

**XacBank LLC**

Financial Statements for the year ended  
31 December 2003

**XacBank LLC**  
**Corporate information**

**Banking Licence No. 24** dated 27 December 2001, issued by the Bank of Mongolia.

<b>Board of Directors</b>	Stephen Mitchell Stephen D. Vance Jambaldorj Erdenechimeg Chuluun Ganhuyag Tsend Enhtuya Ser-Od Jargalsaihan Nyamaa Tumenbayar Chuluun Ganbold Ganhuyag Munhbat Tuvdendorj Galbaatar Steve Zimmerman Lhagvaa Sahiya Ekkehard Esser Bekhbat Bodnom James Anderson	Chairman (from April 2003) Chairman (until April 2003) Director Director Director (from July 2003) Director (from July 2003) Director (from July 2003) Director (from July 2003) Director (from October 2003) Director (from October 2003) Director (from October 2003) Director (until October 2003) Director (until July 2003) Director (until July 2003) Non-voting Director (from April 2003)
<b>Executive Committee</b>	Chuluun Ganbold Nyamaa Tumenbayar Steve Zimmerman Chuluun Ganhuyag James Anderson	Chairman (from December 2003) Member Member Member Non-voting Member
<b>Audit Committee</b>	Stephen Mitchell James Anderson Ser-Od Jargalsaihan Jambaldorj Erdenechimeg	Chairman Non-voting Vice-chairman Member Member
<b>Risk Management and Lending Committee</b>	James Anderson Tsend Enhtuya Tuvdendorj Galbaatar Ganhuyag Munhbat Chuluun Ganhuyag	Non-voting Chairman Member Member Member Member

**XacBank LLC**  
**Corporate information**

<b>Executive Officers</b>	Chuluun Ganhuyag	Executive Director
	Dugersuren Bat-Ochir	Finance and Accounting Division, Director
	Lhagvasuren Soronzonbold	Branch Banking Division, Director
	Bayanjargal Delgerjargal	Lending Division, Director
	Ganzorig Zul	Administration Division, Director
	Galbadrah Tsogbadrah	Internal Audit Unit, Director

<b>Registered office</b>	XacBank Building Prime Minister Amar's Street Sukhbaatar District, Ulaanbaatar Mongolia
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<b>Auditors</b>	KPMG Limited Vietnam
	ITGELT-AUDIT LLC



**REPORT OF INDEPENDENT AUDITORS**

**To the Shareholders  
XacBank LLC**

**Scope**

We have audited the accompanying balance sheet of XacBank LLC as of 31 December 2003 and the related statements of income, changes in equity and cash flows for the year then ended, as set out on pages 4 to 40. These financial statements are the responsibility of the Company's Directors. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Company for the year ended 31 December 2002 were audited by another firm of auditors whose report dated 7 March 2003 expressed an unqualified opinion on the financial statements.

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

**Audit opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of XacBank LLC as of 31 December 2003 and the results of its operations and its cash flows for the year then ended in accordance with the International Financial Reporting Standards adopted by the International Accounting Standard Board ("IASB").

*KPMG Limited*

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**KPMG Limited**  
Vietnam  
Investment Licence No: 863/GP

*Ugel Audit*

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**ITGELT-AUDIT LLC**  
Certified Public Accountants  
Licence No 24/1001

Ulaanbaatar,

**XacBank LLC**  
**Balance sheet at 31 December 2003**

	Note	2003 MNT'000	2002 MNT'000
<b>ASSETS</b>			
Cash on hand	3	637,419	497,393
Balances with other banks	3	1,143,765	2,228,751
Balances with the Bank of Mongolia	3	1,121,497	553,158
Investment securities	3	1,946,792	898,060
Loans and advances	4	10,840,446	5,401,168
Amounts due from the holding company	5	-	101,868
Property, plant and equipment	6	1,386,299	1,113,460
Other assets	7	727,184	567,229
		<hr/>	<hr/>
<b>TOTAL ASSETS</b>		<b>17,803,402</b>	<b>11,361,087</b>
		<hr/>	<hr/>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
Placement from financial institutions		-	400,000
Deposits from customers	8	10,012,172	6,180,013
Loans from local financial institutions	9	1,680,000	280,000
Loans from foreign financial institutions	10	1,197,200	1,153,125
Loans from government agencies	11	856,245	245,000
Deferred grants	12	88,365	93,189
Other liabilities	13	849,571	166,790
		<hr/>	<hr/>
<b>Total liabilities</b>		<b>14,683,553</b>	<b>8,518,117</b>
		<hr/>	<hr/>
<b>Shareholders' equity</b>			
Share capital	14	3,004,000	3,004,000
Reserves		9,436	9,436
Retained earnings/(accumulated losses)		106,413	(170,466)
		<hr/>	<hr/>
<b>Total shareholders' equity</b>		<b>3,119,849</b>	<b>2,842,970</b>
		<hr/>	<hr/>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>17,803,402</b>	<b>11,361,087</b>
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Chuluun Ganhuyag  
*Executive Director*

Dugersuren Bat-Ochir  
*Finance and Accounting Division Director*

*The notes set out on pages 9 to 40 form an integral part of these financial statements*

**XacBank LLC**  
**Statement of income for the year ended 31 December 2003**

	Note	2003 MNT'000	2002 MNT'000
Interest and similar income	15	3,715,511	1,826,684
Interest expense and similar charges	16	(1,168,688)	(371,623)
<b>Net interest income</b>		2,546,823	1,455,061
Fees and commissions	17	218,398	68,721
Net foreign exchange gains/(losses)		(451)	(1,879)
Other operating income	18	151,930	62,674
<b>Net non-interest income</b>		369,877	129,516
<b>Operating income</b>		2,916,700	1,584,577
General and administration expenses	19	(2,290,314)	(1,577,492)
Impairment losses	20	(123,164)	(161,533)
Grant income		241,187	33,372
Other expenses		(241,187)	(33,372)
<b>Profit/(loss) from operations</b>		<b>503,222</b>	<b>(154,448)</b>
Corporate income tax	21	(226,343)	(16,018)
<b>Net profit/(loss) after tax</b>		<b>276,879</b>	<b>(170,466)</b>
<b>Earning per share</b>			
<b>Basic earning/(loss) per share (MNT)</b>	22	<b>85</b>	<b>(53)</b>

Chuluun Ganhuyag  
*Executive Director*

Dugersuren Bat-Ochir  
*Finance and Accounting Division Director*

*The notes set out on pages 9 to 40 form an integral part of these financial statements*

