



AG BANK
Agricultural Bank of Mongolia

Annual Report

2002

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AG BANK'S MISSION

To be the principal nationwide provider of financial services in Mongolia, by delivering first class products with the highest level of customer service.



OUR COMMITMENT TO CUSTOMERS

Ag Bank values and respects our customers. We adhere to the following policies on confidentiality and transparency:

- ❖ All employees of Ag Bank Offices shall serve customers equally and openly without any discrimination as to age, race, sex, occupation, official position, economic status, religion or party membership.
- ❖ Ag Bank employees shall not favor customers because they are friends or relatives, nor shall they have any financial interest in customers or receive any payments, gifts or other benefits from them.
- ❖ Neither Ag Bank nor any employee shall accept or pay bribes under any circumstances with any person or organization.
- ❖ Bank employees shall not use any information on customer accounts, deposits or transactions for personal gain nor disclose such information to any individual or other entity except as provided by law or as required by execution of a court decision.
- ❖ No bank employee shall process any transactions from customer accounts or deposits without the consent of the customer, nor suspend such transactions except as required by an official notification from a tax officer, social insurance officer, bailiff or other official acting in a legal capacity.

Ag Bank customers may request the freely available full version of the Confidentiality Policy from any of the Bank's offices. Any person who is disadvantaged by an Ag Bank employee who has violated these policies should call the office of the CEO in Mongolian or English at 45 78 80 or email directly to info@magicnet.mn

CEO'S MESSAGE



The year 2002 was extraordinary for customers, employees, our owner and the other stakeholders of Agricultural Bank of Mongolia.

In August 2000 Ag Bank was wholly owned by the Government of Mongolia, and after years of accumulated losses it was in receivership and for all practical purposes shut down. In that month your Independent Board and a Management Team, supplied by Development Alternatives, Inc. (DAI) took control of the Bank under a unique remediation program funded by the U.S. Agency for International Development. Under agreements among USAID, the World Bank, the Bank of Mongolia and the Government our mandates were: 1) to restore banking services in rural Mongolia, 2) to return the Bank to profitability and sound financial condition and 3) to prepare the Bank for privatization. These objectives now have been achieved.

To date we have made 520,000 loans to small businesses, herders, consumers and pensioners, with 56% of the total volume in soum offices in the most rural areas. We have opened over 210,000 new current accounts, and overall deposits have grown from MNT 10 billion to 52 billion .

In 2002 the Bank earned MNT 3255 million before tax and MNT 1880 million after tax. Cumulatively over the past two years Ag Bank has paid MNT 1935 million to the Government as income taxes and retained another MNT 2763 million in capital. The Bank in 2002 was the second most profitable bank in Mongolia and the most profitable in terms of return on average assets (4.91%) and average equity (52.3%)

Our balance sheet is now strong and liquid. Capital at December 31 was MNT 3595 million, or 11.99% of adjusted risk assets, meeting all Bank of Mongolia regulatory requirements. Cash and short term investments were 19.9 billion, almost 40% of total assets.

The third objective, privatization of the Bank, was achieved in early 2003. H.S. Securities of Tokyo, part of the Hideo Sawada group of companies, acquired Ag Bank through an international tender for US\$ 6,850,000. We welcome our new owner to the Ag Bank family and look forward to considerable synergies and joint promotion of trade and investment between Mongolia and Japan.

I am also pleased to advise that DAI has been retained by our new owners to continue to manage Ag Bank, and your Chief Operating Officer Debra Boyer and I will stay on in our current roles. Our superb Mongolian executives and managers also will remain on our team.

As part of our rapid expansion of services to Mongolia we have opened 87 new offices, and our network of 356 offices now reaches every aimag and virtually every soum in the country. We have added over 700 staff, mostly in the countryside, and now employ over 1500 at Ag Bank. We have a comprehensive training program for all employees, with over 12,000 person days of training completed to date. We are proud of the strong and capable staff who have led our success.

Customers all over Mongolia have responded positively to our new marketing initiatives. At the end of 2000 we re-branded the Bank as "XAAH БААК" in Mongolian and "AG BANK" in English. Recent independent surveys show that 94% of Mongolians know our name and 80% are satisfied with our service.

A personal note: my past two and a half years at Ag Bank have been the experience of a lifetime. Together with Debra Boyer and our Mongolian executives Sukhbold, Enkhtur, Delgermaa and Zandanshatar and our managers throughout the country, we have built a company that we are very proud of. Restoring important banking services to Mongolians all over the countryside has been especially gratifying. Now we look forward to a new era in the private sector and to working even harder for our customers, employees and owners.

