

XacBank LLC

**FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006**

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XacBank LLC

CORPORATE INFORMATION

REGISTERED OFFICE

: XacBank Building
Prime Minister Amar's Street
Suhbaatar District, Ulaanbaatar
Mongolia

BOARD OF DIRECTORS

: Mr. Ganbold Chuluun
Mr. Stephen Mitchell
Mr. Ganhuyag Ch. Hutagt
Ms. Erdenechimeg Jambaldorj
Mr. Bekhbat Sodnom
Mr. Zorigt Namsrayjav
Ms. Erdenejargal Perenley
Mr. Mark Coffey
Mr. Stephen D. Vance
Ms. Femke Bos
Mr. Gilbert Crawford
Mr. Tanto Hiroshi
Mr. Jim Anderson

BOARD SECRETARY

: Ms. Botagoz Gulislam

AUDITORS

: Ernst & Young Mongolia Audit LLC
Certified Public Accountants

STATEMENT BY DIRECTOR AND MANAGEMENT

I, Ganhuyag Ch. Hutagt, being one of the directors of XACBANK LLC ("the Bank"), and Delgerjargal Bayanjargal, being the officer primarily responsible for the financial management of the Bank, do hereby state that, in our opinion, the accompanying financial statements set out on pages 4 to 51 give a true and fair view of the financial position of the Bank as at 31 December 2006 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ganhuyag Ch. Hutagt
(Chief Executive Officer)

Delgerjargal Bayanjargal
(Chief Financial Officer)

Ulaanbaatar, Mongolia
29, March 2007

REPORT OF THE INDEPENDENT AUDITORS
To the Shareholders of XacBank LLC

We have audited the accompanying financial statements of XacBank LLC as at 31 December 2006 set out on pages 4 to 51.

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

Auditors' Responsibility

It is our responsibility to form an independent opinion, based on our audit, on the financial statements and to report our opinion to you, as a body in accordance with Article 91 of Company Law of Mongolia and for no other purpose. We do not assume responsibility to any other person for the content of this report.

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

REPORT OF THE INDEPENDENT AUDITORS (CONTD.)
To the Shareholders of XacBank LLC

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ulaanbaatar, Mongolia

XacBank LLC**INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006**

	Note	2006 MNT '000	2005 MNT '000
Interest and similar income	3	14,595,145	9,834,002
Interest and similar expenses	4	<u>(6,205,888)</u>	<u>(4,258,189)</u>
Net interest income		8,389,257	5,575,813
Non-interest income	5	<u>1,302,524</u>	<u>875,585</u>
Operating income		9,691,781	6,451,398
Operating expenses	6	<u>(6,724,769)</u>	<u>(4,444,193)</u>
Profit before impairment losses		2,967,012	2,007,205
(Impairment losses)/Write back of impairment losses	7	(397,439)	135,461
Grant income	22	83,803	227,558
Grant expenses	22	(83,803)	(227,558)
Profit before taxation		<u>2,569,573</u>	<u>2,142,666</u>
Taxation	8	<u>(796,421)</u>	<u>(653,738)</u>
Profit for the year attributable to equity holders of the Bank		<u>1,773,152</u>	<u>1,488,928</u>

The accompanying notes form an integral part of the financial statements.

XacBank LLC**BALANCE SHEET AS AT 31 DECEMBER 2006**

	Note	2006 MNT '000	2005 MNT '000
ASSETS			
Cash and short term funds	10	5,301,179	2,100,229
Deposits and placements with other banks and financial institutions	11	13,492,176	10,141,200
Financial investments	12	500	1,105,366
Loans and advances	13	60,350,085	38,597,470
Other assets	14	1,422,422	1,230,830
Property, plant and equipment	15	7,978,334	5,919,929
Intangible assets	16	376,876	112,756
TOTAL ASSETS		88,921,572	59,207,780
LIABILITIES			
Deposits from customers	17	43,007,055	31,396,813
Deposits from local financial institutions	18	4,080,959	2,800,917
Loans from local financial institutions	19	-	1,305,167
Loans from foreign financial institutions	20	26,264,286	10,178,109
Loans from the Bank of Mongolia and government agencies	21	3,889,314	3,336,197
Deferred grants	22	160,629	126,864
Other liabilities	23	409,858	312,466
Tax payable		240,718	205,646
TOTAL LIABILITIES		78,052,819	49,662,179
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK			
Ordinary shares	24	8,034,200	8,034,200
Share premium		8,551	8,551
Other reserves	25	1,052,792	13,864
Retained profits		1,773,210	1,488,986
TOTAL EQUITY		10,868,753	9,545,601
TOTAL EQUITY AND LIABILITIES		88,921,572	59,207,780

The accompanying notes form an integral part of the financial statements.

XacBank LLC

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2006**

		Non- distributable	← Distributable →			
	Note	Share premium	Other reserves	Retained profits	Total	
		MNT '000	MNT '000	MNT '000	MNT '000	
At 1 January 2005		4,205,530	8,551	13,864	631,907	4,859,852
Profit for the year		-	-	-	1,488,928	1,488,928
Issuance of ordinary shares		3,324,750	-	-	-	3,324,750
Dividends capitalised to ordinary shares	9	503,920	-	-	(503,920)	-
Dividends	9	-	-	-	(127,929)	(127,929)
At 31 December 2005		8,034,200	8,551	13,864	1,488,986	9,545,601
Profit for the year		-	-	-	1,773,152	1,773,152
Transfer to other reserves	25	-	-	1,038,928	(1,038,928)	-
Dividends	9	-	-	-	(450,000)	(450,000)
At 31 December 2006		8,034,200	8,551	1,052,792	1,773,210	10,868,753

The accompanying notes form an integral part of the financial statements.

XacBank LLC**CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006**

	2006	2005
	MNT '000	MNT '000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit before taxation	2,569,573	2,142,666
<i>Adjustments for:-</i>		
Depreciation of property, plant and equipment	544,697	409,941
Amortisation of intangible assets	66,181	2,427
Net impairment losses/(written back) for loans and advances	387,118	(130,469)
Impairment of other assets	10,321	1,053
Impairment written back of financial investments	-	(6,045)
Loss on disposal of property, plant and equipment	9,613	6,255
Amortisation of deferred grants	(83,803)	(227,558)
Operating profit before working capital changes	3,503,700	2,198,270
<i>Changes in operating assets:-</i>		
Loans and advances	(22,139,733)	(17,774,817)
Other assets	(201,913)	(422,098)
<i>Changes in operating liabilities:-</i>		
Deposits from customers	11,610,242	15,201,730
Deposits from local financial institutions	1,280,042	1,818,650
Other liabilities	97,333	445,294
Cash (used in)/generated from operations	(5,850,329)	1,467,029
Income tax paid	(761,349)	(478,995)
Net cash flow (used in)/generated from operating activities	(6,611,678)	988,034
CASH FLOWS FROM INVESTING ACTIVITIES		
Net decrease/(increase) in financial investments	1,104,866	(133,947)
Proceeds on disposal of property, plant and equipment	75,793	120,429
Purchase of property, plant and equipment	(2,688,508)	(4,019,047)
Purchase of intangible assets	(330,301)	(115,183)
Net cash flow used in investing activities	(1,838,150)	(4,147,748)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of ordinary shares	-	3,324,750
Net drawdown of loans from local and foreign financial institutions	14,781,010	3,660,082
Net drawdown of loans from the Bank of Mongolia and government agencies	553,117	1,671,236
Deferred grants received	117,568	222,512
Dividends paid	(449,941)	(126,839)
Net cash flow generated from financing activities	15,001,754	8,751,741
Net increase in cash and cash equivalents	6,551,926	5,592,027
Cash and cash equivalents brought forward (Note 26)	12,241,429	6,649,402
Cash and cash equivalents carried forward (Note 26)	18,793,355	12,241,429

The accompanying notes form an integral part of the financial statements.

XacBank LLC

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006

1. CORPORATE INFORMATION

The Bank is principally engaged in the business of provision of banking and financial services pursuant to License No. 24 issued by the Bank of Mongolia. There have been no significant changes in the nature of these activities during the year.

The Bank is a limited liability company, incorporated and domiciled in Mongolia. The registered address and the principal place of business of the Bank is XacBank Building, Prime Minister Amar's Street, Suhbaatar District, Ulaanbaatar, Mongolia.

The holding company of the Bank is XAC-GE LLC, which is incorporated in Mongolia. The shareholders of the holding company are:

- Mercy Corps
- MicroVest 1, LP
- Tuushin LLC
- Shorecap International LTD
- EIT LLC
- Triodos Fair Share Fund
- Stichting Triodos Doen
- Open Society Forum
- Newcom LLC
- Mongolian Women's Federation
- Rotary Club of Ulaanbaatar
- CYDAN SCC
- Employees of XAC-GE LLC and XacBank LLC
- Liberal Women's Intellectual Pool

These financial statements of the Bank for the year ended 31 December 2006 were authorised for issue by the Board of Directors in accordance with a resolution of the directors on 29, March. 2007

2. ACCOUNTING POLICIES

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with International Financial Reporting Standards.

