

XacBank LLC

Audited Financial Statements
31 December 2007

XacBank LLC

**FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007**

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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. 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. Jim Anderson
Ms. Teresa Yiu
Ms. Pam Eser
Mr. John Chomel-Doe

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 75 give a true and fair view of the financial position of the Bank as at 31 December 2007 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 Operating Officer)

Ulaanbaatar, Mongolia

**REPORT OF THE INDEPENDENT AUDITORS
To the Shareholders of XacBank LLC**

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

Management's Responsibility for the Financial Statements

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

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 2007, 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 2007**

	Note	2007 MNT '000	2006 MNT '000
Interest and similar income	3	18,835,462	14,595,145
Interest and similar expenses	4	<u>(8,733,018)</u>	<u>(6,205,888)</u>
Net interest income		10,102,444	8,389,257
Net fees and commissions	5	1,449,839	1,058,107
Other operating income	6	<u>301,702</u>	<u>244,417</u>
Operating income		11,853,985	9,691,781
Operating expenses	7	<u>(8,204,746)</u>	<u>(6,724,769)</u>
Operating profit before credit loss expense		3,649,239	2,967,012
Credit loss expense	8	(340,290)	(397,439)
Grant income	21	69,100	83,803
Grant expenses	21	(69,100)	(83,803)
Profit before tax		<u>3,308,949</u>	<u>2,569,573</u>
Income tax expense	9	<u>(417,180)</u>	<u>(796,421)</u>
Profit for the year attributable to equity holders of the Bank		<u>2,891,769</u>	<u>1,773,152</u>

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

XacBank LLC**BALANCE SHEET AS AT 31 DECEMBER 2007**

	Note	2007 MNT '000	2006 MNT '000
ASSETS			
Cash and short term funds	11	5,529,661	5,301,179
Due from banks	12	23,913,044	13,492,176
Financial investments	13	1,675,587	500
Loans and advances to customers	14	101,197,164	60,350,085
Other assets	15	1,513,616	1,422,422
Property, plant and equipment	16	9,104,375	7,978,334
Intangible assets	17	494,198	376,876
TOTAL ASSETS		<u>143,427,645</u>	<u>88,921,572</u>
LIABILITIES			
Due to customers	18	63,429,217	43,007,055
Due to banks	19	14,581,140	4,080,959
Borrowed funds	20	51,450,730	30,153,600
Deferred grants	21	114,058	160,629
Other liabilities	22	559,635	409,858
Tax payable		16,735	240,718
Deferred tax liabilities	23	47,553	-
TOTAL LIABILITIES		<u>130,199,068</u>	<u>78,052,819</u>
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	2,293,999	1,052,792
Retained profits		2,891,827	1,773,210
TOTAL EQUITY		<u>13,228,577</u>	<u>10,868,753</u>
TOTAL EQUITY AND LIABILITIES		<u>143,427,645</u>	<u>88,921,572</u>

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

XacBank LLC

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2007**

		Non- distributable	← Distributable →			
	Note	Ordinary shares MNT '000	Share premium MNT '000	Other reserves MNT '000	Retained profits MNT '000	Total MNT '000
At 1 January 2006		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	10	-	-	-	(450,000)	(450,000)
At 31 December 2006		8,034,200	8,551	1,052,792	1,773,210	10,868,753
Profit for the year		-	-	-	2,891,769	2,891,769
Transfer to other reserves	25	-	-	1,241,207	(1,241,207)	-
Dividends	10	-	-	-	(531,945)	(531,945)
At 31 December 2007		<u>8,034,200</u>	<u>8,551</u>	<u>2,293,999</u>	<u>2,891,827</u>	<u>13,228,577</u>

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

XacBank LLC**CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2007**

	2007	2006
	MNT '000	MNT '000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit before tax	3,308,949	2,569,573
<i>Adjustments for:-</i>		
Depreciation of property, plant and equipment (Note 16)	633,456	544,697
Amortisation of intangible assets (Note 17)	97,851	66,181
Credit loss for loans and advances to customers (Note 8)	291,628	387,118
Credit loss for other receivables (Note 8)	48,662	-
Credit loss for foreclosure properties (Note 8)	-	10,321
Unrealised gain	(66,845)	(22,345)
Loss on disposal of property, plant and equipment	13,668	9,613
Amortisation of deferred grants (Note 21)	(69,100)	(83,803)
Operating profit before working capital changes	4,258,269	3,481,355
<i>Changes in operating assets:-</i>		
Loans and advances to customers	(41,071,862)	(22,117,388)
Other assets	(139,856)	(201,913)
<i>Changes in operating liabilities:-</i>		
Due to customers	20,422,162	11,610,242
Due to banks	10,500,181	1,280,042
Other liabilities	149,913	97,333
Cash used in operations	(5,881,193)	(5,850,329)
Income tax paid	(593,610)	(761,349)
Net cash flow used in operating activities	(6,474,803)	(6,611,678)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (increase)/decrease in financial investments	(1,675,087)	1,104,866
Proceeds on disposal of property, plant and equipment	20,874	75,793
Purchase of property, plant and equipment	(1,812,679)	(2,688,508)
Purchase of intangible assets	(196,533)	(330,301)
Net cash flow used in investing activities	(3,663,425)	(1,838,150)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net drawdown of borrowed funds	21,297,130	15,334,127
Deferred grants received	22,529	117,568
Dividends paid	(532,081)	(449,941)
Net cash flow generated from financing activities	20,787,578	15,001,754
Net increase in cash and cash equivalents	10,649,350	6,551,926
Cash and cash equivalents brought forward (Note 26)	18,793,355	12,241,429
Cash and cash equivalents carried forward (Note 26)	29,442,705	18,793,355

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

XacBank LLC

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2007

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
- Mongolian Women's Federation
- Rotary Club of Ulaanbaatar
- XacBank LLC
- CYDAN SCC
- Liberal Women's Intellectual Pool
- Employees of XAC-GE LLC and XacBank LLC

These financial statements of the Bank for the year ended 31 December 2007 were authorised for issue by the Board of Directors in accordance with a resolution of the directors on 31 March 2008.

2. ACCOUNTING POLICIES

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The financial statements have been prepared under the historical cost basis, except for available-for-sale and held for trading investments that have been measured at fair value. 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 through profit or loss are recognised in 'Interest and similar income' and 'Interest and similar expense' 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 rates 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.

Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

(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.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(d) Income tax (Contd.)

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. 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 and due from banks.

(f) Financial instruments - initial recognition and subsequent measurement

(i) Date of recognition

Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace are recognised on the trade date, i.e. the date that the Bank commits to purchase or sell the asset. Derivatives are recognised on trade date basis.

(ii) Initial recognition of financial instruments

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus, in the case of financial assets and financial liabilities not at fair value through profit or loss, any directly attributable incremental costs of acquisition or issue.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(f) Financial instruments - initial recognition and subsequent measurement (Contd.)

(iii) Derivatives recorded at fair value through profit or loss

Derivatives include cross currency swaps, forward foreign exchange contracts and options on foreign currencies. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives held for trading are included in 'Other operating income'.

Derivatives embedded in other financial instruments, such as the embedded equity and currency derivatives in the convertible loan, are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair value in the trading portfolio with changes in fair value in the trading portfolio being reported through profit or loss.

(iv) Financial assets or financial liabilities held for trading

Financial assets or financial liabilities held-for-trading, comprising financial instruments held for trading other than derivatives, are recorded in the balance sheet at fair value. Changes in fair value are recognised in 'other operating income'. Interest and dividend income or expense are recorded in 'other operating income' according to the terms of the contract, or when the right to the payment has been established.

(v) Financial assets or financial liabilities designated at fair value through profit or

Financial assets and financial liabilities classified in this category are designated at initial recognition when the following criteria are met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing the gains or losses on them on a different basis; or
- the assets and liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(f) Financial instruments - initial recognition and subsequent measurement (Contd.)

(v) Financial assets or financial liabilities designated at fair value through profit or loss (Contd.)

- the financial instruments contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial assets and financial liabilities at fair value through profit or loss are recorded in the balance sheet at fair value. Changes in fair value are recorded in 'Net gain or loss on financial assets and liabilities designated at fair value through profit and loss'. Interest earned or incurred is accrued in interest income or expense, respectively, according to the terms of the contract, while dividend income is recorded in 'Other operating income' when the right to the payment has been established.

(vi) 'Day 1' profit

Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognises the differences between the transaction price and fair value (a 'Day 1' profit) in the income statement in 'Net trading income'. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognised in the income statement when the inputs become observable, or when the instrument is derecognised.

(vii) Held-to-maturity financial investments

Held-to-maturity financial investments are those which carry fixed or determinable payments and have fixed maturities and which the Bank has the intention and ability to hold to maturity. After initial measurement, held-to-maturity financial investments are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. 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 line 'Impairment losses on financial investments'.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(f) Financial instruments - initial recognition and subsequent measurement (Contd.)

(viii) Due from banks and loans and advances to customers

'Due from banks' and 'Loans and advances to customers' are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market and are classified as loans and receivables. After initial measurement, amounts due from banks and loans and advances to customers are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are integral part of the effective interest rate. The amortisation is included in 'Interest and similar income' in the income statement. The losses arising from impairment are recognised in the income statement in 'Credit loss expense'.

(ix) Available-for-sale financial investments

Available-for-sale financial investments are those designated as such or do not qualify to be classified as designated at fair value through profit or loss, held-to-maturity or loans and receivables. They include equity instruments, investments in mutual funds and money market and other debt instruments.

