

To: THE STOCKHOLDERS OF X.A.C Co., LTD

Subject: Auditor's report

We have audited the financial statements of X.A.C Co., LTD NBFi for the year ended December 31, 2001. Financial statements preparation and submission is the responsibility of the company management. Our responsibility is to express an opinion on the financial statements based on our auditing.

Our auditing was conducted according to the International Standards on Auditing and pre-planned auditing program in the framework of Auditing and Accounting Law of Mongolia, rules issued by Mongolbank, and other effective legislation. We performed the auditing procedures to obtain reasonable evidence that the financial statements are free from material misstatements, we also evaluated the accounting policies, principles, and internal control systems used to prepare the statements. In addition we considered management decisions, their implementation and examined significant estimates on a test basis. We hope that auditor's findings and checked amounts could become a reasonable basis to express an opinion on the above-mentioned financial statements and we are expressing our opinion as follows.

The financial statements of X.A.C Co., LTD Non-Bank Financial Institution present fairly, in all material respects, the financial position, operating results, changes in financial position, and cash flows of the company for the year ended December 31, 2001 in accordance with the accounting standards followed in Mongolia and rules issued by Mongolbank.

NIMM Audit Co., LTD

X.A.C CO., LTD
NON BANK FINANCIAL INSTITUTION
STATEMENT OF PROFIT AND LOSS
For the years ended December 31, 2000 and 2001
(In togros)

	Note	Dec 31, 2000	Dec 31, 2001
Interest income		348,424,152.16	896,237,967.75
Interest expense		(7,298,533.00)	(125,159,007.55)
Net interest income	12	341,125,619.16	771,078,960.20
Gain \loss\ on foreign currency trading and exchange rate difference	13	2,314,626.38	139,014.69
Other operating income	14	13,551,824.72	32,083,438.07
Total other income		15,866,451.10	32,222,452.76
Operating income		356,992,070.26	803,301,412.96
Operating expense	15	(303,038,425.36)	(602,377,162.80)
Income before provisions for contingent loss		53,953,644.90	200,924,250.16
Provisions for contingent loss		(7,263,088.99)	(21,423,506.28)
Income before income tax		46,690,555.91	179,500,743.88
Income tax expense	16	(13,311,800.00)	(62,866,365.79)
Net income		33,378,755.91	116,634,378.09

X.A.C CO., LTD
NON BANK FINANCIAL INSTITUTION
STATEMENT OF CHANGES IN EQUITY
For the year ended December 31, 2001
(In togrogs)

	Share capital	Secondary payable	<u>Reserve fund</u>	Retained earnings	Total equity
Balances as December 31, 2000	180,000,000.00	-	-	86,901,338.95	266,901,338.9
Issued shares	1,656,000,000.00	-	-	-	1,656,000,000.0
Transferred from the UNDP Funding	120,000,000.00	560,000,000.00	100,000,000.00		780,000,000.0
Transferred from the secondary payable	560,000,000.00	(560,000,000.00)		-	
Allocation of previous period retained earnings:					
Stock dividends	48,000,000.00	-		(48,000,000.00)	
Allocated to Reserve fund	-	-	38,901,338.95	(38,901,338.95)	
Decrease in reserve fund			(106,100,000.00)		(106,100,000.00)
Net income for the current period				116,634,378.09	116,634,378.0
Stock dividends allocated from the net income for the current period	140,000,000.00			(140,000,000.00)	
Allocation of reserve fund	-	-	(23,365,621.91)	23,365,621.91	

Balances as December 31, 2001	2,704,000,000.00	-	9,435,717.04	-	2,713,435,717.0
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X.A.C CO., LTD
NON BANK FINANCIAL INSTITUTION
STATEMENT OF CASH FLOWS
For the year ended December 31, 2001
(In togrogs)