The financial statements have been prepared under the historical cost basis, except for revaluation of certain financial instruments. The financial statements are presented in the Mongolian Tugrug, which is denoted by the symbol MNT, rounded to the nearest thousand, except when otherwise indicated.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Interest income and expense

Interest income and expense for all interest-bearing financial instruments except those classified as held for trading or designated at fair value are recognised in "Interest and similar income" and "Interest and similar expenses" in the income statement using the effective interest rates of the financial assets or financial liabilities to which they relate. Interest income is recognised in the income statement as it accrued, except in the case of impaired loans and advances. Interest on impaired financial assets is recognised at the original effective interest rate of the financial assets applied to the impaired carrying amount.

(b) Fees and commission income

Fees and commission income derived by the Bank relate mainly to card service, application, transaction, money transfer service, and other fees. Fees and commission are generally recognised on an accrual basis when service has been provided.

(c) Foreign currencies translation

The financial statements are presented in Mongolian Tugrug, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded at the rates ruling at the date of the transaction. Foreign currency monetary assets and liabilities are translated at the exchange rates ruling at the balance sheet date. All exchange differences are taken to profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(d) Income tax

The Bank provides for current income tax based on its income for financial reporting purposes, adjusted for items which are not assessable or deductible for income tax purpose, in accordance with the regulations of the Mongolian Government and is measured using the tax rates that have been enacted at the balance sheet date

Deferred tax is provided for, using the liability method, on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the financial statements. In principle, deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised for all deductible temporary differences, unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, unused tax losses and unused tax credits can be utilised. Deferred tax is not recognised if the temporary difference arises from goodwill or negative goodwill or from the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction, affects neither accounting profit nor taxable profit

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(d) **Income tax (Contd.)**

Deferred tax is measured at the tax rates that are expected to apply in the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date. Deferred tax is recognised in the income statement, except when it arises from a transaction which is recognised directly in equity, in which case the deferred tax is also recognised directly in equity, or when it arises from a business combination that is an acquisition, in which case the deferred tax is included in the resulting goodwill or negative goodwill.

(e) **Cash and cash equivalents**

For the purposes of the cash flow statement, cash and cash equivalents consist of cash and short term funds, deposits and placements with other banks and financial institutions.

(f) **Investments and other financial assets**

Financial assets within the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets, as appropriate. Financial assets are initially measured at fair value plus, in the case of financial assets not classified at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets at initial recognition.

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Bank commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

(i) **Financial assets at fair value through profit or loss**

Financial assets classified as held for trading are included in the category financial assets at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term.

In addition, a financial instrument, other than one held for trading, is classified in this category if it meets certain criteria and is so designated by management. This designation, once made, is irrevocable in respect of the financial instruments to which it is made. Financial assets so designated, and financial assets classified as held for trading, are recognised initially at fair value, with transaction costs taken directly to the income statement, and are subsequently remeasured at fair value. Gains or losses arising from changes in fair value are recognised in the profit or loss.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(f) Investments and other financial assets (Contd.)

(ii) Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Bank has the positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included in this classification. After initial recognition, held-to-maturity financial investments are subsequently measured at amortised costs using the effective interest rate method, less allowance for impairment. The amortisation is included in “Interest and similar income” in the income statement. The losses arising from impairment of such investments are recognised in the income statement under “Impairment losses”.

(iii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provide money directly to a debtor with no intention of trading the receivable. After initial recognition, such assets are carried at amortised cost using the effective interest method, less allowance for impairment. The amortisation is included in “Interest and similar income” in the income statement. The losses arising from impairment of such investments are recognised in the income statement under “Impairment losses”.

(iv) Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition, available-for-sale financial assets are measured at fair value, with fair value changes recognised as a separate component of equity until the asset is derecognised or until the asset is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement. Impairment losses on equity instruments previously recognised in the income statement that are no longer required are reversed through reserves, not through the income statement.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(g) Determination of fair value

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

(h) Impairment of financial assets

The Bank assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more loss events that has occurred after the initial recognition of the assets (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in economic conditions that correlate with defaults.

(i) Loans and advances

For loans and advances carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(h) Impairment of financial assets (Contd.)

(i) Loans and advances (Contd.)

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. Interest income continues to be accrued based on the original effective interest rate of the asset. If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is reduced accordingly. The reduction of an impairment loss under these circumstances is recognised in the income statement in the period in which it occurs.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of type of the Bank's loan products that considers credit risk characteristics such as purpose of the loan, type of borrowers and collateral type and industry. The Bank adopted the basic approach where the impairment losses are computed on an average of historical loss experience of each risk grouping over the outstanding balance. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

(ii) Held-to-maturity financial investments

For held-to-maturity investments the Bank assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognised in the income statement.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, any amounts formerly charged are credited to the "Impairment losses on financial investments".

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(h) Impairment of financial assets (Contd.)

(iii) Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each balance sheet date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the income statement - is removed from equity and recognised in the income statement. Impairment losses on equity investments are not reversed through the income statement; increases in their fair value after impairment are recognised directly in equity.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset and is recorded as part of "Interest and similar income". If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement

(i) Property, plant and equipment

All items of property, plant and equipment are initially recorded at cost. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Subsequent to recognition, property, plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses.

Assets under construction are not depreciated. Depreciation of other property, plant and equipment is provided for on a straight-line basis to write off the cost of each asset to its residual value over the estimated useful life at the following annual rates:

Buildings	40 years
Furniture, fixtures and vehicles	10 years
Computers	5 years

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(i) Property, plant and equipment (Contd.)

The residual values, useful life and depreciation method are reviewed at each financial year-end to ensure that the amount, method and period of depreciation are consistent with previous estimates and the expected pattern of consumption of the future economic benefits embodied in the items of property, plant and equipment.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. The difference between the net disposal proceeds, if any and the net carrying amount is recognised in profit or loss.

(j) Intangible assets

Intangible assets include the value of computer software and licences, and patents and rights. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the income statement in the expense category consistent with the function of the intangible asset.

Amortisation is calculated using the straight-line method to write down the cost of intangible assets to their residual values over their estimated useful lives as follows:

Software and licences	3-5 years
Patents and rights	3 years

(k) Deposits from customers

Deposits from customers are stated at cost which is the fair value of the consideration to be paid in the future for deposits received.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(l) Impairment of other assets

The Bank assesses at each balance sheet date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Bank makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair values less costs to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. 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.

An assessment is made at each balance sheet date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

(m) Sale and repurchase agreement

Securities sold subject to repurchase agreements ('repos') are retained in the financial statements as available-for-sale or held-for-maturity securities and the counterparty liability is included in amounts due to other financial institutions or as appropriate. Securities purchased under agreement to resell ('reverse repos') are recorded as amount due from other financial institutions or as appropriate. The difference between the sale and repurchase price is treated as interest and accrued over the life of the repo agreements using the effective yield method.

(n) Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letter of credit and guarantees to their customers. These guarantees, with the exception of related premiums, are kept off-balance sheet unless a provision is needed to cover probable losses. Premiums received are initially recognised in the financial statements at fair value, in "Other liabilities". Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(n) Financial guarantees (Contd.)

Any increase in the liability relating to financial guarantees is taken to the income statement in "Impairment losses". The premium received is recognised in the income statement in "Non interest income" on a straight-line basis over the life of the guarantee.

(o) Grants

Grants are recognised initially in the balance sheet as deferred grants when there is reasonable assurance that they will be receivable and that the Bank will comply with the conditions attached to them. Grants that compensate the Bank for expenses incurred are amortised as revenue in income statement on a systematic basis in the same period in which the expenses are incurred. Grants that compensate the Bank for the cost of an asset are recognised in income statement on a systematic basis over the useful life of the asset.

(p) Employee benefits

(i) Short term benefits

Wages, salaries and other salary related expenses are recognised as an expense in the year in which the associated services are rendered by employees of the Bank. Short term accumulating compensated absences such as paid annual leave are recognised when services rendered by employees that increase their entitlement to future compensated absences, and short term non-accumulating compensated absences such as sick leave are recognised when absences occur.

(ii) Defined contribution plans

As required by the law, companies in Mongolia make contributions to the government pension scheme, Social and Health Fund. Such contributions are recognised as an expense in profit or loss as incurred.

(iii) Equity compensation benefits

The Employee Stock Ownership Plan allows the Bank's staff to hold XAC-GE LLC's shares through an employee investment trust company, EIT LLC. The purchase price is at 50% (2005: 30%) of the par value of EIT LLC shares. No change is made to the Bank's total share capital and no compensation cost is recognised by the Bank.