After initial measurement, available-for-sale financial investments are subsequently measured at fair value. Unrealised gains or losses are recognised directly in equity in the 'Available-for-sale reserve'. When security is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the income statement in 'Other operating income' or 'Other operating expenses'. Where the Bank holds more than one investment in the same security they are deemed to be disposed of on a first-in-first-out basis. Interest earned whilst holding available-for-sale financial investments is reported as interest income using the effective interest rate. Dividends earned whilst holding available-for-sale financial investments are recognised in the income statement as 'Other operating income' when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the income statement in 'Impairment losses on financial investments' and removed from the available-for-sale reserve.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(f) Financial instruments - initial recognition and subsequent measurement (Contd.)

(x) Borrowed funds

Issued financial instruments or their components, which are not designated at fair value through profit or loss, are classified as liabilities under 'Borrowed funds', where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset for a fixed number of own equity shares. The components of compound financial instruments, that contain both liability and equity elements, are accounted for separately with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue.

After initial measurement, borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.

(g) Securitisation

As part of its operational activities, the Bank securitises financial assets, generally through the sale of these assets to special purposes entities which issue securities to investors. The transferred assets may qualify for derecognition in full or in part. Reference should be made to the accounting policy on 'Derecognition of financial assets and financial liabilities'. Interests in the securitised financial assets may be retained by the Bank and are primarily classified as financial assets recorded at fair value through profit or loss, and gains and losses are reported in "Interest and similar income". Gains or losses on securitisations are based on the carrying amount of the financial assets derecognised and the retained interest, based on their relative fair values at the date of the transfer.

(h) Derecognition of financial assets and financial liabilities

(i) Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired; or
- the Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(h) Derecognition of financial assets and financial liabilities (contd.)

(i) Financial assets (contd.)

- either (a) the Bank has transferred substantially all the risks and rewards of the asset, or (b) the Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

(ii) Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the financial liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

(i) Determination of fair value

The fair value for financial instruments traded in active markets at the balance sheet date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(j) 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 a 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 events that has occurred after the initial recognition of the asset (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 arrears or economic conditions that correlate with defaults.

(i) Due from banks and loans and advances to customers

For amounts due from banks and loans and advances to customers carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists individually 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.

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 (excluding future expected credit losses that have not yet been incurred). 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 on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account.

If a future write-off is later recovered, the recovery is credited to the 'Credit loss expense'.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(j) Impairment of financial assets (contd.)

(i) Due from banks and loans and advances to customers (contd.)

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current 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 the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

The Bank adopted the basic approach where the impairment allowances 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.

Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(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.)

(j) 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.

(iv) Renegotiated loans

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

(k) Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the balance sheet.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(l) 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 any 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 lives. The estimated useful lives are as follows:

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

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.

(m) 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 at each financial year-end.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(m) Intangible assets (contd.)

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	2-5 years
Patents and rights	3-20 years

(n) Impairment of non-financial 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.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(o) Repurchase and reverse repurchase agreements

Securities sold under agreements to repurchase at a specified future date ('repos') are not derecognised from the balance sheet. The corresponding cash received, including accrued interest, is recognised on the balance sheet as a 'Cash collateral on securities lent and repurchase agreements', reflecting its economic substance as a loan to the Bank. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of the agreement using the effective interest rate method. Where the transferee has the right to sell or pledge the asset, the asset is recorded on the balance sheet as 'Financial assets held for trading pledged as collateral'.

Conversely, securities purchased under agreements to resell at a specified future date ('reverse repos') are not recognised on the balance sheet. The corresponding cash paid, including accrued interest, is recognised on the balance sheet as a 'Cash collateral on securities borrowed and reverse repurchase agreements'. The difference between the purchase and resale prices is treated as interest income and is accrued over the life of the agreement using the effective interest rate method.

(p) Financial guarantees

In the ordinary course of business, the Bank issues financial guarantees, consisting of tender guarantees and letter of credit. Financial guarantees are initially recognised in the financial statements at fair value, in 'Other liabilities', being the premium received. 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.

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 'Other operating income' on a straight-line basis over the life of the guarantee.

(q) 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.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(r) 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. The Bank also contributes to a defined contribution pension plan. The contribution paid is recorded as an expense under "Personnel expenses" in proportion to the services rendered by the employees to the bank. Overpaid contributions are recorded as receivables.

(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. Employees are allowed to purchase EIT LLC shares at a discount. No change is made to the Bank's total share capital and no compensation cost is recognised by the Bank.

(s) Operating leases

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

(t) Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Bank.

Dividends for the year that are approved after the balance sheet date are disclosed as an event after the balance sheet date.

2.3 CHANGE IN ACCOUNTING POLICIES

The Bank has adopted the following new and amended IFRS and IFRIC interpretations during the year.

- * IFRS 7 - Financial Instruments: Disclosures
- * IAS 1 - Amendment - Capital Disclosures
- * IFRIC 7 - Applying the Restatement Approach under IAS 29 "Financial Reporting in Hyperinflationary Economies"
- * IFRIC 8 - Scope of IFRS 2
- * IFRIC 9 - Reassessment of Embedded Derivatives
- * IFRIC 10 - Interim Financial Reporting and Impairment

The adoption of the above new and amended standards and interpretations did not have any significant effect on the financial statements other than IFRS 7 which resulted in additional disclosure.

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

- * IFRS 3 (Revised) - Business Combinations
- * IFRS 8 - Operating Segments
- * IAS 1 (Revised) - Presentation of Financial Statements
- * IAS 23 (Revised) - Borrowing Costs
- * IAS 27 (Amended) - Consolidated and Separate Financial Statements
- * Amendment to IFRS 2 - Share-based Payments - Vesting Conditions and Cancellations
- * Amendments to IAS 32 - Financial Instruments: Presentation and IAS 1: Presentation of Statements - Puttable Financial Instruments
- * IFRIC 11 - IFRS 2 - Group and Treasury Share Transactions
- * IFRIC 12 - Service Concession Arrangements
- * IFRIC 13 - Customer Loyalty Programmes
- * IFRIC 14 - IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

The directors anticipate that the adoption of above new and amended Standards and Interpretations in the future period will have no material impact on the financial statements of the Bank.

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 judgements and estimates are as follows:

(i) Valuation of financial instruments

Where the fair value of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgements include considerations of liquidity and model inputs such as correlation and volatility for derivatives.

(ii) Impairment losses on loans and advances to customers

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, judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific 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. Some of the factors that are taken into consideration are deterioration in industry risk, technological obsolescence, identified structural weaknesses and deterioration in cash flows.

3. INTEREST AND SIMILAR INCOME

	2007	2006
	MNT '000	MNT '000
Loans and advances from customers	18,225,621	13,867,013
Due from banks	451,850	595,875
Financial investments - held-to-maturity	157,991	132,257
	<u>18,835,462</u>	<u>14,595,145</u>

4. INTEREST AND SIMILAR EXPENSES

	2007	2006
	MNT '000	MNT '000
Due to customers	5,105,057	4,057,585
Due to banks	79,710	212,244
Borrowed funds	3,548,251	1,936,059
	<u>8,733,018</u>	<u>6,205,888</u>

5. NET FEES AND COMMISSION INCOME

	2007	2006
	MNT '000	MNT '000
Fees and commission income:		
Card service fees	99,762	114,616
Deposit accounts maintenance and service fees	200,487	125,273
Loan application fees	984,349	643,215
Money transfer fees	191,019	165,272
Other fees income	116,018	85,828
	<u>1,591,635</u>	<u>1,134,204</u>
Less: Fees and commission expenses	(141,796)	(76,097)
	<u>1,449,839</u>	<u>1,058,107</u>

6. OTHER OPERATING INCOME

Non-trading foreign exchange - Realised gain	121,901	111,914
Non-trading foreign exchange - Unrealised gain	66,845	22,345
Rental income	42,957	70,872
Income from penalties	309	692
Recovery of bad loans	-	2,626
Other income	69,690	35,968
	<u>301,702</u>	<u>244,417</u>

7. OPERATING EXPENSES

	2007	2006
	MNT '000	MNT '000
Advertising	357,163	218,499
Amortisation of intangible assets (Note 17)	97,851	66,181
Armoured guard and security	324,579	252,907
Business trips	405,415	399,215
Cash collection service	1,114	809
Communication	398,448	371,237
Computer expenses	3,317	20,484
Depreciation of property, plant and equipment (Note 16)	633,456	544,697
Entertainment	237,525	161,032
Insurance expense	37,509	29,798
Loans collection expenses	9,195	5,547
Maintenance of property, plant and equipment	89,415	71,396
Membership and audit expenses	109,712	87,880
Other operating expenses	488,915	483,059
Personnel expenses *	3,895,200	2,975,312
Rental expenses	445,609	355,683
Stationery	220,260	245,613
Transportation and fuel supplies	307,510	304,305
Utilities	142,553	131,115
	<u>8,204,746</u>	<u>6,724,769</u>

* Personnel expenses

Salaries, incentives and allowances	3,196,840	2,492,526
Contribution to social and health fund	615,891	476,907
Training	82,469	5,879
	<u>3,895,200</u>	<u>2,975,312</u>

8. CREDIT LOSS EXPENSE

	2007 MNT '000	2006 MNT '000
Loans and advances to customers:		
Small business loans	72,902	187,601
Consumer loans	76,082	71,456
SME loans	43,018	82,074
Agricultural loans	52,172	26,964
Wholesale loans	(4,419)	4,419
Mortgage loans	51,872	5,161
Apartment pledged loans	4,022	6,159
Deposit Backed loans	(58)	152
Employee loans	(3,963)	3,132
	<u>291,628</u>	<u>387,118</u>
Foreclosure properties	-	10,321
Other receivables	48,662	-
	<u>340,290</u>	<u>397,439</u>

9. INCOME TAX EXPENSE

Current income tax:

Based on results for the year	369,627	796,421
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Deferred tax (Note 23):

Relating to origination and reversal of temporary differences	47,553	-
	<u>417,180</u>	<u>796,421</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 bank is 10% (2006: 15%) for the first MNT3 billion (2006: MNT100 million) of taxable income, and 25% (2006 30%) on the excess of taxable income over MNT3 billion (2006: MNT100 million). Interest income on government bonds is not subject to income tax. Credit loss expense for loans and advances to customers is deductible for income tax purposes.

