

XACBANK LLC

**Audited Financial Statements
31st December 2008**

XacBank LLC

**FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

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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
Mr. Bekhbat Sodnom
Mr. Zorigt Namsrayjav
Ms. Erdenejargal Perenley
Mr. Mark Coffey
Ms. Femke Bos
Mr. Jim Anderson
Ms. Teresa Yiu
Ms. Pam Eser
Mr. John Chomel-Doe

CORPORATE SECRETARY : Mr. Batbold Ariyasuren

AUDITORS : Ernst & Young Mongolia Audit LLC
Certified Public Accountants

STATEMENT BY DIRECTOR AND MANAGEMENT

I, Bold Magvan, being one of the directors of XacBank LLC ("the Bank"), and Tuul Baljir being the officer primarily responsible for the financial statements of the Bank, do hereby state that, in our opinion, the accompanying financial statements set out on pages 4 to 76 give a true and fair view of the financial position of the Bank as at 31 December 2008 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Bold Magvan
(Chief Executive Officer)

Tuul Baljir
(Chief Financial Officer)

Ulaanbaatar, Mongolia
Date:

**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 2008 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.

Auditor's 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 auditors' 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 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ERNST & YOUNG MONGOLIA AUDIT LLC
Certified Public Accountants

CHUNG SING PETER YONG
Partner

Ulaanbaatar, Mongolia
Date:

XacBank LLC**INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2008**

	Note	2008 MNT '000	2007 MNT '000
Interest and similar income	3	29,492,642	18,835,462
Interest and similar expenses	4	<u>(14,595,147)</u>	<u>(8,733,018)</u>
Net interest income		14,897,495	10,102,444
Net fees and commissions	5	1,827,634	1,449,839
Other operating income	6	<u>664,697</u>	<u>301,702</u>
Operating income		17,389,826	11,853,985
Operating expenses	7	<u>(12,279,305)</u>	<u>(8,204,746)</u>
Operating profit before credit loss expense		5,110,521	3,649,239
Credit loss expense	8	(1,083,385)	(340,290)
Grant income	21	118,421	69,100
Grant expenses	21	(118,421)	(69,100)
Profit before tax		<u>4,027,136</u>	<u>3,308,949</u>
Income tax expense	9	<u>(859,573)</u>	<u>(417,180)</u>
Profit for the year attributable to equity holders of the Bank		<u>3,167,563</u>	<u>2,891,769</u>

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

XacBank LLC**BALANCE SHEET AS AT 31 DECEMBER 2008**

	Note	2008 MNT '000	2007 MNT '000
ASSETS			
Cash and short term funds	11	7,488,261	5,529,661
Due from banks	12	24,287,029	23,913,044
Financial investments	13	7,972,388	1,675,587
Loans and advances to customers	14	149,639,706	101,197,164
Other assets	15	4,095,404	1,513,616
Property, plant and equipment	16	12,462,885	9,104,375
Intangible assets	17	2,023,990	494,198
TOTAL ASSETS		207,969,663	143,427,645
LIABILITIES			
Due to customers	18	76,982,135	63,352,051
Due to banks	19	5,269,224	14,581,140
Borrowed funds	20	100,795,074	51,450,730
Deferred grants	21	102,157	114,058
Other liabilities	22	839,606	636,801
Repurchase agreement	23	1,701,174	-
Tax payable		278,758	16,735
Deferred tax liabilities	24	105,394	47,553
TOTAL LIABILITIES		186,073,522	130,199,068
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK			
Ordinary shares	25	10,947,830	8,034,200
Share premium	25	2,594,922	8,551
Other reserves	26	5,185,768	2,293,999
Retained profits		3,167,621	2,891,827
TOTAL EQUITY		21,896,141	13,228,577
TOTAL EQUITY AND LIABILITIES		207,969,663	143,427,645

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

XacBank LLC

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2008**

		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 2007		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	26	-	-	1,241,207	(1,241,207)	-
Dividends	10	-	-	-	(531,945)	(531,945)
At 31 December 2007		8,034,200	8,551	2,293,999	2,891,827	13,228,577
Profit for the year		-	-	-	3,167,563	3,167,563
Transfer to other reserves	26	-	-	2,891,769	(2,891,769)	-
Issue of share capital	25	2,913,630	2,586,371	-	-	5,500,001
At 31 December 2008		<u>10,947,830</u>	<u>2,594,922</u>	<u>5,185,768</u>	<u>3,167,621</u>	<u>21,896,141</u>

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

XacBank LLC**CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2008**

	2008	2007
	MNT '000	MNT '000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit before tax	4,027,136	3,308,949
<i>Adjustments for:-</i>		
Depreciation of property, plant and equipment (Note 16)	864,960	633,456
Amortisation of intangible assets (Note 17)	140,676	97,851
Credit loss for loans and advances to customers (Note 8)	1,073,647	291,628
Credit loss for other receivables (Note 8)	9,738	48,662
Unrealised foreign exchange loss/(gain)	90,345	(66,845)
Loss on disposal of property, plant and equipment	17,019	13,668
Gain on disposal of intangible assets	(11,000)	-
Gain on disposal of financial investment - held for trading	(171,005)	-
Amortisation of deferred grants (Note 21)	(118,421)	(69,100)
Operating profit before working capital changes	<u>5,923,095</u>	<u>4,258,269</u>
<i>Changes in operating assets:-</i>		
Loans and advances to customers	(49,606,534)	(41,071,862)
Other assets	(2,480,471)	(139,856)
<i>Changes in operating liabilities:-</i>		
Due to customers	13,630,084	20,422,162
Due to banks	(9,311,916)	10,500,181
Other liabilities	202,805	149,913
Cash used in operations	<u>(41,642,937)</u>	<u>(5,881,193)</u>
Income tax paid	(539,709)	(593,610)
Net cash flow used in operating activities	<u>(42,182,646)</u>	<u>(6,474,803)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of financial investments	(38,535,347)	(131,054,422)
Proceeds from disposal of financial investment - held for trading	637,656	-
Proceeds from maturity of financial investments	31,771,895	129,379,335
Proceeds on disposal of property, plant and equipment	338,079	20,874
Proceeds on disposal of intangible assets	39,000	-
Purchase of property, plant and equipment	(4,754,623)	(1,812,679)
Purchase of intangible assets	(1,633,468)	(196,533)
Net cash flow used in investing activities	<u>(12,136,808)</u>	<u>(3,663,425)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from repurchase agreement	1,701,174	-
Proceeds from issuance of ordinary shares	5,500,001	-
Proceeds from drawdown of borrowed funds	52,151,131	23,027,290
Repayment of borrowed funds	(2,806,787)	(1,730,160)
Deferred grants received	106,520	22,529
Dividends paid	-	(532,081)
Net cash flow generated from financing activities	<u>56,652,039</u>	<u>20,787,578</u>
Net increase in cash and cash equivalents	2,332,585	10,649,350
Cash and cash equivalents brought forward (Note 27)	29,442,705	18,793,355
Cash and cash equivalents carried forward (Note 27)	<u>31,775,290</u>	<u>29,442,705</u>

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

XacBank LLC

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2008

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 TenGer Financial Group LLC (*formerly known as XAC-GE LLC*) which is incorporated in Mongolia. The shareholders of the holding company are:

- Mercy Corps
- Tuushin LLC
- EIT Capital Management LLC
- International Finance Corporation
- European Bank for Reconstruction and Development
- Triodos Fair Share Fund
- Stichting Triodos Doen
- Shorecap International LTD
- MicroVest 1, LP
- Open Society Forum
- Rotary Club of Ulaanbaatar
- Mongolian Women's Federation
- Ganhuyag Ch. Hutagt
- Liberal Women's Intellectual Pool
- Cydan SCC

These financial statements of the Bank for the year ended 31 December 2008 were authorised for issue by the Board of Directors in accordance with a resolution of the directors on 31 March 2009.