As we end this turnaround phase, I would like to thank the Government of Mongolia and Bank of Mongolia for all of their assistance to our efforts; the US Embassy and USAID who provided us funding and strong support, and the World Bank and other donors who also played a vital role. Most of all, thanks to our customers throughout Mongolia who have come back to Ag Bank in large numbers, and to my 1500 colleagues at Ag Bank who proved that it could be done.

J. Peter Morrow

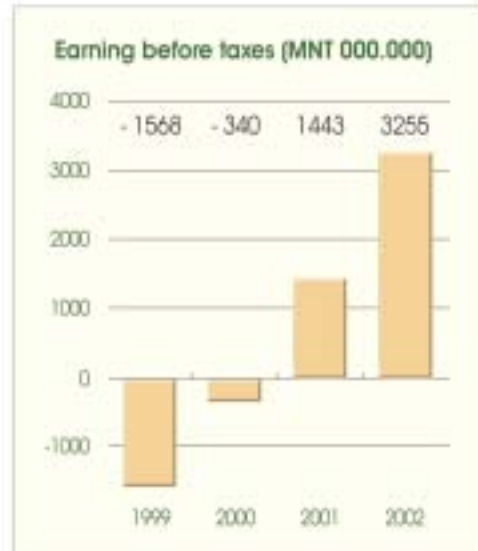


Chief Executive Officer
April 14, 2003

FINANCIAL HIGHLIGHTS

PROFITABILITY

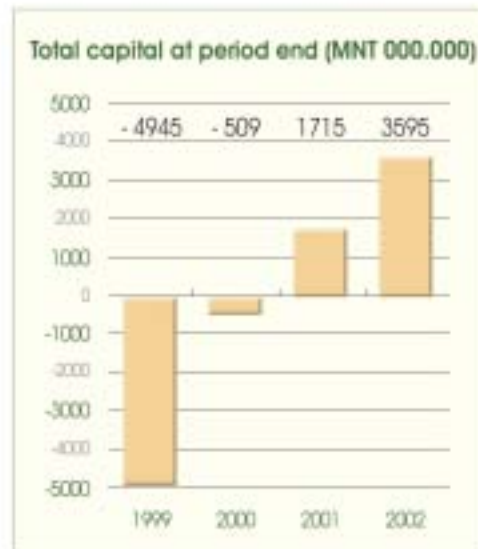
The Bank achieved profitability in January 2001 for the first time since 1997, and pre tax earnings increased sharply in 2001 and 2002. In 2002 Ag Bank was the second most profitable bank in Mongolia and the most profitable in terms of return on average assets (4.91%) and average equity (52.3%). The Bank's overall monthly average pre tax profit in 2002 was 271.2 million.



CAPITAL

Capital was negative (MNT 508 million) at year end 2000.

It increased in 2001 to MNT 1715 million, and at year end 2002 to approximately MNT 3.6 billion, representing 11.99% of risk weighted assets which meets all Bank of Mongolia prudential requirements.



LIQUIDITY

Cash and short-term investments at December 31 totaled MNT 19.9 billion, resulting in a regulatory liquidity ratio of 36.9%, well above the Bank of Mongolia required 18%. Management's policy has been to maintain substantial liquidity in the form of cash and short term Bank of Mongolia and GOM securities.

LOANS

All old loans, repossessed property and related assets inherited by this management were charged off in 2000 and 2001 and treated as recovery items.

The new loan portfolio initiated in November 2000 is well diversified and has turned over rapidly. Through December 402,000 loans were made in 356 offices in the total amount of MNT 96 billion. The December 31 loan balance was 25 billion.

The average loan amount was about MNT 240,000 and the average final term about four months, normally with equal monthly amortization.

At December 31, 2002 342 loans were past due in the amount of MNT 138 million, representing, respectively, 0.4 % and 0.6% of the portfolio.

DEPOSITS

Business and individual deposits increased in 2002 from 63.5 % to 86.2% of total deposits. Current accounts from non-government sources at December 31 were MNT 9.6 billion, up from MNT 5.9 billion at the beginning of the year. The Bank generally pays no interest on these accounts. Time and savings deposits from non-government sources grew to MNT 27.3 billion from MNT 9.8 billion at year end 2001. Interest rates on these deposits ranged from 3.6% to 18% per annum and averaged 14.8%

Pension agency deposits were MNT 5.0 billion at December 31, 2002. The Bank disburses approximately 4 billion in pension payments to individuals monthly.