A reconciliation of income tax expense applicable to profit before tax 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:

	2007 MNT '000	2006 MNT '000
Profit before tax	<u>3,308,949</u>	<u>2,569,573</u>
Tax at statutory tax rate of 25% (2006: 30%)	827,237	770,872
Effect of income subject to lower tax rate	(450,000)	(15,000)
Effect of income not subject to tax	(67,607)	(96,416)
Effect of expenses not allowable for tax purposes	107,550	136,965
Tax expense for the year	<u>417,180</u>	<u>796,421</u>

9. INCOME TAX EXPENSE (CONTD.)

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

10. DIVIDENDS

	2007 MNT '000	2006 MNT '000
Declared during the year:		
Equity dividends on ordinary shares		
Final dividend for 2006: MNT66.21 (2005: MNT56.01)	<u>531,945</u>	<u>450,000</u>

11. CASH AND SHORT TERM FUNDS

Cash and short term funds represented by:

Local currency	3,026,924	2,572,761
Foreign currencies	<u>2,502,737</u>	<u>2,728,418</u>
	<u>5,529,661</u>	<u>5,301,179</u>

12. DUE FROM BANKS

Current accounts with the Bank of Mongolia	4,460,431	3,986,386
Placements with other banks and financial institutions	<u>19,452,613</u>	<u>9,505,790</u>
	<u>23,913,044</u>	<u>13,492,176</u>

Current accounts with the Bank of Mongolia ("Central Bank"), are maintained in accordance with the Bank of Mongolia's requirements. The balances maintained with Central Bank are determined at set percentages based on the basis of 14-day period. As at 31 December 2007, the mandatory reserve required by the Bank of Mongolia was MNT 3.73 billion (2006: MNT 3.19 billion).

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.

13. FINANCIAL INVESTMENTS

	-----2007-----			
	Held-to- maturity MNT'000	Held for trading MNT'000	Available- for-sale MNT'000	Total MNT'000
Unquoted investments:				
Bank of Mongolia treasury bills	984,636	-	-	984,636
Equities	-	466,651	224,300	690,951
	<u>984,636</u>	<u>466,651</u>	<u>224,300</u>	<u>1,675,587</u>
	-----2006-----			
	Held-to- maturity MNT'000	Held for trading MNT'000	Available- for-sale MNT'000	Total MNT'000
Unquoted investments:				
Equities	-	-	500	500
	<u>-</u>	<u>-</u>	<u>500</u>	<u>500</u>

The Bank of Mongolia treasury bills are interest bearing short term bills with maturities of less than three months, and are issued at a discount.

Unquoted available-for-sale equities are recorded at cost since its fair value cannot be reliably estimated using valuation technique. There is no market value for this investment and the bank intends to hold it for the long term.

Unquoted held-for-trading equities are recorded at fair value and represents investments in XAC-GE LLC, the Bank's holding company during the year. On 12 December 2007, the Bank entered into Sales and Purchase Agreement to sell the equities to European Bank of Recontruction and Development. The shares transfer was completed on 1 February 2008.

14. LOANS AND ADVANCES TO CUSTOMERS

	2007	2006
	MNT '000	MNT '000
Small business loans	25,502,486	19,561,384
Consumer loans	21,249,502	12,039,901
SME loans	25,241,193	8,706,365
Agricultural loans	3,643,386	5,331,763
Wholesale loans	412,009	665,865
Mortgage loans	19,230,651	9,146,903
Apartment pledged loans	2,840,579	1,827,335
Deposit backed loans	2,182,297	2,287,937
Employee loans and advances	1,588,314	1,268,806
Gross loans and advances to customers	<u>101,890,417</u>	<u>60,836,259</u>
Less: Allowance for impairment losses	<u>(693,253)</u>	<u>(486,174)</u>
	<u><u>101,197,164</u></u>	<u><u>60,350,085</u></u>

14. LOANS AND ADVANCES TO CUSTOMERS (CONTD.)

Impairment allowance for loans and advances to customers

A reconciliation of the allowance for impairment losses for loans and advances to customers by class is as follows:

	Small Business Loans	Consumer Loans	SME Loans	Agricultural Loans	Wholesale Loans	Mortgage Loans	Apartment Pledged Loans	Deposit Backed Loans	Employee Loans	Total
At 31 December 2007	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000
At 1 January 2007	261,981	82,728	88,647	31,109	4,419	5,161	6,985	157	4,987	486,174
Charge for the year	80,177	80,007	46,486	53,941	-	53,374	4,312	-	-	318,297
Impairment written off	(58,645)	(9,791)	-	(16,113)	-	-	-	-	-	(84,549)
Recoveries	(7,275)	(3,925)	(3,468)	(1,769)	(4,419)	(1,502)	(290)	(58)	(3,963)	(26,669)
At 31 December 2007	276,238	149,019	131,665	67,168	-	57,033	11,007	99	1,024	693,253
Specific Impairment	35,300	-	30,542	11,616	-	7,718	-	-	-	85,176
Collective Impairment	240,938	149,019	101,123	55,552	-	49,315	11,007	99	1,024	608,077
	276,238	149,019	131,665	67,168	-	57,033	11,007	99	1,024	693,253
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	54,315	-	80,578	17,395	-	7,718	-	-	-	160,006

14. LOANS AND ADVANCES TO CUSTOMERS (CONTD.)

	Small Business Loans	Consumer Loans	SME Loans	Agricultural Loans	Wholesale Loans	Mortgage Loans	Apartment Pledged Loans	Deposit Backed Loans	Employee Loans	Total
At 31 December 2006	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000
At 1 January 2006	97,472	14,776	6,573	6,100	-	-	826	5	1,855	127,607
Charge for the year	190,814	72,471	83,161	27,346	4,473	5,224	6,245	154	3,193	393,081
Impairment written off	(23,092)	(3,504)	-	(1,955)	-	-	-	-	-	(28,551)
Recoveries	(3,213)	(1,015)	(1,087)	(382)	(54)	(63)	(86)	(2)	(61)	(5,963)
At 31 December 2006	<u>261,981</u>	<u>82,728</u>	<u>88,647</u>	<u>31,109</u>	<u>4,419</u>	<u>5,161</u>	<u>6,985</u>	<u>157</u>	<u>4,987</u>	<u>486,174</u>
Specific Impairment	46,182	11,367	33,409	16,753	-	-	356	-	-	108,067
Collective Impairment	215,799	71,361	55,238	14,356	4,419	5,161	6,629	157	4,987	378,107
	<u>261,981</u>	<u>82,728</u>	<u>88,647</u>	<u>31,109</u>	<u>4,419</u>	<u>5,161</u>	<u>6,985</u>	<u>157</u>	<u>4,987</u>	<u>486,174</u>
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	<u>98,814</u>	<u>32,298</u>	<u>199,255</u>	<u>27,961</u>	<u>-</u>	<u>-</u>	<u>3,067</u>	<u>-</u>	<u>-</u>	<u>361,395</u>

The fair value of the collateral that the Bank holds relating to loans individually determined to be impaired at 31st December 2007 amounts to MNT 887 million (2006: MNT 909 million). These value are estimated by the management based on the latest available information. For a more detailed description, see 'Collateral and other credit enhancement' under Note 34 .

14. LOANS AND ADVANCES TO CUSTOMERS (CONTD.)

Derecognition of a loan portfolio

In December 2007, the Bank sold the rights to 100% of the cash flows arising on a portfolio of floating rate mortgage loans carried at USD 1,033,382, with a fair value of USD 1,033,382, to Mongolian Mortgage Corporation for a payment of USD 1,033,382. The Bank has determined that substantially all the risks and rewards of the portfolio has been transferred. The risk include credit, interest rate, currency, prepayment and price risks. Hence the Bank has derecognised the entire portfolio from its balance sheet.

15. OTHER ASSETS

	2007	2006
	MNT '000	MNT '000
Other receivables	279,406	354,696
Less: Allowance for impairment losses	<u>(49,760)</u>	<u>(2,393)</u>
	<u>229,646</u>	<u>352,303</u>
Foreclosure properties	3,436	11,821
Less: Allowance for impairment losses	<u>(3,436)</u>	<u>(11,821)</u>
	<u>-</u>	<u>-</u>
Prepaid expenses	828,617	564,423
Consumables and other inventories	<u>455,353</u>	<u>505,696</u>
	<u>1,513,616</u>	<u>1,422,422</u>
Allowance for impairment losses of other receivables		
At 1st January	2,393	5,711
Charge for the year	49,074	571
Amount written off	(1,295)	(3,131)
Amount written back	<u>(412)</u>	<u>(758)</u>
At 31st December	<u>49,760</u>	<u>2,393</u>

16. PROPERTY, PLANT AND EQUIPMENT

31 December 2007	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 2007	4,356,062	1,806,590	1,629,884	1,505,294	9,297,830
Additions	5,411	277,681	535,061	994,526	1,812,679
Disposals	-	(46,742)	(6,724)	-	(53,466)
Write-offs	-	-	(5,502)	-	(5,502)
Transfer	736,303	-	-	(754,943)	(18,640)
At 31 December 2007	<u>5,097,776</u>	<u>2,037,529</u>	<u>2,152,719</u>	<u>1,744,877</u>	<u>11,032,901</u>
Accumulated Depreciation					
At 1 January 2007	213,737	362,060	743,699	-	1,319,496
Charge for the year (Note 7)	127,339	187,336	318,781	-	633,456
Disposals	-	(13,035)	(5,889)	-	(18,924)
Write-offs	-	-	(5,502)	-	(5,502)
At 31 December 2007	<u>341,076</u>	<u>536,361</u>	<u>1,051,089</u>	<u>-</u>	<u>1,928,526</u>
Net Book Value	<u>4,756,700</u>	<u>1,501,168</u>	<u>1,101,630</u>	<u>1,744,877</u>	<u>9,104,375</u>
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 7)	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>

During the year the Bank transferred land usage right amounting to MNT18.6 million to intangible assets and amortised over the a period of 15-20 years.