2. ACCOUNTING POLICIES

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board (IASB).

The financial statements have been prepared under the historical cost basis, except for available-for-sale, held for trading investments and derivative financial instruments 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 (MNT'000), 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 loss

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, software under development 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 TenGer Financial Group LLC's (*formerly known as XAC-GE LLC*) 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 IAS, IFRS and IFRIC interpretations during the year.

- * IAS 39 - Financial Instruments: Recognition and Measurement and IFRS 7: Financial Instruments: Disclosures - Reclassification of Financial Assets (Amendments)
- * IFRIC 11 - IFRS 2 - Group and Treasury Share Transactions
- * IFRIC 12 - Service Concession Arrangements
- * IFRIC 14 - IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their interactions

The adoption of the above Amendment to IFRS and IFRIC interpretations did not result in significant changes to accounting policies and did not have any effect on the financial performance or position of the Bank.

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

- * IAS 1 - Presentation of Financial Statements (Revised)
- * IAS 23 - Borrowing Costs (Revised)
- * IAS 27 - Consolidated and Separate Financial Statements - Cost of an Investment in a Subsidiary Jointly Controlled Entity or Associate (Amendment)
- * IAS 27 - Consolidated and Separate Financial Statements (Amendment)
- * IAS 32 - Financial Instruments: Presentation - Amendments relating to puttable instruments and obligations arising on liquidation
- * IAS 39 - Financial Instruments: Recognition and Measurement - Eligible Hedged Items (Amendment)
- * IAS 39 - Financial Instruments: Recognition and Measurement - Amendments for embedded derivatives when reclassifying financial instruments
- * IFRS 1 - First-time Adoption of International Financial Reporting Standards - Costs of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (Amendment)
- * IFRS 2 - Share-based payments - Vesting Conditions and Cancellations (Amendment)
- * IFRS 3 - Business Combinations (Revised)
- * IFRS 7 - Financial Instruments: Disclosures - Amendments enhancing disclosures about fair value and liquidity risk
- * IFRS 8 - Operating Segments
- * IFRIC 13 - Customer Loyalty Arrangements
- * IFRIC 15 - Agreements for the Construction of Real Estate
- * IFRIC 16 - Hedges of a Net Investment in a Foreign Operation
- * IFRIC 17 - Distributions of Non-Cash Assets to Owners
- * IFRIC 18 - Transfers of Assets from Customers

Improvement to International Financial Reporting Standards which includes:

- * IFRS 5 - Non-current Assets Held for Sale and Discontinued Operations
- * IAS 1 - Presentation of Financial Statements
- * IAS 16 - Property, Plant and Equipment

2.3 CHANGE IN ACCOUNTING POLICIES (CONTD.)

- * IAS 19 - Employee Benefits
- * IAS 20 - Accounting for Government Grants and Disclosure of Government Assistance
- * IAS 23 - Borrowing Costs
- * IAS 27 - Consolidated and Separate Financial Statements
- * IAS 28 - Investments in Associates
- * IAS 29 - Financial Reporting in Hyperinflationary Economies
- * IAS 31 - Interest in Joint Ventures
- * IAS 36 - Impairment of Assets
- * IAS 38 - Intangible Assets
- * IAS 39 - Financial Instruments - Recognition and Measurement
- * IAS 40 - Investment Property
- * IAS 41 - Agriculture

The directors anticipate that the adoption of these Standards, Amendment to IFRSs and Interpretations in the future periods will have no material impact on the financial statements of the Bank.

2.4 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed as follows:

1 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.

2 Depreciation of buildings

Buildings are depreciated on a straight line basis over the estimated useful life of 40 years even though the lease period of the land on which the buildings are on are shorter than 40 years. By virtue of the Law of Mongolia on Land, the Bank enjoys the rights to request for extension of the lease period and the authority shall extend the period of lease subject to certain conditions being met. The management believes that the Bank have met the conditions set consistently and for the purpose of depreciation of buildings, the Bank estimated that a cumulative lease period of 40 years is reasonable and appropriate.

3. INTEREST AND SIMILAR INCOME

	2008	2007
	MNT '000	MNT '000
Loans and advances from customers	28,300,360	18,225,621
Due from banks	858,523	451,850
Financial investments - held-to-maturity	333,759	157,991
	<u>29,492,642</u>	<u>18,835,462</u>

4. INTEREST AND SIMILAR EXPENSES

	2008	2007
	MNT '000	MNT '000
Due to customers	6,769,421	5,105,057
Due to banks	667,434	79,710
Borrowed funds	7,158,292	3,548,251
	<u>14,595,147</u>	<u>8,733,018</u>

5. NET FEES AND COMMISSION INCOME

	2008	2007
	MNT '000	MNT '000
Fees and commission income:		
Card service fees	156,149	99,762
Deposit accounts maintenance and service fees	231,941	200,487
Loan application fees	1,267,831	984,349
Money transfer fees	179,500	191,019
Other fees income	204,272	116,018
	<u>2,039,693</u>	<u>1,591,635</u>
Less: Fees and commission expenses	(212,059)	(141,796)
	<u>1,827,634</u>	<u>1,449,839</u>

6. OTHER OPERATING INCOME

	2008	2007
	MNT '000	MNT '000
Non-trading foreign exchange - Realised gain	383,609	121,901
Non-trading foreign exchange - Unrealised (loss)/gain	(90,345)	66,845
Rental income	64,736	42,957
Income from penalties	643	309
Gain on disposal of financial investments - held for trading	171,005	-
Other income	135,049	69,690
	<u>664,697</u>	<u>301,702</u>

7. OPERATING EXPENSES

	2008	2007
	MNT '000	MNT '000
Advertising	804,350	357,163
Amortisation of intangible assets (Note 17)	140,676	97,851
Armoured guard and security	540,121	324,579
Business trips	610,551	405,415
Cash collection service	1,992	1,114
Communication	506,713	398,448
Computer expenses	975	3,317
Depreciation of property, plant and equipment (Note 16)	864,960	633,456
Entertainment	617,616	237,525
Insurance expense	39,990	37,509
Loans collection expenses	10,156	9,195
Maintenance of property, plant and equipment	92,995	89,415
Membership and audit expenses	109,172	109,712
Other operating expenses	527,699	488,915
Personnel expenses *	5,903,150	3,895,200
Rental expenses	632,702	445,609
Stationery	271,303	220,260
Transportation and fuel supplies	409,228	307,510
Utilities	194,956	142,553
	<u>12,279,305</u>	<u>8,204,746</u>

* Personnel expenses

Salaries, incentives and allowances	5,110,787	3,196,840
Contribution to social and health fund	570,085	615,891
Amortisation of contribution to defined contribution pension pla	36,465	-
Training	185,813	82,469
	<u>5,903,150</u>	<u>3,895,200</u>

8. CREDIT LOSS EXPENSE

	2008 MNT '000	2007 MNT '000
Loans and advances to customers:		
Small business loans	141,045	72,902
Consumer loans	171,874	76,082
SME loans	432,366	43,018
Agricultural loans	94,009	52,172
Wholesale loans	10,166	(4,419)
Mortgage loans	77,755	51,872
Apartment pledged loans	145,232	4,022
Deposit Backed loans	1	(58)
Employee loans	1,199	(3,963)
	<u>1,073,647</u>	<u>291,628</u>
Other receivables	9,738	48,662
	<u>1,083,385</u>	<u>340,290</u>

9. INCOME TAX EXPENSE

	2008 MNT '000	2007 MNT '000
Current income tax:		
Based on results for the year	734,125	369,627
Underprovision of tax in prior year	67,607	-
	<u>801,732</u>	<u>369,627</u>
Deferred tax (Note 24):		
Relating to origination and reversal of temporary differences	57,841	47,553
	<u>859,573</u>	<u>417,180</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% (2007: 10%) for the first MNT3 billion (2007: MNT3 billion) of taxable income, and 25% (2007: 25%) on the excess of taxable income over MNT3 billion (2007: MNT3 billion). Interest income on government bonds is not subject to income tax.