(q) Operating leases

Lease payments for operating leases, where substantially all risk and benefits remain with the lessor, are charged as an expense in the income statement on a straight-line basis over the term of the relevant lease

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(r) Financial instruments

Financial instruments are recognised in the balance sheet when the Bank has become a party to the contractual provisions of the instrument. The accounting policies on recognition and measurement of these items are disclosed in their respective accounting policies.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends and gains and losses relating to a financial instrument classified as a liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are recognised directly in equity. Financial instruments are offset when the Bank has a legally enforceable right to offset and intends to settle either on a net basis or to realise the asset and settle the liability simultaneously.

(s) Equity instruments

Ordinary shares are classified as equity and dividends are recognised in equity in the year in which they are declared.

(t) Financial liabilities

The Bank classifies its financial liabilities in the following categories:

- (i) financial liabilities at fair value through profit or loss; and
- (ii) non-trading liabilities.

Financial liabilities classified at fair value through profit or loss are carried at fair value, with gains and losses from change in fair value recognised through the income statement. Non-trading liabilities are carried at amortised cost using the effective interest method. A financial liability is removed or derecognised from the balance sheet when the obligation specified in the contract is discharged, cancelled or expired.

2.3 CHANGE IN ACCOUNTING POLICIES

The Bank has adopted the following new and amended IFRS and IFRIC interpretations during the year. Adoption of these new and amended standards and interpretations does not have any effect on equity and changes in comparative figures as at 1 January 2006.

- * IAS 19 Amendment - Actuarial Gains and Losses, Group Plans and Disclosures;
- * IAS 39 Amendment - Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- * IAS 39 Amendment - The Fair Value Option;
- * IAS 39 and IFRS 4 Amendment - Financial Guarantee Contracts;
- * IFRS 6 - Exploration for and Evaluation of Mineral Resources;
- * IFRIC 4 - Determining whether an Arrangement contains a Lease.

2.3 CHANGE IN ACCOUNTING POLICIES (CONTD.)

At the date of authorisation of these financial statements, the following Standards, Amendments and Interpretations were in issue but not yet effective:

- * IFRS 7 - Financial Instruments: Disclosures;
- * IAS 1 - Amendment - Presentation of Financial Statements;
- * IFRIC 8 - Scope of IFRS 2;
- * IFRIC 9 - Reassessment of Embedded Derivatives;
- * IFRIC 10 - Interim Financial Reporting and Impairment;
- * IFRIC 11 - IFRS 2 Group and Treasury Share Transactions;
- * IFRIC 12 - Service Concessions Arrangement.

The directors anticipate that the adoption of these Standards, Amendments and Interpretations in the financial year ended 31 December 2007 will have no material impact on the financial statements of the Bank. They will however give rise to additional disclosures.

2.4 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgments and estimates are as follows:

Impairment losses on loans and advances

The Bank reviews its problem loans and advances at each reporting date to assess whether an allowance for impairment should be recorded in the income statement. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific allowance against individually significant loans and advances, the Bank also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This takes into consideration factors such as any deterioration in industry risk and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

3. INTEREST AND SIMILAR INCOME

	2006	2005
	MNT '000	MNT '000
Loans and advances	13,867,013	9,413,196
Deposits and placements with other banks and financial institutions	595,875	308,813
Financial investments - available-for-sale	132,257	111,993
	<u>14,595,145</u>	<u>9,834,002</u>

4. INTEREST AND SIMILAR EXPENSES

	2006	2005
	MNT '000	MNT '000
Current account	101,206	15,774
Time and demand deposits	3,956,379	2,782,966
Deposits and placements of financial institutions	212,244	279,382
Loans from local and foreign financial institutions and government agencies	1,936,059	1,180,067
	<u>6,205,888</u>	<u>4,258,189</u>

5. NON-INTEREST INCOME

	2006	2005
	MNT '000	MNT '000
Fees and commission income:		
Card service fees	114,616	31,933
Deposit account maintenance and service fees	105,640	81,279
Loan application fees	501,256	386,630
Money transfer fees	153,425	97,376
Other fees income	259,267	133,414
	<u>1,134,204</u>	<u>730,632</u>
Less: Fees and commission expenses	(76,097)	(49,593)
	<u>1,058,107</u>	<u>681,039</u>
Other income:		
Realised foreign currencies gain	111,914	80,602
Unrealised foreign currencies gain	22,345	26,974
Rental income	70,872	64,493
Income from penalties	692	763
Recovery of bad loans	2,626	1,568
Other operating income	35,968	20,146
	<u>244,417</u>	<u>194,546</u>
Total non-interest income	<u>1,302,524</u>	<u>875,585</u>

6. OPERATING EXPENSES

	2006	2005
	MNT '000	MNT '000
Advertising	218,499	137,057
Amortisation of intangible assets (Note 16)	66,181	2,427
Armoured guard and security	252,907	51,341
Business trips	399,215	357,093
Cash collection service	809	108
Communication	371,237	211,502
Computer expenses	20,484	6,289
Depreciation of property, plant and equipment (Note 15)	544,697	409,941
Entertainment	161,032	107,583
Insurance expense	29,798	23,860
Loans collection expenses	5,547	5,259
Maintenance of property, plant and equipment	71,396	26,852
Membership and audit expenses	87,880	71,041
Other operating expenses	483,059	318,996
Staff costs *	2,975,312	1,987,091
Rental expenses	355,683	211,728
Stationery	245,613	200,703
Transportation and fuel supplies	304,305	220,237
Utilities	131,115	95,085
	<u>6,724,769</u>	<u>4,444,193</u>

* Staff costs

Salaries, incentives and allowances	2,492,526	1,663,095
Contribution to social and health fund	476,907	318,512
Training	5,879	5,484
	<u>2,975,312</u>	<u>1,987,091</u>

7. IMPAIRMENT LOSSES/(WRITE BACK OF IMPAIRMENT LOSSES)

	2006	2005
	MNT '000	MNT '000
Loans and advances	387,118	(130,469)
Foreclosure properties	10,321	98
Other receivables	-	955
Financial investments	-	(6,045)
	<u>397,439</u>	<u>(135,461)</u>

8. TAXATION

	2006 MNT '000	2005 MNT '000
Current income tax:		
Based on results for the year	<u>796,421</u>	<u>653,738</u>

The Bank provides for income taxes on the basis of its income for financial reporting purposes, adjusted for items which are not assessable or deductible for income tax purposes. The income tax rate for profits of the Bank is 15% (2005 : 15%) for the first MNT 100 million of taxable income, and 30% (2005 : 30%) on the excess of taxable income over MNT 100 million. Interest income on government bonds is not subject to income tax. Impairment losses for loans and advances is deductible for income tax purposes.

A reconciliation of income tax expense applicable to profit before taxation at the statutory income tax rate to income tax expense at the effective income tax rate of the Bank for the year ended 31 December is as follows:

	2006 MNT '000	2005 MNT '000
Profit before taxation	<u>2,569,573</u>	<u>2,142,666</u>
Tax at statutory tax rate of 30% (2005: 30%)	770,872	642,800
Effect of income subject to lower tax rate	(15,000)	(15,000)
Effect of income not subject to tax	(96,416)	(46,321)
Effect of expenses not allowable for tax purposes	136,965	78,370
Other items	-	(6,111)
Tax expense for the year	<u>796,421</u>	<u>653,738</u>

Deferred tax is not provided for in the current and previous financial years as there are no temporary differences

Management believes that the Bank is in substantial compliance with the tax laws affecting its operations.

9. DIVIDENDS

	2006	2005
	MNT '000	MNT '000
Declared during the year in respect of:		
<u>Year 2005</u>		
Dividends declared: MNT 56.01 per ordinary shares	450,000	-
<u>Year 2004</u>		
Dividends declared: MNT 30.42 per ordinary shares	-	127,929
Dividends capitalised: MNT 119.82 per ordinary shares	-	503,920
	<u>450,000</u>	<u>631,849</u>

10. CASH AND SHORT TERM FUNDS

	2006	2005
	MNT '000	MNT '000
Cash and short term funds represented by:		
Local currency	2,572,761	1,342,828
Foreign currencies	<u>2,728,418</u>	<u>757,401</u>
	<u>5,301,179</u>	<u>2,100,229</u>

11. DEPOSITS AND PLACEMENTS WITH OTHER BANKS AND FINANCIAL INSTITUTIONS

	2006	2005
	MNT '000	MNT '000
Current accounts with the Bank of Mongolia	3,986,386	3,255,842
Placements with other banks and financial institutions	<u>9,505,790</u>	<u>6,885,358</u>
	<u>13,492,176</u>	<u>10,141,200</u>

Current accounts with the Bank of Mongolia are maintained in accordance with the Bank of Mongolia's requirements. The balances maintained with the Bank of Mongolia are determined at set percentages based on 15 days average cash balances.