**XacBank LLC**  
**Statement of changes in equity for the year ended 31 December 2003**

	<b>Share capital MNT'000</b>	<b>Reserves MNT'000</b>	<b>Retained earnings/ (accumulated losses) MNT'000</b>	<b>Total MNT'000</b>
Balance at 1 January 2002	2,704,000	9,436	-	2,713,436
Issue of share capital	300,000	-	-	300,000
Net loss for the year	-	-	(170,466)	(170,466)
Balance at 1 January 2003	3,004,000	9,436	(170,466)	2,842,970
Net profit for the year	-	-	276,879	276,879
Balance at 31 December 2003	3,004,000	9,436	106,413	3,119,849

Chuluun Ganhuyag  
*Executive Director*

Dugersuren Bat-Ochir  
*Finance and Accounting Division Director*

*The notes set out on pages 9 to 40 form an integral part of these financial statements*

**XacBank LLC****Statement of cash flows for the year ended 31 December 2003**

	Note	2003 MNT'000	2002 MNT'000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
<b>Profit/(loss) before tax</b>		<b>503,222</b>	<b>(154,448)</b>
<i>Adjustments for</i>			
Depreciation and amortisation		168,555	96,208
Write-off of property, plant and equipment		-	5,020
Allowance for loan losses		115,079	47,591
Impairment losses of other assets		8,085	113,942
(Gain)/losses on disposal of property, plant and equipment		(5,324)	5,811
		<hr/>	<hr/>
<b>Operating profit before changes in operating assets and liabilities</b>		<b>789,617</b>	<b>114,124</b>
Increase in loans and advances		(5,554,357)	(2,900,113)
Decrease/(increase) in amount due from the holding company		101,868	(101,868)
Increase in other assets		(212,097)	(385,914)
(Decrease)/increase in placements from financial institutions		(400,000)	400,000
Increase in deposits from customers		3,832,159	6,180,013
Increase in other liabilities		637,072	128,531
		<hr/>	<hr/>
		<b>(805,738)</b>	<b>3,434,773</b>
Corporate income tax paid		(136,577)	(60,075)
		<hr/>	<hr/>
<b>Net cash flows (absorbed by)/generated from operating activities</b>		<b>(942,315)</b>	<b>3,374,698</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of property, plant and equipment		(457,317)	(638,758)
Proceeds from disposals of property, plant and equipment		21,247	5,635
		<hr/>	<hr/>
<b>Net cash flows used in investing activities</b>		<b>(436,070)</b>	<b>(633,123)</b>

*The notes set out on pages 9 to 40 form an integral part of these financial statements*

**XacBank LLC****Cash flow statement for the year ended 31 December 2003 (continued)**

	Note	2003 MNT'000	2002 MNT'000
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from the issues of shares		-	300,000
Increase/(decrease) in loans from local financial institutions		1,400,000	(220,000)
Increase in loans from foreign financial institutions		44,075	714,325
Increase in loans from government agencies		611,245	245,000
(Decrease)/increase in deferred grants		(4,824)	34,129
		<hr/>	<hr/>
<b>Net cash flows generated from financing activities</b>		<b>2,050,496</b>	<b>1,073,454</b>
		<hr/>	<hr/>
<b>Net cash flows generated in the year</b>		<b>672,111</b>	<b>3,815,029</b>
<b>Cash and cash equivalents at the beginning of the year</b>		<b>4,177,362</b>	<b>362,333</b>
		<hr/>	<hr/>
<b>Cash and cash equivalents at the end of the year</b>	<b>3</b>	<b>4,849,473</b>	<b>4,177,362</b>
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Chuluun Ganhuuyag  
*Executive Director*

Dugersuren Bat-Ochir  
*Finance and Accounting Division Director*

*The notes set out on pages 9 to 40 form an integral part of these financial statements*

## **XacBank LLC**

### **Notes to the financial statements for the year ended 31 December 2003**

These notes form an integral part of and should be read in conjunction with the accompanying financial statements.

#### **1. Corporate information and principal activities**

X.A.C. Co., Ltd. commenced operations in 1999 as a non-bank financial institution. The Company first started its operation by rendering five types of loan services. In October 2001, this company entered into a merger agreement with Goviin Ekhlel Co., Ltd., another non-bank financial institution, to form XAC-GE Group, a holding company, which owns a majority stake in XacBank LLC. The shareholders of the holding company are:

- Mercy Corps
- Mongolian Foundation for Open Society
- Mongolian Women's Federation
- Liberal Women's Intellectual Pool
- National Association of Mongolian Agricultural Cooperatives
- Rotary Club of Ulaanbaatar
- Local Governance Development Foundation

The principal activities of XacBank LLC ("the Bank"), which is incorporated as a commercial bank under the Mongolian Banking Law, are to provide a wide-range of banking products and services, including deposit taking, lending, international and domestic payment services, foreign exchange dealing, securities trading, financial and investment consulting, under Banking Licence No. 24 issued by the Bank of Mongolia on 27 December 2001 (referred to as "the Banking Licence").

The Bank has been and continues to be predominantly involved in providing micro financing to the general public to develop retail and small and medium enterprises.

As at 31 December 2003 the Company had 413 employees (2002: 325 employees).

#### **2. Summary of significant accounting policies**

The financial statements were authorised for issue by the Board of Directors on 31 March 2004. The following significant accounting policies have been adopted by the Bank in the preparation of these financial statements.

##### **(a) Statement of compliance**

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued and adopted by the International Accounting Standards Board ("IASB"), and interpretations issued by the Standing Interpretations Committee of the IASB.

**XacBank LLC**

**Notes to the financial statements for the year ended 31 December 2003 (continued)**

**(b) Basis of financial statement preparation**

The financial statements are presented in Mongolian Tugrug (“MNT”), rounded to the nearest thousand. MNT is the Bank’s measurement currency. The financial statements are prepared on the historical cost basis, except the following financial assets and liabilities are stated at fair value: investments held for trading and investments available-for-sale. The accounting policies have been consistently applied by the Bank and are consistent with those used in the previous year.

**(c) Foreign currency transactions**

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at fair value, are translated into MNT at foreign exchange rates ruling at the dates that the values were determined.

**(d) Financial instruments**

**(i) Classification**

*Trading instruments* are those that the Bank principally holds for the purposes of short-term trading and liquidity management.

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

*Held-to-maturity assets* are financial assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity.

*Available-for-sale assets* are financial assets that are not held for trading purposes, originated by the Bank, or held to maturity.