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:

	2008 MNT '000	2007 MNT '000
Profit before tax	<u>4,027,136</u>	<u>3,308,949</u>
Tax at statutory tax rate of 25% (2007: 25%)	1,006,784	827,237
Effect of income subject to lower tax rate	(450,000)	(450,000)
Effect of income not subject to tax	(3,585)	(67,607)
Effect of expenses not allowable for tax purposes	238,767	107,550
Underprovision of tax in prior year	67,607	-
Tax expense for the year	<u>859,573</u>	<u>417,180</u>

9. INCOME TAX EXPENSE (CONTD.)

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

10. DIVIDENDS

	2008 MNT '000	2007 MNT '000
Declared during the year:		
Equity dividends on ordinary shares		
Final dividend for 2007: MNT66.21	-	531,945
	<u> </u>	<u> </u>

11. CASH AND SHORT TERM FUNDS

	2008 MNT '000	2007 MNT '000
Cash and short term funds represented by:		
Local currency	4,589,859	3,026,924
Foreign currencies	2,898,402	2,502,737
	<u>7,488,261</u>	<u>5,529,661</u>

12. DUE FROM BANKS

	2008 MNT '000	2007 MNT '000
Current accounts with the Bank of Mongolia	14,378,543	4,460,431
Placements with other banks and financial institutions	9,908,486	19,452,613
	<u>24,287,029</u>	<u>23,913,044</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 2008, the mandatory reserve required by the Bank of Mongolia was MNT 3.66 billion (2007: MNT 3.73 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

	<-----2008----->			
	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	7,453,722	-	-	7,453,722
Government bond	294,366	-	-	294,366
Equities	-	-	224,300	224,300
	<u>7,748,088</u>	<u>-</u>	<u>224,300</u>	<u>7,972,388</u>

	<-----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>

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 government bond is issued by The Ministry of Finance with maturity less than 9 months, and 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.

14. LOANS AND ADVANCES TO CUSTOMERS

	2008 MNT '000	2007 MNT '000
Small business loans	27,467,306	25,502,486
Consumer loans	33,734,018	21,249,502
SME loans	39,765,684	25,241,193
Agricultural loans	1,104,047	3,643,386
Wholesale loans	1,237,969	412,009
Mortgage loans	37,683,780	19,230,651
Apartment pledged loans	3,888,022	2,840,579
Deposit backed loans	3,554,711	2,182,297
Employee loans and advances	2,892,588	1,588,314
Gross loans and advances to customers	<u>151,328,125</u>	<u>101,890,417</u>
Less: Allowance for impairment losses	<u>(1,688,419)</u>	<u>(693,253)</u>
	<u>149,639,706</u>	<u>101,197,164</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 2008	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000
At 1 January 2008	276,238	149,019	131,665	67,168	-	57,033	11,007	99	1,024	693,253
Charge for the year	274,403	297,745	488,204	121,896	10,166	86,330	152,210	101	1,580	1,432,634
Impairment written off	(45,497)	(17,770)	-	(15,214)	-	-	-	-	-	(78,481)
Recoveries	(133,358)	(125,872)	(55,838)	(27,887)	-	(8,575)	(6,978)	(99)	(381)	(358,987)
At 31 December 2008	<u>371,786</u>	<u>303,123</u>	<u>564,031</u>	<u>145,963</u>	<u>10,166</u>	<u>134,788</u>	<u>156,239</u>	<u>100</u>	<u>2,223</u>	<u>1,688,419</u>
Specific Impairment	176,538	99,918	561,518	126,423	2,399	15,626	119,012	-	1,212	1,102,646
Collective Impairment	195,248	203,205	2,512	19,541	7,766	119,161	37,228	100	1,011	585,773
	<u>371,786</u>	<u>303,123</u>	<u>564,031</u>	<u>145,963</u>	<u>10,166</u>	<u>134,788</u>	<u>156,239</u>	<u>100</u>	<u>2,223</u>	<u>1,688,419</u>
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	<u>246,750</u>	<u>137,564</u>	<u>3,444,446</u>	<u>174,220</u>	<u>23,472</u>	<u>28,997</u>	<u>207,754</u>	<u>-</u>	<u>1,253</u>	<u>4,264,456</u>

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 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	<u>276,238</u>	<u>149,019</u>	<u>131,665</u>	<u>67,168</u>	<u>-</u>	<u>57,033</u>	<u>11,007</u>	<u>99</u>	<u>1,024</u>	<u>693,253</u>
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
	<u>276,238</u>	<u>149,019</u>	<u>131,665</u>	<u>67,168</u>	<u>-</u>	<u>57,033</u>	<u>11,007</u>	<u>99</u>	<u>1,024</u>	<u>693,253</u>
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	<u>54,315</u>	<u>-</u>	<u>80,578</u>	<u>17,395</u>	<u>-</u>	<u>7,718</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>160,006</u>

The fair value of the collateral that the Bank holds relating to loans individually determined to be impaired at 31 December 2008 amounts to MNT 7,376 million (2007: MNT 887 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 35 .

15. OTHER ASSETS

	2008	2007
	MNT '000	MNT '000
Other receivables	401,089	279,406
Less: Allowance for impairment losses	(57,283)	(49,760)
	<u>343,806</u>	<u>229,646</u>
Foreclosure properties	-	3,436
Less: Allowance for impairment losses	-	(3,436)
	<u>-</u>	<u>-</u>
Prepaid expenses	2,719,308	828,617
Consumables and other inventories	921,775	455,353
Property held for sale	110,515	-
	<u>4,095,404</u>	<u>1,513,616</u>
Allowance for impairment losses of other receivables		
At 1st January	49,760	2,393
Charge for the year	10,610	49,074
Amount written off	(2,215)	(1,295)
Amount written back	(872)	(412)
At 31st December	<u>57,283</u>	<u>49,760</u>

16. PROPERTY, PLANT AND EQUIPMENT

31 December 2008	Buildings MNT '000	Furniture, fixtures and vehicles MNT '000	Computers MNT '000	Renovation MNT '000	Capital work-in- progress MNT '000	Total MNT '000
At Cost						
At 1 January 2008	5,097,776	2,037,529	2,152,719	-	1,744,877	11,032,901
Additions	135,842	1,121,333	1,396,954	78,080	2,022,414	4,754,623
Disposals	(261,642)	(151,732)	(98,723)	-	-	(512,097)
Write-offs	-	(4,746)	(35,228)	-	(32,622)	(72,596)
Transfer	2,542,945	109,712	104,028	-	(2,932,740)	(176,055)
At 31 December 2008	<u>7,514,921</u>	<u>3,112,096</u>	<u>3,519,750</u>	<u>78,080</u>	<u>801,929</u>	<u>15,026,776</u>
Accumulated Depreciation						
At 1 January 2008	341,076	536,361	1,051,089	-	-	1,928,526
Charge for the year (Note 7)	147,343	263,069	454,548	-	-	864,960
Disposals	(25,306)	(68,335)	(97,806)	-	-	(191,447)
Write-offs	-	(3,423)	(34,725)	-	-	(38,148)
At 31 December 2008	<u>463,113</u>	<u>727,672</u>	<u>1,373,106</u>	<u>-</u>	<u>-</u>	<u>2,563,891</u>
Net Book Value	<u>7,051,808</u>	<u>2,384,424</u>	<u>2,146,644</u>	<u>78,080</u>	<u>801,929</u>	<u>12,462,885</u>