Other government deposits totaled MNT 5.9 billion at December 31 and are declining as the government consolidates funds at the Bank of Mongolia under its Single Account fiscal management program.

2002 YEAR IN REVIEW

PENSION DISBURSEMENT

Our direct deposit pension service was expanded successfully into all branches and 154,200 pensioners now receive their pension through deposit into an account.

According to an independent survey conducted by Sant Maral Foundation 98 % of the pensioners say they are happy with the service.

In aimags and soums where the pension account service is introduced there no longer are problems with long queues or delays, and exposure to fraud or pension theft is reduced. Ag Bank pensioner customers now can pick up their pension proceeds in any of our aimag center or city offices.



Ag Bank Customers in Dundgovi

LOAN ACTIVITY

In 2002, 318 799 loans totaling MNT 65.0 billion were made through 14 different loan products. Interest rates were lowered for some of our most popular loan products, including small business and herder loans. Ag Bank's loan products now range from an annual rate of 21% to 48%.

Our main loan products are still showing strong demand, and are able to generate a high volume of good quality loans. However we continue to revise and expand our loan products as experience with our customers improves.

Once again, in 2002, loan product requirements were liberalized in order to serve customers with more flexibility and to involve a greater range of people. As a result:

- ◆ The term of Salary and Pension loans was increased to 12 and 6 months respectively.
- ◆ Requirements for Herder loans were relaxed for the summer season.
- ◆ Business Investment Loan program (BIL) was expanded to customers in aimag centers.

NEW LOAN PRODUCTS

In 2002 we designed and launched a number of new loan products:

1. Vegetable grower's loan
2. Crop farmer's loan
3. Raw material changer's loan
4. Small business preferred borrower's loan
5. Pensioner credit line
6. Salary loan secured by apartment

To ensure effective organizational control over the loan portfolio, the Credit department has been enhanced with the addition of supervisor positions, filled with employees with branch credit experience.



Ag Bank Customers at Chingeltei branch in UB

DIRECT DEPOSIT PROGRAMS

Under this program pensions, salaries, loan proceeds and other payments are paid directly into customer current accounts which have lower fees and higher interest than typical at other banks. We have expanded the availability of the program to all 356 offices of the Bank. Partly as a result of direct deposit activity, we have opened 210,000 new customer accounts and this helped total deposits grow to MNT 45 billion at the end of the 2002 from 24 billion at the end of 2001.

Only two years ago it was common for UB based businesses to carry bags of currency under special guard to buy agricultural raw materials from the countryside. Parents would send subsistence money to their student children in UB through individuals. Ag Bank restored transfers throughout Mongolia and introduced the Quick Pay service which has proven very popular with both businesses and ordinary citizens. In the year 2002 277,000 thousand transfers totaling MNT 28 billion were made through the Ag Bank network.

AG BANK PRIVATIZATION

The Ag Bank remediation program that began in 2000 required privatization of the Bank at the end of the two-year program. Consistent with this, the Government of Mongolia announced on July 8, 2002 an international tender for the sale of its 100% equity interest in the Bank. Many banks and financial institutions in Mongolia and abroad were contacted and invited to participate. The minimum acceptable price was set by appraisal at US \$ 3.28 million.



Hideo Sawada receiving a closing memorandum from L.Purevsdorj, Chairman of the State Property Committee

In the end, after extensive due diligence, formal bids were received from H.S. Securities of Japan, Alfa Bank Holdings of Russia, and a consortium led by Golomt Bank of Mongolia, together with Mongolia's Altan Taria Company and Itochu Corporation of Japan. All three bidders met the requirements for the technical evaluation phase of the tender and proceeded to the auction phase of the process. H.S. Securities' bid of US \$6.85 million prevailed over Alfa Bank's bid of US \$6.2 million and the Golomt Consortium's bid of US \$5.28 million.

In an official ceremony held on March 25, 2003, the Government's State Property Committee transferred its 100% equity interest in Ag Bank to H.S. Securities and received the consideration of US \$6.85 million. In addition HS committed additional investments into Ag Bank of US \$13 million during the next two to three years, for an aggregate investment into Mongolia of nearly US \$20 million.

The new owner of the bank, H. S. Securities, is one of the leading securities companies in Japan. It is part of a larger group of companies controlled by prominent Japanese businessman Hideo Sawada. These include H.I.S. Co. Ltd, the most profitable travel agency in Japan, Skymark Airlines and more than 50 other companies. With the acquisition of Ag Bank, H.S. Securities management emphasized its intentions to maintain and enhance the current successful operations of the Bank, as well as to expand into Japan in due course.