**(ii) Initial recognition**

Financial instruments are measured initially at cost, including transaction costs, when purchased or originated by the Bank.

**XacBank LLC**

**Notes to the financial statements for the year ended 31 December 2003 (continued)**

**(iii) Subsequent measurement**

Subsequent to initial recognition, all trading instruments and all available-for-sale assets are measured at fair market value, except that any instrument that does not have a quoted market price in an active market and whose fair market value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses.

All non-trading financial liabilities, originated loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

**(iv) Specific instruments**

Please refer to the respective accounting policy notes for specific financial instruments.

**(e) Cash and cash equivalents**

Cash comprises cash balances on hand, and cash deposits with the Bank of Mongolia and other banks. Cash equivalents are short-term and highly liquid investments with maturities of three months or less when purchased, which include the Bank of Mongolia's bills, with maturity of one month when purchased and eligible for rediscounting with the Bank of Mongolia.

**(f) Loans and advances**

Loans and advances originated by the Bank are classified as originated loans and receivables. Loans and advances are reported net of allowances to reflect the estimated recoverable amounts (refer to accounting policy (i)).

**(g) Property, plant and equipment**

**(i) Cost**

Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The initial cost of an item of property, plant and equipment comprises its purchase price, including import duties, non-refundable purchase taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after property, plant and equipment have been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to income in the year in which the costs are incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard of performance, the expenditure is capitalised as an additional cost of property, plant and equipment.

**XacBank LLC**

**Notes to the financial statements for the year ended 31 December 2003 (continued)**

**(ii) Depreciation**

Depreciation is charged to the statement of income on a straight-line basis over the estimated useful lives of property, plant and equipment. The estimated useful lives are as follows:

■	buildings	40 years
■	motor vehicles	10 years
■	office equipment	10 years
■	computers	5 years

**(h) Construction in progress**

Construction in progress represents the cost of construction of new buildings and premises, which have not been fully completed or installed. No depreciation is provided for construction in progress during the period of construction.

**(i) Impairment**

The carrying amounts of the Bank's assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If such an indication exists, the asset's recoverable amount is estimated.

**(i) Originated loans and advances**

Loans and advances are presented net of specific and general allowances for uncollectability. Specific allowances are made against the carrying amount of loans and advances that are identified as being potentially impaired, based on regular reviews of outstanding balances, to reduce these loans and advances to their recoverable amount. General allowances are maintained to reduce the carrying amount of portfolios of similar loans and advances to their estimated recoverable amounts at the balance sheet date. Increases in the allowance account are recognised in the statement of income. When a loan is known to be uncollectible, all the necessary legal procedures have been completed and the final loss has been determined, the loan is written off directly.

If in a subsequent period the amount of impairment loss decreases and the decrease can be linked objectively to an event occurring after the write down, the write-down or allowance is reversed through the statement of income.

## **XacBank LLC**

### **Notes to the financial statements for the year ended 31 December 2003 (continued)**

#### **(ii) *Assets other than loans and advances***

The recoverable amount is the greater of the asset's net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the statement of income.

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

#### **(j) **Non-trading financial liabilities****

Non-trading financial liabilities include deposits from customers and from other financial institutions, interest-bearing borrowings and other amounts payable. Non-trading financial liabilities are initially stated at cost. Subsequent to the initial recognition, they are stated at amortised cost with any difference between cost and redemption value being recognised in the statement of income over the period of the instrument on an effective interest basis.

#### **(k) **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 attaching to them. Grants that compensate the Bank for expenses incurred are recognised as revenue in the statement of income 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 the statement of income on a systematic basis over the useful life of the asset.

#### **(l) **Provisions****

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

**XacBank LLC**

**Notes to the financial statements for the year ended 31 December 2003 (continued)**

**(m) Revenue**

**(i) *Interest income***

Interest income and expense is recognised in the statement of income as it accrues, taking into account the effective yield of the asset. Interest income and expense include the amortisation of any discount or premium or other differences between the carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis. The recognition of interest income is suspended when the recoverability of principal or interest becomes doubtful. In accordance with the requirement of the Bank of Mongolia, interest is suspended when payment are in arrears for three months (non performing loans). On the commencement of the suspension, related interest receivable is written off. Subsequent to the suspension, interest income is recognised on a cash basis. Interest income recognition will resume on an accrual basis when the uncertainties surrounding the recoverability are removed.

**(ii) *Fee income and commission***

Fee and commission income is charged to customers for the financial services provided. Fee and commission income is recognised when the corresponding service is provided.

**(iii) *Rental income***

Rental income from leased property is recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

**(n) *Operating lease payments***

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

**(o) *Income tax***

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the statement of income except to the extent that it relates to items recognised directly to equity, in which case it is recognised in equity.

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

**XacBank LLC**

**Notes to the financial statements for the year ended 31 December 2003 (continued)**

Deferred tax is provided using the balance sheet liability method providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not provided for temporary differences arising on the initial recognition of assets or liabilities that affect neither accounting nor taxable profit. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using the tax rates approved at balance sheet date. Deferred tax assets are recognised in the financial statements only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

**(p) Employee benefits**

**(i) *Defined contribution plan***

Employee benefits include statutory social insurance payments to the State Social Insurance Scheme. Contributions to this defined contribution plan are recognised as an expense in the statement of income as incurred.

**(ii) *Equity compensation benefits***

The Employee Stock Ownership Plan allows the Bank's staff to acquire shares of the Bank from XAC-GE Group. The purchase price is at 10% of the par value. No compensation cost or obligation is recognised when options are granted. When shares are purchased, the holding company records the proceeds and share discount in respect of the options exercised and shares will be transferred from the holding company to the employees. No change is made to the Bank's total share capital and no compensation cost is recognised by the Bank.

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****3. Cash and cash equivalents**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Cash	637,419	497,393
Balances with other banks	1,143,765	2,228,751
Balances with the Bank of Mongolia	1,121,497	553,158
	<hr/>	<hr/>
Total cash	2,902,681	3,279,302
Investment securities	1,946,792	898,060
	<hr/>	<hr/>
Total cash and cash equivalents	4,849,473	4,177,362
	<hr/> <hr/>	<hr/> <hr/>

Balances are maintained with the Bank of Mongolia in accordance with the Bank of Mongolia's requirements and bear no interest. Balances are determined based on average deposits and liabilities balances.