16. PROPERTY, PLANT AND EQUIPMENT (CONTD.)

31 December 2007	Buildings MNT '000	Furniture, fixtures and vehicles MNT '000	Computers MNT '000	Capital work-in- progress MNT '000	Total 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>

17. INTANGIBLE ASSETS

31 December 2008	Software and Licenses MNT '000	Patents and Rights MNT '000	Software Under Development MNT '000	Total MNT '000
At Cost				
At 1 January 2008	610,874	49,783	-	660,657
Addition	90,452	3,163	1,539,853	1,633,468
Disposals	-	(30,000)	-	(30,000)
Transfer	-	65,000	-	65,000
At 31 December 2008	<u>701,326</u>	<u>87,946</u>	<u>1,539,853</u>	<u>2,329,125</u>
Accumulated Amortisation				
At 1 January 2008	163,715	2,744	-	166,459
Charge for the year (Note 7)	138,437	2,239	-	140,676
Disposals	-	(2,000)	-	(2,000)
Reclassification	(185)	185	-	-
At 31 December 2008	<u>301,967</u>	<u>3,168</u>	<u>-</u>	<u>305,135</u>
Net Book Value	<u>399,359</u>	<u>84,778</u>	<u>1,539,853</u>	<u>2,023,990</u>

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>

18. DUE TO CUSTOMERS

	2008	2007
	MNT '000	MNT '000
Current accounts	10,622,799	11,761,026
Demand deposits	19,105,900	16,402,620
Time deposits	47,253,436	35,188,405
	<u>76,982,135</u>	<u>63,352,051</u>

19. DUE TO BANKS

	2008	2007
	MNT '000	MNT '000
Deposits from local banks	4,103,840	14,581,140
Deposits from foreign banks	1,165,384	-
	<u>5,269,224</u>	<u>14,581,140</u>

20. BORROWED FUNDS

	2008	2007
	MNT '000	MNT '000
Borrowed funds from foreign financial institutions		
<i>Unsecured:</i>		
International Finance Corporation	6,509,980	292,512
Dexia Micro Credit Fund	3,855,369	-
Calvert Social Investment Foundation, Inc	1,544,045	840,136
ASN-Novib Fonds	9,026,972	2,987,058
Oikocredit Ecumenical Development Cooperative Society U.A	7,305,190	4,080,874
Shorecap International Ltd	-	439,178
Stichting Triodos Doen	2,236,461	2,870,179
Triodos Fair Share Fund	3,203,948	3,583,259
BlueOrchard Finance S.A.	14,133,551	13,480,502
DB-Global Commercial Microfinance Consortium, Ltd	5,393,480	4,766,988
DWM Securitizations S.A.	2,535,396	2,334,554
European Bank for Reconstruction and Development	5,146,844	5,918,162
Netherland Development Finance Company	11,897,731	5,756,281
Monarch Community Fund LLC	640,304	-
Finethic Microfinance	1,277,809	-
Credit Suisse Microfinance Fund Management Company	3,843,460	-
responsAbility SICAV (Lux)	6,542,992	-
Dual Return Fund S.I.C.A.V.	3,881,221	-
KfW, Frankfurt am Main	1,826,495	-
	<u>90,801,248</u>	<u>47,349,683</u>

20. BORROWED FUNDS (CONTD.)

	2008 MNT '000	2007 MNT '000
Borrowed funds from BOM and government agencies		
<i>Unsecured:</i>		
Employment Generation Support Fund	1,101,409	500,940
Micro Finance Development Fund	833,642	550,779
Rural Poverty Reduction Program	2,460,829	2,120,522
Ministry of Trade and Industry	1,439,454	858,563
Ministry of Finance and Japan Bank for International Cooperation	451,382	70,243
	<u>6,286,716</u>	<u>4,101,047</u>
	<u>97,087,964</u>	<u>51,450,730</u>
Subordinated loans from KfW, Frankfurt am Main	<u>3,707,110</u>	-
Totals	<u>100,795,074</u>	<u>51,450,730</u>

International Finance Corporation ("IFC")

The loans obtained from International Finance Corporation comprise the following:

- (i) USD 400,000, which bears interest at a rate of 6.62% (2007: 8.89%) 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.
- (ii) USD 5,000,000, which bears interest at a rate of 6.6% per annum. The loan was obtained in 2008 to finance the Bank's micro finance and SME lending activities. The loan will be fully repaid in December 2013.

Dexia Micro Credit Fund ("DMCF")

The Bank obtained the promissory note in 2008 for a principal amount of USD 3,000,000 to finance micro-finance and SME lending activities. The note bears interest at a rate of 7.25% per annum and will be fully repaid in April 2011.

Calvert Social Investment Foundation, Inc ("CSIF")

The loan obtained from CSIF is in the form of promissory notes issued by the CSIF for a principal amount of USD 700,000 and USD 500,000. The note was obtained in 2004, 2005, 2006 and 2008 respectively to finance the bank's micro-finance and SME lending activities. The notes bear interest at a rate of 6.0% and 6.3% (2007: 6%) per annum and will be fully repaid in December 2012.

20. BORROWED FUNDS (CONTD.)

ASN-Novib Fonds

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

- (i) USD 2,500,000, which bears interest at a rate of 7.75% per annum. The loan was obtained in 2008 to support further expansion of the Bank's micro-finance and SME lending activities. The loan will be fully repaid in December 2012.
- (ii) USD 4,500,000, which bears interest at a rate of 7.75% per annum. The loan was obtained in 2008 to support further expansion of the Bank's micro-finance and SME lending activities. The loan will be fully repaid in May 2012.
- (iii) MNT 584,000,000, which bears interest at a rate of 12.5% (2007: 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 was fully repaid in December 2008.
- (iv) USD 1,000,000, which bears interest at a rate of 8.5% (2007: 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 was fully repaid in December 2008.
- (v) USD 1,000,000, which bears interest at a rate of 8.5% (2007: 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 was fully repaid in December 2008.

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, bears interest at a rate of 12% (2007: 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 was fully settled during the year.
- (ii) USD 1,500,000, which bears interest at a rate of 6.4% (2007: 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.
- (iii) USD 500,000, which was converted to MNT 582,000,000 and bears interest at a rate of 9.5% (2007: 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.

20. BORROWED FUNDS (CONTD.)

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

- (iv) USD 1,000,000, which was converted to MNT 1,183,310,000, bears interest at a rate of 9.5% (2007: 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
- (v) USD 1,500,000, which bears interest at a rate of 7.0% per annum. The loan was obtained in 2008 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in six equal semi-annual instalments of USD 250,000 each commencing February 2011 and will be fully settled in August 2013.
- (vi) EURO 1,300,000, which bears interest at a rate of 6.91% per annum. The loan was obtained in 2008 to finance the Bank's micro-finance and SME lending activities for the duration of 3 years.