Placements with other banks and financial institutions represent local and foreign currencies current accounts maintained with foreign and local financial institutions and short term deposits with local financial institutions.

Other information on financial risks of deposits and placements with other banks and financial institutions are disclosed in Note 27.

12. FINANCIAL INVESTMENTS

	2006	2005
	MNT '000	MNT '000
Available-for-sale:		
Bank of Mongolia treasury bills, at fair value	-	1,104,866
Equity, unquoted	500	500
	<u>500</u>	<u>1,105,366</u>

Unquoted equity represents an investment made in NTB Art Exhibition LLC, a small handcraft production company. The investment is recorded at cost since its fair value cannot be reliably estimated. There is no market value for this investment.

Other information on financial risks of financial investments are disclosed in Note 27.

13. LOANS AND ADVANCES

	2006	2005
	MNT '000	MNT '000
Term loans	58,545,723	37,183,513
Staff loans	1,051,498	768,000
Loans to key management personnel	215,769	126,376
Accrued interest receivables	1,023,269	647,188
Gross loans and advances	<u>60,836,259</u>	<u>38,725,077</u>
Allowance for impairment losses		
- specific	(357,851)	(127,607)
- collective	(128,323)	-
Net loans and advances	<u>60,350,085</u>	<u>38,597,470</u>

13. LOANS AND ADVANCES (CONTD.)

Loans and advances analysed by their economic purposes are as follows:

	2006	2005
	MNT '000	MNT '000
Textile and production	2,513,272	1,726,861
Trading	18,905,075	15,677,211
Food processing	1,407,442	787,028
Services	6,883,889	2,911,046
Consumption	13,056,348	7,577,500
Agricultural	3,264,052	2,470,119
Mortgage	9,045,439	4,664,828
Deposit backed	2,237,728	1,251,998
Construction, mining and education	1,232,478	116,922
Loans to staff	1,051,498	768,000
Loans to key management personnel	215,769	126,376
	<u>59,812,990</u>	<u>38,077,889</u>
Accrued interest receivables	1,023,269	647,188
Allowance for impairment losses	(486,174)	(127,607)
Net loans and advances	<u>60,350,085</u>	<u>38,597,470</u>

In accordance with guidelines and regulations issued by the Bank of Mongolia, a loan is classified as non-performing when payment of interest and principal is overdue by more than 90 days. The details of non-performing loans ("NPLs") are as follows:

	2006	2005
	MNT '000	MNT '000
Gross balance at end of year	517,080	178,242
Less: Allowance for impairment losses	<u>(344,115)</u>	<u>(118,009)</u>
Net balance at year end	<u>172,965</u>	<u>60,233</u>
Gross NPLs as a percentage of gross total loans	<u>0.8%</u>	<u>0.5%</u>
Net NPLs as a percentage of net total loans	<u>0.3%</u>	<u>0.2%</u>

13. LOANS AND ADVANCES (CONTD.)

Movements in the impairment losses are as follows:

	2006	2005
	MNT '000	MNT '000
Specific Impairment		
Balance at beginning of year	127,607	67,523
Impairment made during the year	258,795	70,569
Impairment written off	(28,551)	(10,485)
Balance at end of year	<u>357,851</u>	<u>127,607</u>
	2006	2005
	MNT '000	MNT '000
Collective Impairment		
Balance at beginning of year	-	201,038
Impairment made during the year	134,286	-
Impairment written back	(5,963)	(201,038)
Balance at end of year	<u>128,323</u>	<u>-</u>

Other information on financial risks of loans and advances are disclosed in Note 27.

The allowance for impairment losses is considered adequate by the management based upon their formal reviews and analysis of existing credits using their knowledge of prevailing and anticipated economic conditions.

14. OTHER ASSETS

	2006	2005
	MNT '000	MNT '000
Other receivables	354,696	106,915
Less: Allowance for impairment losses	(2,393)	(5,711)
	<u>352,303</u>	<u>101,204</u>
Foreclosure properties	11,821	1,500
Less: Allowance for impairment losses	(11,821)	(1,500)
	<u>-</u>	<u>-</u>
Prepaid expenses	564,423	656,744
Consumables and other inventories	505,696	467,658
Accrued interest receivables	-	5,224
	<u>1,422,422</u>	<u>1,230,830</u>

15. PROPERTY, PLANT AND EQUIPMENT

31 December 2006	Buildings	Furniture, fixtures and vehicles	Computers	Capital work-in- progress	Total
	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000
At Cost					
At 1 January 2006	3,622,083	1,415,086	1,319,931	431,361	6,788,461
Additions	341,341	501,177	374,452	1,471,538	2,688,508
Disposals	(4,967)	(109,673)	(52,698)	-	(167,338)
Write-offs	-	-	(11,801)	-	(11,801)
Transfer	397,605	-	-	(397,605)	-
At 31 December 2006	<u>4,356,062</u>	<u>1,806,590</u>	<u>1,629,884</u>	<u>1,505,294</u>	<u>9,297,830</u>
Accumulated Depreciation					
At 1 January 2006	118,074	229,605	520,853	-	868,532
Charge for the year (Note 6)	96,367	165,754	282,576	-	544,697
Disposals	(704)	(33,299)	(47,929)	-	(81,932)
Write-offs	-	-	(11,801)	-	(11,801)
At 31 December 2006	<u>213,737</u>	<u>362,060</u>	<u>743,699</u>	<u>-</u>	<u>1,319,496</u>
Net Book Value	<u>4,142,325</u>	<u>1,444,530</u>	<u>886,185</u>	<u>1,505,294</u>	<u>7,978,334</u>

31 December 2005	Buildings	Furniture, fixtures and vehicles	Computers	Capital work-in- progress	Total
	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000
At Cost					
At 1 January 2005	943,607	964,817	823,617	269,820	3,001,861
Additions	2,573,076	584,324	594,706	266,941	4,019,047
Disposals	-	(134,055)	(74,842)	-	(208,897)
Write-offs	-	-	(23,550)	-	(23,550)
Transfer	105,400	-	-	(105,400)	-
At 31 December 2005	<u>3,622,083</u>	<u>1,415,086</u>	<u>1,319,931</u>	<u>431,361</u>	<u>6,788,461</u>
Accumulated Depreciation					
At 1 January 2005	36,789	165,540	362,025	-	564,354
Charge for the year (Note 6)	81,285	109,642	219,014	-	409,941
Disposals	-	(45,577)	(36,636)	-	(82,213)
Write-offs	-	-	(23,550)	-	(23,550)
At 31 December 2005	<u>118,074</u>	<u>229,605</u>	<u>520,853</u>	<u>-</u>	<u>868,532</u>
Net Book Value	<u>3,504,009</u>	<u>1,185,481</u>	<u>799,078</u>	<u>431,361</u>	<u>5,919,929</u>

16. INTANGIBLE ASSETS

31 December 2006	Software and Licenses MNT '000	Patents and Rights MNT '000	Total MNT '000
At Cost			
At 1 January 2006	114,133	1,050	115,183
Addition	330,208	93	330,301
At 31 December 2006	<u>444,341</u>	<u>1,143</u>	<u>445,484</u>
Accumulated Amortisation			
At 1 January 2006	2,427	-	2,427
Charge for the year (Note 6)	65,868	313	66,181
At 31 December 2006	<u>68,295</u>	<u>313</u>	<u>68,608</u>
Net Book Value	<u>376,046</u>	<u>830</u>	<u>376,876</u>
31 December 2005	Software and Licenses MNT '000	Patents and Rights MNT '000	Total MNT '000
At Cost			
At 1 January 2005	-	-	-
Addition	114,133	1,050	115,183
At 31 December 2005	<u>114,133</u>	<u>1,050</u>	<u>115,183</u>
Accumulated Amortisation			
At 1 January 2005	-	-	-
Charge for the year (Note 6)	2,427	-	2,427
At 31 December 2005	<u>2,427</u>	<u>-</u>	<u>2,427</u>
Net Book Value	<u>111,706</u>	<u>1,050</u>	<u>112,756</u>

17. DEPOSITS FROM CUSTOMERS

	2006	2005
	MNT '000	MNT '000
Current account	5,372,795	3,671,545
Demand deposits	9,349,055	6,345,471
Time deposits	28,271,453	21,379,797
Other deposits	13,752	-
	<u>43,007,055</u>	<u>31,396,813</u>

Other information on financial risks of deposits from customers are disclosed in Note 27.

18. DEPOSITS FROM LOCAL FINANCIAL INSTITUTIONS

	2006	2005
	MNT '000	MNT '000
Time Deposit from Chinggis Khaan Bank	1,750,959	-
Time Deposit from Ulaanbaatar City Bank	2,330,000	-
Time Deposit from Mongol Post Bank	-	800,000
Time Deposit from Zoos Bank	-	2,000,917
	<u>4,080,959</u>	<u>2,800,917</u>

Other information on financial risks of deposits from local financial institutions are disclosed in Note 27.