Investment securities represent zero-coupon bills issued by the Bank of Mongolia at a discount and stated at amortised cost, with cost adjusted for amortisation of discount to maturity date on a straight-line basis. The investment securities are classified as cash equivalents for the statement of cash flows.

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****4. Loans and advances**

	<b>2003</b> <b>MNT'000</b>	<b>2002</b> <b>MNT'000</b>
Loans and advances to customers	10,753,582	5,344,149
Loans to staff	203,732	92,921
Loans to executive officers	54,901	33,897
	<hr/>	<hr/>
	11,012,215	5,470,967
Allowance for impairment	(171,769)	(69,799)
	<hr/>	<hr/>
<b>Net loans and advances</b>	<b>10,840,446</b>	<b>5,401,168</b>

Included in the gross balance of loans and advances is an amount of non-performing loans of MNT212 million (2002: MNT11 million). As at 31 December 2003, assets valued at MNT14,607 million (2002: MNT6,868 million) were pledged as collateral for loans outstanding.

Movements in the allowance for impairment losses of loans and advances during the year were as follows:

	<b>2003</b> <b>MNT'000</b>	<b>2002</b> <b>MNT'000</b>
Balance as at 1 January	69,799	29,720
Additional allowance during the year	115,079	47,591
Recoveries	-	(5,350)
Write off	(13,109)	(2,162)
	<hr/>	<hr/>
Balance as at 31 December	<b>171,769</b>	<b>69,799</b>

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)**

Loans and advances can be analysed by industry as follows:

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Textile and production	771,066	83,429
Trading	5,188,031	2,672,516
Food processing	314,608	164,728
Services	717,099	209,751
Consumption	2,298,856	1,055,433
Others	1,463,922	1,158,292
Loans to staff	203,732	92,921
Loans to executive officers	54,901	33,897
	<hr/>	<hr/>
	11,012,215	5,470,967
	<hr/> <hr/>	<hr/> <hr/>

Others include borrowers in construction, agriculture, mining and education.

**5. Amounts due from the holding company**

Amounts due from the holding company, XAC-GE Group, as at 31 December 2002 have been fully repaid in 2003. The loans bore interest at a rate of 14% (2002: 13% to 14%) per annum.

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****6. Property, plant and equipment**

	<b>Buildings</b>	<b>Motor vehicles</b>	<b>Office equipment</b>	<b>Computers</b>	<b>Construction in progress</b>	<b>Total</b>
	<b>MNT'000</b>	<b>MNT'000</b>	<b>MNT'000</b>	<b>MNT'000</b>	<b>MNT'000</b>	<b>MNT'000</b>
<b>Cost</b>						
Opening balance	459,451	238,605	144,443	462,491	-	1,304,990
Additions	3,000	120,010	116,013	182,294	36,000	457,317
Disposals	(10,992)	(10,260)	(305)	-	-	(21,557)
Closing balance	451,459	348,355	260,151	644,785	36,000	1,740,750
<b>Accumulated depreciation</b>						
Opening balance	12,728	32,639	29,336	116,827	-	191,530
Charge for the year	11,472	27,280	43,960	85,843	-	168,555
Disposals	(883)	(4,512)	(239)	-	-	(5,634)
Closing balance	23,317	55,407	73,057	202,670	-	354,451
<b>Net book value</b>						
Closing balance	428,142	292,948	187,094	442,115	36,000	1,386,299
Opening balance	446,723	205,966	115,107	345,664	-	1,113,460

Included in the cost of tangible fixed assets were assets costing approximately MNT8 million which were fully depreciated as of 31 December 2003 (2002: Nil), but which are still in active use.

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****7. Other assets**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Foreclosed properties	32,698	3,155
Prepaid expenses	284,717	289,803
Supplies	96,034	32,491
Low value assets	60,137	21,341
Accrued interest receivable	206,722	113,338
Corporate income tax receivable	-	44,057
Other receivables	46,876	63,044
	<hr/>	<hr/>
	727,184	567,229
	<hr/> <hr/>	<hr/> <hr/>

**8. Deposits from customers**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Current accounts	880,022	3,228,979
Savings deposits	1,816,232	467,327
Time deposits	7,315,918	2,483,707
	<hr/>	<hr/>
	10,012,172	6,180,013
	<hr/> <hr/>	<hr/> <hr/>

Current accounts bear interest at a rate of 3.6% per annum applicable to individual balances more than MNT5 million (2002: Nil). Savings deposits bear interest at a rate of approximately 8.60% (2002: 9.39%) per annum. Time deposits bear interest at rates ranging from 3.60% to 18.00% (2002: 6.60% to 22.80%) per annum.

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****9. Loans from local financial institutions**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Loan from Anod Bank	280,000	280,000
Loan from MongolPost Bank	400,000	-
Loan from Golomt Bank	1,000,000	-
	<hr/>	<hr/>
	1,680,000	280,000
	<hr/>	<hr/>

The loans bear interest at rates ranging from 12% to 15% per annum and are repayable in 2004 and 2005.

**10. Loans from foreign financial institutions**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Loan from Deutsche Bank Micro Credit Development Fund ("DBMCDF")	146,000	140,625
Loan from International Finance Corporation ("IFC")	467,200	450,000
Loan from Dexia Micro Credit Fund ("DMCF")	584,000	562,500
	<hr/>	<hr/>
	1,197,200	1,153,125
	<hr/>	<hr/>

The loan from the DBMCDF is in the form of a promissory note issued by the Bank for a principal amount of USD125,000. The note bears interest at a rate of 2% (2002: 2%) per annum and is repayable in August 2007.

The loan from IFC, amounting to USD400,000, bears interest at rate of LIBOR+3.5%% (2002: LIBOR +3.5%). The loan is repayable in twelve semi-annual instalments commencing 15 January 2005.

The loan from DMCF, amounting to USD500,000, bears interest at rate of LIBOR+6% (2002: LIBOR+6.5%) per annum. The loan is repayable in four equal two-monthly instalments of USD125,000 each, commencing in February 2006.

These loans are to support further expansion of the Bank's micro-finance and small-medium enterprise lending activities and to strengthen the Bank's technical capability.

**XacBank LLC**

**Notes to the financial statements for the year ended 31 December 2003 (continued)**

**11. Loans from government agencies**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Loans from Employment Generation Support Fund	445,000	245,000
Loans from Bank of Mongolia	411,245	-
	<hr/>	<hr/>
	856,245	245,000
	<hr/>	<hr/>

The objective of the loans from Employment Generation Support Fund is to channel funds to small business entities and individuals. The loans, which are in Mongolian Tugrug, bear interest at a rate of 6% (2002: 6%) per annum and are repayable on 24 May 2004. The Bank expects that the loans will be rolled-over for another period of one year, as a result of the Bank's compliance with the loans contract and objectives.

