



Grant Thornton

Independent Auditor's Report and Financial
Statements

Renewable Resources and Energy Efficiency Fund

December 31, 2010

Contents

	Page
Independent auditor's report	1
Members of the board of trustees of the Renewable Resources and Energy Efficiency Fund	3
Statement of financial position	4
Statement of comprehensive income	5
Statement of changes in equity	6
Statement of cash flows	7
Notes to the financial statements	8

Independent auditor's report

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To the board of trustees of Renewable Resources and Energy Efficiency Fund,

We have audited the accompanying financial statements of the Renewable Resources and Energy Efficiency Fund (the "Fund"), which comprise the statement of financial position as of December 31, 2010, and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the 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 of 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 entity's internal control. An audit includes

evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall financial statement presentation.

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Fund as of December 31, 2010, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

March 24, 2011

Gagik Gyulbudaghyan

Managing Partner



Emil Vassilyan, FCCA

Engagement Partner



Members of the board of trustees of the Renewable Resources and Energy Efficiency Fund

Chairman

- | | | |
|---|---|--------------|
| 1 | Minister of Energy and Natural Resources of the Republic of Armenia | A. Movsisyan |
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Board members

- | | | |
|----|--|----------------|
| 2 | Adviser of the Prime Minister of the Republic of Armenia | A. Gharibyan |
| 3 | Deputy Minister of Energy and Natural Resources of the Republic of Armenia | A. Galstyan |
| 4 | Deputy Minister of Territorial Administration of the Republic of Armenia | A. Bakhshyan |
| 5 | Principal Adviser of Minister of Finance of the Republic of Armenia | K. Atoyán |
| 6 | Deputy President of the Committee on Public Services Regulation of the Republic of Armenia | N. Grigoryan |
| 7 | President of "Armenian Energy Service Providers Association" | M. Martirosyan |
| 8 | Deputy Minister of Economy of the Republic of Armenia | G. Badalyan |
| 9 | Deputy Minister of Natural Protection of the Republic of Armenia | S. Papyan |
| 10 | Head of directorate of Ministry of Urban Development of the Republic of Armenia | G. Qamalyan |
| 11 | Director of "Energy Efficiency Alliance" Armenian Branch | A. Pasoyan |

Statement of financial position

In thousand drams		As of December 31, 2010	As of December 31, 2009
	Note		
Assets			
<i>Non-current assets</i>			
Property and equipment	4	18,935	23,370
Intangible assets		336	840
Prepayments for acquisition of non-current assets		-	2,064
Borrowings provided	5	<u>1,392,450</u>	<u>1,392,450</u>
		<u>1,411,721</u>	<u>1,418,724</u>
<i>Current assets</i>			
Inventories		1,780	1,156
Receivables and advances	6	129,402	93,391
Borrowings provided	5	-	16
Cash and bank balances	7	<u>1,228,990</u>	<u>1,025,539</u>
		<u>1,360,172</u>	<u>1,120,102</u>
Total assets		<u><u>2,771,893</u></u>	<u><u>2,538,826</u></u>
Equity and liabilities			
<i>Equity</i>			
Accumulated profit		<u>386,355</u>	<u>293,842</u>
		<u>386,355</u>	<u>293,842</u>
<i>Non-current liabilities</i>			
Grants related to assets	8	3,065	15,095
Borrowings received	5	<u>1,392,450</u>	<u>1,392,450</u>
		<u>1,395,515</u>	<u>1,407,545</u>
<i>Current liabilities</i>			
Accounts payable	9	244,876	365,784
Borrowings received	5	4,069	3,313
Deferred income	10	726,469	455,716
Current income tax liabilities		<u>14,609</u>	<u>12,626</u>
		<u>990,023</u>	<u>837,439</u>
Total equity and liabilities		<u><u>2,771,893</u></u>	<u><u>2,538,826</u></u>

The financial statements were approved on March 11, 2011 by:

Tamara Babayan
 Executive director

Roza Manucharyan
 Financial Manager



The statement of financial position is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 5-10.



Statement of comprehensive income

In thousand drams		Year ended December 31, 2010	Year ended December 31, 2009
	Note	<u>2010</u>	<u>2009</u>
Income from operations	11	1,064,608	1,193,226
Other income		125,025	133,379
Project expenses	12	(1,037,299)	(1,177,581)
Administrative expenses		(65,566)	(70,769)
Results from operating activities		<u>86,768</u>	<u>78,255</u>
Finance income		92,288	79,613
Finance costs		(13,729)	(12,033)
Other financial items	13	(36,123)	133,449
Profit before income tax		<u>129,204</u>	<u>279,284</u>
Income tax expense	14	(36,691)	(29,167)
Profit for the year		<u>92,513</u>	<u>250,117</u>
Other comprehensive income		<u>-</u>	<u>-</u>
Total comprehensive income for the year		<u><u>92,513</u></u>	<u><u>250,117</u></u>

The statement of comprehensive income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 8 to 27.