19. LOANS FROM LOCAL FINANCIAL INSTITUTIONS

	2006	2005
	MNT '000	MNT '000
Unsecured:		
Mongol Post Bank	-	800,000
Chinggis Khaan Bank	-	505,167
	<u>-</u>	<u>1,305,167</u>

Other information on financial risks of loans from local financial institutions are disclosed in Note 27.

20. LOANS FROM FOREIGN FINANCIAL INSTITUTIONS

	2006	2005
	MNT '000	MNT '000
Unsecured:		
Deutsche Bank Microcredit Development Fund, Inc	101,613	154,549
International Finance Corporation	364,358	445,102
Dexia Micro Credit Fund	587,012	1,854,593
Calvert Social Investment Foundation, Inc	836,010	618,198
Microvest 1, LP	-	1,854,594
ASN-Novib Fonds	1,764,657	1,236,395
Oikocredit Ecumenical Development Cooperative Society U.A	1,745,762	2,221,140
Shorecap International Ltd	583,228	611,178
Triodos Doen	1,557,667	578,057
Triodos Fair Share Fund	1,160,990	604,303
BlueOrchard Finance S.A.	7,583,539	-
DB-Global Commercial Microfinance Consortium, Ltd	4,798,047	-
DWM Securitizations S.A.	2,321,777	-
European Bank for Reconstruction and Development	2,859,626	-
	<u>26,264,286</u>	<u>10,178,109</u>

Loans from Foreign Financial Institutions are non-secured and the Bank has not had any defaults of principal, interest or other breaches with respect to their liabilities during the year.

Loan from Deutsche Bank Microcredit Development Fund, Inc ("DB")

The loan was obtained in 2002 in the form of subordinated debt for a principal amount of USD 125,000 to finance the Bank's micro-finance and small and medium enterprise ("SME") lending activities. The loan bears interest at a rate of 2% (2005: 2%) per annum and is repayable in August 2007.

Loan from the International Finance Corporation ("IFC")

The loan from IFC, amounting to USD 400,000, bears interest at a rate of 9.11% (2005: 7.32%) per annum. The loan was obtained in 2002 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in twelve semi-annual instalments which commenced on 15 January 2005 and will be fully repaid in July 2010.

20. LOANS FROM FOREIGN FINANCIAL INSTITUTIONS (CONTD.)

Loans from Dexia Micro Credit Fund ("DMCF")

The loans obtained from DMCF comprise the following:

(i) A promissory note issued by the Bank for a principal amount of USD 500,000. The note bears interest at a rate of 11.53% (2005: 10.67%) per annum. The loan was fully settled during the year.

(ii) A promissory note issued by the Bank for a principal amount of USD 1,000,000. The note was obtained in 2005 to finance the Bank's micro-finance and SME lending activities. The note bears interest at a rate of 9.75% (2005: 9.75%) per annum. The loan is repayable in two equal semi-annual instalments of USD 500,000 each, commencing in December 2006 and to be fully repaid in June 2007.

Loan from Calvert Social Investment Foundation, Inc ("CSIF")

The loan obtained from CSIF is in the form of promissory notes issued by the foundation for a principal amount of USD 700,000. The note was obtained in 2004, 2005 and 2006 respectively to finance the bank's micro-finance and SME lending activities. The notes bear interest at a rate of 6% (2005: 6%) per annum and will be fully repaid in July 2008.

Loan from Microvest 1, LP

The loan obtained from Microvest 1, LP, amounting to USD 1,500,000, bears interest at a rate of 10.48% (2005: 9.77%) per annum. The loan was obtained in 2004 to support further expansion of the Bank's micro-finance and SME lending activities. The loan has been fully repaid during the year.

Loans from ASN-Novib Fonds

The loans obtained from ASN-Novib Fonds comprise the following:

(i) USD 1,000,000, which bears interest at a rate of 9% (2005: 9%) per annum. The loan was obtained in 2004 to support further expansion of the Bank's micro-finance and SME lending activities. The loan has been fully repaid during the year.

(ii) MNT 584,000,000, which bears interest at a rate of 12.5% per annum. The loan was obtained in 2006 to support further expansion of the Bank's micro-finance and SME lending activities. The loan will be fully repaid in September 2008.

(iii) USD 1,000,000, which bears interest at a rate of 8.5% per annum. The loan was obtained in 2006 to support further expansion of the Bank's micro-finance and SME lending activities. The loan will be fully repaid in September 2008.

20. LOANS FROM FOREIGN FINANCIAL INSTITUTIONS (CONTD.)

Loans from Oikocredit Ecumenical Development Cooperative Society U.A ("Oikocredit")

The loans obtained from Oikocredit comprise the following:

(i) MNT 444,690,000, which bears interest at a rate of 13% (2005: 13%) per annum. The loan was obtained to finance the Bank's micro-finance and SME lending activities. The loan has been fully repaid during the year.

(ii) USD 724,920, which was converted to MNT 853,955,760 during the year, bears interest at a rate of 12% per annum. The loan was obtained in 2005 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in four equal semi-annual instalments of MNT 213,488,940 each commencing April 2007 and will be fully settled in October 2008.

(iii) EUR 600,000, which bears interest at a rate of 9.09% (2005: 8.02%) per annum. The loan was obtained in 2005 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in four equal semi-annual instalments commencing April 2007 and will be fully repaid in October 2008.

Loan from Shorecap International Ltd ("SCI")

The loan obtained from SCI, amounting to USD 500,000, bears interest at a rate of 9% (2005: 9%) per annum. The loan was obtained in 2005 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in four equal quarterly instalments commencing December 2007 and will be fully repaid in September 2008.

Loans from Triodos Doen

The loans obtained from Triodos Doen comprise of the following:

(i) MNT 560,185,000, which bears interest at a rate of 13% (2005: 13%) per annum. The loan was obtained in 2005 to finance the expansion of Bank's lending activities. The loan will be fully repaid in October 2008.

(ii) MNT 1,000,000,000, which bears interest at a rate of 13% per annum. The loan was obtained in 2006 to finance the expansion of Bank's lending activities. The loan will be fully repaid in July 2010.

Loans from Triodos Fair Share Fund

The loans obtained from Triodos Fair Share Fund comprise of the following:

(i) USD 500,000, which bears interest at a rate of 9% (2005: 9%) per annum. The loan was obtained in 2005 to finance the expansion of Bank's lending activities. The loan will be fully repaid in October 2008.

(ii) USD 500,000, which bears interest at a rate of 8.5% per annum. The loan was obtained in 2006 to finance the expansion of Bank's lending activities. The loan will be fully repaid in July 2011

20. LOANS FROM FOREIGN FINANCIAL INSTITUTIONS (CONTD.)

Loan from BlueOrchard Finance S.A.

The loan obtained from BlueOrchard, amounting to USD 6,500,000, bears interest at a rate of 8.25% per annum. The loan was obtained in 2006 to finance the expansion of the Bank's micro-finance lending activities. The loan is repayable in four equal quarterly instalments commencing June 2010 and will be fully repaid in March 2011.

Loan from DB-Global Commercial Microfinance Consortium, Ltd. ("DBGC")

The loan obtained from DBGC, amounting to MNT 4,672,000,000, bears interest at a rate of 9.25% per annum. The loan was obtained in 2006 to finance the Bank's micro-finance and small-medium enterprise lending activities. The loan is repayable in eight equal semi-annual instalments commencing March 2007 and will be fully repaid in September 2010.

Loan from DWM Securitizations S.A. ("DWMS")

The loan obtained from DWMS, amounting to USD 2,000,000, bears interest at a rate of 8.25% per annum. The loan was obtained in 2006 to finance the expansion of the Bank's micro-finance and small-medium enterprise lending activities. The loan will be fully repaid in June 2011.

Loan from the European Bank for Reconstruction and Development ("EBRD")

The loan was obtained from EBRD, amounting to USD 2,500,000, bears interest at a rate of 9.12% per annum. The loan was obtained in 2006 to assist the development of the micro and small business sector in Mongolia. The loan is repayable in five equal semi-annual instalments commencing September 2008 and will be fully repaid in September 2010.

Other information on financial risks of loans from foreign financial institutions are disclosed in Note 27.