	<u>Subtotal</u>	<u>Total</u>
Income before income tax		179,500,744
Adjustment:		
Fixed asset depreciation	56,016,592	
Provisions for contingent loss	18,625,041	
Interest income	(896,237,968)	
Interest expenses	125,159,008	(696,437,327)
Operating income before working capital changes		(516,936,584)
Increase \decrease\ in operating assets		
Loans	(1,685,767,484)	
Other owned assets	(449,449)	
Other assets	(152,245,292)	(1,838,462,226)
Increase \decrease\ in operating liabilities		
Notes payable	250,000,000	
Other liabilities	(8,463,770)	241,536,230
Cash flows used in operating activities		(2,113,862,579)
Interest received	862,817,841	
Interest paid	(118,924,845)	
Payment of income tax	(70,416,552)	
Loans written down to reserve for contingent loss		671,047,078
Net cash flows used in operating activities		(1,442,815,501)
Cash flows from investing activities		
Purchase of fixed assets	(514,520,603)	
Net cash flows used in investing activities		(514,520,603)
Cash flows from financing activities		
Increase in share capital	2,524,000,000	
Increase in reserve fund /net/	9,435,717	
Increase in short term loans from other banks	250,000,000	
Decrease in long terms liabilities	(661,204,637)	

Dividends distributed	(188,000,000)	
Net cash flows provided by financing activities		1,934,231,080
Net cash flows		(23,105,023)
Cash and cash equivalents, beginning of the year		339,227,862
Cash and cash equivalents, ending of the year		362,332,885

X.A.C Co., LTD
NON BANK FINANCIAL INSTITUTION
DISCLOSURE TO THE FINANCIAL STATEMENTS
As December 31, 2000 and 2001
(in thousand togrogs)

1. ORGANIZATION AND OPERATION

The Micro-Start Mongolia Program was started as a result of a contract between the Government of Mongolia and UNDP with the aim to develop the micro-finance market and eliminate poverty in Mongolia. X.A.C was first established in September 1998 as an organization of the second phase to implement the project

During the trial phase until September 1999, X.A.C rendered financial services to entrepreneurs and offered small amounts of loan to increase living standards of low-income families through the project implementation units of socia-oriented Non Government Organizations such as the Mongolian Women’s Federation (MWF) and Liberal Women’s Brain Pool (LWBP).

To unify the operations of these project implementation units, Micro-Start Mongolia decided to establish an independent non-bank financial institution, and approved the Charter of X.A.C Co., LTD on the 23rd of August 1999. Six non governmental organizations the Mongolian Women’s Federation, Liberal Women’s Brain Pool, National Association of Mongolian Agricultural Cooperatives (NAMAC), Local Governance Development Fund (LGDF), Mongolian Foundation for Open Society (Soros Fund), and Ulaanbaatar-Rotary Club became initial shareholders of the company.

X.A.C Co., LTD received a special permission to conduct loan operations from Mongolbank on the 16th of September 1999 and started its operation officially as registered at the State Registration Office on the 20th of September 1999.

X.A.C Co., LTD was rendering five types of loan services named Start, Growth, Family, Development, and Employee to individuals and legal entities through the loan units and branches. There are 6 branches in Ulaanbaatar, one each in Sainshand and Airag soums of Dornogobi aimag, one in centers of Hentii, Darhan-Uul, Uverhangai, Selenge, Gobisumber, Orhon, Arhangai, Zavhan, Darhan-Uul aimags respectively.

X.A.C Co., LTD and its shareholders merged with Goviin Ekhlel Co., LTD, a non-bank financial institution, to form a holding company named XAC-GE Group. Further they decided to establish XacBank with 100 percent investment and concluded a Letter of Intent on the 20th of August 2001 and a Merger Contract on the 1st of October 2001.

According to the contract, X.A.C Co., LTD became an operating company and took all assets and liabilities of Goviin Ekhlel Co., LTD on the 25th of December 2001.

Disclosure to the financial statements-Continued
(in thousand togrogs)

1. ORGANIZATION AND OPERATION (continued)

XAC-GE Group Ltd., was given permission to establish a bank, and its subsidiary XacBank Ltd., was given permission to conduct banking operations and a Banking certificate (number 24) by the Decree No. 610 of the President of Mongolbank dated December 27, 2001. As a result, it was newly registered at the State Registration and the beginning balance sheet of XacBank Ltd., was prepared as December 31, 2001.

2. CORE PRINCIPLES OF PREPARING THE FINANCIAL STATEMENTS

The financial statements are prepared in accordance with the accounting principles followed in Mongolia and the accounting principles of non-bank financial institutions issued by Mongolbank.

3. MAIN ACCOUNTING POLICIES

The company prepared its financial statements based on the following accounting policies.

a) Interest income and expense

Interest incomes and expenses are recorded on accrual basis.

b) Service charges and fees

Service charges and fees are recognized when cash is paid.

c) Fine income

Fine income is calculated from an overdue loan by 0.2 percent in case of infringing the loan payback period and recognized as an income when cash is paid.

d) Loans

Loans are expressed in the financial statements at the net amount deducting the reserve for contingent loan loss from loans given to business entities and individuals.