Statement of changes in equity

In thousand drams	Accumulated profit	Total
as of January 1, 2009	43,725	43,725
Profit for the year	250,117	250,117
Total comprehensive income for the year	250,117	250,117
as of December 31, 2009	293,842	293,842
Profit for the year	92,513	92,513
Total comprehensive income for the year	92,513	92,513
as of December 31, 2010	386,355	386,355

The statement of changes in equity is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 8 to 27.

Statement of cash flows

In thousand drams	Year ended December 31, 2010	Year ended December 31, 2009
Cash flows from operating activities		
Profit for the year	92,513	250,117
<i>Adjustments</i>		
Depreciation and amortization	15,260	15,381
Finance costs	13,729	12,033
Finance income	(92,288)	(79,613)
Income tax expense	36,691	29,167
Income from grants	(921,428)	(1,110,581)
<i>Operating loss before working capital changes</i>	(855,523)	(883,496)
Change in inventories	(624)	22
Change in receivables and advances	(33,947)	(4,236)
Change in payables	(120,908)	204,896
	(1,011,002)	(682,814)
Income tax paid	(34,708)	(31,064)
Interest paid	(12,973)	(13,960)
<i>Net cash used in operating activities</i>	(1,058,683)	(727,838)
Cash flows from investing activities		
Acquisition of property and equipment	(10,321)	-
Grants received	1,358,175	1,326,442
Grants utilized	(178,024)	(294,326)
Interest received	92,304	81,205
<i>Net cash from investing activities</i>	1,262,134	1,113,321
Cash flows from financing activities		
Proceeds from loans and borrowings	-	113,000
Repayment of loans and borrowings	-	(113,000)
<i>Net cash from financing activities</i>	-	-
Net increase in cash and cash equivalents	203,451	385,483
Cash and cash equivalents at the beginning of the year	1,025,539	640,056
Cash and cash equivalents at the end of the year	1,228,990	1,025,539

The statement of cash flows is to be read conjunction with the notes to and forming part of the financial statements set out on pages 8 to 27.

Notes to the financial statements

1 Nature of operations and general information

Renewable Resources and Energy Efficiency Fund (the "Fund") has been established on November 21, 2005, in accordance with the decree N799 of the Government of the Republic of Armenia dated April 28, 2005.

The Fund is a non-for-profit organization. The founder of the Fund is the Republic of Armenia (the "Founder").

The objectives of the Fund are to:

- a) facilitate investments in the renewable energy and energy efficiency sectors;
- b) promote the development of energy efficiency and renewable energy market in Armenia;
- c) reduce adverse anthropogenic impacts on the environment and human health;
- d) develop activities focused on energy safety and increasing energy system reliability;
- e) in case of obtaining respective authority under the legislation of Republic of Armenia, initiate loan and credit projects promoting the sector development on behalf of the Government, based upon the agency contracts signed with the Government.

The Fund implements the following projects:

- Urban Heating Project, which is financed under the Credit Agreement dated July 20, 2005 signed between the International Development Association (the "IDA") and the Government of the Republic of Armenia. The objective of the Project is to increase the use of clean, efficient, safe and affordable heating technologies in urban schools and multi-apartment buildings.
- Gas and Heating Project, which is financed under the Grant Agreement dated April 28, 2006 signed between the International Bank for Reconstruction and Development and the Fund. The objective of the Project is to improve the access to gas and heating services for the eligible households in urban multi-apartment buildings.
- Preparation of Electricity Supply Reliability and Energy Efficiency Project (GEF PPG Grant TF 094673), which is financed under the agreement dated July 16, 2009 signed between the International Bank for Reconstruction and Development and the Government of the Republic of Armenia. The objective of the Project is to prepare the Energy efficiency component of Electricity Supply Reliability and Energy Efficiency Project.

- Renewable Energy Project, which is financed under the grant agreement TF 056211 dated April 7, 2006 signed between the International Bank for Reconstruction and Development and the Government of the Republic of Armenia and credit agreement 4159 AM signed between the International Development Association and the Government of the Republic of Armenia. The objective of the Project is to increase the role of the privately-owned and operated power generation, utilizing the renewable energy.
- Global Environment Facility Project (GEF PPG Grant TF 093563), which is financed under the agreement dated January 22, 2009 signed between the International Bank for Reconstruction and Development and the Republic of Armenia. The objective of the Project is to assess the feasibility of exploratory drilling of the geothermal site with the highest estimated geothermal potential.

