Placements with other banks	951,709	2.16%	836,502	2.40%
Loans to customers				
<i>Liabilities</i>				
Due to other banks	164,916	2.17%	35,482	0.00%
Current accounts and deposits from customers	557	0.00%	1,170	0.00%

Amounts included in the income statement in relation to transactions with entities under common control are as follows:

	<u>31/12/06</u>	<u>('000 AMD) 31/12/05</u>
Interest income	25,148	48,644
Interest expense	(812)	(1,187)
Fee and commission income	69	-
Fee and commission expense	(2,807)	(3,331)
Other operating income	930	-
General administrative expenses	(331,231)	(134,383)

In the above disclosure related parties are defined as related to the Bank in accordance with the requirements of the “Law on banks and banking activities of the Republic of Armenia”.

Had the Bank defined related parties according to ASRA 24 the placements with banks and income/expense on transactions with the parent and entities under common control would be as follows:

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
<i>Balance sheet</i>		
Placements with other banks	7,266,901	5,717,676
<i>Income statement</i>		
Interest income	211,340	365,434
Interest expense	(1,223)	(1,369)
Fee and commission income	69	-
Fee and commission expense	(23,157)	(22,488)
Other income	1,237	1,762
General administrative expenses	(403,009)	(389,516)

## 44 Cash and cash equivalents

Cash and cash equivalents at the end of the financial year as shown in the statement of cash flow is composed of the following items:

	<u>31/12/06</u>	<u>(’000 AMD) 31/12/05</u>
Cash and equivalent payment documents	4,457,544	4,009,572
Correspondent accounts and deposits with the Central Bank of Armenia	5,893,209	9,459,599
Correspondent accounts with other banks	16,115,079	23,035,345
	<u>26,465,832</u>	<u>36,504,516</u>

## 45 Fair value of financial instruments

The Bank has performed an assessment of its financial instruments, as required by ASRA 32 *Financial Instruments: Disclosure and Presentation*, to determine whether it is practicable within the constraints of timeliness and cost to determine their fair values with sufficient reliability.

The Bank estimates the fair value of financial assets and liabilities, except as described below, not to be materially different from their carrying values. The estimated fair values of its financial assets and liabilities, is calculated using discounted cash flow techniques based on estimated future cash flows and discount rates for a similar instruments at the balance sheet date.

As disclosed in note 19 the fair value of unquoted equity securities with a carrying value of AMD 22,326 thousand (2005: AMD 12,922 thousand) could not be determined.

The estimates of fair value are intended to approximate the amount for which a financial instrument could be exchanged between knowledgeable, willing parties in an arm's length transaction. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or settlement of liabilities.

## **46 Risk management**

Management of risk is fundamental to the business of banking and is an essential element of the Bank's operations. The major risks faced by the Bank are those related to market risk, which includes price, fair value interest rate and currency risks, credit risk and liquidity risk. These risks are managed in the following manner:

### **Market risk**

#### ***Price risk***

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 instrument or factors affecting all instruments traded in the market. Price risk arises when the Bank takes a long or short position in a financial instrument.

#### ***Fair value interest rate risk***

Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rate. Fair value interest rate risk arises when the actual or forecasted assets of a given maturity period are either greater or less than the actual or forecasted liabilities in that maturity period. For further information on the Bank's exposure to fair value interest rate risk at year end refer to notes 37 and 39.

#### ***Currency risk***

The Bank has assets and liabilities denominated in several foreign currencies. Foreign currency risk arises when the actual or forecasted assets in a foreign currency are either greater or less than the liabilities in that currency. For further information on the Bank's exposure to currency risk at year end refer to note 38.

The Bank manages its market risk by setting open position limits in relation to financial instrument, interest rate maturity and currency positions which are monitored on a regular basis.

The Bank's market policy is in line with HSBC Group standards and local regulations.

### **Credit risk**

Credit risk is the risk of financial loss occurring as a result of default by a borrower or counterparty on their obligation to the Bank. The Bank has developed policies and procedures for the management of credit exposures, including guidelines to limit portfolio concentration, ongoing monitoring of counterparty activities and establishment of limits for approval of credit instruments.

The Bank's credit policy is in line with HSBC Group standards and local regulations.

### **Liquidity risk**

Liquidity risk is the risk that the Bank will encounter difficulty in raising funds to meet commitments associated with financial instruments. The Bank maintains liquidity management with the objective of ensuring that funds will be available at all times to honor all cash flow obligations as they become due.

The Bank's liquidity policy is in line with HSBC Group standards and local regulations.

For further information on the Bank's exposure to liquidity risk at year end refer to note 37.