The new owners have retained Development Alternatives, Inc. of Bethesda, MD, to manage the bank, and announced that J. Peter Morrow will continue to serve as Chief Executive Officer. A new four person Board of Directors was appointed at closing, consisting of Mr. Sawada as Chairman and two representatives of HS and Mr. Morrow as members.

This privatization was extremely successful for the Government of Mongolia in several respects. It is the second largest privatization ever in Mongolia, and brought more than double the minimum price in a transaction that met all international standards. Perhaps more important, it marks the entry into Mongolia of a major Japanese group with the stated objective of increasing the level of investment, trade and tourism from Japan into Mongolia.



US Ambassador John Dinger, Japanese Ambassador Tatsuo Toda, H.S. Securities owner Hideo Sawada, Ag Bank's CEO Pete Morrow celebrating the purchase in Ag Bank's ceremonial ger.

AG BANK AND RURAL MONGOLIA

AG BANK OFFICES BY AIMAGS



* in UB city – 9 offices

Almost 70% of Mongolia's population of 2.4 million is spread out across the country's vast and sparsely populated territory of 1567 square kilometres – nearly four times the size of California. The rural economy produces about 60% of the country's GNP and herders account for more than a 40% of the rural population.

With its extensive network throughout Mongolia, Ag Bank is the only financial institution capable of reaching and providing full banking services to the rural population, even in remote areas. Currently, Ag Bank operates in all 21 aimags, 336 soums and other settlements and 6 districts in the capital city. Ag Bank's range of offerings includes products and services, such as herder loans, which have been specially designed to meet the needs of the rural population.

Ag Bank's extensive nationwide network serves the financial needs of organizations and individuals in rural soums and other settlements which are beyond the reach of other banks. In addition, Ag Bank serves major government, business and non-government institutions based in Ulaanbaatar in need of money transfers to and from the countryside. Ag Bank also works with large organizations in Ulaanbaatar that have significant branch activity in the countryside, such as the Ulaanbaatar Electricity Distribution Company, the Pension Authority, NIC, and major cashmere companies.

AG BANK OFFICES

Name of branch	Number of Subbranches	Name of branch manager	Phone number
Darkhan-Uul	11	Ch.Chuluuntsetseg	01372 33308
Orikhon	5	B.Khaltar	01352 22089
Arkhangai	18	R.Tserennadmid	01332 21082
Bayan-Ulgii	13	Kh.Khurmet	01422 22513
Bayankhongor	21	B.Tomorbaatar	01442 22764
Bulgan	16	S.Batbayar	01342 22018
Gobi-Altai	20	T.Tuul	01482 23373
Dornogobi	16	D.Tsetsegee	01522 22724
Dornod	15	D.Baatarkhuyag	01582 21332
Dundgobi	15	O.Tomorbaatar	01592 22246
Zavkhan	23	B.Nyamsuren	01462 22251
Uvurkhangai	19	D.Enkhbat	01322 22040
Umnogobi	17	A.Idertsogi	01532 22374
Selenge	12	Kh.Altangerel	01362 22181
Sukhbaatar	13	Y.Lkhagvasuren	01512 21424
Uvs	19	D.Unurtsetseg	01452 22511
Khovd	17	S.Erdenechimeg	01432 23788
Khuvsgul	25	Y.Nyamaa	01382 22364
Khentii	20	J.Gongor	01562 22413
Gobi-Sumber	2	G.Naranchimeg	01542 23449
UB Tov	30	Y.Otgonjargal	460938
Chingeltei	8	A.Minj	322326
Head office	1	S.Erdenechimeg	458677, 460669
Total	356		

MANAGEMENT AND ORGANIZATION

From August 2000 until 25 March 2003 Ag Bank was operated under a special corporate governance structure specified in a Memorandum of Understanding between the Government of Mongolia and Bank of Mongolia, pursuant to conditionalities of the World Bank's Financial Sector Restructuring Credit Program. In these and other agreements, the Government agreed not to exercise its normal prerogatives of ownership and to delegate control of the Bank to the Board and Management.

The Board of Representatives' primary duties were to monitor implementation of the restructuring plan and to assure the absence of government interference in the operations of the Bank. By agreement, the Board was comprised of five members: two appointed by the Government; two appointed by the USAID Mongolia mission and a Chairman appointed by the Government who was to be an individual with substantial experience in banking and finance and independent of the Government.