Within the framework of the Urban Heating Project the Government of the Republic of Armenia should allocate borrowings through the Fund. The Fund agreed to provide its borrowings to potential beneficiaries, which are financial institutions such as commercial banks or credit organizations.

The potential beneficiaries of projects implemented by the Fund can be:

- a) management bodies of multi-apartment buildings;
- b) economic entities;
- c) secondary schools;
- d) individuals.

An agency contract was signed on January 16, 2006 between the Government of the Republic of Armenia represented by the Ministry of Finance and Economy and the Fund, which is described below:

- according to the contract, the Fund shall carry out legal and other activities for the implementation of the Urban Heating Project on behalf of the Government of Republic of Armenia;
- within the Urban Heating Project framework, the Fund shall ensure the execution of activities anticipated by components specified in the Development Credit Agreement.
- the Fund shall execute the lenders right pursuant to civil contracts in force and signed by "Heating and Multi-apartment Buildings Assistance Management Bodies Support Projects PIU" SI, within the framework of Letter-Agreement No PPF Q 353-0-AM of "Advance for Proposed Urban Heating Project" signed between Republic of Armenia and IDA on April 3, 2003.

The average number of employees of the Fund during 2010 was 21(2009: 20).

The legal address of the Fund is Melik Adamyan 1, Yerevan, Armenia.

2 Basis of preparation

2.1 Statement of compliance

The financial statements have been prepared based on the accounting records maintained under the requirements of the Armenian legislation and presented in accordance with International Financial Reporting Standards ("IFRS").

In presenting the financial statements in accordance with IFRS only additional disclosures have been made in accordance with IFRS 7 "Financial Instruments: Disclosures", which relates to financial instruments and financial risk management disclosed in the notes 16 and 17.

Currently, IFRS do not contain specific guidance for non-profit organizations and non-governmental organizations concerning the accounting treatment and presentation of financial statements. Where IFRS do not give guidance on how to treat transactions specific to not for profit sector, accounting policies have been based on the general principles of IFRS, as detailed in the International Accounting Standards Board ("IASB") *Framework for Preparation and Presentation Financial Statements*.

2.2 Basis of measurement

The financial statements have been prepared on the historical cost basis.

2.3 Functional and presentation currency

The national currency of Armenia is the Armenian dram ("dram"), which is the Fund's functional currency, since this currency best reflects the economic substance of the underlying events and transactions of the Fund.

These financial statements are presented in Armenian drams, since management believes that this currency is more useful for the users of these financial statements. All financial information presented in Armenian drams has been rounded to the nearest thousand.

2.4 Use of estimates and judgment

The preparation of financial statements in conformity with IFRS requires management to make critical accounting estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in the note 15 to the financial statements.

2.5 Adoption of new and revised standards

In the current year the Fund has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the "IASB") and International Financial Reporting Interpretations Committee (the "IFRIC") of the IASB that are relevant to its operations and effective for annual reporting periods beginning on January 1, 2010.

Standards and Interpretations in issue but not yet adopted

IFRS 9 Financial Instruments

This Standard 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. IFRS 9 requires all recognised financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* to be subsequently measured at amortised 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 amortised 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.

The most significant effect of IFRS 9 regarding the classification and measurement of financial liabilities relates to the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. Specifically, under IFRS 9, for financial liabilities that are designated as at fair value through profit or loss, 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 recognized 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, 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.

IFRS 9 is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted. The directors anticipate that IFRS 9 will be adopted in the Fund's financial statements for the annual period beginning January 1, 2013 and that the application of the new Standard will have a significant impact on amounts reported in respect of the Fund's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

3 Significant accounting policies

3.1 Foreign currencies

Foreign currency transactions

In preparing the financial statements, transactions in currencies other than the functional currency are recorded at the rates of exchange defined by the Central Bank of Armenia prevailing on the dates of the transactions. At each reporting date, monetary items denominated in foreign currencies are retranslated at the rates defined by the Central Bank of Armenia prevailing on the reporting date, which is 363.44 drams for 1 US dollar as of December 31, 2010 (December 31, 2009: 377.89 drams for 1 US dollar). Non-monetary items that are measured in terms of historic cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement and retranslation of monetary items, are included in the statement of comprehensive income for the period.

3.2 Property and equipment

Property and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses. Cost comprises purchase price including import duties and non-refundable purchase taxes and other directly attributable costs.

The 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.

Subsequent expenditure is capitalized if future economic benefits will arise from the expenditure. All other expenditure, including repair and maintenance, is recognized in the statement of comprehensive income as incurred.