17. INTANGIBLE ASSETS

31 December 2007	Software and Licenses MNT '000	Patents and Rights MNT '000	Total MNT '000
At Cost			
At 1 January 2007	444,341	1,143	445,484
Addition	196,533	-	196,533
Reclassification	(30,000)	30,000	-
Transfer	-	18,640	18,640
At 31 December 2007	<u>610,874</u>	<u>49,783</u>	<u>660,657</u>
Accumulated Amortisation			
At 1 January 2007	68,295	313	68,608
Charge for the year (Note 7)	95,420	2,431	97,851
At 31 December 2007	<u>163,715</u>	<u>2,744</u>	<u>166,459</u>
Net Book Value	<u>447,159</u>	<u>47,039</u>	<u>494,198</u>
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 7)	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>

18. DUE TO CUSTOMERS

	2007 MNT '000	2006 MNT '000
Current accounts	11,761,026	5,372,795
Demand deposits	16,402,620	9,349,055
Time deposits	35,188,405	28,271,453
Other deposits	77,166	13,752
	<u>63,429,217</u>	<u>43,007,055</u>

19. DUE TO BANKS

Deposits from local banks	<u>14,581,140</u>	<u>4,080,959</u>
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20. BORROWED FUNDS

Borrowed funds from foreign financial institutions

Unsecured:

Deutsche Bank Microcredit Development Fund, Inc	-	101,613
International Finance Corporation	292,512	364,358
Dexia Micro Credit Fund	-	587,012
Calvert Social Investment Foundation, Inc	840,136	836,010
ASN-Novib Fonds	2,987,058	1,764,657
Oikocredit Ecumenical Development Cooperative Society U.A	4,080,874	1,745,762
Shorecap International Ltd	439,178	583,228
Stichting Triodos Doen	2,870,179	1,557,667
Triodos Fair Share Fund	3,583,259	1,160,990
BlueOrchard Finance S.A.	13,480,502	7,583,539
DB-Global Commercial Microfinance Consortium, Ltd	4,766,988	4,798,047
DWM Securitizations S.A.	2,334,554	2,321,777
European Bank for Reconstruction and Development	5,918,162	2,859,626
Netherland Development Finance Company	5,756,281	-
	<u>47,349,683</u>	<u>26,264,286</u>

Borrowed funds from BOM and government agencies

Unsecured:

Agricultural Sector Development Project Loan	-	290,966
Employment Generation Project	-	70,300
Employment Generation Support Fund	500,940	500,000
Micro Finance Development Fund	550,779	837,579
Rural Poverty Reduction Program	2,120,522	1,849,458
Ministry of Trade and Industry	858,563	341,011
Ministry of Finance and Japan Bank for International Cooperation	70,243	-
	<u>4,101,047</u>	<u>3,889,314</u>
Totals	<u>51,450,730</u>	<u>30,153,600</u>

20. BORROWED FUNDS (CONTD.)

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% (2006: 2%) per annum. The loan was fully settled during the year.

International Finance Corporation ("IFC")

The loan from IFC, amounting to USD 400,000, bears interest at a rate of 8.89% (2006: 9.11%) 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.

Dexia Micro Credit Fund ("DMCF")

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

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% (2006: 6%) per annum and will be fully repaid in July 2008.

ASN-Novib Fonds

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

- (i) MNT 584,000,000, which bears interest at a rate of 12.5% (2006: 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.
- (ii) USD 1,000,000, which bears interest at a rate of 8.5% (2006: 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.
- (iii) USD 1,000,000, which bears interest at a rate of 8.5% per annum. The loan was obtained in 2007 to support further expansion of the Bank's micro-finance and SME lending activities. The loan will be fully repaid in September 2008.

20. BORROWED FUNDS (CONTD.)

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

The loans obtained from Oikocredit comprise the following:

- (i) USD 724,920, which was converted to MNT 853,955,760 during the year, bears interest at a rate of 12% (2006: 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.
- (ii) EUR 600,000, which bears interest at a rate of 9.09% (2006: 9.09%) per annum. The loan was obtained in 2005 to finance the Bank's micro-finance and SME lending activities. The loan was fully settled in July 2007.
- (iii) USD 1,500,000, which bears interest at a rate of 8.9% per annum. The loan was obtained in 2007 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in four equal semi-annual instalments commencing February 2010 and will be fully settled in August 2011.
- (iv) USD 500,000, which was converted to MNT 582,000,000 and bears interest at a rate of 11.02% per annum. The loan was obtained in 2007 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in five equal semi-annual instalments of MNT 116,400,000 each commencing February 2008 and will be fully settled in February 2010.
- (v) USD 1,000,000, which was converted to MNT 1,183,310,000, bears interest at a rate of 11.02% per annum. The loan was obtained in 2007 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in five equal semi-annual instalments of MNT 236,662,000 each commencing February 2008 and will be fully settled in February 2010.

Shorecap International Ltd ("SCI")

The loan obtained from SCI, amounting to USD 500,000, bears interest at a rate of 9% (2006: 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.

Stichting Triodos Doen

The loans obtained from Stichting Triodos Doen comprise of the following:

- (i) MNT 560,185,000, which bears interest at a rate of 12% (2006: 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.

20. BORROWED FUNDS (CONTD.)

Stichting Triodos Doen (contd.)

- (ii) MNT 1,000,000,000, which bears interest at a rate of 12% (2006: 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.
- (iii) MNT 1,200,000,000, which bears interest at a rate of 12.5% per annum. The loan was obtained in 2007 to finance the expansion of Bank's lending activities. The loan will be fully repaid in April 2011.

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% (2006: 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% (2006: 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.
- (iii) USD 2,000,000, which bears interest at a rate of 8.25% per annum. The loan was obtained in 2007 to finance the expansion of Bank's lending activities. The loan will be fully repaid in April 2011.

BlueOrchard Finance S.A.

The loans obtained from BlueOrchard Finance S.A. comprise of the following:

- (i) USD 6,500,000, which bears interest at a rate of 8.25% (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.
- (ii) USD 5,000,000, which was converted to MNT5,825,000,000 during the year, bears interest at a rate of 12% per annum. The loan was obtained in 2007 to finance the expansion of the Bank's micro-finance lending activities. The loan will be fully repaid in June 2012.

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% (2006: 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 will be fully repaid in September 2010.

20. BORROWED FUNDS (CONTD.)

DWM Securitizations S.A. ("DWMS")

The loan obtained from DWMS, amounting to USD 2,000,000, bears interest at a rate of 8.25% (2006: 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.

European Bank for Reconstruction and Development ("EBRD")

The loans obtained from EBRD comprise of the following:

- (i) USD 2,500,000, which bears interest at a rate of 9.30% (2006: 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.
- (ii) USD 2,500,000, which bears interest at a rate of 8.21% per annum. The loan was obtained in 2007 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.

Netherland Development Finance Company ("FMO")

The loan obtained from FMO, amounting to USD 5,000,000, which was converted to MNT5,850,450,000 during the year, bears interest at a rate of 11% per annum. The loan was obtained in 2007 to finance the bank's micro-finance and SME lending activities. The loan is repayable in 10 semi-annual instalments commencing October 2009 and will be fully repaid in April 2014.

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% (2006: 5.5%) per annum, payable on a quarterly basis which commenced on 5 January 2006. The loan was fully settled during the year.

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% (2006: 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 fully settled during the year.

20. BORROWED FUNDS (CONTD.)

Employment Generation Support Fund

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 was obtained in 2006, which bears interest at rate of 0.8% (2006: 0.8%) per annum and was fully settled during the year. The Bank obtained another loan from Ministry of Social Welfare and Labour during the year amounting to MNT 500 million. The purpose of the loan is to assist herders and unemployed people to own or expand their business. The loan bears no interest but the Bank is required to pay MNT 1 million commission fee on a quarterly basis until maturity.

Micro Finance Development Fund

The Bank obtained this loan from World Bank to support and improve the living standard of inhabitant in the rural areas. The loan bears interest rate at 8% (2006: 8%) per annum, payable on a monthly basis with principal repayment commencing September 2005 and final repayment due in March 2009 in accordance with the repayment schedule.

Rural Poverty Reduction Program

The Bank obtained this loan from International Fund for Agricultural Development 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% (2006: 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.

Ministry of Trade and Industry

The objective of the loan is to support micro and medium businesses. The loans comprise of the following:

- (i) MNT 340 million, which bears interest at a rate of 1.2% (2006: 1.2%) per annum. The loan was obtained in 2006 and will be due and fully repaid in November 2008.
- (ii) MNT 513,998,000, which bears interest at a rate of 1.2% per annum. The loan was obtained in 2007 and will be due and fully repaid in April 2009.

Ministry of Finance and Japan Bank for International Cooperation ("JBIC")

The Bank obtained MNT 69.9 million loan from Ministry of Finance and JBIC during the year to support micro and medium businesses. The loan bears interest rate at 5.9% per annum and will be fully repaid in August 2010.

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

21. DEFERRED GRANTS

	2007	2006
	MNT '000	MNT '000
Consultative Group to Assist the Poorest ("CGAP")	48,368	78,475
International Finance Corporation ("IFC")	5,666	7,308
United States Agency for International Development ("USAID")	60,024	74,846
	<u>114,058</u>	<u>160,629</u>

Movements in the deferred grants are as follows:

	2007	2006
	MNT '000	MNT '000
Balance at beginning of year	160,629	126,864
Received during the year	22,529	117,568
Amortised during the year	(69,100)	(83,803)
Balance at end of year	<u>114,058</u>	<u>160,629</u>

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
- Secure higher standard of external audit services; and
- Strengthen senior management and corporate governance, in particular, financial management and banking skills.