21. LOANS FROM THE BANK OF MONGOLIA AND GOVERNMENT AGENCIES

	2006 MNT '000	2005 MNT '000
Unsecured:		
<u>Loans from the Bank of Mongolia</u>		
Agricultural Sector Development Project Loan	290,966	497,136
Employment Generation Project	70,300	42,200
	361,266	539,336
 <u>Loan from the Ministry of Social Welfare and Labour</u>		
Employment Generation Support Fund	500,000	500,000
 <u>Loan from the World Bank</u>		
Micro Finance Development Fund	837,579	924,858
 <u>Loan from the International Fund for Agricultural Development</u>		
Rural Poverty Reduction Program	1,849,458	1,372,003
 <u>Loan from the Ministry of Trade and Industry</u>		
	341,011	-
	3,889,314	3,336,197

Loans from the Bank of Mongolia

(i) Agricultural Sector Development Project Loan

The Bank obtained this loan in Mongolian Tugrug from the Bank of Mongolia. The objective of the loan is to provide financial aid to small and medium enterprises in the agricultural sector. The loan bears interest at 5.5% (2005: 5.5%) per annum, payable on a quarterly basis which commenced on 5 January 2006 and will be fully repaid in October 2007.

(ii) Employment Generation Project

The Bank obtained this loan in Mongolian Tugrug from the Bank of Mongolia amounting to MNT 118,500,000 bears interest at a rate of 10% (2005: 10%) per annum. The loan was obtained through 4 disbursements from October 2005 to June 2006 to support micro and medium business entities in Mongolia. The loan is repayable in 7 instalments, commencing on April 2006 and to be fully repaid in June 2007.

Loan from the Ministry of Social Welfare and Labour

The Bank obtained this loan in Mongolian Tugrug from the Ministry of Social Welfare and Labour. The objective of the loan is to provide financial aid to small and medium enterprises. The loan amounting to MNT 500 million obtained in 2005, which bears interest at rate of 6% per annum was fully repaid in 2006. The Bank obtained another loan which amounts to MNT 500 million during the year. The loan bears interest at a rate of 0.8% per annum and will be fully repaid in July 2007

**21. LOANS FROM THE BANK OF MONGOLIA AND GOVERNMENT AGENCIES
(CONTD.)**

Loan from the World Bank

The objective of the loan is to support and improve the living standard of inhabitant in the rural areas. The loan bears interest rate at 8% (2005: 5%-8%) per annum, payable on a monthly basis with principal repayment commencing on September 2005 and final repayment due in March 2009 in accordance with the repayment schedule.

Loan from the International Fund for Agricultural Development

The objective of the loan is to support and reduce the poverty in the rural areas. The loan, which amounts to USD 1,823,380, is to be received from March 2004 to December 2009. It bears interest at a rate of 6% (2005: 6%) per annum. The loan is repayable in 10 equal semi-annual instalments commencing from June 2013 and will be fully repaid in December 2017.

Loan from the Ministry of Trade and Industry

The objective of the loan is to support micro and medium businesses. The loan, which is in Mongolian Tugrug amounting to MNT 340 million was obtained in 2006, bears interest at a rate of 1.2% per annum and will be due and fully repaid on 8 November 2008.

The loans are unsecured and the Bank has not had any defaults of principal, interest or other breaches with respect to their liabilities during the year.

Other information on financial risks of loans from the Bank of Mongolia and government agencies are disclosed in Note 27.

22. DEFERRED GRANTS

	2006	2005
	MNT '000	MNT '000
Consultative Group to Assist the Poorest ("CGAP")	78,475	26,164
International Finance Corporation ("IFC")	7,308	7,659
United States Agency for International Development ("USAID")	74,846	92,331
Other grants	-	710
	<u>160,629</u>	<u>126,864</u>

Movements in the deferred grants are as follows:

	2006	2005
	MNT '000	MNT '000
Balance at beginning of year	126,864	131,910
Received during the year	117,568	222,512
Amortised during the year	(83,803)	(227,558)
Balance at end of year	<u>160,629</u>	<u>126,864</u>

22. DEFERRED GRANTS (CONTD.)

The CGAP grant was approved in 2001 with the objective of assisting the X.A.C Co., Ltd in making a successful transition to a micro-finance bank. The grant allows the Bank to carry out the following activities:

- Develop internal systems that meet the requirements and needs of a micro-finance bank;
- Secure higher standard of external audit services; and
- Strengthen senior management and corporate governance, in particular, financial management and banking skills.

During the year, XacBank won the CGAP's Pro Poor Innovation Challenge for its "Development Guide" service supporting rural savings and credit cooperatives. The grant was disbursed to XacBank to improve the Bank's service to the public, which include provide training to cooperative managers and members, finance awards for the best cooperatives and provides MIS program to cooperatives.

The IFC grant was received in 2002 with the objective of providing funds for technical assistance in the following initiatives:

- Hiring of technical advisor;
- Provide training for senior managers with an established micro-finance institution; and
- Participation by an international participant in the meetings of the Bank's Board of Directors and training for the Bank's Board members.

The Microenterprise Implementation Grant Program ("MIGP") grant was received in 2003 from United States Agency for International Development ("USAID") with the objective of assisting the Bank in expanding its branch network, staff training and developing new products and services, as well as internal systems needed to control growth.

Expenditure financed by grants

Donor and Purpose	2006 MNT '000	2005 MNT '000
• Expenditure financed by grants from "CGAP" covering consulting fee	-	4,767
• Expenditure financed by grants from "CGAP" covering meeting and training fee	4,689	-
• Expenditure financed by grants from United Nations Development Program covering scholarships to students	710	1,461
• Expenditure financed by grants from USAID's Income Generation Project covering facility improvements	-	187,814
• Expenditure financed by grants from USAID's Income Generation Project covering internal systems development & IT audit consultancy, training and exposure trip	14,243	33,516
• Expenditure financed by grants from MIGP covering purchasing of accounting program	14,825	
• Expenditure financed by grants from MIGP covering renovation of building	49,336	-
	<u>83,803</u>	<u>227,558</u>

23. OTHER LIABILITIES

	2006	2005
	MNT '000	MNT '000
Delay on clearing settlement	95,406	150,550
Other payables	313,303	160,826
Dividends payable	1,149	1,090
	<u>409,858</u>	<u>312,466</u>

24. ORDINARY SHARES

	Number of Ordinary Shares of		Amount	
	MNT1,000 each			
	2006	2005	2006	2005
			MNT '000	MNT '000
At 1 January	8,034,200	4,205,530	8,034,200	4,205,530
Issued during the year	-	3,324,750	-	3,324,750
Dividend capitalised to ordinary shares	-	503,920	-	503,920
At 31 December	<u>8,034,200</u>	<u>8,034,200</u>	<u>8,034,200</u>	<u>8,034,200</u>

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Bank. All shares rank equally with regard to the Bank's residual assets.

25. OTHER RESERVES

During the year the Board of Directors approved the transfer of MNT 1,038,928,000 from retained profits to other reserves. At the date of this report, no policy is formalised by the Board as to the purpose of this reserves.

26. CASH AND CASH EQUIVALENTS

	2006	2005
	MNT '000	MNT '000
Cash and short term funds	5,301,179	2,100,229
Deposits and placements with other banks and financial institutions	13,492,176	10,141,200
	<u>18,793,355</u>	<u>12,241,429</u>

27. FINANCIAL RISK MANAGEMENT POLICIES

Management of risk is fundamental to the banking business and is an essential element of the Bank's operations. The main risks inherent to the Bank's operations are those related to credit exposures, liquidity and market movements in interest rates and foreign exchange rates. A description of the Bank's risk management policies in relation to those risks are as follows:

Credit risk

The Bank is exposed to credit risk which is the risk that Bank's customers, clients or counterparties will be unable or unwilling to pay interest, repay capital, or otherwise fulfil their contractual obligations under loan agreements, other credit facilities, or in respect of other financial instruments. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Credit limit to any single borrower and portfolio limits by loan products are approved and reviewed periodically by the Board Credit Committee.

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

Apart from deposits and placements with other banks and financial institutions amounting to MNT 904 million (2005 : MNT 1,082 million), all banking assets and liabilities were geographically concentrated in Mongolia.

Currency risk

The Bank is exposed to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Bank's management sets limits on the level of exposure by currencies (primarily USD) and in total for both overnight and intra-day positions, which are monitored daily. The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December.

27. FINANCIAL RISK MANAGEMENT POLICIES (CONTD.)

Currency risk (contd.)

Concentrations of assets, liabilities and off balance sheet items	Local	Foreign Currencies		Total (MNT million)
	Currency (MNT million)	USD (MNT million)	Others (MNT million)	
As at 31 December 2006				
Assets				
Cash and short term funds	2,573	1,528	1,200	5,301
Deposits and placements with other banks and financial institutions	5,668	7,390	434	13,492
Financial investments	1	-	-	1
Loans and advances	45,205	15,403	228	60,836
Other assets	1,125	294	3	1,422
	<u>54,572</u>	<u>24,615</u>	<u>1,865</u>	<u>81,052</u>
Liabilities				
Deposits from customers	37,514	5,405	88	43,007
Deposits from local financial institutions	4,081	-	-	4,081
Loans from foreign financial institutions	7,827	17,575	862	26,264
Loans from the Bank of Mongolia and government agencies	2,039	1,850	-	3,889
Other liabilities	377	33	-	410
Tax payable	241	-	-	241
	<u>52,079</u>	<u>24,863</u>	<u>950</u>	<u>77,892</u>
Net position	<u>2,493</u>	<u>(248)</u>	<u>915</u>	<u>3,160</u>
Off balance sheet items	<u>70,236</u>	<u>160</u>	<u>-</u>	<u>70,396</u>

27. FINANCIAL RISK MANAGEMENT POLICIES (CONTD.)

Currency risk (contd.)