Depreciation is charged to the statement of comprehensive income on a straight line basis over the estimated useful lives of the individual assets. Depreciation commences when assets are available for use. The estimated useful lives are as follows:

Computers and accessories	- 4 years
Vehicles	- 5 years
Other	- 5 years

3.3 Intangible assets

Intangible assets, which are acquired by the Fund and which have finite useful lives, are stated at cost less accumulated amortization and impairment losses.

Amortization is charged to the statement of income and expenses on a straight line basis over the estimated useful lives of the intangible assets, which is estimated at 5 years for accounting software.

3.4 Inventories

Inventories are stated at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of inventories is based on the first-in first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition.

3.5 Financial instruments

Financial assets and financial liabilities are recognized when the Fund becomes a part to the contractual provisions of the financial instrument.

Financial assets and financial liabilities are measured initially at fair value plus transaction costs.

Financial assets and financial liabilities are measured subsequently as described below.

Financial assets

Financial assets are divided into the following categories:

- loans and receivables
- financial assets at fair value through profit or loss
- available-for-sale financial assets
- held-to-maturity investments.

As of the reporting dates the financial assets of the Fund are categorized under "loans and receivables". A financial instrument's category is relevant for the way it is measured and whether any resulting income and expenses are recognized in profit or loss or directly in other comprehensive income and credited to the equity. See note 16.2 for a summary of the Fund's financial assets by category.

i Borrowings provided

Borrowings are recognized initially at fair value, net of transaction costs associated with the borrowing. Subsequent to initial recognition, borrowings are stated at amortized cost.

Borrowings, provided by the Fund to commercial banks and credit organizations within the framework of the agreement signed with the Republic of Armenia government, are recorded in the statement of financial position of the Fund as financial assets, although the Fund acts as an agent in this transaction, since the Fund bears the risks of non-repayment of the borrowings by the commercial banks and credit organizations. However, where the Fund does not bear this risk of non-repayment, the borrowings are not recognized in the Fund's statement of financial position. Instead, the Fund records the interest payments related to these borrowings to be transferred to the Government under "Payables to the State budget against borrowings redeemed" caption in accounts payable. The amounts collected from the redemption of the principal amounts of these borrowings are included in the statement of cash flows as "Grants received" under investing activities.

ii Accounts receivable

Current accounts receivable are initially recognized at fair value. Subsequently they are measured at amortized cost less provision for impairment.

Grants that are receivable as compensation for expenses already incurred are recognized in the period when their collection is considered probable.

iii Cash and bank balances

The Fund's cash and bank balances comprise cash in hand, bank accounts and cash in transit.

Financial liabilities

The Fund's financial liabilities include borrowings and payables, which are measured at amortized cost using the effective interest rate method. A summary of the Fund's financial liabilities by category is given in note 16.2.

iv Borrowings received

Borrowings received are recognized initially at fair value, net of issuance costs associated with the borrowing. Subsequent to initial recognition, borrowings are stated at amortized cost with any difference between cost and redemption value recognized in the statement of comprehensive income over the period of the borrowings on an effective interest basis. Interest and other costs incurred in connection with borrowings are expensed as incurred as part of finance expenses.

v Payables

Trade and other payables are stated at fair value and subsequently stated at amortized cost.

3.6 Impairment

Impairment of property and equipment and intangible assets

Assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

Recoverable amount is the higher of net selling price and value in use. 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. Impairment losses are recognized as an expense immediately, 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 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 recognized for the asset or cash-generating unit in prior years. A reversal of an impairment loss is recognized as income immediately, unless the relevant asset is carried at a revalued amount, in which case any reversal of impairment loss is treated as a revaluation increase.

3.7 Grants related to assets

Grants are not recognized until there is reasonable assurance that the Fund will comply with the conditions attaching to them and the grants will be received.

Grants whose primary condition is that the Fund should purchase, construct or otherwise acquire non-current assets are recognized as deferred income in the statement of financial position and transferred to the statement of comprehensive income on a systematic and rational basis over the useful lives of the related assets.

3.8 Deferred income

Financing received within the framework of the projects implemented by the Fund are recognized in the statement of financial position as deferred income under current liabilities since at the point of receipt of financing the directions how the resources will be utilized are not defined.

Deferred income is decreased by the amount, which is used for borrowings; these amounts are recognized as "Borrowings provided"(refer to note 3.5 for the accounting policy of borrowings).

Amounts received by the Fund as redemption of the borrowings provided are accrued in deferred income, since at the point of receipt the directions how the resources will be utilized are not defined.

Grants that are receivable as compensation for expenses already incurred are recognized in the period in which they become receivable.

The other amounts are recognized as income on a systematic basis in the period in which amounts disbursed within the scope of the projects are reimbursed.

3.9 Income tax

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

The assets and services received by the Fund for off charge and the expenditures related to them are not exposed to income taxation.