In 2006, the Bank 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.

21. DEFERRED GRANTS (CONTD.)

Expenditure financed by grants

Donor and Purpose	2007 MNT '000	2006 MNT '000
• Expenditure financed by grants from "CGAP" covering meeting and training fee and technical assistance fee for MIS	42,518	4,689
• Expenditure financed by grants from United Nations Development Program covering scholarships to students	-	710
• Expenditure financed by grants from USAID's Income Generation Project covering internal systems development & IT audit consultancy, training and exposure trip	-	14,243
• Expenditure financed by grants from MIGP covering purchasing of accounting program	14,825	14,825
• Expenditure financed by grants from MIGP covering renovation of building	-	49,336
• Expenditure financed by grants from IFC covering training fee	1,667	-
• Expenditure financed by grants from BlueOrchard covering conference fee	2,425	-
• Expenditure financed by grant from Eurogiro covering training fee	2,308	-
• Expenditure financed by grant from Shorecap International Ltd. covering meeting and training fee	5,357	-
	<u>69,100</u>	<u>83,803</u>

22. OTHER LIABILITIES

Delay on clearing settlement	88,974	95,406
Other payables	469,648	313,303
Dividends payable	1,013	1,149
	<u>559,635</u>	<u>409,858</u>

23. DEFERRED TAX LIABILITIES

The movements of deferred tax liabilities during the financial year are as follows:

	Property, plant and equipments 2007 MNT '000	Property, plant and equipments 2006 MNT '000
At 1 January 2007	-	-
Recognised in income statement	47,553	-
At 31 December 2007	<u>47,553</u>	<u>-</u>

24. ORDINARY SHARES

	Number of Ordinary Shares		Amount	
	of MNT1,000 each 2007	2006	2007 MNT '000	2006 MNT '000
At 1 January/ 31 December	8,034,200	8,034,200	8,034,200	8,034,200

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 1,241,206,394 (2006: MNT 1,038,928,527) 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

	2007 MNT '000	2006 MNT '000
Cash and short term funds (Note 11)	5,529,661	5,301,179
Due from banks (Note 12)	23,913,044	13,492,176
	<u>29,442,705</u>	<u>18,793,355</u>

27. 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. In 2007, EIT LLC allotted 85,708 shares of MNT 1,000 each to XacBank LLC employees based on the discretion of the Board. In 2006, the shares were offered at a price of 50% (2005: 30%) of the par value of EIT LLC shares, 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.

28. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled. See Note 34.3 'Liquidity risk and funding management' for the Bank's contractual undiscounted repayment obligations.

At 31 December 2007	Less than 12 months MNT 'million	More than 12 months MNT 'million	Total MNT 'million
Financial assets			
Cash and short term funds	5,530	-	5,530
Due from banks	23,913	-	23,913
Financial investments	985	691	1,676
Loans and advances to customers	61,281	39,916	101,197
Other receivables	230	-	230
	<u>91,939</u>	<u>40,607</u>	<u>132,546</u>
Non financial assets			
Property, plant and equipment	-	9,104	9,104
Intangible assets	-	494	494
Other assets	745	539	1,284
	<u>745</u>	<u>10,137</u>	<u>10,882</u>
Total	<u>92,684</u>	<u>50,744</u>	<u>143,428</u>
Financial liabilities			
Due to customers	48,810	14,619	63,429
Due to banks	14,581	-	14,581
Borrowed funds	9,168	42,283	51,451
Other liabilities	558	2	560
	<u>73,117</u>	<u>56,904</u>	<u>130,021</u>
Non financial liabilities			
Deferred grants	55	59	114
Tax payable	17	-	17
Deferred tax liabilities	-	47	47
	<u>72</u>	<u>106</u>	<u>178</u>
Total	<u>73,189</u>	<u>57,010</u>	<u>130,199</u>
Net	<u>19,495</u>	<u>(6,266)</u>	<u>13,229</u>

28. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTD.)

At 31 December 2006	Less than 12 months MNT 'million	More than 12 months MNT 'million	Total MNT 'million
Financial assets			
Cash and short term funds	5,301	-	5,301
Due from banks	13,461	31	13,492
Financial investments	-	1	1
Loans and advances to customers	43,130	17,220	60,350
Other receivables	352	-	352
	<u>62,244</u>	<u>17,252</u>	<u>79,496</u>
Non financial assets			
Property, plant and equipment	-	7,978	7,978
Intangible assets	-	377	377
Other assets	455	615	1,070
	<u>455</u>	<u>8,970</u>	<u>9,425</u>
Total	<u>62,699</u>	<u>26,222</u>	<u>88,921</u>
Financial liabilities			
Due to customers	32,919	10,088	43,007
Due to banks	4,081	-	4,081
Borrowed funds	3,235	26,919	30,154
Other liabilities	406	4	410
	<u>40,641</u>	<u>37,011</u>	<u>77,652</u>
Non financial liabilities			
Deferred grants	86	74	160
Tax payable	241	-	241
	<u>327</u>	<u>74</u>	<u>401</u>
Total	<u>40,968</u>	<u>37,085</u>	<u>78,053</u>
Net	<u>21,731</u>	<u>(10,863)</u>	<u>10,868</u>

29. RELATED PARTY DISCLOSURES

The Bank is controlled by XAC-GE LLC (incorporated in Mongolia). XAC-GE LLC is owned by 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.

	2007	2006
	MNT '000	MNT '000
(a) Compensations to key management personnel		
- Salaries, incentives and allowances	299,321	199,336
- Contribution to social and health fund	56,871	37,874
	<u>356,192</u>	<u>237,210</u>
(b) Loans to key management personnel	<u>193,824</u>	<u>215,769</u>
Repayable		
- within one year	44,204	26,982
- one year to five years	26,725	44,619
- over five years	122,895	144,168
	<u>193,824</u>	<u>215,769</u>

The loans to Bank's employees bear interest rates ranging from 5% to 12% (2006 : 5% to 30%) per annum.

	2007	2006
	MNT '000	MNT '000
(c) Loans from shareholders of XAC-GE LLC		
Shorecap International Ltd	439,178	583,228
Stichting Triodos Doen	2,870,179	1,557,667
Triodos Fair Share Fund	3,583,259	1,160,990
	<u>6,892,616</u>	<u>3,301,885</u>
(d) Loan interest paid to shareholders of XAC-GE LLC	<u>522,089</u>	<u>355,053</u>
(e) Deposits from corporate shareholders	<u>3,423,192</u>	<u>2,913,868</u>
(f) Due to holding company		
-Current account	61,778	1,097,388
-Demand deposit	608	3,108
-Time deposit	593,000	-
	<u>655,386</u>	<u>1,100,496</u>
(g) Security fees paid to fellow Subsidiary Company		
- XacSecurity LLC	<u>278,836</u>	<u>225,334</u>

29. RELATED PARTY DISCLOSURES (CONTD.)

	2007	2006
	MNT '000	MNT '000
(h) Deposits from fellow Subsidiary Companies		
- XacSecurity LLC	5,969	1,851
- XacLeasing LLC	116,081	-
	<u>122,050</u>	<u>1,851</u>
(i) Deposit interest paid to holding and fellow Subsidiary Companies		
- XAC-GE LLC	22,250	39,368
- XacSecurity LLC	123	87
- XacLeasing LLC	2,715	-
	<u>25,088</u>	<u>39,455</u>
(j) Hire purchase interest income from fellow Subsidiary Company		
- XacLeasing LLC	<u>234</u>	<u>-</u>
(k) Dividend paid to holding company		
- XAC-GE LLC	<u>530,783</u>	<u>449,016</u>

30. CONTINGENT LIABILITIES AND COMMITMENTS

To meet the financial needs of customers, the Bank enters into various irrevocable commitments and contingent liabilities. Even though these obligations may not be recognised on the balance sheet, they do contain credit risk and are therefore part of the overall risk of the Bank.

	2007 MNT '000	2006 MNT '000
Contingent liability		
Letter of credit	<u>201,231</u>	<u>159,826</u>

Letters of credit (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Standby letters of credit carry the same credit risk as loans. No material losses are anticipated as a result of these transactions.

	2007 MNT '000	2006 MNT '000
Commitments		
Undrawn commitments to lend	<u>960,377</u>	<u>137,980</u>

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed expiry dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

However, the potential credit loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific standards. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Other commitments

	2007 MNT '000	2006 MNT '000
Approved and contracted for:		
Property, plant and equipment	<u>361,736</u>	<u>407,315</u>

Legal claims

Litigation is a common occurrence in the banking industry due to the nature of the business. The Bank has an established protocol for dealing with such legal claims. Once professional advice has been obtained and the amount of damages reasonably estimated, the Bank makes adjustments to account for any adverse effects which the claims may have on its financial standing. At year end, the Bank had no unresolved legal claims.

30. CONTINGENT LIABILITIES AND COMMITMENTS (CONTD.)

Operating lease commitments - Bank as lessee

The Bank as lessee entered all the operating leases of various buildings under cancellable operating lease agreements. The Bank is required to give a month notice for the termination of those agreements. The leases have no renewal option, purchase option and escalation clauses included in the agreements. There are no restrictions placed upon the Bank by entering these leases.

31. EVENTS AFTER THE BALANCE SHEET DATE

On 1 February 2008, the Bank disposed off its investment of 158,941 shares in XAC-GE LLC at MNT 2,936 each to European Bank of Reconstruction and Development.

On 25 January 2008 and 13 March 2008, the Bank received USD 865,545 (equivalent of EUR 600,000) and USD 865,798 (equivalent of EUR 600,000) respectively under a 10-year subordinated convertible loan from KfW, Frankfurt am Main ("KfW"). The subordinated convertible loan bears interest at 5% above USD LIBOR relating to each interest period with maximum interest rate to be capped at 9% per annum. Interest shall be accrued from the first disbursement date and to be paid on 20 July 2017.