Shorecap International Ltd ("SCI")

The loan obtained from SCI, amounting to USD 500,000, bears interest at a rate of 9% (2007: 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. The loan was fully settled during the year.

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% (2007: 12%) per annum. The loan was obtained in 2005 to finance the expansion of Bank's lending activities. The loan was fully settled during the year.
- (ii) MNT 1,000,000,000, which bears interest at a rate of 12% (2007: 12%) 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% (2007: 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% (2007: 9%) per annum. The loan was obtained in 2005 to finance the expansion of Bank's lending activities. The loan was fully settled during the year.

20. BORROWED FUNDS (CONTD.)

Triodos Fair Share Fund (contd.)

- (ii) USD 500,000, which bears interest at a rate of 8.5% (2007: 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% (2007: 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% (2007: 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, bears interest at a rate of 12% (2007: 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 loans obtained from DB-Global Commercial Microfinance Consortium, Ltd. comprise of the following:

- (i) The loan obtained from DBGC, amounting to MNT 4,672,000,000, bears interest at a rate of 9.25% (2007: 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.
- (ii) The loan obtained from DBGC, amounting to USD 500,000, which was converted to MNT 613,575,000 bears interest at a rate of 9.25% per annum. The loan was obtained in 2008 to finance the Bank's micro-finance and small-medium enterprise lending activities. The loan will be fully repaid in October 2010.

DWM Securitizations S.A. ("DWMS")

The loan obtained from DWMS, amounting to USD 2,000,000, bears interest at a rate of 8.25% (2007: 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.

20. BORROWED FUNDS (CONTD.)

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 6.11% (2007: 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 6.11% (2007: 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 loans obtained from FMO comprise of the following:

- (i) USD 5,000,000, which was converted to MNT 5,850,450,000, bears interest at a rate of 11.4% (2007: 11%). 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.
- (ii) USD 5,000,000, which was converted to MNT 5,859,150,000, bears interest at a rate of 11.4% per annum. The loan was obtained in 2008 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.

Monarch Community Fund, LLC

The loan obtained from Monarch Community Fund, amounting to USD 500,000, bears interest at rate of 6.0% per annum. The loan was obtained in 2008 to finance the bank's micro-finance and SME lending activities. The loan will be fully repaid in April 2011.

Finethic Microfinance

The loan obtained from Finethic Microfinance is in the form of promissory note issued by the foundation for a principal amount of USD 1,000,000. The note was obtained in 2008 to increase the liquidity and expansion of the bank's microfinance and small medium enterprise lending activities. The note bears interest at rate of 7.5% per annum and will be fully repaid in May 2013.

20. BORROWED FUNDS (CONTD.)

Credit Suisse Microfinance Fund Management Company

The loans obtained from Credit Suisse Microfinance Fund Management Company is in the form of promissory notes and comprise of the following:

- (i) USD 2,000,000, which bears interest at rate of 7.5% per annum. The note was obtained in 2008 to increase the liquidity and working capital of the Bank and will be fully repaid in July 2013.
- (ii) USD 1,000,000, which bears interest at rate of 7.5% per annum. The note was obtained in 2008 to increase the liquidity and working capital of the Bank and will be fully repaid in August 2013.
- (iii) USD 2,000,000, which bears interest at rate of 7.5% per annum. The note was obtained in 2008 to increase the liquidity and working capital of the Bank and will be fully repaid in June 2013.

responsAbility SICAV (Lux)

The loans obtained from responsAbility SICAV (Luv) is in the form of promissory notes and comprise the following:

- (i) USD 1,000,000, which bears interest at rate of 7.5% per annum. The note was obtained in 2008 to increase the liquidity and working capital of the Bank and will be fully repaid in July 2013.
- (ii) USD 2,000,000, which bears interest at rate of 7.5% per annum. The note was obtained in 2008 to increase the liquidity and working capital of the Bank and will be fully repaid in August 2013.

Dual Return Fund SICAV

The loans obtained from Dual Return Fund SICAV is in the form of promissory notes and comprise the following:

- (i) USD 1,000,000, which bears interest at rate of 7.5% per annum. The note was obtained in 2008 to increase the liquidity and working capital of the Bank and will be fully repaid in May 2013.
- (ii) USD 2,000,000, which bears interest at rate of 7.5% per annum. The note was obtained in 2008 to increase the liquidity and working capital of the Bank and will be fully repaid in August 2013.

20. BORROWED FUNDS (CONTD.)

KfW, Frankfurt am Main ("KfW")

The loan obtained from KfW, amounting to USD 1,371,508 equivalent of EUR 900,000, bears interest at 3.25% above USD LIBOR per annum with maximum interest rate to be capped at 8.0% per annum. The loan was obtained in 2008 to assist the development of the micro and small business sector in Mongolia, to improve low income person's living situation, to promote the urban development by financing housing projects, to strengthen the bank's equity basis and refinancing situation for business expansion and for the financing of consulting services to improve the banks risk management with respect to its microfinance lending business. The loan will be fully repaid in July 2017.

Employment Generation Support Fund

The loans obtained from Ministry of Social Welfare and Labour comprise of the following:

- (i) Mongolian Tugrug amounting to MNT 200,000,000, which bears interest at a rate of 0.8% per annum. The loan was obtained in 2007 to assist fresh graduated students to start-up new business. The loan will be fully repaid in Aug 2009.
- (ii) Mongolian Tugrug amounting to MNT 900,000,000, which bears no interest. The loan was obtained in 2008 to assist herders and unemployed people to start or expand their business.

Micro Finance Development Fund

The loans obtained from World Bank comprise of the following:

- (i) USD 359,000, which bears interest at rate of 8.0% (2007: 8.0%) per annum. The loan was obtained in 2006 to support and improve the living standard of inhabitant in the rural areas. The loan is payable on a monthly basis with principal repayment commencing June 2008 and final repayment due in March 2009 in accordance with the repayment schedule.
- (ii) MNT 722,500,000, which bears interest at rate of 8.1% per annum. The loan was obtained in 2008 to support and improve the living standard of inhabitant in the rural areas. The loan is payable on a monthly basis and final repayment due in July 2011 in accordance with the repayment schedule.

20. BORROWED FUNDS (CONTD.)

Rural Poverty Reduction Program

The Bank obtained this loan from International Fund for Agricultural Development to 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 2008. It bears interest at a rate of 6% (2007: 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% (2007: 1.2%) per annum. The loan was obtained in 2006 and due in November 2008. However, the loan was then further extended and will be due and fully repaid in May 2009.
- (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.
- (iii) MNT 572,080,000, which bears interest at a rate of 1.2% per annum. The loan was obtained in 2008 and will be due and fully repaid in Dec 2009.

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

The Bank obtained MNT 379.2 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.

Subordinated convertible loans from KfW, Frankfurt am Main ("KfW")

The Bank received USD 2,747,230 equivalent of EUR 1,800,000 under a 10-year subordinated convertible loan from KfW during the year. The subordinated convertible loan bears interest at 5% above USD LIBOR relating to each interest period with maximum interest rate to be capped at 9.0% per annum.

20. BORROWED FUNDS (CONTD.)

Subordinated convertible loans from KfW, Frankfurt am Main ("KfW") (contd.)

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 TenGer Financial Group LLC (formerly known as 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 TenGer Financial Group 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 TenGer Financial Group LLC and shall not exceed 20% of the aggregate share capital of TenGer Financial Group 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.