Concentrations of assets, liabilities and off balance sheet items	Local	Foreign Currencies		Total (MNT million)
	Currency (MNT million)	USD (MNT million)	Others (MNT million)	
As at 31 December 2005				
Assets				
Cash and short term funds	1,343	528	229	2,100
Deposits and placements with other banks and financial institutions	4,441	5,039	661	10,141
Financial investments	1,105	-	-	1,105
Loans and advances	31,330	7,250	145	38,725
Other assets	831	400	-	1,231
	<u>39,050</u>	<u>13,217</u>	<u>1,035</u>	<u>53,302</u>
Liabilities				
Deposits from customers	28,096	3,296	5	31,397
Deposits from local financial institutions	2,801	-	-	2,801
Loans from local financial institutions	1,305	-	-	1,305
Loans from foreign financial institutions	999	8,296	883	10,178
Loans from the Bank of Mongolia and government agencies	1,967	1,369	-	3,336
Other liabilities	159	153	-	312
Tax payable	206	-	-	206
	<u>35,533</u>	<u>13,114</u>	<u>888</u>	<u>49,535</u>
Net position	<u>3,517</u>	<u>103</u>	<u>147</u>	<u>3,767</u>
Off balance sheet items	<u>41,732</u>	<u>-</u>	<u>-</u>	<u>41,732</u>

27. FINANCIAL RISK MANAGEMENT POLICIES (CONTD.)

Liquidity risk

The Bank is exposed to liquidity risks that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. The Bank sets limits on the minimum proportion of maturing funds available to cover such cash outflows and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand. The following table analyses assets and liabilities of the Bank into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

27. FINANCIAL RISK MANAGEMENT POLICIES (CONTD.)

Liquidity risk (contd.)

The contractual maturities of banking assets and liabilities for the year ended 31 December 2006 are as follows (MNT million):

	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
Assets						
Cash and short term funds	5,301	-	-	-	-	5,301
Deposits and placements with other banks and financial institutions	9,631	3,830	-	31	-	13,492
Financial investments	-	-	-	-	1	1
Loans and advances	14,543	13,904	15,169	10,902	6,318	60,836
Other assets	688	106	13	110	-	917
	<u>30,163</u>	<u>17,840</u>	<u>15,182</u>	<u>11,043</u>	<u>6,319</u>	<u>80,547</u>
Liabilities						
Deposits from customers	23,481	4,469	4,969	3,762	6,326	43,007
Deposits from local financial institutions	1,751	2,330	-	-	-	4,081
Loans from foreign financial institutions	21	1,329	722	24,192	-	26,264
Loans from the Bank of Mongolia and government agencies	262	187	714	887	1,839	3,889
Deferred grants	-	-	-	-	161	161
Other liabilities	202	53	151	4	-	410
Tax payable	241	-	-	-	-	241
	<u>25,958</u>	<u>8,368</u>	<u>6,556</u>	<u>28,845</u>	<u>8,326</u>	<u>78,053</u>
Net liquidity gap	<u>4,205</u>	<u>9,472</u>	<u>8,626</u>	<u>(17,802)</u>	<u>(2,007)</u>	<u>2,494</u>
Accumulated gap	<u>4,205</u>	<u>13,677</u>	<u>22,303</u>	<u>4,501</u>	<u>2,494</u>	

27. FINANCIAL RISK MANAGEMENT POLICIES (CONTD.)

Liquidity risk (contd.)

The contractual maturities of banking assets and liabilities for the year ended 31 December 2005 are as follows (MNT million):

	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
Assets						
Cash and short term funds	2,100	-	-	-	-	2,100
Deposits and placements with other banks and financial institutions	8,432	1,098	611	-	-	10,141
Financial investments	1,105	-	-	-	-	1,105
Loans and advances	12,501	10,057	9,460	3,389	3,318	38,725
Other assets	615	128	1	19	-	763
	<u>24,753</u>	<u>11,283</u>	<u>10,072</u>	<u>3,408</u>	<u>3,318</u>	<u>52,834</u>
Liabilities						
Deposits from customers	16,127	5,118	3,897	2,595	3,660	31,397
Deposits from local financial institutions	2,801	-	-	-	-	2,801
Loans from local financial institutions	-	505	800	-	-	1,305
Loans from foreign financial institutions	948	1,217	2,761	5,252	-	10,178
Loans from the Bank of Mongolia and government agencies	193	751	230	800	1,362	3,336
Deferred grants	-	-	-	-	127	127
Other liabilities	65	244	3	-	-	312
Tax payable	206	-	-	-	-	206
	<u>20,340</u>	<u>7,835</u>	<u>7,691</u>	<u>8,647</u>	<u>5,149</u>	<u>49,662</u>
Net liquidity gap	<u>4,413</u>	<u>3,448</u>	<u>2,381</u>	<u>(5,239)</u>	<u>(1,831)</u>	<u>3,172</u>
Accumulated gap	<u>4,413</u>	<u>7,861</u>	<u>10,242</u>	<u>5,003</u>	<u>3,172</u>	

27. FINANCIAL RISK MANAGEMENT POLICIES (CONTD.)

Interest rate risk

The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest rate risk is measured by the extent to which changes in market interest rates impact margins and net income. To the extent the term structure of interest bearing assets differs from that of liabilities, net of interest income will increase or decrease as a result of movements in interest rates. The Bank's expected repricing and maturity dates do not differ significantly from the contract dates, which are disclosed in the liquidity risk table above

Interest rate risk is managed by increasing or decreasing positions within limits specified by the Bank's management. These limits restrict the potential effect of movements in interest rates on interest margin and on the value of interest sensitive assets and liabilities.

The Bank's interest rate policy is reviewed and approved by the Board's Risk Management Committee. The following table summarises repricing mismatches on the Bank's financial assets and liabilities at the balance sheet date. The carrying amounts of interest rate sensitive assets and liabilities are presented in the periods in which they next reprice to market rate or mature, and are summed to show the interest rate sensitivity gap.

27. FINANCIAL RISK MANAGEMENT POLICIES (CONTD.)

Interest rate risk

As at 31 December 2006	Effective interest rate %	Non-interest sensitive MNT million	Less than 3 months MNT million	3 to 6 months MNT million	6 months to 1 year MNT million	1 to 5 years MNT million	Over 5 years MNT million	Total MNT million
Assets								
Cash and short term funds	-	5,301	-	-	-	-	-	5,301
Deposits and placements with other banks and financial institutions	3.00%	5,468	4,163	3,830	-	31	-	13,492
Financial investments	-	1	-	-	-	-	-	1
Loans and advances	27.67%	-	25,589	13,665	12,498	9,084	-	60,836
Other assets	-	917	-	-	-	-	-	917
		<u>11,687</u>	<u>29,752</u>	<u>17,495</u>	<u>12,498</u>	<u>9,115</u>	<u>-</u>	<u>80,547</u>
Liabilities								
Deposits from customers	11.38%	-	43,007	-	-	-	-	43,007
Deposits from local financial institutions	0.86%	-	1,751	2,330	-	-	-	4,081
Loans from foreign financial institutions	7.92%	-	21	1,329	722	24,192	-	26,264
Loans from the Bank of Mongolia and government agencies	5.37%	-	262	187	714	887	1,839	3,889
Other liabilities	-	410	-	-	-	-	-	410
Tax payable	-	241	-	-	-	-	-	241
		<u>651</u>	<u>45,041</u>	<u>3,846</u>	<u>1,436</u>	<u>25,079</u>	<u>1,839</u>	<u>77,892</u>
Net financial assets/(liabilities)		<u>11,036</u>	<u>(15,289)</u>	<u>13,649</u>	<u>11,062</u>	<u>(15,964)</u>	<u>(1,839)</u>	<u>2,655</u>

27. FINANCIAL RISK MANAGEMENT POLICIES (CONTD.)

Interest rate risk (Contd.)