ADB and UNDP loans were channelled through the Bank of Mongolia. The objective of the loans from the Bank of Mongolia is to develop Mongolia's agriculture sector and credit and saving cooperatives. The loans, which are in Mongolian Tugrug, bear interest at rates ranging from 5.5% to 6% per annum and are repayable from 19 May 2004 to 15 January 2006.

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****12. Deferred grants**

	<b>2003</b> <b>MNT'000</b>	<b>2002</b> <b>MNT'000</b>
Grant from Consultative Group to Assist the Poorest ("CGAP")	46,557	21,712
Grant from International Finance Corporation ("IFC")	38,872	67,500
Others	2,936	3,977
	<hr/>	<hr/>
	88,365	93,189
	<hr/>	<hr/>

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

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

The IFC grant was received during the year 2002 with the objective of providing funds for technical assistance in the following initiatives: technical advice, 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.

**13. Other liabilities**

	<b>2003</b> <b>MNT'000</b>	<b>2002</b> <b>MNT'000</b>
Interest payable	299,941	46,351
Remittances payables	248,492	16,699
Corporate income tax payables	45,709	-
Other payables	255,429	103,740
	<hr/>	<hr/>
	849,571	166,790
	<hr/>	<hr/>

Included in other payables are accruals for audit fees and staff salary.

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****14. Share capital**

<i>In thousand of shares</i>	<b>2003</b>	<b>2002</b>
On issue at 1 January	300,400	270,400
Issue for cash	-	30,000
	<hr/>	<hr/>
On issue at 31 December – fully paid	300,400	300,400

As at 31 December 2003, the authorised share capital of the Bank was MNT4,000 million (2002: MNT4,000 million), which consists of 400,000 ordinary shares at par value of MNT10,000 each. Subsequent to the year-end, each share was split into ten shares in accordance with the Bank's bylaw. The par value was reduced to MNT1,000. The Bank is required to issue this share capital in full by 1 April 2004. See the subsequent event described in note 28. In January 2004, the Board of Directors approved an increase in the authorised share capital to MNT6,000 million.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and entitled to one vote per share at meetings of the Bank, except employees owning shares under the Employee Stock Ownership Plan, who do not have such rights for the first three years of ownership. All shares rank equally with regard to the Bank's residual assets.

As at 31 December 2003, 96% (2002: 96%) of issued shares are owned by XAC-GE Group, the holding company, and 4% (2002: 4%) are owned by other shareholders.

**15. Interest and similar income**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Loans and advances	3,573,322	1,805,975
Placements with other banks	98,258	15,614
Investment securities	43,931	5,095
	<hr/>	<hr/>
	3,715,511	1,826,684

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****16. Interest expense and similar charges**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Time and savings deposits	970,169	130,289
Loans	178,180	226,317
Others	20,339	15,017
	<hr/>	<hr/>
	1,168,688	371,623
	<hr/> <hr/>	<hr/> <hr/>

**17. Fees and commissions**

Fees and commissions represent income from loan application fees, payment service fees, loan commissions and money transfer service fees.

**18. Other operating income**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Rental income	122,994	55,624
Other	28,936	7,050
	<hr/>	<hr/>
	151,930	62,674
	<hr/> <hr/>	<hr/> <hr/>

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****19. General and administrative expenses**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Salaries, provision for staff welfare and bonus	922,244	579,640
Depreciation on property, plant and equipment	168,555	95,454
Travel	83,571	72,685
Rental	329,255	254,269
Representation	39,040	27,714
Fuel and maintenance of vehicles	77,367	45,721
Communication	111,341	86,414
Advertising	68,389	33,540
Maintenance of property and equipment	12,797	57,188
Office supplies	96,744	63,054
Social insurance	177,003	110,945
Other	204,008	150,868
	<hr/>	<hr/>
	2,290,314	1,577,492
	<hr/>	<hr/>

**20. Impairment losses**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Allowance for loan losses	115,079	47,591
Impairment losses of other assets	8,085	113,942
	<hr/>	<hr/>
	123,164	161,533
	<hr/>	<hr/>

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****21. Corporate income tax****Recognised in the statement of income:**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
<b><i>Current tax expense</i></b>		
Current year	228,403	16,018
Under/(over) provided in prior years	(2,060)	-
Income tax expense in the statement of income	226,343	16,018

**Reconciliation of effective tax rate**

	<b>2003</b>	<b>2002</b>
	<b>MNT'000</b>	<b>MNT'000</b>
Profit/(loss) before tax	503,221	(154,448)
Tax at income tax rate of 15%	75,483	(23,167)
Tax effect of non-deductible expenses	16,835	43,042
Tax effect of tax exempt revenues	(576)	(4,493)
Under/(over) provided in prior years	(2,060)	-
Tax effect of progressive tax rate of 40% on the portion of taxable income exceeding MNT100 million	136,661	636
Income tax expense	226,343	16,018

The calculation of income tax is subject to the review and approval of the tax authorities.

According to Mongolian Tax Laws, the Company has an obligation to pay the Government Income Tax at the rate of 15% of the portion of taxable profits up to MNT100 million and 40% of the portion of taxable profits above MNT100 million.

According to the Mongolian Tax Laws, tax losses cannot be carried forward to offset against future taxable income.

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****22. Earnings per share**

The calculation of basic earnings per share at 31 December 2003 was based on the net profit attributable to the ordinary shareholders of MNT276,879,000 (2002: net loss of MNT170,466,000) and a weighted average number of ordinary shares outstanding during the year ended 31 December 2003 of 320,358 (2002: 315,358), calculated as follows:

<i>In thousands of shares</i>	<b>2003</b>	<b>2002</b>
Issued ordinary shares at 1 January	3,004,000	2,704,000
Effect of shares issued at par in February 2002	-	250,000
Effect of bonus shares issued in January 2004 (note 28)	199,580	199,580
Effect of bonus shares issued in March 2004 (note 28)	61,950	61,950
	<hr/>	<hr/>
Weighted average number of ordinary shares	3,265,530	3,215,530

The number of shares issued as part of dividend distributions in 2004 has been added to the number of shares outstanding as at 31 December, as if these shares had been issued at the beginning of the year.

The share split in 2004, whereby each outstanding share was split into ten shares, has been added to the number of shares outstanding as at 31 December, as if these shares had been split at the beginning of the year.