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

21. DEFERRED GRANTS

	2008	2007
	MNT '000	MNT '000
Consultative Group to Assist the Poorest ("CGAP")	57,528	48,368
International Finance Corporation ("IFC")	2,336	5,666
United States Agency for International Development ("USAID")	42,293	60,024
	<u>102,157</u>	<u>114,058</u>

Movements in the deferred grants are as follows:

	2008	2007
	MNT '000	MNT '000
Balance at beginning of year	114,058	160,629
Received during the year	106,520	22,529
Amortised during the year	(118,421)	(69,100)
Balance at end of year	<u>102,157</u>	<u>114,058</u>

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

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

21. DEFERRED GRANTS (CONTD.)

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 the Bank 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 CGAP grant which was received in 2008 was a technology program project with the objective of assisting the bank to carry out the following activities:

- Develop and manage a cash-handling agent network in rural areas beyond the bank's branch network;
- Market cell phone payments and savings products accessible to customers via those agent locations;
- Develop products and marketing methods for people who live in dispersed sparsely populated areas;
- Cooperate with World Bank's research of the project

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

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

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

Expenditure financed by grants:

Donor and Purpose	2008 MNT '000	2007 MNT '000
• Expenditure financed by grants from "CGAP" covering meeting and training fee and franchising fee	22,837	42,518
• Expenditure financed by grants from "CGAP" covering mobile banking service fees	26,528	-
• Expenditure financed by grants from MIGP covering purchasing of accounting program	17,790	14,825
• Expenditure financed by grants from IFC covering meeting and training fee	5,250	1,667
• Expenditure financed by grants from BlueOrchard covering conference fee	4,863	2,425

21. DEFERRED GRANTS (CONTD.)

	2008	2007
	MNT '000	MNT '000
• Expenditure financed by grant from Western Union covering training fee	21,384	2,308
• Expenditure financed by grant from Shorecap International Ltd. covering meeting and training fee	2,444	5,357
• Expenditure financed by grants from Microsave India Foundation covering meeting and training fee	2,281	-
• Expenditure financed by grant from EBRD covering conference and training fee	15,044	-
	<u>118,421</u>	<u>69,100</u>

22. OTHER LIABILITIES

	2008	2007
	MNT '000	MNT '000
Delay on clearing settlement	41,686	88,974
Other payables	796,907	546,814
Dividends payable	1,013	1,013
	<u>839,606</u>	<u>636,801</u>

23. REPURCHASE AGREEMENT

As part of the repurchase agreement, the Bank has sold The Bank of Mongolia's bill that it is allowed to repurchase in the future. The bill bears term for 21 days. The fair value of the bill approximate its carrying amount at 31 December 2008.

24. DEFERRED TAX LIABILITIES

	Property, plant and equipment	Property, plant and equipment
	2008	2007
	MNT '000	MNT '000
At 1 January	47,553	-
Recognised in income statement (Note 9)	57,841	47,553
At 31 December	<u>105,394</u>	<u>47,553</u>

25. ORDINARY SHARES

	Number of Ordinary Shares of MNT1,000 each		Amount	
	2008	2007	2008 MNT '000	2007 MNT '000
At 1 January	8,034,200	8,034,200	8,034,200	8,034,200
Issued during the year	2,913,630	-	2,913,630	-
At 31 December	<u>10,947,830</u>	<u>8,034,200</u>	<u>10,947,830</u>	<u>8,034,200</u>

On 15 August 2008 and 10 September 2008, the Bank issued 2,913,630 numbers of ordinary shares at an issue price of MNT 1,887.68 per share. As a result the share premium account increased by MNT 2,586 million to MNT 2,594 million for year ended 31 December 2008.

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.

26. OTHER RESERVES

During the year the Board of Directors approved the transfer of MNT 2,891,768,740 (2007: MNT 1,241,206,394) 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.

27. CASH AND CASH EQUIVALENTS

	2008 MNT '000	2007 MNT '000
Cash and short term funds (Note 11)	7,488,261	5,529,661
Due from banks (Note 12)	24,287,029	23,913,044
	<u>31,775,290</u>	<u>29,442,705</u>

28. EMPLOYEE BENEFITS

Equity Compensation Benefits

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

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

28. EMPLOYEE BENEFITS (CONTD.)

Equity Compensation Benefits

The number of shares offered for sale and its price will be determined at the discretion of the Bank's Board of Directors. In 2008, EIT LLC allotted 28,086 shares of MNT 1,000 each (2007: 85,708) 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.

29. 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 35.3 'Liquidity risk and funding management' for the Bank's contractual undiscounted repayment obligations.

At 31 December 2008	Less than 12 months MNT 'million	More than 12 months MNT 'million	Total MNT 'million
Financial assets			
Cash and short term funds	7,488	-	7,488
Due from banks	24,287	-	24,287
Financial investments	7,748	224	7,972
Loans and advances to customers	84,478	65,162	149,640
Other receivables	344	-	344
	124,345	65,386	189,731
Non financial assets			
Property, plant and equipment	-	12,463	12,463
Intangible assets	-	2,024	2,024
Other assets	3,182	569	3,751
	3,182	15,056	18,238
Total	127,527	80,442	207,969
Financial liabilities			
Due to customers	57,906	19,076	76,982
Due to banks	5,269	-	5,269
Borrowed funds	10,083	90,712	100,795
Other liabilities	566	274	840
Repurchased agreement	1,701	-	1,701
	75,525	110,062	185,587
Non financial liabilities			
Deferred grants	78	24	102
Tax payable	279	-	279
Deferred tax liabilities	-	105	105
	357	129	486
Total	75,882	110,191	186,073
Net	51,645	(29,749)	21,896

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

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	14,542	63,352
Due to banks	14,581	-	14,581
Borrowed funds	9,168	42,283	51,451
Other liabilities	558	79	637
	<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>

30. RELATED PARTY DISCLOSURES

The Bank is controlled by TenGer Financial Group LLC (formerly known as XAC-GE LLC) (incorporated in Mongolia). TenGer Financial Group 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.

	2008	2007
	MNT '000	MNT '000
(a) Compensations to key management personnel		
- Salaries, incentives and allowances	559,294	299,321
- Contribution to social and health fund	61,122	56,871
	<u>620,416</u>	<u>356,192</u>
(b) Loans to key management personnel	<u>432,523</u>	<u>193,824</u>
Repayable		
- within one year	89,420	44,204
- one year to five years	147,461	26,725
- over five years	195,642	122,895
	<u>432,523</u>	<u>193,824</u>
The loans to Bank's employees bear interest rates ranging from 5% to 12% (2007 : 5% to 12%) per annum.		
(c) Loans from shareholders of TenGer Financial Group LLC		
Shorecap International Ltd	-	439,178
Stichting Triodos Doen	2,236,461	2,870,179
Triodos Fair Share Fund	3,203,948	3,583,259
International Finance Corporation ("IFC")	6,509,980	292,512
European Bank for Reconstruction and Development	5,146,844	5,918,162
	<u>17,097,233</u>	<u>13,103,290</u>
(d) Loan interest paid to shareholders of TenGer Financial Group LLC	<u>1,515,618</u>	<u>522,089</u>
(e) Deposits from corporate shareholders	<u>8,236,264</u>	<u>3,423,192</u>
(f) Due to holding company		
-Current account	130	61,778
-Demand deposit	514,454	608
-Time deposit	752,947	593,000
	<u>1,267,531</u>	<u>655,386</u>