As at 31 December 2005	Effective interest rate %	Non-interest sensitive MNT million	Less than 3 months MNT million	3 to 6 months MNT million	6 months to 1 year MNT million	1 to 5 years MNT million	Over 5 years MNT million	Total MNT million
Assets								
Cash and short term funds	-	2,100	-	-	-	-	-	2,100
Deposits and placements with other banks and financial institutions	7.19%	3,256	5,176	1,098	611	-	-	10,141
Financial investments	6.79%	-	1,105	-	-	-	-	1,105
Loans and advances	30.59%	-	12,501	10,057	9,460	3,389	3,318	38,725
Other assets	-	763	-	-	-	-	-	763
		6,119	18,782	11,155	10,071	3,389	3,318	52,834
Liabilities								
Deposits from customers	10.48%	-	16,127	5,118	3,897	2,595	3,660	31,397
Deposits from local financial institutions	9.80%	-	2,801	-	-	-	-	2,801
Loans from local financial institutions	12.00%	-	-	505	800	-	-	1,305
Loans from foreign financial institutions	9.38%	-	948	1,217	2,761	5,252	-	10,178
Loans from the Bank of Mongolia and government agencies	6.42%	-	193	751	230	800	1,362	3,336
Other liabilities	-	312	-	-	-	-	-	312
Tax payable	-	206	-	-	-	-	-	206
		518	20,069	7,591	7,688	8,647	5,022	49,535
Net financial assets/(liabilities)		5,601	(1,287)	3,564	2,383	(5,258)	(1,704)	3,299

28. EMPLOYEE BENEFITS

Equity Compensation Benefits

Under the Bank's Employee Stock Ownership plan, shares are allocated to employees on the following conditions:

- Employment duration with the Bank and its predecessor companies must be at least one year and the employee must complete more than 1,000 hours of service.
- Performing rating in the most recent evaluation period; and
- Employee shall read, understand and agree to abide by the policy prior to purchasing any Stock under this policy.

The number of shares offered for sale and its price will be determined at the discretion of the Bank's Board of Directors. The shares were offered at a price of 50% (2005: 30%) of the par value of EIT LLC shares. Prior to 2005, the Plan enables employees to purchase shares which were held by XAC-GE LLC in XacBank LLC. In 2005, all XacBank's shares (except 12,311 shares) previously held by the employees in XacBank LLC are transferred to XAC-GE LLC. In return the employee's interest were transferred to EIT LLC, an investment trust company set up to hold the shares in XAC-GE LLC. The share capital of XacBank LLC is not affected by these transactions. The Bank does not bear or incur any cost in connection with these transactions.

29. RELATED PARTY DISCLOSURES

The Bank is controlled by XAC-GE LLC (incorporated in Mongolia). XAC-GE LLC is owned by the shareholders as disclosed in Note 1

A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits and foreign currency transactions. These transactions were carried out on commercial terms and at market rates. The volumes of related party transactions, outstanding balances as at the year end, and relating expense for the year are listed below.

	2006	2005
	MNT '000	MNT '000
(a) Compensations to key management personnel		
- Salaries, incentives and allowances	199,336	98,414
- Contribution to social and health fund	37,874	18,699
	<u>237,210</u>	<u>117,113</u>

29. RELATED PARTY DISCLOSURES (CONTD.)

	2006 MNT '000	2005 MNT '000
(b) Loans to key management personnel	<u>220,561</u>	<u>119,405</u>
Repayable		
- within one year	24,227	11,617
- one year to five years	55,631	83,003
- over five years	140,703	24,785
	<u>220,561</u>	<u>119,405</u>

The loans to Bank's employees bear interest rates ranging from 5% to 30% (2005 : 5% to 18.0%) per annum.

	2006 MNT '000	2005 MNT '000
(c) Loans from shareholders of XAC-GE LLC		
Microvest 1, LP	-	1,854,594
Shorecap International Ltd	583,228	611,178
Triodos Doen	1,557,667	578,057
Triodos Fair Share Fund	1,160,990	604,303
	<u>3,301,885</u>	<u>3,648,132</u>

	2006 MNT '000	2005 MNT '000
(d) Loan interest paid to shareholders of XAC-GE LLC	<u>355,053</u>	<u>221,615</u>

	2006 MNT '000	2005 MNT '000
(e) Deposits from corporate shareholders	<u>4,011,256</u>	<u>3,634,495</u>

30. CAPITAL ADEQUACY

Bank of Mongolia requires commercial banks to maintain a core capital adequacy ratio of 5% and risk weighted capital ratio of 10%, compiled on the basis of total equity and total assets as adjusted for their risk. The capital adequacy ratios of the Bank as at 31 December are as follows:

	2006	2005
Core capital ratio	15.81%	21.12%
Risk weighted capital ratio	15.81%	21.12%
	2006	2005
	MNT '000	MNT '000
<u>Tier I capital</u>		
Statutory fund	8,034,200	8,034,200
Share premium	8,551	8,551
Other reserves	1,052,792	13,864
Retained profits	1,773,210	1,488,986
Total Tier I capital	<u>10,868,753</u>	<u>9,545,601</u>

Breakdown of risk weighted assets in the various categories of risk weights are as follows:

	2006		2005	
	MNT '000		MNT '000	
%	Assets	Risk Weighted	Assets	Risk Weighted
0	9,287,565	-	6,450,438	-
10	-	-	-	-
20	9,580,297	1,916,059	6,852,474	1,370,495
50	9,278,324	4,639,162	4,673,022	2,336,511
100	62,207,945	62,207,945	41,494,295	41,494,295
Total	<u>90,354,131</u>	<u>68,763,166</u>	<u>59,470,229</u>	<u>45,201,301</u>

31. CAPITAL COMMITMENTS

	2006	2005
	MNT '000	MNT '000
<u>Approved and contracted for:</u>		
Property, plant and equipment	<u>407,315</u>	<u>-</u>

32. OFF BALANCE SHEET ITEMS

	2006	2005
	MNT '000	MNT '000
Letters of credit	159,826	-
Assets pledged to the Bank as collateral	69,583,507	41,341,256
Other off balance sheet items	652,983	391,353
	<u>70,396,316</u>	<u>41,732,609</u>

Letters of credit commit the Bank to make payment on behalf of customers in the event of a specific act, generally related to the import or export of goods.

Assets pledged to the Bank are strictly for the purpose of providing collateral for loans and advances. To the extent that the Bank is permitted to sell the assets, they are classified on the balance sheet as foreclosure properties. The pledged assets will be returned when the underlying transaction is terminated.

33. COMPARATIVES

The comparative figures have been audited by a firm of certified public accountants other than Ernst & Young Mongolia Audit LLC. The presentation and classification of items in the current year financial statements have been consistent with the previous financial year except that certain comparative amounts as at 31 December 2005 have been reclassified to conform with current year presentation as disclosed belows:

	As		As Previously
	Restated	Adjustment	Stated
	MNT'000	MNT'000	MNT'000
Income statements			
Interest and similar expenses	(4,258,189)	(23,488)	(4,234,701)
Non-interest income	875,585	29,742	845,843
Operating expenses	(4,444,193)	(6,254)	(4,437,939)
Balance sheet			
Deposits and placements with other banks and financial institutions	10,141,200	32,884	10,108,316
Financial investments	1,105,366	205	1,105,161
Loans and advances	38,597,470	647,188	37,950,282
Other assets	1,230,830	(724,796)	1,955,626
Deposits from customers	31,396,813	498,654	30,898,159
Deposits from local financial institutions	2,800,917	917	2,800,000
Loans from local financial institutions	1,305,167	5,167	1,300,000
Loans from foreign financial institutions	10,178,109	110,002	10,068,107
Loans from the Bank of Mongolia and government agencies	3,336,197	16,062	3,320,135
Other liabilities	312,466	(675,321)	987,787

34. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

Financial instruments comprise financial assets and financial liabilities. The fair value of a financial instrument is the amount at which the instrument could be exchanged or settled between knowledgeable and willing parties in an arm's length transaction, other than in a forced or liquidation sale. Where quoted market prices are not available, the fair values are measured at discounted rates commensurate with the quality and duration of the asset or liability. As there is no active market for large part of the Bank's financial instruments, judgement is necessary in estimating fair value, based on current economic conditions and specific risk attributable to the instrument.

A considerable portion of the financial instruments as at 31 December 2006 and 2005 are short term in nature with maturities of less than one year. Based on fair value assessments as indicated above, the estimated fair values of those financial assets and financial liabilities, both short and long term as at the balance sheet date, approximate their carrying amounts as shown in the balance sheet except for the followings:

	Carrying Values		Fair Value	
	2006 MNT'000	2005 MNT'000	2006 MNT'000	2005 MNT'000
Loan from Deutsche Bank Microcredit Development Fund	101,613	154,549	142,414	144,072
Loan from the Ministry of Social Welfare and Labour	500,000	500,000	481,048	470,281
Loan from the Ministry of Trade and Industry	341,011	-	301,306	-
	<u>942,624</u>	<u>654,549</u>	<u>924,768</u>	<u>614,353</u>

35. MONGOLIAN TRANSLATION

These financial statements are also prepared in the Mongolian language. In the event of discrepancies or contradictions between the English version and the Mongolian version, the English version will prevail.