Deferred income 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 amount of deferred income tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred income tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the unused tax losses and credits can be utilized. Deferred

income tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

3.10 Income

The Fund receives income from different sources in the framework of different projects. The policies for the utilization of deferred income and grants related to assets are described in the notes 3.7 and 3.8, respectively.

The finance income relates to interests earned on borrowings provided by the Fund.

According to the agency contract signed between Republic of Armenia and the Fund, the Fund is obliged to pursue the objective of the projects on the request, on behalf and at the expense of the Republic of Armenia. Expenses incurred are covered by the Ministry of Finance and recognized as income in the period in which the appropriate service is rendered (included in other income).

4 Property and equipment

In thousand drams	Machinery and equipment	Vehicles	Other	Total
<i>Cost</i>				
as of January 1, 2009	32,228	22,771	11,346	66,345
as of December 31, 2009	32,228	22,771	11,346	66,345
Additions	10,321	-	-	10,321
as of December 31, 2010	42,549	22,771	11,346	76,666
<i>Accumulated depreciation</i>				
as of January 1, 2009	15,293	7,477	5,328	28,098
Charge for the year	8,054	4,554	2,269	14,877
as of December 31, 2009	23,347	12,031	7,597	42,975
Charge for the year	7,933	4,554	2,269	14,756
as of December 31, 2010	31,280	16,585	9,866	57,731
<i>Carrying amount</i>				
as of December 31, 2009	8,881	10,740	3,749	23,370
as of December 31, 2010	11,269	6,186	1,480	18,935

During the reporting period the depreciation expense amounting to drams 12,052 thousand (2009: drams 12,173 thousand) was included in administrative expenses and drams 2,704 thousand in project expenses (2009: drams 2,704 thousand).

As of December 31, 2010 and December 31, 2009 the Fund does not have any pledged property and equipment.

As of December 31, 2010 the cost of fully depreciated property and equipment is drams 20,228 thousand (as of December 31, 2009: nil).

5 Borrowings provided and received

In accordance with the Development Credit Agreement signed between the IDA and the Republic of Armenia, the IDA provided a borrowing amounting to 10 million SDR to the Republic of Armenia to implement the Urban Heating Project (refer to note 1).

The Government of the Republic of Armenia has agreed with the IDA to allocate the borrowings through the Fund. The Fund has agreed to provide the funds received as a borrowing to Participating Financial Institutions, which are either commercial banks or credit organizations. These funds will be subsequently forwarded by these Participating Financial Institutions as loans to beneficiaries in the framework of the Project.

For this purpose an additional agreement has been signed between the Ministry of Finance and Economy of the Republic of Armenia and the Fund. The maturity period of each part of the loan is seven years. The Fund is obliged to pay to the Ministry of Finance and Economy of the Republic of

Armenia an interest of 1% per annum to be accrued on the outstanding balance of each borrowing. In 2010 no borrowings were provided to the Fund (2009: drams 113,000 thousand).

In 2009 the Fund signed contracts on borrowing with "ACBA Credit Agricol Bank" CJSC, "Ardshinvestbank" CJSC and "Cascade Bank" CJSC. In 2010 "Cascade Bank" CJSC was restructured to "Ameria Bank" CJSC.

During 2010 the Fund has not provided any loans to Participating Financial Institutions (PFIs) (2009: drams 113,000 thousand were provided to "ACBA Credit Agricol Bank" CJSC).

Borrowings to PFIs are provided both in Armenian drams and US dollars.

The interest rates are defined as follows:

- For borrowings denominated in US dollars: 6 months LIBOR plus 1 percent;
- For borrowings denominated in Armenian drams: the weighted average interest rate of 91-180 days deposits attracted from individuals as calculated by the Central Bank of Armenia for Armenian banks. The average rate for the past 6 months will be used, which can not be lower than US Dollars 6 months LIBOR.

Under the agency contract signed between the Ministry of Finance and Economy of the Republic of Armenia and the Fund, within the framework of Letter-Agreement No PPF Q 353-0-AM of "Advance for Proposed Urban Heating Project", the rights of control of the principal amount of the borrowings belong to the Ministry of Finance and Economy of the Republic of Armenia. The principal amount is directed to be used as sub-loan resources, defined by the additional borrowing agreement.

As presented in the note 3.5 and 15, amounts borrowed from the Government of the Republic of Armenia and allocated to commercial banks are recognized in the statement of financial position of the Fund, considering the fact that the Fund has a contractual agreement to repay the borrowings to the Government of the Republic of Armenia, even if it fails to collect all due borrowings from the commercial banks.