**XacBank LLC**

**Notes to the financial statements for the year ended 31 December 2003 (continued)**

**23. 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;
- Performance rating in the most recent evaluation period; and
- No disciplinary action is pending or due.

The number of shares offered for sale will be determined at the discretion of the Bank's management. The Plan enables employees to purchase shares in XacBank LLC already held by XAC-GE Group. The share capital of XacBank LLC is not affected by these transactions.

The shares are purchased within the financial year in which they are offered at a discount price of 10% of the par value.

	<b>Movement of shares offered under the Plan (expressed in number of shares)</b>	
	<b>2003</b>	<b>2002</b>
Share offer vested during the year	10,160	12,450
Shares offered outstanding at 1 January	-	-
Shares offered during the year	10,160	12,450
Shares offered and purchased during the year	(8,030)	(11,400)
Shares offered and expired during the year	(2,130)	(1,050)
Shares offered outstanding at 31 December	-	-

The Bank does not bear or incur any cost in connection with these transactions.

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****24. Significant transactions with related parties**

The Bank has a controlling related party relationship with XAC-GE Group, the holding company.

The Bank also has a related party relationship with the shareholders of XAC-GE Group (see note 1), and with its directors and executive officers.

As at 31 December 2003, executive officers held 3,200 (2002: 3,200) voting shares of the Bank.

During the year the Bank had the following transactions with related parties:

	<b>2003</b> <b>MNT'000</b>	<b>2002</b> <b>MNT'000</b>
Loan to executive officers	54,901	33,897
Loans to the holding company	-	101,868
	<hr/>	<hr/>
	54,901	135,765
	<hr/>	<hr/>

Total remuneration of directors and executive officers included in general and administrative expenses:

	<b>2003</b> <b>MNT'000</b>	<b>2002</b> <b>MNT'000</b>
Directors	3,050	3,000
Executive officers	80,264	70,040
	<hr/>	<hr/>
	83,314	73,040
	<hr/>	<hr/>

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****25. Capital adequacy**

The Bank of Mongolia requires commercial banks to maintain a capital adequacy ratio of 10%, compiled on the basis of total equity and total assets as adjusted for their risk. As at 31 December 2003, the Bank has a risk weighted capital ratio of 24% (2002: 37%), calculated as follows:

	<b>2003</b> <b>MNT'000</b>	<b>2002</b> <b>MNT'000</b>
<b>Tier I capital</b>		
Share capital	3,004,000	3,004,000
Retained earnings/(accumulated losses)	106,413	(170,466)
Reserve	9,436	9,436
	<hr/>	<hr/>
Total Tier I capital	3,119,849	2,842,970
<b>Tier II capital</b>	-	-
	<hr/>	<hr/>
Total Tier I and II capital	3,119,849	2,842,970
	<hr/> <hr/>	<hr/> <hr/>

Breakdown of risk weighted assets as follows:

<b>Risk weighted factor (%)</b>	<b>2003</b> <b>MNT'000</b>	<b>2002</b> <b>MNT'000</b>
0	3,705,708	1,948,611
10	-	-
20	1,143,765	2,228,751
50	-	-
100	12,953,929	7,183,725
	<hr/>	<hr/>
Total	17,803,402	11,361,087
	<hr/>	<hr/>
Risk weighted capital ratio	24%	37%
	<hr/> <hr/>	<hr/> <hr/>

## **26. Risk management disclosure**

This section provides details of the Bank's exposure to risk and describes the methods used by management to control risk. Because of the Bank's activities, which are predominantly non-trading, assets structure, consists mainly of loans and advances, and their financing, which is mainly from deposits from customers. The most important types of financial risk to which the Bank is exposed are credit risk, liquidity risk, interest rate risk and, to a less extent, foreign currency risk.

Below is a discussion of these risks and the approach taken to manage them:

### **(i) Credit risk**

The Bank's primary exposure to credit risk arises through its loans and advances. The amount of credit risk exposure in this regard is represented by the carrying amounts of the assets on the balance sheet.

The Bank structures the level of credit risk it undertakes by placing limits on the amount of risk acceptable to one individual borrower or a group of borrowers and to an industry sector. Exposure to credit risk is managed through regular analysis of the ability of the borrowers and potential borrowers to meet interest and capital repayment obligations. Credit limit is changed when needed. Exposure to credit risk is also managed by obtaining collateral and corporate and personal guarantees.

The major concentration of credit risk arises by industry sector in relation to the Bank's loans and advances to customers. See note 4 for analysis of total loans and advances to customers by industry sector. The Bank has concentration of credit risk by geographical location as all borrowers are in Mongolia. However, the Bank has no significant exposure to any individual borrower.

### **(ii) Liquidity risk**

Liquidity risk arises in the general funding of the Bank's activities and in the management of its positions. It includes both risk of being unable to fund assets at appropriate maturities and rates and risk of being unable to liquidate an asset at a reasonable price in an appropriate time frame.

The Bank has access to a diverse funding base. Funds are raised using a broad range of instruments including deposits, interest-bearing borrowings from local and overseas financial institutions and share capital. This enhances funding flexibility and limits dependence on any source of funds or any fund provider. The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required to meet business goals and targets set in terms of the overall strategy.

In addition, the Bank holds a portfolio of liquid assets as part of its liquidity risk management policy.

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)**

The following table provides an analysis of the financial assets and liabilities of the Bank into relevant maturity groupings based on the remaining periods to repayment:

*As at 31 December 2003*

	<b>Less than three months MNT'000</b>	<b>Three to six months MNT'000</b>	<b>Six months to one year MNT'000</b>	<b>One to five years MNT'000</b>	<b>Over five years MNT'000</b>	<b>Total MNT'000</b>
<b>Financial assets</b>						
Cash on hand	637,419	-	-	-	-	637,419
Balances with other banks	63,365	350,400	-	730,000	-	1,143,765
Balances with the Bank of Mongolia	1,121,497	-	-	-	-	1,121,497
Investment securities	1,946,792	-	-	-	-	1,946,792
Loans and advances	1,314,462	2,726,718	5,911,499	887,767	-	10,840,446
Other assets	269,086	-	83,900	172,502	-	525,488
	5,352,621	3,077,118	5,995,399	1,790,269	-	16,215,407
<b>Financial liabilities</b>						
Deposits from customers	2,713,309	1,661,750	4,156,326	421,240	1,059,547	10,012,172
Loans from local financial institutions	-	400,000	280,000	1,000,000	-	1,680,000
Loans from foreign financial institutions	-	-	-	1,010,320	186,880	1,197,200
Loans from government agencies	-	452,500	215,320	188,425	-	856,245
Other liabilities	688,664	-	61,859	99,048	-	849,571
	3,401,973	2,514,250	4,713,505	2,719,033	1,246,427	14,595,188
Net financial assets/(liabilities)	1,950,648	562,868	1,281,894	(928,764)	(1,246,427)	1,620,219
Cumulative total	1,950,648	2,513,516	3,795,410	2,866,646	1,620,219	