The subordinated convertible loan can be repaid by cash as a bullet repayment in one amount on 20 July 2017 or based on approval from shareholders meeting, to be converted into equity shares of the Bank's holding Company XAC-GE LLC. The mode of repayment is further subjected to KfW's decision. The price of new shares to be issued shall be fixed by the Shareholders Meeting of XAC-GE LLC that authorizes the Capital Increase. The new shares to be acquired by KfW shall be common shares with full voting powers and rank pari passu to all other shares of XAC-GE LLC and shall not exceed 20% of the aggregate share capital of XAC-GE LLC. The Bank cannot repay the loan prior to the maturity date, except in the case of revocation of its banking license, its insolvency, liquidation or restructuring and with the prior approval of the Bank of Mongolia.

32. CAPITAL ADEQUACY

The Bank actively manages its capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Bank of Mongolia.

During the past year, the Bank had complied in full all its externally imposed capital requirements.

Capital management

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

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to the shareholder or new equity or equity related securities.

Regulatory capital

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

	2007	2006
Core capital ratio	11.08%	15.81%
Risk weighted capital ratio	11.08%	15.81%

	2007 MNT '000	2006 MNT '000
<u>Tier I capital</u>		
Statutory fund	8,034,200	8,034,200
Share premium	8,551	8,551
Other reserves	2,293,999	1,052,792
Retained profits	2,891,827	1,773,210
Less: Held for trading equities *	(466,651)	-
Total Tier I capital	12,761,926	10,868,753

32. CAPITAL ADEQUACY (CONTD.)

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

	2007		2006	
	MNT '000		MNT '000	
%	Assets	Risk Weighted	Assets	Risk Weighted
0	10,974,728	-	9,287,565	-
10	-	-	-	-
20	19,489,669	3,897,934	9,580,297	1,916,059
50	7,540,256	3,770,128	9,278,324	4,639,162
100	107,957,596	107,957,596	62,207,945	62,207,945
Total	<u>145,962,249</u>	<u>115,625,658</u>	<u>90,354,131</u>	<u>68,763,166</u>
Less: Held for trading equities *	-	(466,651)	-	-
	<u>145,962,249</u>	<u>115,159,007</u>	<u>90,354,131</u>	<u>68,763,166</u>

* Held for trading equities represents investments in XAC-GE LLC, the Bank's holding company during the year.

33. FAIR VALUE OF FINANCIAL INSTRUMENTS

Set out below is a comparison by class of the carrying values and fair values of the Bank's financial instruments that are carried in the financial statements. The table does not include the fair value of non financial assets and non financial liabilities

	Note	Carrying value 2007 MNT '000	Fair value 2007 MNT '000	Unrecognised gain/ (loss) 2007 MNT '000	Carrying value 2006 MNT '000	Fair value 2006 MNT '000	Unrecognised gain/ (loss) 2006 MNT '000
<i>Financial assets</i>							
Cash and short term funds	11	5,529,661	5,529,661	-	5,301,179	5,301,179	-
Due from banks	12	23,913,044	23,913,044	-	13,492,176	13,492,176	-
Financial investments - available-for-sale	13	224,300	224,300	*	500	500	*
Financial investments - held for trading	13	466,651	466,651	-	-	-	-
Financial investments - held to maturity	13	984,636	984,636	-	-	-	-
Loans and advances to customers	14	101,197,164	100,612,952	(584,212)	60,350,085	61,281,006	930,921
Other receivables	15	229,646	229,646	-	352,303	352,303	-
<i>Financial liabilities</i>							
Due to customers	18	63,429,217	63,429,217	-	43,007,055	43,007,055	-
Due to banks	19	14,581,140	14,581,140	-	4,080,959	4,080,959	-
Borrowed funds	20	51,450,730	51,341,994	(108,736)	30,153,600	30,135,744	(17,856)
Other payables	22	559,635	559,635	-	409,858	409,858	-
<i>Total unrecognised change in unrealised fair value</i>				(692,948)	913,065		

* As disclosed in Note 13, the fair value of unquoted equities cannot be reliably measured using valuation techniques.

33. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTD.)

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets for which fair value approximate carrying value

For financial assets and financial liabilities that are liquid or having short term maturity (less than one year), it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to time deposits, saving accounts without a specific maturity and variable rate financial instruments and held for trading unquoted equities. Based on fair value assessments performed by the management, the estimated fair values of due to customers of more than one year approximate their carrying amounts as shown in the balance sheet. This is principally due to the fact that the current market rates offered for similar deposit products do not differ from market rate at inception.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognised with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing loans and advances to customers is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued, the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term of maturity.

34. RISK MANAGEMENT

34.1 Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. The main risk inherent in the Bank's day to day operation involves credit risk, liquidity risk, foreign currency risk, interest rate risk, prepayment risk and operation risk. Such risk could either result in a direct loss in earnings and capital or may result in constraints on the Bank's ability to meet its objectives.

The Bank has a clearly defined risk management framework which is not designed to eliminate the risk but to optimize the risk and return trade off. The risk management framework in place is to ensure that:

- (i) Individuals who manage the risks clearly understands the requirement and measurement system;
- (ii) The Bank's risk exposure is within the limits established by the Board of Directors ("BOD");
- (iii) The risk measured is in line with the business strategy as approved by the BOD;

34. RISK MANAGEMENT (CONTD.)

34.1 Introduction (Contd.)

- (iv) The capital allocation is consistent with the risk exposures; and
- (v) The Bank's performance objectives are aligned with the risk tolerance.

Risk management structure

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles. However, there are separate independent bodies responsible for managing and monitoring risks.

Board Risk Management Committee ("BRMC") and Risk Management Committee ("RMC")

The RMC sets the comprehensive risk management policies and tolerances. RMC is responsible for anticipating and managing new and ongoing financial risk across business departments and maintaining appropriate limits on risk taking, adequate systems and standards for measuring financial risk and performance, comprehensive risk reporting and management review process. The BRMC is responsible for reviewing and approving the business strategies set by RMC.

Treasury Department

The Bank's Treasury Department has direct accountability for identifying, measuring, monitoring, and managing the daily financial positions and market risk. It is also primarily responsible for the funding and liquidity risk of the Bank.

Internal Audit

Risk management processes throughout the bank are audited annually by the internal audit function, that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting system

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

34. RISK MANAGEMENT (CONTD.)

34.1 Introduction (Contd.)

Risk measurement and reporting system (Contd.)

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Board of Directors, BRMC, RMC, and the head of each business division. The report includes aggregate credit exposure, credit metric forecasts, hold limit exceptions, VaR, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry and customer risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Supervisory Board receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

A monthly briefing is given to the Executive Committee and all other relevant members of the Bank on the utilisation of market limits, analysis of VaR and liquidity, plus any other risk developments.

Risk mitigation

As part of its overall risk management, the Bank uses VaR and basis sensitivity analysis to manage exposures resulting from changes in interest rates, foreign currencies, credit risks, and exposures arising from forecast transactions. The Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

34. RISK MANAGEMENT (CONTD.)

34.1 Introduction (Contd.)

Excessive risk concentration (Contd.)

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. At the individual basis, the Bank of Mongolia ("Central Bank") sets the standards of a limitation on as follows:

- (i) The maximum amount of the overall credit exposures issued and other credit-equivalent assets to the individual and his/her related persons shall not exceed the 20 percent. of the capital of the Bank.
- (ii) The maximum amount of the credit exposures issued and other credit-equivalent assets shall not exceed the 5% of the capital for one related person to the bank, and the aggregation of overall lending to the relates persons shall not exceed 20% of the capital of the Bank.

34.2 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's RMC, through the Credit Management Division ("CMD") promotes diversification of the loan portfolio of the Bank's lending activities. The CMD 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 by the Board of Directors and reviewed periodically by the CMD.

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.

Credit-related commitments risks

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans.

34. RISK MANAGEMENT (CONTD.)

34.2 Credit risk (Contd.)

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

The table below shows the maximum exposure to credit risk for the components of the balance sheet. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

		Gross maximum exposure 2007 MNT'000	Gross maximum exposure 2006 MNT'000
Cash and short term funds	11	5,529,661	5,301,179
Due from banks	12	23,913,044	13,492,176
Financial investments - available for sale	13	224,300	500
Financial investments - held-to-maturity	13	984,636	-
Financial investments - held for trading	13	466,651	-
Loans and advances to customers	14	101,197,164	60,350,085
Total		<u>132,315,456</u>	<u>79,143,940</u>
Contingent liabilities	30	201,231	159,826
Commitments - undrawn commitments to lend	30	960,377	137,980
Other commitments	30	361,736	407,315
Total		<u>1,523,344</u>	<u>705,121</u>
Total credit risk exposure		<u>133,838,800</u>	<u>79,849,061</u>

34. RISK MANAGEMENT (CONTD.)

34.2 Credit risk (Contd.)

Risk concentrations by industry

The table below show the analysis per industry sector and economic purpose of the Bank's Loans and Advances to customers (Note 14) in gross amounts , before and after taking into account the fair value of the loan collateral held or other credit enhancements.