30. RELATED PARTY DISCLOSURES (CONTD.)

	2008 MNT '000	2007 MNT '000
(g) Security fees paid to fellow Subsidiary Company		
- XacSecurity LLC	530,610	278,836
(h) Deposits from fellow Subsidiary Companies		
- XacSecurity LLC	15,670	5,969
- XacLeasing LLC	9,809	116,081
- Horus Nomadic Solutions LLC	47,808	-
	<u>73,287</u>	<u>122,050</u>
(i) Deposit interest paid to holding and fellow Subsidiary Companies		
- TenGer Financial Group LLC	188,341	22,250
- XacSecurity LLC	210	123
- XacLeasing LLC	2,734	2,715
- Horus Nomadic Solutions LLC	306	-
	<u>191,591</u>	<u>25,088</u>
(j) Dividend paid to holding company		
- TenGer Financial Group LLC	-	530,783
(k) Loan to fellow subsidiary companies		
- XacLeasing LLC	761,433	-
- XacSecurity LLC	-	5,772
	<u>761,433</u>	<u>5,772</u>
(l) Interest income from fellow subsidiary companies		
- XacLeasing LLC	42,204	-
- XacSecurity LLC	369	224
	<u>42,573</u>	<u>224</u>
(m) Commission income from fellow subsidiary company		
- XacLeasing LLC	6,265	-
(n) Contract fee paid to a fellow subsidiary company		
- Horus Nomadic Solutions LLC	68,565	-

31. 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.

	2008 MNT '000	2007 MNT '000
Contingent liability		
Letter of credit	782,370	201,231

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.

Commitments

Undrawn commitments to lend	2,143,972	960,377
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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

	2008 MNT '000	2007 MNT '000
Approved and contracted for:		
Property, plant and equipment	1,509,121	361,736
Capital contribution to a related company	173,919	-
	<u>1,683,040</u>	<u>361,736</u>

31. CONTINGENT LIABILITIES AND COMMITMENTS (CONTD.)

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.

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.

32. SIGNIFICANT AND SUBSEQUENT EVENTS

On 31 December 2008, the Bank signed a paid up capital agreement to acquire 10% equity interest in MCC Mol-Bulak Finance LLC, a micro credit company incorporated in Kyrgyz Republic for a consideration of SOM 5,493,139 (MNT173.9 million equivalent). The acquisition was completed on 21 January 2009.

33. 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.

33. CAPITAL ADEQUACY (CONTD.)

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:

	2008	2007
Core capital ratio	13.24%	11.08%
Risk weighted capital ratio	15.49%	11.08%
	2008	2007
	MNT '000	MNT '000
<u>Tier I capital</u>		
Statutory fund	10,947,830	8,034,200
Share premium	2,594,922	8,551
Other reserves	5,185,768	2,293,999
Retained profits	3,167,621	2,891,827
Less: Held for trading equities *	-	(466,651)
Total Tier I capital	21,896,141	12,761,926
<u>Tier II capital</u>		
Subordinated loans	3,707,110	-
Total capital /capital base	25,603,251	12,761,926

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

	2008		2007	
	MNT '000		MNT '000	
%	Assets	Risk Weighted	Assets	Risk Weighted
0	29,614,891	-	10,974,728	-
20	10,612,512	2,122,502	19,489,669	3,897,934
50	16,279,845	8,139,922	7,540,256	3,770,128
100	155,055,507	155,055,507	107,957,596	107,957,596
Total	211,562,754	165,317,931	145,962,249	115,625,658
Less: Held for trading equities *	-	-	-	(466,651)
	211,562,754	165,317,931	145,962,249	115,159,007

* Held for trading equities represents investments in TenGer Financial Group LLC (formerly known as XAC-GE LLC), the Bank's holding company in year 2007.

34. 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 2008 MNT '000	Fair value 2008 MNT '000	Unrecognised gain/ (loss) 2008 MNT '000	Carrying value 2007 MNT '000	Fair value 2007 MNT '000	Unrecognised gain/ (loss) 2007 MNT '000
<i>Financial assets</i>							
Cash and short term funds	11	7,488,261	7,488,261	-	5,529,661	5,529,661	-
Due from banks	12	24,287,029	24,287,029	-	23,913,044	23,913,044	-
Financial investments - available-for-sale	13	224,300	224,300	*	224,300	224,300	*
Financial investments - held for trading	13	-	-	-	466,651	466,651	-
Financial investments - held-to-maturity	13	7,748,088	7,748,088	-	984,636	984,636	-
Loans and advances to customers	14	149,639,706	147,148,132	(2,491,574)	101,197,164	100,612,952	(584,212)
Other receivables	15	343,806	343,806	-	229,646	229,646	-
<i>Financial liabilities</i>							
Due to customers	18	76,982,135	76,982,135	-	63,352,051	63,352,051	-
Due to banks	19	5,269,224	5,269,224	-	14,581,140	14,581,140	-
Borrowed funds	20	100,795,074	100,879,342	84,268	51,450,730	51,341,994	(108,736)
Other payables	22	839,606	839,606	-	636,801	636,801	-
Repurchased agreement	23	1,701,174	1,701,174	-	-	-	-
<i>Total unrecognised change in unrealised fair value</i>				(2,407,306)	(692,948)		

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

34. 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.

35. RISK MANAGEMENT

35.1 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;

35. RISK MANAGEMENT (CONTD.)

35.1 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.

Consolidated Risk Management Division ("CRMD")

The CRMD has direct accountability for identifying, measuring, monitoring, and managing the daily financial positions and market risk. It is also primarily responsible for the credit portfolio risk, liquidity risk and operational 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.

35. RISK MANAGEMENT (CONTD.)

35.1 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.

35. RISK MANAGEMENT (CONTD.)

35.1 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.

35.2 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.

35. RISK MANAGEMENT (CONTD.)

35.2 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.

	Notes	Gross maximum exposure 2008 MNT'000	Gross maximum exposure 2007 MNT'000
Cash and short term funds	11	7,488,261	5,529,661
Due from banks	12	24,287,029	23,913,044
Financial investments - available-for-sale	13	224,300	224,300
Financial investments - held-to-maturity	13	7,748,088	984,636
Financial investments - held for trading	13	-	466,651
Loans and advances to customers	14	149,639,706	101,197,164
Total		189,387,384	132,315,456
Contingent liabilities	31	782,370	201,231
Commitments - undrawn commitments to lend	31	2,143,972	960,377
Other commitments	31	1,683,040	361,736
Total		4,609,382	1,523,344
Total credit risk exposure		193,996,766	133,838,800

35. RISK MANAGEMENT (CONTD.)

35.2 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.

	2008		2007	
	Gross Maximum Exposure		Gross Maximum Exposure	
	Amount	%	Amount	%
	MNT'000		MNT'000	
Textile and production	12,605,417	8.3%	3,996,338	3.9%
Trading	38,694,654	25.6%	31,464,842	30.9%
Food processing	1,464,604	1.0%	1,459,718	1.4%
Services	14,672,106	9.7%	13,376,842	13.1%
Consumption	33,734,018	22.3%	22,837,814	22.4%
Agricultural	1,366,204	0.9%	3,254,177	3.2%
Mortgage	37,683,780	24.9%	20,013,495	19.6%
Deposit backed	3,554,711	2.3%	2,179,510	2.1%
Construction and education	4,660,043	3.1%	1,701,290	1.7%
Loans to staff	2,460,065	1.6%	1,412,567	1.4%
Loans to key management personnel	432,523	0.3%	193,824	0.2%
Total	151,328,125	100.0%	101,890,417	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.

35. RISK MANAGEMENT (CONTD.)

35.2 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.