Disclosure to the financial statements-Continued
(in thousand togogs)

To classify loans and estimate reserve for contingent loan loss, it uses following policies and procedures issued by the management.

Loan classification	Ö.Ä.Ñ Co., LTD		Mongolbank	
	Criteria	Perc	Criteria	Perc
Normal loan				
Standard loan	-	1%	-	1%
Re-scheduled loan	Extended	25%	-	1%
Non-qualitative loan				
Over due loan	1-30 days	1%	1-90 days	1%
Abnormal loan	31-60 days	25%	91-180 days	25%
Doubtful loan	61-90 days	50%	181-360 days	50%
Bad loan	over 91 days	100%	over 360 days	100%

e) Fixed assets

Fixed assets are reported in the financial statements at the net amount, which is the historical cost less accumulated depreciation. The cost of assets is recorded at the sum total of the purchase price, other incidental expenses incurred for acquisition of assets and the cost of capital improvement of fixed assets.

Assets are depreciated under the straight-line method based on useful lives of assets. The depreciation method is different from the method stipulated in the Corporate Income Tax Law of Mongolia.

Useful lives of fixed assets are as follows:

Types of fixed assets	Useful lives	
	Ö.Ä.Ñ Co., LTD	Income Tax Law
Building	25	40
Furniture and fixture	5	10
Computer	3	10
Vehicles	5	10

f) Other assets

Accrued interest receivables, prepaid expenses, advances to employees, materials and supplies are classified and reported as other assets.

g) Foreign currency translation

Transactions in foreign currencies are recorded at that currency, and at the same time translated into Mongolian togrog using the exchange rate stated by Mongolbank on the date of the transaction.

Disclosure to the financial statements-Continued
(in thousand togrogs)

Cash balances, receivables, and payables in foreign currencies are translated in Mongolian togrog using the official exchange rate on the balance sheet date.

Cash balances, receivables, and payables in foreign currencies are restated and translated each time when the official exchange rate is changed during the accounting period and related foreign currency translation gains and losses are recognized.

Gains and losses incurred from foreign currency purchases and sales or trading are reported as foreign currency trading loss and gain.

4. CASH

Categories of cash	Dec 31, 2000	Dec 31, 2001
A. Cash on hand in domestic currency	5,864.4	51,213.8
in foreign currency	2,451.5	724.4
	<u>8,315.9</u>	<u>51,938.2</u>
B. Current accounts at other commercial banks		
in domestic currency	21,254.4	168,156.9
in foreign currency	11,316.6	62,008.5
	<u>32,571.0</u>	<u>230,165.4</u>
C. Cash deposits at other commercial banks		
in domestic currency	680.3	80,206.9
in foreign currency	297,660.6	22.4
	<u>298,340.9</u>	<u>80,229.3</u>
Total cash	339,227.8	362,332.9

5. LOANS

Loans classification	Dec 31, 2000	Dec 31, 2001
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	Loan	Reserve	Loan	Reserve
Standard loan	938,889.0	(9,388.9)	2,622,465.6	(26,224.6)
Re-scheduled loan	1,715.4	(428.8)	1,542.6	(385.6)
Non-qualitative loan				
Over due loan	1,515.1	(15.2)	900.1	(9.0)
Abnormal loan	242.9	(60.7)	121.0	(30.3)
Doubtful loan	1,383.3	(691.7)	3,969.6	(1,984.8)
Bad loan	570.7	(570.7)	1,085.0	(1,085.0)
Total	944,316.4	(11,156.0)	2,630,083.9	(29,719.3)

Disclosure to the financial statements-Continued
(in thousand togrogs)

6. OTHER OWNED ASSETS

	Dec 31, 2000		Dec 31, 2001	
	O.O.Assets	Reserve	O.O.Assets	Reserve
Normal	756.7	(7.6)	643.5	(6.4)
Abnormal	-	-	239.0	(59.7)
Doubtful	75.0	(37.5)	388.7	(194.4)
Bad	135.0	(135.0)	144.9	(144.9)
Total	966.7	(180.1)	1,416.1	(405.4)