	2007		2006	
	Gross Maximum Exposure		Gross Maximum Exposure	
	Amount	%	Amount	%
	MNT'000		MNT'000	
Textile and production	3,996,338	3.9%	2,543,485	4.2%
Trading	31,464,842	30.9%	19,227,659	31.6%
Food processing	1,459,718	1.4%	1,419,424	2.3%
Services	13,376,842	13.1%	6,966,127	11.5%
Consumption	22,837,814	22.4%	13,386,565	22.0%
Agricultural	3,254,177	3.2%	3,456,724	5.7%
Mortgage	20,013,495	19.6%	9,046,209	14.9%
Deposit backed	2,179,510	2.1%	2,286,542	3.8%
Construction, mining and education	1,701,290	1.7%	1,235,521	2.0%
Loans to staff	1,412,567	1.4%	1,052,234	1.7%
Loans to key management personnel	193,824	0.2%	215,769	0.4%
Total	101,890,417	100.0%	60,836,259	100.0%

Collateral and other credit enhancement

The amount and type of collateral required depends on the assessment of the credit risk of the borrower or counterparty and the type of loan granted. The Bank follows the collateral guidelines set by the Credit Management Committee in determining the type and value of collateral to be obtained.

The main types of collateral obtained are as follows:

- For small business, consumer, agricultural, SME and employee loans - cash, guarantees, securities and real estate properties, chattels, inventory, etc.
- For mortgage loans - mortgages on residential properties and vehicles.
- For wholesale loans - cash, equities and real estate properties.
- For deposit backed loans - cash deposit.

The Bank performs physical inspection of the collateral and regularly monitors the market value of collateral, requests additional collateral in accordance with underlying agreement, and monitors the market value of collateral obtained during its review of adequacy of the allowance for impairment losses.

34. RISK MANAGEMENT (CONTD.)

34.2 Credit risk (Contd.)

Credit quality per class of financial assets

The credit quality of loans and advances to customers is managed by the Bank using internal credit rating.

The following table shows the description of Credit Risk Grading System of the Bank:

<u>Credit Rating</u>	<u>Grade Description</u>
A	Excellent
B	Good
C	Satisfactory
D	Substandard

The Bank's 4-Grade Risk Rating is used in order to categorize exposures according to the risk profile. The 4-Grade Risk Rating is modeled using parametric approaches (logit model) that quantify the probability of default in determining the risk grade. Both qualitative and quantitative historical experience provide background for the bank's credit risk management department for the assumptions used. The risk grading system is used for determining impairment provisions against specific credit exposures. The current risk grading framework consists of four grades which are applied in an uniform matter.

It is the Bank's policy to maintain accurate and consistent risk grades across the credit portfolio. This facilitates the management of the applicable risks and the comparison of credit exposures across all lines of loan products. The grading system is supported by a variety of financial and statistical analytics, combined with processed portfolio and market information to provide the main inputs for the measurement of counterparty risk. All risk grades are tailored to the various loans exposures and are derived in accordance with the bank's grading policy across all risk groupings reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation.

The bank does not rate its cash and short term funds, due from banks and financial investments.

34. RISK MANAGEMENT (CONTD.)

34.2 Credit risk (Contd.)

Credit quality per class of financial assets

The table below shows that credit quality by class of asset for loan-related balance sheet lines, based on the Bank's internal credit rating system.

At 31 December 2007	Notes	Neither past due nor impaired					Past due or individually impaired MNT '000	Total MNT '000
		Excellent MNT '000	Good MNT '000	Satisfactory MNT '000	Substandard MNT '000	Not Rated MNT '000		
Cash and short term funds	11	-	-	-	-	5,529,661	-	5,529,661
Due from banks	12	-	-	-	-	23,913,044	-	23,913,044
Loans and advance to customers								
Small Business Loans		2,059,751	12,325,309	10,716,988	41,771	-	358,667	25,502,486
Consumer Loans		2,203,135	7,532,615	11,248,873	61,703	-	203,176	21,249,502
SME Loans		1,852,106	4,841,640	18,301,442	6,562	-	239,443	25,241,193
Agricultural Loans		17,156	1,810,845	1,630,894	26,658	-	157,833	3,643,386
Wholesale Loans		10,009	179,265	222,735	-	-	-	412,009
Mortgage Loans		148,432	488,220	18,544,291	437	-	49,271	19,230,651
Apartment Pledged Loans		431,877	374,365	2,019,435	7,941	-	6,961	2,840,579
Deposit Backed Loans		2,182,297	-	-	-	-	-	2,182,297
Employee Loans		377,892	1,208,561	423	-	-	1,438	1,588,314
	14	9,282,655	28,760,820	62,685,081	145,072	-	1,016,789	101,890,417
Financial investments - available for sale	13	-	-	-	-	224,300	-	224,300
Financial investments - held-to-maturity	13	-	-	-	-	984,636	-	984,636
Financial investments - held for trading	13	-	-	-	-	466,651	-	466,651
Total		9,282,655	28,760,820	62,685,081	145,072	31,118,292	1,016,789	133,008,709

34. RISK MANAGEMENT (CONTD.)

34.2 Credit risk (Contd.)

Credit quality per class of financial assets (Contd.)

At 31 December 2006	Notes	Neither past due nor impaired					Past due or individually impaired MNT '000	Total MNT '000
		Excellent MNT '000	Good MNT '000	Satisfactory MNT '000	Substandard MNT '000	Not Rated MNT '000		
Cash and short term funds	11	-	-	-	-	5,301,179	-	5,301,179
Due from banks	12	-	-	-	-	13,492,176	-	13,492,176
Loans and advance to customers								
Small Business Loans		254,442	6,254,447	12,163,105	450,431	-	438,959	19,561,384
Consumer Loans		125,962	2,294,991	9,186,537	272,456	-	159,955	12,039,901
SME Loans		-	988,961	7,507,526	7,564	-	202,314	8,706,365
Agricultural Loans		-	418,179	4,548,430	268,537	-	96,617	5,331,763
Wholesale Loans		-	-	662,574	-	-	3,291	665,865
Mortgage Loans		-	33,077	9,097,875	5,533	-	10,418	9,146,903
Apartment Pledged Loans		-	175,421	1,603,166	44,866	-	3,882	1,827,335
Deposit Backed Loans		2,287,725	-	-	-	-	212	2,287,937
Employee Loans		175,102	1,092,172	-	-	-	1,532	1,268,806
	14	2,843,231	11,257,248	44,769,213	1,049,387	-	917,180	60,836,259
Financial investments - available for sale	13	-	-	-	-	500	-	500
Total		2,843,231	11,257,248	44,769,213	1,049,387	18,793,855	917,180	79,630,114

34. RISK MANAGEMENT (CONTD.)

34.2 Credit risk (Contd.)

Past due loans and advances to customers include those that are only past due by a few days. An analysis of past due loans by age is provided as follows. The majority of the past due loans are not considered to be impaired.

Aging analysis of past due but not impaired loans per class of financial assets

At 31 December 2007	Less than 30 days MNT '000	31 to 60 days MNT '000	61 to 90 days MNT '000	More than 91 days MNT '000	Total MNT '000
Loans and advance to customers					
Small Business Loans	43,053	17,885	18,805	224,609	304,352
Consumer Loans	39,549	22,670	7,915	133,042	203,176
SME Loans	112,528	-	36,658	9,679	158,865
Agricultural Loans	47,048	17,033	9,336	67,021	140,438
Wholesale Loans	-	-	-	-	-
Mortgage Loans	9,877	-	-	31,676	41,553
Apartment Pledged Loans	2,615	-	-	4,346	6,961
Deposit Backed Loans	-	-	-	-	-
Employee Loans	708	-	110	620	1,438
	255,378	57,588	72,824	470,993	856,783

34. RISK MANAGEMENT (CONTD.)

34.2 Credit risk (Contd.)

Aging analysis of past due but not impaired loans per class of financial assets (Contd.)

At 31 December 2006	Less than 30 days MNT '000	31 to 60 days MNT '000	61 to 90 days MNT '000	More than 91 days MNT '000	Total MNT '000
Loans and advance to customers					
Small Business Loans	56,342	27,277	13,194	243,332	340,145
Consumer Loans	31,160	28,070	15,046	53,381	127,657
SME Loans	-	1,420	-	1,639	3,059
Agricultural Loans	26,768	6,540	9,157	26,191	68,656
Wholesale Loans	-	-	2,696	595	3,291
Mortgage Loans	10,418	-	-	-	10,418
Apartment Pledged Loans	-	-	-	815	815
Deposit Backed Loans	-	212	-	-	212
Employee Loans	915	475	-	142	1,532
	<u>125,603</u>	<u>63,994</u>	<u>40,093</u>	<u>326,095</u>	<u>555,785</u>

Of the total aggregate amount of gross past due but not impaired loans and advances to customers, the fair value of collateral that the Bank held as at 31 December 2007 was MNT 2,368 million (2006: MNT 1,923 million). Please refer Note 14 for more detailed information with respect to allowance for impairment losses on loans and advances to customers.

34. RISK MANAGEMENT (CONTD.)

34.2 Credit risk (Contd.)

Carrying amount per class of financial assets whose terms have been renegotiated

The table below shows the carrying amount for renegotiated financial assets, by class.

	2007 MNT '000	2006 MNT '000
Loans and advances to customers		
Small Business Loans	6,579	6,810
Consumer Loans	12,376	-
SME Loans	-	10,591
Mortgage Loans	31,622	-
	<u>50,577</u>	<u>17,401</u>

Restructuring or renegotiating is done on case by case basis. A loan can be renegotiated only if the borrower faces temporary cash flow problem which would have reasonable evidence of future recovery. Proposal to restructure a loan is prepared by a credit officer and the final decision is made at head office by Credit Committee comprises of Senior Managers. Restructured loans are reported to Board as well.

Impairment assessment

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

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan or advance on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of the other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans and advances that are not individually significant and for individually significant loans and advances where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review by the management.

34. RISK MANAGEMENT (CONTD.)

34.2 Credit risk (Contd.)

Impairment assessment (Contd.)

Collectively assessed allowances (Contd.)

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the bank's overall policy.

34.3 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 funding composition that should be in place to cover withdrawals at unexpected levels of demand. It is the Bank's policy to maintain a prudent mix of borrowed and core deposit base. In addition, the Bank maintains a statutory deposit with the Central Bank of Mongolia equal to 5% of customer deposits.