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)***As at 31 December 2002*

	<b>Less than three months MNT'000</b>	<b>Three to six months MNT'000</b>	<b>Six months to one year MNT'000</b>	<b>One to five years MNT'000</b>	<b>Over five years MNT'000</b>	<b>Total MNT'000</b>
<b>Financial assets</b>						
Cash on hand	497,393	-	-	-	-	497,393
Balances with other banks	2,228,751	-	-	-	-	2,228,751
Balances with the Bank of Mongolia	553,158	-	-	-	-	553,158
Investment securities	898,060	-	-	-	-	898,060
Loans and advances	1,196,062	1,592,432	1,989,059	308,210	315,405	5,401,168
Amounts due from holding company	-	-	-	101,868	-	101,868
Other assets	213,254	285,209	-	-	-	498,463
	<b>5,586,678</b>	<b>1,877,641</b>	<b>1,989,059</b>	<b>410,078</b>	<b>315,405</b>	<b>10,178,861</b>
<b>Financial liabilities</b>						
Placement from financial institutions	400,000	-	-	-	-	400,000
Deposits from customers	4,753,935	219,315	418,963	-	787,800	6,180,013
Loans from local financial institutions	-	-	280,000	-	-	280,000
Loans from foreign financial institutions	-	-	562,500	140,625	450,000	1,153,125
Loan from government agencies	-	245,000	-	-	-	245,000
Other liabilities	166,790	-	-	-	-	166,790
	<b>5,320,725</b>	<b>464,315</b>	<b>1,261,463</b>	<b>140,625</b>	<b>1,237,800</b>	<b>8,424,928</b>
Net financial assets/(liabilities)	265,953	1,413,326	727,596	269,453	(922,395)	1,753,933
Cumulative total	265,953	1,679,279	2,406,875	2,676,328	1,753,933	

## **XacBank LLC**

### **Notes to the financial statements for the year ended 31 December 2003 (continued)**

#### **(iii) Interest rate risk**

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or reprice at different times or in different amounts. In the case of floating rate assets and liabilities the Bank is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices, such as six months LIBOR and different types of interest. Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the Bank's business strategies.

Assets-liabilities risk management activities are conducted in the context of the Bank's sensitivity to interest rate changes. In general, the Bank is liability sensitive because its interest assets have a longer duration and reprice less frequently than interest-bearing liabilities. This means that in rising interest rate environments, margins earned will narrow as liabilities reprice. However, the actual effect will depend on a number of factors, including the extent to which repayments are made earlier or later than the contracted dates and variations in interest rate sensitivity within repricing periods and among currencies.

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

The table below summarises repricing mismatches on the Bank's financial assets and liabilities at the balance sheet date. The carrying amounts of interest rate sensitive assets and liabilities are presented in the periods in which they next reprice to market rate or mature, and are summed to show the interest rate sensitivity gap.

**XacBank LLC**

**Notes to the financial statements for the year ended 31 December 2003 (continued)**

*As at 31 December 2003*

	Effective interest rate %	Total MNT'000	Floating rate instruments MNT'000	Less than three months MNT'000	Fixed rate instruments			
					Three to six months MNT'000	Six months to one year MNT'000	One to five years MNT'000	Over five years MNT'000
<b>Financial assets</b>								
Cash on hand	-	637,419	-	637,419	-	-	-	-
Balances with other banks	5% - 7.5%	1,143,765	-	63,365	350,400	-	730,000	-
Balances with the Bank of Mongolia	-	1,121,497	-	1,121,497	-	-	-	-
Investment securities	7% - 11.5%	1,946,792	-	1,946,792	-	-	-	-
Loans and advances	7% - 31.45%	10,840,446	-	1,314,462	2,726,718	5,911,499	887,767	-
Other assets	-	525,488	-	269,086	-	83,900	172,502	-
		16,215,407	-	5,352,621	3,077,118	5,995,399	1,790,269	-
<b>Financial liabilities</b>								
Deposits from customers	3.6% - 18%	10,012,172	-	2,713,309	1,661,750	4,156,326	421,240	1,059,547
Loans from local financial institutions	12% - 15%	1,680,000	-	-	400,000	280,000	1,000,000	-
Loans from foreign financial institutions	2% - 7.22%	1,197,200	1,051,200	-	-	-	146,000	-
Loans from government agencies	5.5% - 6%	856,245	-	-	452,500	215,320	188,425	-
Other liabilities	-	849,571	-	688,664	-	61,859	99,048	-
		14,595,188	1,051,200	3,401,973	2,514,250	4,713,505	1,854,713	1,059,547
Net financial assets/(liabilities)		1,620,219	(1,051,200)	1,950,648	562,868	1,281,894	(64,444)	(1,059,547)

**XacBank LLC**

**Notes to the financial statements for the year ended 31 December 2003 (continued)**

*As at 31 December 2002*

	Effective interest rate	Total MNT'000	Floating rate instruments MNT'000	Less than three months MNT'000	Fixed rate instruments			
					Three to six months MNT'000	Six months to one year MNT'000	One to five years MNT'000	Over five years MNT'000
<b>Financial assets</b>								
Cash on hand	-	497,393	-	497,393	-	-	-	-
Balances with other banks	6.75% - 12.5%	2,228,751	-	2,228,751	-	-	-	-
Balances with the Bank of Mongolia	-	553,158	-	553,158	-	-	-	-
Investment securities	4.5%	898,060	-	898,060	-	-	-	-
Loans and advances	24.7% - 48.2%	5,401,168	-	1,196,062	1,592,432	1,989,059	308,210	315,405
Amounts due from holding company	13%-14%	101,868	-	-	-	-	101,868	-
Other assets	-	498,463	-	213,254	285,209	-	-	-
		10,178,861	-	5,586,678	1,877,641	1,989,059	410,078	315,405
<b>Financial liabilities</b>								
Placement from financial institutions	18%	400,000	-	400,000	-	-	-	-
Deposits from customers	3.6% - 20.1%	6,180,013	-	4,753,935	219,315	418,963	-	787,800
Loans from local financial institutions	15%	280,000	-	-	-	280,000	-	-
Loans from foreign financial institutions	5.34% - 9.37%	1,153,125	1,012,500	-	-	-	140,625	-
Loans from government agencies	6%	245,000	-	-	245,000	-	-	-
Other liabilities	-	166,790	-	166,790	-	-	-	-
		8,424,928	1,012,500	5,320,725	464,315	698,963	140,625	787,800
Net financial assets/(liabilities)		1,753,933	(1,012,500)	265,953	1,413,326	1,290,096	269,453	(472,395)