7. FIXED ASSETS

Fixed asset classification	Dec 31, 2000		Dec 31, 2001	
	His. Cost	Accum. Dep	His. Cost	Accum. Dep
Building	35,663.6	(153.8)	266,760.0	(2,729.7)
Vehicles	10,260.0	(684.0)	106,303.1	(20,435.2)
Furniture & fixture	32,504.9	(7,432.2)	78,524.8	(17,651.3)
Computer	83,855.8	(30,788.9)	246,815.2	(70,210.8)
Expenditure related With fixed assets	336.2	-	-	-
Total	162,620.5	(39,058.9)	698,403.1	(111,027.0)

8. OTHER ASSETS

	Dec 31, 2000	Dec 31, 2001
Receivables	1,919.7	87,114.6
Prepaid accounts	7,161.5	7,236.9
Advances to employees	-	371.9
Materials	2,929.6	13,895.6

Supplies	6,546.5	10,213.9
Prepaid income taxes	-	5,191.3
Deferred income tax assets	-	12,827.2
Accrued interest receivables	28,199.5	61,619.6
Total	46,756.8	198,471.0

9. LONG TERM LIABILITIES

	Dec 31, 2000	Dec 31, 2001
A. Long term loan from the foreign bank	438,800.0	438,800.0
B. Funding from UNDP	690,419.4	3,716.3
C. CGAP payable	-	55,083.5
D. MSM project	-	1,486.2
Total	1,129,219.4	499,086.0

Disclosure to the financial statements-Continued (in thousand togrogs)

A. X.A.C Co., LTD took a convertible loan in the amount of 438,800.0 thousand togrogs from Triodos Doen, Holland to expand its loan portfolio.

The annual interest rate is 18 percent and interest is estimated from the principal amount converted to togrog. At the end of the quarters, interest amounts in togrog are converted to US Dollars by an official rate and are paid. For the current period interest of 78,984.0 thousand togrog was paid.

B. Income and expenditure of UNDP Funding for the year 2001 are as follows:

	(in togrogs)
	Amounts
Beginning funding of UNDP, January 01, 2001	690,419,396.58
Funding for the current period	97,111,704.75
	<u>787,531,101.33</u>
Allocation:	
- Allocated to the stockholders for owning the stocks of X.A.C Co., LTD	(380,000,000.00)
- Allocated to Reserve fund	(100,000,000.00)
- Allocated to employees for conditional owning the stocks	(300,000,000.00)
- Returned to UNDP	(3,814,803.36)
Unallocated balances, December 31, 2001	<u>3,716,297.97</u>

C. It was decided to provide a special conditional grant of 95.0 thousand US dollars to XacBank for expanding its operation as a result of agreement between the

International Bank for Reconstruction and Development for the Consultative Group to assist the Poorest and X.A.C Co., LTD.

The first part of the financing of 49,985 US dollars (equal to 55,083.5 thousand togros) was recorded as secondary payable.

10. OTHER LIABILITIES

	Dec 31, 2000	Dec 31, 2001
Payables	33,685.9	20,487.6
Social insurance payable	582.2	4,283.5
Withholding tax payable	1,243.4	2,306.6
Income tax payable	2,358.9	-
Deferred income tax payable	3,114.1	3,114.1
Accrued interest payable	7,240.2	6,841.7
Total	48,224.7	37,033.5

Disclosure to the financial statements-Continued **(in thousand togros)**

11. SHARE CAPITAL

Transactions of share capital of X.A.C Co., LTD are as follows:

	(in togros)
	Common stock
Beginning balance, as January 01, 2001	180,000,000
Issued shares	160,000,000
Transferred from UNDP financing /Memo of May 03, 2001/	120,000,000
Transferred from the secondary payable /Memo of Oct 08, 2001/	260,000,000
Stock dividends allocated from previous Retained earnings	48,000,000
Stock dividends allocated from current Retained earnings	140,000,000
Issued stocks for the secondary payable transferred to GE	300,000,000
Issued stocks for the reverse fund transferred to GE	100,000,000
Issued stocks for the assets transferred from GE	935,930,436
Issued stocks for the notes payable	350,000,000
Issued stocks for cash	110,069,564
Ending balance, as December 31, 2001	2,704,000,000

XAC-GE Group Ltd., owns 100 percent of these 270400 shares (par value of 10,000 togros or total 2,704.0 million togros) as of December 31, 2001.