35. RISK MANAGEMENT (CONTD.)

35.2 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 2008	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	-	-	-	-	7,488,261	-	7,488,261
Due from banks	12	-	-	-	-	24,287,029	-	24,287,029
Loans and advance to customers								
Small Business Loans		11,955,512	64,576	14,692,292	-	-	754,926	27,467,306
Consumer Loans		13,283,991	25,244	19,999,567	-	-	425,216	33,734,018
SME Loans		5,850,677	1,577,408	27,988,353	418,793	-	3,930,453	39,765,684
Agricultural Loans		490,887	10,953	340,644	-	-	261,563	1,104,047
Wholesale Loans		277,159	-	926,582	-	-	34,228	1,237,969
Mortgage Loans		301,675	214,122	36,475,635	573,068	-	119,280	37,683,780
Apartment Pledged Loans		969,312	-	2,631,147	-	-	287,563	3,888,022
Deposit Backed Loans		3,554,711	-	-	-	-	-	3,554,711
Employee Loans		418,290	2,468,781	-	-	-	5,517	2,892,588
	14	37,102,214	4,361,084	103,054,220	991,861	-	5,818,746	151,328,125
Financial investments - available-for-sale	13	-	-	-	-	224,300	-	224,300
Financial investments - held-to-maturity	13	-	-	-	-	7,748,088	-	7,748,088
Total		37,102,214	4,361,084	103,054,220	991,861	39,747,678	5,818,746	191,075,803

35. RISK MANAGEMENT (CONTD.)

35.2 Credit risk (Contd.)

Credit quality per class of financial assets (Contd.)

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

35. RISK MANAGEMENT (CONTD.)

35.2 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 2008	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	187,505	137,654	62,081	120,935	508,175
Consumer Loans	121,987	82,998	26,535	56,131	287,651
SME Loans	100,763	161,037	103,802	120,405	486,007
Agricultural Loans	17,797	16,293	11,588	41,665	87,343
Wholesale Loans	10,756	-	-	-	10,756
Mortgage Loans	25,638	27,214	-	37,432	90,284
Apartment Pledged Loans	26,648	42,795	10,367	-	79,810
Employee Loans	4,264	-	-	-	4,264
	<u>495,358</u>	<u>467,991</u>	<u>214,373</u>	<u>376,568</u>	<u>1,554,290</u>

35. RISK MANAGEMENT (CONTD.)

35.2 Credit risk (Contd.)

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

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
Employee Loans	708	-	110	620	1,438
	<u>255,378</u>	<u>57,588</u>	<u>72,824</u>	<u>470,993</u>	<u>856,783</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 2008 was MNT 4,911 million (2007: MNT 2,368 million). Please refer Note 14 for more detailed information with respect to allowance for impairment losses on loans and advances to customers.

35. RISK MANAGEMENT (CONTD.)

35.2 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.

	2008 MNT '000	2007 MNT '000
Loans and advances to customers		
Small Business Loans	11,467	6,579
Consumer Loans	4,452	12,376
SME Loans	31,095	-
Mortgage Loans	31,480	31,622
Wholesale Loans	14,601	-
	<u>93,096</u>	<u>50,577</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.

35. RISK MANAGEMENT (CONTD.)

35.2 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.

35.3 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 2008 and 31 December 2007 based on contractual undiscounted repayment obligations. Please refer also note 29 "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.

35. RISK MANAGEMENT (CONTD.)

35.3 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 2008							
Due to customers	29,846,005	11,696,682	10,367,473	8,018,592	12,238,080	20,381,095	92,547,927
Due to banks	-	1,856,710		3,745,892	-	-	5,602,602
Borrowed funds	-	5,362,493	1,478,322	5,381,079	111,349,514	11,299,732	134,871,140
Other liabilities	-	512,066	53,659	240,955	32,926	-	839,606
Total	29,846,005	19,427,951	11,899,454	17,386,518	123,620,520	31,680,827	233,861,275
At 31 December 2007							
Due to customers	29,568,092	9,320,095	7,448,493	5,944,739	6,280,753	10,604,036	69,166,208
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	77,166	1,841	-	636,801
Total	29,568,092	13,917,286	17,268,126	16,245,326	48,198,917	14,595,304	139,793,051

35. RISK MANAGEMENT (CONTD.)

35.3 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
2008							
Contingent liabilities	-	316,421	107,508	358,441	-	-	782,370
Commitments	-	1,141,034	512,347	29,659	-	-	1,683,040
Total	-	1,457,455	619,855	388,100	-	-	2,465,410
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

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

35. RISK MANAGEMENT (CONTD.)

35.4 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 2008 and 31 December 2007.

	Change in basis points	2008 Sensitivity of net interest income MNT'000	2007 Sensitivity of net interest income MNT'000
Floating rate financial assets and liabilities	50 (50)	(167,607) 167,607	(104,378) 104,378

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.

35. RISK MANAGEMENT (CONTD.)

35.4 Market risk (Contd.)

Currency risk (Contd.)

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 on 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:

	Variance/ Covariance MNT'000
2008 - 31 December	8,652
2008 - Average Daily	6,067
2008 - Highest	15,632
2008 - Lowest	287

35. RISK MANAGEMENT (CONTD.)

35.4 Market Risk (Contd.)

Currency risk (contd.)

The table below summarizes the Bank's exposure to foreign exchange risk as December 31, 2008 and December 31, 2007. 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 2008								
Assets								
Cash and short term funds	4,590	2,185	253	-	410	9	41	7,488
Due from banks	6,679	16,217	1,347	1	25	1	17	24,287
Financial investments	7,972	-	-	-	-	-	-	7,972
Loans and advances to customers	89,576	59,012	1,051	-	1	-	-	149,640
Other receivables	206	138	-	-	-	-	-	344
	<u>109,023</u>	<u>77,552</u>	<u>2,651</u>	<u>1</u>	<u>436</u>	<u>10</u>	<u>58</u>	<u>189,731</u>
Liabilities								
Due to customers	65,841	10,439	338	-	361	3	-	76,982
Due to banks	5,269	-	-	-	-	-	-	5,269
Borrowed funds	31,545	66,927	2,323	-	-	-	-	100,795
Repurchase agreement	1,701	-	-	-	-	-	-	1,701
Other liabilities	689	147	-	-	4	-	-	840
	<u>105,045</u>	<u>77,513</u>	<u>2,661</u>	<u>-</u>	<u>365</u>	<u>3</u>	<u>-</u>	<u>185,587</u>
Net position	<u>3,978</u>	<u>39</u>	<u>(10)</u>	<u>1</u>	<u>71</u>	<u>7</u>	<u>58</u>	<u>4,144</u>

35. RISK MANAGEMENT (CONTD.)

35.4 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 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	53,955	9,144	199	-	51	3	-	63,352
Due to banks	14,581	-	-	-	-	-	-	14,581
Borrowed funds	23,979	27,472	-	-	-	-	-	51,451
Other liabilities	493	143	1	-	-	-	-	637
	<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>

35. RISK MANAGEMENT (CONTD.)

35.4 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 MNT '000	Effect on equity MNT '000
At 31 December 2008			
Loans and advances to customers	2.76	63,470	-
At 31 December 2007			
Loans and advances to customers	6.38	81,305	-

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.

36. COMPARATIVES

The following comparative amounts have been reclassified to conform with current year's presentation.

Description of Change	Previously Stated MNT '000	Increase/ (Decrease) MNT '000	Restated MNT '000
<u>Balance Sheet</u>			
Due to customers	63,429,217	(77,166)	63,352,051
Other liabilities	559,635	77,166	636,801

37. 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.