**XacBank LLC****Notes to the financial statements for the year ended 31 December 2003 (continued)****(iv) Foreign currency risk**

The Bank is exposed to foreign currency risk through transactions in foreign currencies, primarily in USD. The Bank's management sets limits on the level of exposure by currencies. These limits have been set below the minimum requirements of the Bank of Mongolia.

The Bank's transactional exposures comprise the monetary assets and monetary liabilities that are not denominated in the measurement currency. These exposures are as follows:

	31 December 2003			31 December 2002		
	MNT denominated MNT'000	Foreign currencies MNT'000	Total MNT'000	MNT denominated MNT'000	Foreign currencies MNT'000	Total MNT'000
<b>Financial assets</b>						
Cash on hand	517,222	120,197	637,419	360,539	136,854	497,393
Balances with other banks	36,052	1,107,713	1,143,765	1,511,578	717,173	2,228,751
Balances with the Bank of Mongolia	700,923	420,574	1,121,497	357,618	195,540	553,158
Investment securities	1,946,792	-	1,946,792	898,060	-	898,060
Loans and advances	10,321,670	518,776	10,840,446	4,980,708	420,460	5,401,168
Amounts due from holding company	-	-	-	101,868	-	101,868
Other assets	243,609	281,879	525,488	422,205	76,258	498,463
	13,766,268	2,449,139	16,215,407	8,632,576	1,546,285	10,178,861
<b>Financial liabilities</b>						
Placement from financial institutions	-	-	-	400,000	-	400,000
Deposits from customers	9,382,519	629,653	10,012,172	5,875,807	304,206	6,180,013
Loans from local financial institutions	1,680,000	-	1,680,000	280,000	-	280,000
Loans from foreign financial institutions	-	1,197,200	1,197,200	-	1,153,125	1,153,125
Loans from government agencies	856,245	-	856,245	245,000	-	245,000
Other liabilities	399,500	450,071	849,571	65,554	101,236	166,790
	12,318,264	2,276,924	14,595,188	6,866,361	1,558,567	8,424,928
Net financial assets/(liabilities)	1,448,004	172,215	1,620,219	1,766,215	(12,282)	1,753,933

**XacBank LLC**

**Notes to the financial statements for the year ended 31 December 2003 (continued)**

**27. Fair value information**

As there is no active market for a large part of the Bank's financial instruments, judgement is necessary in estimating fair value, based on current economic conditions and specific risk attributable to the instrument. Based on these estimates, fair value of financial assets and liabilities are considered to not differ significantly from their carrying amount. The following methods and assumptions are used in estimating the fair value of financial instruments:

**(i) Loans and advances**

The fair value of the loan portfolio is based on the credit and interest rate characteristics of each individual loan. The estimation of the provision for loan losses includes consideration of risk premium applicable to various types of loans based on factors such as the current situation of the borrower and collateral obtained. Accordingly, the provision for loan losses is considered a reasonable estimate of the discount required to reflect the impact of the credit risk. The carrying amount of loans is a reasonable estimate of their fair value.

**(ii) Deposits from customers**

For demand deposits and deposits with no defined maturity, fair value is taken to be the amount payable on demand at the balance sheet date. The estimated fair value of fixed-maturity deposits is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. As most of the deposits have original maturity of less than one year and the rates offered by the Bank are similar to the market rate, the carrying amount of deposits is considered to be a reasonable estimate of fair value.

**(iii) Loans from local financial institutions government agency**

These loans mature within one year. Their carrying amount is considered to be a reasonable estimate of fair value.

**(iv) Loans from foreign financial institutions**

Most of the loans bear interest at floating rate. Their carrying amount is considered to be a reasonable estimate of fair value.

**XacBank LLC**

**Notes to the financial statements for the year ended 31 December 2003 (continued)**

**28. Subsequent events**

**(i) Dividend distributions**

Subsequent to the year-end, a MNT200,000,000 dividend was proposed by the Directors to the shareholders existing at 31 December 2003, with MNT199,580,000 in the form of 19,958 new shares issued and MNT420,000 in cash. The new shares were allocated to shareholders so as to cover as much as possible the amount of the dividend to the nearest MNT10,000. The balance was paid by cash.

Subsequent to the year-end, a further MNT62,000,000 dividend was proposed by the Directors to the shareholders existing at 31 December 2003, with MNT61,950,000 in the form of 61,950 new shares issued at par of MNT1,000 and MNT50,000 in cash. The new shares were allocated to shareholders so as to cover as much as possible the amount of the dividend to the nearest MNT1,000. The balance was paid by cash.

These dividend distributions were not recognised in these financial statements except in the calculation of earnings per share (note 22).

**(ii) Share capital contributions**

Subsequent to the year-end, the following capital contributions were made:

- On February 2004, the Bank issued 52,000 new shares at par to the holding company for cash. The Bank received proceeds of MNT520,000,000 for this share issue. To fund this transaction, the holding company issued 40,000 new shares to Tuushin LLC, a company incorporated in Mongolia, for cash of MNT520,000,000.
- On March 2004, the Bank issued 221,960 shares at MNT1,020, MNT20 above par, to the holding company for cash. To fund this transaction, the holding company issued shares to Mercy Corps, a company incorporated in United States of America and Monnis, a company incorporated in Mongolia, for cash.
- On March 2004, the Bank issued 50,000 shares at MNT1,020, MNT20 above par, to Cydan S&C, a company incorporated in Mongolia.

These transactions resulted in issued capital, amounting to MNT4,061,930,000, exceeding the minimum issued capital of MNT4,000,000,000 set out by the Bank of Mongolia. They have not been not recognised in the financial statements.

**29. Corresponding figures**

Certain corresponding figures have been reclassified to conform with the current year's presentation.

Chuluun Ganhuyag  
*Executive Director*

Dugersuren Bat-Ochir  
*Finance and Accounting Division Director*