12. NET INTEREST INCOME

	2000	2001
Interest income		
Interest income on loans	329,965.6	887,177.8
Interest income from other banks	18,458.5	9,060.2
	<u>348,424.1</u>	<u>896,238.0</u>
Interest expenses on notes payable	-	(37,550.0)
Interest expenses paid to other banks	(7,298.5)	(87,609.0)
	<u>(7,298.5)</u>	<u>(125,159.0)</u>
Net interest income	341,125.6	771,079.0

13. FOREIGN CURRENCIES TRADING & EXCHANGE RATE DIFFERENCE

	2000	2001
Gain on trading of foreign currencies	212.9	303.4
Loss on trading of foreign currencies	(115.0)	(185.0)
	97.9	118.4
Gain on exchange rate of foreign currencies	3,501.2	1,078.0
Loss on exchange rate of foreign currencies	(1,284.5)	(1,057.4)
	<u>2,216.7</u>	<u>20.6</u>
Net gain (or loss) on trading and exchange rate difference of foreign currencies	2,314.6	139.0

Disclosure to the financial statements-Continued (in thousand togrogs)

14. OTHER OPERATING INCOME

	2000	2001
Service charges and fees	8,754.6	29,719.9
Fine income	2,294.6	-
Other income	2,502.6	2,363.5
Total	13,551.8	32,083.4

15. OPERATING EXPENSES

	2000	2001
Payroll expense	(101,454.5)	(183,649.3)
Social insurance expense	(22,129.7)	(41,237.9)
Payroll of non staffs and voluntary persons	(12,190.5)	(15,247.8)
Training expenses	(2,415.3)	(5,078.9)
Business trip	(22,104.3)	(35,379.9)

Allowances	(14,517.6)	(30,381.7)
Finance charge	(8,111.7)	(2,800.3)
Insurance	(1,274.0)	(1,665.0)
Auditing fees	(3,195.6)	(3,970.2)
Advertisement	(2,920.5)	(8,536.6)
Depreciation of fixed assets	(24,854.8)	(56,016.6)
Rental and utility expenses	(22,856.9)	(61,575.0)
Ordinary maintenance of fixed assets	(7,535.0)	(32,995.1)
Stationary expenses	(10,709.5)	(28,748.6)
Armored guard and security	-	(6,315.2)
Communication	(12,358.9)	(34,093.6)
Entertainment	(9,324.3)	(10,115.0)
Transportation and fuel supply	(10,329.4)	(18,972.9)
Subscriptions	(314.5)	(722.4)
Current expenses of automation	(4,969.7)	(15,618.9)
Sanitary expenses	(757.0)	(1,341.2)
Uniforms	(1,050.6)	(10.3)
Cash collection expenses	-	(469.8)
Client training expense	(1,856.2)	(4,063.6)
Other	(5,807.9)	(3,371.4)
Total	(303,038.4)	(602,377.2)

Disclosure to the financial statements-Continued
(in thousand togrogs)

16. INCOME TAX EXPENSES

According to the Mongolian tax legislation the company pays 15% income tax on the taxable income up to 100.0 million togrogs and 40% tax on the income in excess of that amount.

Taxable income of the company was 248,336.3 thousand togrogs and it was imposed income tax amounts of 75,693.6 thousand togrogs for the year 2001.

As a result of different depreciation policies for fixed assets, depreciation expense amounts of 32,068.0 thousand togrogs was imposed tax of 12,827.2 thousand togrogs. This 12,827.2 thousand togrogs were recorded in Deferred tax asset accounts. Remaining taxes (75,693.6-12,827.2) were recorded as tax expenses for the period.

17. RATIOS OF FINANCIAL PERFORMANCE

a) Quick ratio

As required by the Mongolbank a quick ratio should not be less than 10 percent. This ratio of the company was 35.2 percent in domestic and foreign currencies as December 31, 2001.

b) Capital adequacy

A risk weighted ratio of the first-class equity to total assets should not be less than 4 percent, a ratio of total equity to total assets should not be less than 8 percent as required by Mongolbank. These two ratios of the company are 81.96 percent as December 31, 2001.

c) Concentration risk ratio on loans

- The sum of the loans, guarantees, and letters of credit provided to a borrower and related parties must not exceed 20 percent of total equity according to the requirement of Mongolbank. This ratio of the company was about 11.0 percent as December 31, 2001.

- The sum of loans, guarantees, and letters of credit provided to shareholders, employees, and their related parties must not exceed 20 percent of total equity, for a single person, it must not exceed 5 percent of the equity according to the requirement of Mongolbank. This ratio of the company was 0.55 percent as December 31, 2001.