On the other hand, where the Fund itself does not bear the risk of non-repayment of the borrowings, those borrowings are not included in the Fund's statement of financial position. During 2010 the Fund has provided such a borrowing of US dollars 12,500 (2009: US dollars 1,216,532) to "Cascade UCO" CJSC (present "Ameria Bank" CJSC). These amounts were not reflected in the financial statements of the Fund, due to the reason above.

5.1 Borrowings provided

In thousand drams	As of December 31, 2010	As of December 31, 2009
Borrowings provided	1,392,450	1,392,466
Including:		
Long-term portion	1,392,450	1,392,450
Short-term portion	-	16

Borrowings mature in 7 years and bear a weighted average interest rate of 6.6% annually (2009: 6.6% annually).

Borrowings are secured by guarantees, property and other pledges.

The maturity periods for the borrowings are as follows:

In thousand drams	As of December 31, 2010	As of December 31, 2009
Less than 1 year	-	16
1-5 years	1,279,450	929,450
Over 5 years	113,000	463,000
	<u>1,392,450</u>	<u>1,392,466</u>

Interests receivable as of December 31, 2010 is nil (December 31, 2009: drams 16 thousand included in the cost of borrowings).

The carrying amounts of borrowings provided to banks are presented below:

In thousand drams	As of December 31, 2010	As of December 31, 2009
'ACBA Credit Agricol Bank' CJSC	<u>1,392,450</u>	<u>1,392,466</u>

5.2 Borrowings received

In thousand drams	As of December 31, 2010	As of December 31, 2009
Borrowings received	1,396,519	1,395,763
Including:		
Long-term portion	<u>1,392,450</u>	<u>1,392,450</u>
Short-term portion	<u>4,069</u>	<u>3,313</u>

Borrowings received mature in 7 years and bear a weighted average interest rate of 1% annually (2009: 1% annually).

The maturity periods for the borrowings are as follows:

In thousand drams	As of December 31, 2010	As of December 31, 2009
Less than 1 year	4,069	3,313
1-5 years	1,279,450	929,450
Over 5 years	113,000	463,000
	<u>1,396,519</u>	<u>1,395,763</u>

The fair values of borrowings equal their carrying amount, since it is possible to attract such amounts with similar terms only in the scope of special contracts.

As of December 31, 2010 interests payable amounted to drams 4,069 thousand (2009: drams 3,313 thousand).

6 Receivables and advances

In thousand drams	As of December 31, 2010	As of December 31, 2009
Receivables from the Government of RA and the World Bank (refer to note 11)	116,569	79,150
Receivables from the State budget	2,187	-
Other	10,646	14,241
	<u>129,402</u>	<u>93,391</u>

Receivable from the Government of the Republic of Armenia and the World Bank consists of accrued expenses, which are subject to subsequent redemption by the Government of Republic of Armenia and the World Bank based on the existing agreement. Management believes that this amount is fully recoverable.

7 Cash and bank balances

In thousand drams	As of December 31, 2010	As of December 31, 2009
Bank accounts	1,140,030	1,025,539
Cash in transit	88,960	-
	<u>1,228,990</u>	<u>1,025,539</u>

8 Grants related to assets

In thousand drams	2010	2009
Balance at beginning of year	15,095	27,246
Recognized as income (refer to note 11)	(12,030)	(12,151)
Balance at end of year	<u>3,065</u>	<u>15,095</u>

9 Accounts payable

In thousand drams	As of December 31, 2010	As of December 31, 2009
Payables to contractors	99,718	233,434
Taxes payable	10,187	13,576
Payables to the State budget against borrowings redeemed	117,877	92,263
Advances from beneficiaries	10,965	19,400
Other	6,129	7,111
	<u>244,876</u>	<u>365,784</u>

Payables to contractors include gas access, installation of gas stoves as well as payables for consulting and other services.

Payables to the State budget against borrowings redeemed include repayments made against provided borrowings, which were not included in the financial statements of the Fund.

10 Deferred income

In thousand drams	2010	2009
Balance at beginning of year	455,716	522,030
Additions	1,358,175	1,326,442
Borrowings repaid/(provided), net	-	(111,617)
Recovery of receivables from the Ministry of Finance of RA	(98,874)	(98,874)
Recovery of the financing to be received from the Government of RA and the World Bank	(79,150)	(83,835)
Use of deferred income (refer to note 11)	(909,398)	(1,098,430)
Balance at end of year	<u>726,469</u>	<u>455,716</u>

Additions

Additions include amounts received to pursue the objectives of the Project (refer to note 1).

The financing is received from the following sources:

- The World Bank,
- The Government of Republic of Armenia.

Borrowings repaid (provided)

In 2010 there were no borrowings provided (2009: drams 113,000 thousand) and no borrowings repaid (2009: drams 1,383 thousand).