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2007 and 31 December 2006 based on contractual undiscounted repayment obligations. Please refer also note 28 "Maturity analysis of assets and liabilities" for the expected maturities of these liabilities. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

34. RISK MANAGEMENT (CONTD.)

34.3 Liquidity risk (Contd.)

Financial Liabilities	On Demand MNT'000	Less than 3 months MNT'000	3 to 6 months MNT'000	6 months to 1 year MNT'000	1 to 5 years MNT'000	Over 5 years MNT'000	Total undiscounted financial liabilities MNT'000
At 31 December 2007							
Due to customers	29,568,092	9,320,095	7,448,493	6,021,905	6,280,753	10,604,036	69,243,374
Due to banks	-	3,369,890	9,245,050	2,330,000	-	-	14,944,940
Borrowed funds	-	686,408	557,682	7,893,421	41,916,323	3,991,268	55,045,102
Other liabilities	-	540,893	16,901	-	1,841	-	559,635
Total	29,568,092	13,917,286	17,268,126	16,245,326	48,198,917	14,595,304	139,793,051
At 31 December 2006							
Due to customers	15,334,274	7,606,748	5,218,771	5,703,283	6,104,553	7,445,787	47,413,416
Due to banks	-	1,758,750	2,330,000	-	-	-	4,088,750
Borrowed funds	-	301,421	1,304,403	1,540,898	27,461,071	1,950,016	32,557,809
Other liabilities	-	205,385	-	204,473	-	-	409,858
Total	15,334,274	9,872,304	8,853,174	7,448,654	33,565,624	9,395,803	84,469,833

34. RISK MANAGEMENT (CONTD.)

34.3 Liquidity risk (Contd.)

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments.

	On Demand MNT'000	Less than 3 months MNT'000	3 to 6 months MNT'000	6 months to 1 year MNT'000	1 to 5 years MNT'000	Over 5 years MNT'000	Total MNT'000
2007							
Contingent liabilities	-	-	-	201,231	-	-	201,231
Commitments	-	-	12,106	1,310,007	-	-	1,322,113
Total	-	-	12,106	1,511,238	-	-	1,523,344
2006							
Contingent liabilities	-	-	-	159,826	-	-	159,826
Commitments	-	19,680	-	482,505	43,110	-	545,295
Total	-	19,680	-	642,331	43,110	-	705,121

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

34. RISK MANAGEMENT (CONTD.)

34.4 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates or foreign exchange rates. The Bank manages and monitors this risk element using VaR and sensitivity analyses. Except for the concentrations within foreign currencies, the Bank has no significant concentration of market risk.

Interest rate risk

Interest rate risk arises when there is a mismatch between positions, which are subject to interest rate adjustment within a specified period. The Bank's lending, funding and investment activities give rise to interest rate risk. The immediate impact of variation in interest rate is on Bank's net interest income, while a long term impact is on the Bank's net worth since the economic value of the Bank's assets, liabilities and off-balance sheet exposures will be affected. The management has established limits on the interest rate gaps for stipulated periods. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained with the established limits.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's income statement. The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate financial assets and financial liabilities held at 31 December 2007 and 31 December 2006.

December 31, 2007		
	Change in basis points	Sensitivity of net interest income MNT'000
Floating rate financial assets and liabilities	50 (50)	(104,378) 104,378

December 31, 2006		
	Change in basis points	Sensitivity of net interest income MNT'000
Floating rate financial assets and liabilities	50 (50)	(179,404) 179,404

34. RISK MANAGEMENT (CONTD.)

34.4 Market risk (Contd.)

Currency risk

Currency risk is the possibility of financial loss to the Bank arising from adverse movements in foreign exchange rates. The Bank's management sets limits on the level of exposure by currencies, which are monitored on a frequent basis. Apart from using foreign exchange exposure mismatch, the Bank applies Value-at-Risk ("VaR") simulation model to manage and measure foreign exchange risk since March 2007. VaR is a method used in measuring financial risk by estimating the potential negative change in the market value of a portfolio at a given confidence level and over specified time horizon.

Objective, assumptions and limitations of VaR Methodology

The VaR model are designed to measure market risk in a normal market environment. The models assume that any changes occurring in the risk factors affecting the normal market environment will follow a normal distribution. The Bank uses Variance/Covariance model to assess possible changes in foreign currency portfolio based on historical data from the past one day. The VaR methodology employed by the Bank uses a one-day period, using 99% confidence level, of the potential loss that is not expected to be exceeded if the current market risk positions were to be held unchanged for one day, and are determined by observing market data movements over a 250-day period. The use of a 99% confidence level means that, within one day horizon, losses exceeding the VaR figure should occur, on average, not more than once every hundred days.

The use of VaR has limitations because it is based on historical correlations and volatilities in market prices and assumes that future price movements will follow a statistical distribution. Due to the fact that VaR relies heavily on historical data to provide information and may not clearly predict the future changes and modifications of the risk factors, the probability of large market moves may be underestimated if changes in risk factors fail to align with the normal distribution assumption. VaR may also be under or over-estimated due to the assumptions placed on risk factors and the relationship between such factors for specific instruments. Even though positions may change throughout the day, the VaR only represents the risk of the portfolios at the close of each business day, and it does not account for any losses that may occur beyond the 99% confidence level.

VaR is an integral part of the Bank's market risk management since March 2007, VaR limits and exposures are reviewed regularly against the limits by management. The estimated potential one-day losses on its foreign currency denominated financial instruments, as calculated in the VAR model are the following:

34. RISK MANAGEMENT (CONTD.)

34.4 Market Risk (Contd.)

	Variance/ Covariance MNT'000
2007 - 31 December	3,786
2007 - Average Daily	3,235
2007 - Highest	8,148
2007 - Lowest	803

34. RISK MANAGEMENT (CONTD.)

34.4 Market Risk (Contd.)

Currency risk (contd.)

The table below summarizes the Bank's exposure to foreign exchange risk as December 31, 2007 and December 31, 2006. Included in the table are the Bank's financial assets and liabilities at carrying amounts, categorized by currencies.

Concentrations of financial assets and financial liabilities	Local	Foreign Currencies					Total	
	Currency	USD	EUR	GBP	CNY	RUB		JPY
-----MNT 'million-----								
As at 31 December 2007								
Assets								
Cash and short term funds	3,027	1,759	56	-	264	414	10	5,530
Due from banks	4,609	19,014	259	-	23	3	5	23,913
Financial investments	1,676	-	-	-	-	-	-	1,676
Loans and advances to customers	86,425	14,730	42	-	-	-	-	101,197
Other receivables	211	19	-	-	-	-	-	230
	<u>95,948</u>	<u>35,522</u>	<u>357</u>	<u>-</u>	<u>287</u>	<u>417</u>	<u>15</u>	<u>132,546</u>
Liabilities								
Due to customers	54,032	9,144	199	-	51	3	-	63,429
Due to banks	14,581	-	-	-	-	-	-	14,581
Borrowed funds	23,979	27,472	-	-	-	-	-	51,451
Other liabilities	416	143	1	-	-	-	-	560
	<u>93,008</u>	<u>36,759</u>	<u>200</u>	<u>-</u>	<u>51</u>	<u>3</u>	<u>-</u>	<u>130,021</u>
Net position	<u>2,940</u>	<u>(1,237)</u>	<u>157</u>	<u>-</u>	<u>236</u>	<u>414</u>	<u>15</u>	<u>2,525</u>

34. RISK MANAGEMENT (CONTD.)

34.4 Market Risk (Contd.)

Currency risk (contd.)

Concentrations of financial assets and financial liabilities	Local	Foreign Currencies					Total	
	Currency	USD	EUR	GBP	CNY	RUB		JPY
-----MNT 'million-----								
As at 31 December 2006								
Assets								
Cash and short term funds	2,573	1,528	275	-	511	404	10	5,301
Due from banks	5,668	7,390	415	-	-	3	16	13,492
Financial investments	1	-	-	-	-	-	-	1
Loans and advances to customers	44,719	15,403	228	-	-	-	-	60,350
Other receivables	329	23	-	-	-	-	-	352
	<u>53,290</u>	<u>24,344</u>	<u>918</u>	<u>-</u>	<u>511</u>	<u>407</u>	<u>26</u>	<u>79,496</u>
Liabilities								
Due to customers	37,514	5,405	85	-	1	2	-	43,007
Due to banks	4,081	-	-	-	-	-	-	4,081
Borrowed funds	9,866	19,425	862	-	-	-	-	30,153
Other liabilities	377	33	-	-	-	-	-	410
	<u>51,838</u>	<u>24,863</u>	<u>947</u>	<u>-</u>	<u>1</u>	<u>2</u>	<u>-</u>	<u>77,651</u>
Net position	<u>1,452</u>	<u>(519)</u>	<u>(29)</u>	<u>-</u>	<u>510</u>	<u>405</u>	<u>26</u>	<u>1,845</u>

34. RISK MANAGEMENT (CONTD.)

34.4 Market risk (Contd.)

Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected.

The Bank uses the simplified approach to project the impact of varying levels of prepayment on its net interest income. The effect on profit before tax for one year and on equity, assuming the historical annual prepayment ratio for the year, with all other variables held constant, is as follows:

	Prepayment rate	Effect on net interest income	Effect on equity
At 31 December 2007	%	MNT '000	MNT '000
Loans and advances to customers	6.38	81,305	-
At 31 December 2006			
Loans and advances to customers	4.46	31,598	-

Operation risk

Operational risk is the risk of loss arising from systems failure, human errors, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, and lead to financial loss. The Bank cannot expect to eliminate all operational risk, but through a dual control framework, segregation of duties between front-office and back office functions, controlled access to systems, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit, the Bank seeks to manage operational risk.

35. MONGOLIAN TRANSLATION

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