Recovery of receivables from the Ministry of Finance of the Republic of Armenia

Within the scope of the agency contract signed between the Fund and the Republic of Armenia, the Fund submitted invoices to the Ministry of Finance of the Republic of Armenia.

Receivables that arise from the submitted invoices are covered from the deferred income. In 2010 these receivables amounted to drams 98,874 thousand (2009: drams 98,874 thousand).

Recovery of the financing to be received from the Government of the Republic of Armenia and the World Bank

Amounts disbursed at the expense of the Fund for the implementation of projects have to be reimbursed by the funds to be received from the Government of the Republic of Armenia and the World Bank. The recovered amounts are repaid from the funds disbursed by the Fund.

11 Income from operations

In thousand drams	Year ended December 31, 2010	Year ended December 31, 2009
Use of deferred income	909,398	1,098,430
Income recognized from grant related to assets	12,030	12,151
Income recognized from advances to beneficiaries	11,322	-
Income from the financing of the Government of RA and the World Bank	116,569	79,150
Other	15,289	3,495
	<u>1,064,608</u>	<u>1,193,226</u>

Income from the financing of the Government of the Republic of Armenia and the World Bank

Amounts disbursed by the Fund to pursue the objectives of the projects are subject to be reimbursed by the Government of the Republic of Armenia and the World Bank and recognized as income from operations (also refer to note 6).

12 Project expenses

In thousand drams	Year ended December 31, 2010	Year ended December 31, 2009
Urban Heating Project	822,873	415,794
Electricity Supply Reliability and Energy Efficiency Project	33,094	-
Renewable Energy Project	166,989	165,680
Gas and Heating Project	-	390,856
Global Environment Facility Project	14,343	205,251
	<u>1,037,299</u>	<u>1,177,581</u>

13 Other financial items

In thousand drams	Year ended December 31, 2010	Year ended December 31, 2009
Gain/(loss) from exchange rate differences		
Financial liabilities measured at amortized cost	3,424	(2,009)
Borrowings and receivables	(39,547)	135,458
	<u>(36,123)</u>	<u>133,449</u>

605 borrowing against

14 Income tax expense

In thousand drams	Year ended December 31, 2010	Year ended December 31, 2009
Current tax	36,691	29,167
Deferred tax	-	-
	<u>36,691</u>	<u>29,167</u>

Reconciliation of effective tax rate is as follows:

In thousand drams	Year ended December 31, 2010	Effective tax rate (%)	Year ended December 31, 2009	Effective tax rate (%)
Profit before taxation (under IFRS)	129,204		279,284	
Tax calculated at a tax rate of 20% (2009: 20%)	25,841	20.00	55,857	20.00
(Non-taxable)/non-deductible items, net	10,850	8.40	(26,690)	(9.56)
Income tax expense	36,691	28.40	29,167	10.44

15 Critical accounting estimates and judgments

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

15.1 Critical accounting estimates

The Fund makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

According to the borrowing contract signed between the Fund and the Ministry of Finance and Economy of the Republic of Armenia, the Fund has received borrowings from the Government of the Republic of Armenia and redirected those amounts to commercial banks as "borrowings provided" (refer to note 5).

The assets and liabilities generated from these borrowings (including interest receivables and payables) provided to "ACBA Credit Agricol Bank" CJSC are recognized in the statement of the financial position of the Fund, because according to the contract signed between the Fund and the Ministry of Finance and Economy of the Republic of Armenia, the non-redemption risks connected to those borrowings are carried by the Fund. On the other hand, borrowings provided to "Cascade UCO" CJSC (presently "Ameria Bank" CJSC) are not recognized in the statement of financial position of the Fund, since the Fund will not carry any obligation for non-redemption of the borrowing.

However, had not been those borrowings recognized in the financial statements of the Fund, the borrowings included in the statement of financial position would be presented as follows:

2010

In thousand drams	Current accounting	Without those borrowings
Assets		
Non-current assets		
Borrowings provided	1,392,450	-
Liabilities		
Borrowings received	1,396,519	4,069

2009

In thousand drams	Current accounting	Without those borrowings
Assets		
<i>Non-current assets</i>		
Borrowings provided	1,392,466	16
Liabilities		
Borrowings received	1,395,763	3,313

16 Financial instruments

16.1 Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition and the basis on which income and expenses are recognized, in respect of each class of financial asset, financial liability and equity instrument are disclosed in the note 3.5.

16.2 Categories of financial instruments

The carrying amounts presented in the financial statement relate to the following categories of assets and liabilities:

Financial assets

In thousand drams	As of December 31, 2010	As of December 31, 2009
Loans and receivables:		
Borrowings provided	1,392,450	1,392,466
Receivables	127,215	85,538
Bank balances	1,228,990	1,025,539
	<u>2,748,655</u>	<u>2,503,543</u>

Financial liabilities

In thousand drams	As of December 31, 2010	As of December 31, 2009
Financial liabilities measured at amortized costs:		
Loans and borrowings	1,396,519	1,395,763
Payables	223,724	332,808
	<u>1,620,243</u>	<u>1,728,571</u>

See note 3.5 for a description of the accounting policies for each category of financial instruments. The fair values are presented in the related notes.

17 Financial risk management

Exposure to market risk (including currency risk), credit risk and liquidity risk arises in the normal course of the Fund's activity.

17.1 Financial risk factors

a) Market risk

The Fund's activities expose it primarily to the risks of changes in foreign currency exchange rates (see b below).

b) Foreign currency risk

The Fund undertakes certain transactions denominated in foreign currencies. Hence, exposures to exchange rate fluctuations arise.

The exposure of the Fund's financial assets and financial liabilities to the foreign currency risk is as follows:

Item	Armenian drams	Freely convertible currencies
2010		
<i>Financial assets</i>		
Borrowings provided	1,392,450	-
Receivables	127,215	-
Bank balances	675,025	553,965
	<u>2,194,690</u>	<u>553,965</u>
<i>Financial liabilities</i>		
Borrowings received	1,396,519	-
Payables	223,724	-
	<u>1,620,243</u>	<u>-</u>
Net position	<u>574,447</u>	<u>553,965</u>
2009		
<i>Financial assets</i>		
Borrowings provided	1,392,466	-
Receivables	85,538	-
Bank balances	362,871	662,668
	<u>1,840,875</u>	<u>662,668</u>
<i>Financial liabilities</i>		
Borrowings received	1,393,769	1,994
Payables	332,808	-
	<u>1,726,577</u>	<u>1,994</u>
Net position	<u>114,298</u>	<u>660,674</u>

The Fund is mainly exposed to US dollar and Euro exchange rates. The following table details the Fund's sensitivity to a 10% (2009:10%) increase and decrease in dram against US dollar. 10% (2009:10%) represents management's assessment of the 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% (2009: 10%) change in foreign currency rates. A positive number indicates an increase in profit or loss and other equity where dram strengthens against the relevant currency.

	US dollar impact	
	2010	2009
Statement of comprehensive income	55,396	66,067

c) Liquidity risk

The Fund's policy is to run a prudent liquidity management policy by means of holding sufficient cash and bank balances, as well as highly liquid assets for making all operational liabilities when those become due.

18 Commitments

18.1 Operating lease commitments

The Fund as lessor

Operating leases relate to building with lease term of 5 years. The lessee does not have an option to purchase the leased asset at the expiry of the lease period.

Non-cancelable operating lease payables are disclosed below:

In thousand drams	As of December 31, 2010	As of December 31, 2009
Not later than 1 year	18,000	18,000
1-5 years	-	18,000
	<u>18,000</u>	<u>36,000</u>

19 Contingencies

19.1 Business environment

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

The possible effects of these factors on the Fund may include the inability to pay creditors when they become due, impaired reputation, difficulties in selling the goods and services, difficulties in obtaining funds, etc. All these problems may lead to the lessened liquidity of the Fund and, accordingly, to going concern problems. However, as the number of variables and assumptions

involved in these uncertainties is big, management cannot make a reliable estimate of the amounts by which the carrying amounts of assets and liabilities of the Fund may be affected.

The financial statements of the Fund do not include the effects of adjustments, if any, which might have been considered necessary, had the effects of the current global crisis become observable and reliably measurable in Armenia.

19.2 Insurance

The Armenian insurance industry is in its development stage and many forms of insurance protection common in other parts of the world are not yet generally available in Armenia. The Fund does not have full coverage for its plant facilities, business interruption, or third party liability in respect of property or environmental damage arising from accidents on the Fund property or relating to the Fund operations. Until the Fund obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets or environmental damage could have a materially adverse affect on the Fund's operations and financial position.

19.3 Tax contingencies

The taxation system in Armenia is relatively new and is characterized by frequently changing legislation, which is often subject to interpretation. Often differing interpretations exist among various taxation authorities and jurisdictions. Taxes are subject to review and investigations by tax authorities, which are enabled by law to impose severe fines and penalties.

These facts may create tax risks in Armenia substantially more than in other developed 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 and the effects could be significant.

20 Related party transactions

20.1 Transactions with management and close family members

The Fund's related parties include its key management.

Key management received the following remuneration during the year, which is included in payroll and employee benefits.

In thousand drams	Year ended December 31, 2010	Year ended December 31, 2009
Salaries and bonuses	19,742	20,109