BOARD OF DIRECTORS



D. Bailykhuu
*Advisor to the Chairman,
State Property Committee*



Dr. S. Nyamzagd
(Chairman)
Rector, Institute of Commerce and Business



Dr. Harry Baumann
*Chief of Party, Economic Policy
Support Project*



Dr. David Dyer
*Agricultural Program Director Govt
Regional Economic Growth Initiative*



O. Erdembileg
*Head of Department, Ministry
of Finance and Economy*

The Management Team was supplied by Development Alternatives, Inc., of Bethesda, Md. under a Management Agreement with the Bank, and consisted of two American and four Mongolian banking executives. The Management Agreement delegated to the Team broad authority over the Bank's operations.



Management Team: *(front from left) G. Delgermaa, S. Sukhbold, Debra Boyer, COO, J. Peter Morrow, CEO
(back from left) G. Zandanshatar, E. Oyunbileg, Z. Enkhtur*

J. Peter Morrow serves as Chief Executive Officer and Debra Boyer as Chief Operating Officer, while executive responsibility for the operating functions of the Bank is held by the four Vice Directors. Vice Director S. Sukhbold is responsible for management of the Bank's branch network and staff operations. Vice Director Z. Enkhtur is Chief Financial Officer responsible for the finance and accounting functions. Vice Director G. Delgermaa is responsible for loan products and policies and Vice Director G. Zandanshatar heads the marketing function. E. Oyunbileg manages the executive support team and contracts between stakeholders. Under their overall direction, the Bank's management activities are delegated to the following department heads:

DEPARTMENT HEADS



M. Erdenechimeg
Branch Supervisor



N. Oyunkhand
Credit



S. Sandagdorj
Human Resources



P. Baasanjav
Marketing



B. Enkhbold
Information Technology



A. Ganchimeg
Corporate Communications



S. Sukhbat
Accounting



Ch. Batsaikhan
Internal Audit



O. Khurelbaatar
Foreign Settlement



Ts. Oyunchimeg
Special Assets



M. Unurtsetseg
Administration

COMMUNITY CONNECTIONS

Ag Bank takes seriously its place in the country's community life. Being the only bank with branch offices throughout Mongolia, we are deeply connected with Mongolia's community life and culture.

At the completion of remodeling its Head Office in the spring of 2002, Ag Bank engaged art historian Ts. Uranchimeg to curate a collection of contemporary Mongolian art for permanent display. Creative arts are at the core of Mongolian history and culture. The works on Ag Bank's walls are all modern art, some of the best works by the best Mongolian artists working today, but they are rooted in Mongolian history and culture and remind us we are bound up with it.

In Jan 2003 Ag Bank hosted a fund raising event for local artists and the newly formed Art Council. The party guests were able to visit Paint Bars at each floor of Ag Bank to enjoy the creation of modern art pieces of famous Mongolian artists, Ts. Enkhjin, M. Erdenebayar and Ts. Enkhjargal.



Oljargal of MCS Company and Composer N. Jantsannorov are visiting a Paint Bar hosted by Artist Ts. Enkhjin

Last summer, an Ag Bank team took a group of popular Mongolian entertainers on a countrywide road show with the theme of "Let's Work Together Listening to Each Other". They traveled more than 11,000 km all over Mongolia visiting more than 70 towns, soums and villages in 16 aimags. Some 35,000 people enjoyed the entertainment and promotional activities.

Participating artists included S. Batsukh, renowned singer and Honored Artist of Mongolia, G. Erdenebat, leading soloist from the Academic Theater of Opera and Ballet, S. Erdenetsetseg and D. Bat-Erdene, stars of the State Dance and Folk Ensemble.



Erdenetsetseg thrills the audience in Khvargul

Following the huge success of the countrywide road show, Ag Bank organized street shows in districts of Ulaanbaatar in cooperation with the Soros Foundation and the Capital City Police Department.

The music entertained large crowds and the Ag Bank team was able to talk to many current and potential customers in person. As well as getting to express their views to the Bank, those attending the events were able to participate in a quiz about Ag Bank to win gift items and new savings accounts with starter balances.



Street show launch at Ulaanbaatar City Circus with representatives of the Soros Foundation, Ulaanbaatar Police Department and Ag Bank

AUDITORS' REPORT

To Agricultural Bank of Mongolia

We have audited the financial statements of Agricultural Bank of Mongolia on pages 1 to 28.

Respective responsibilities of Directors and Auditors

The Bank's Board of Directors is responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on the financial statements and to report our opinion to you.

Specifically, the financial statements of Agricultural Bank of Mongolia have been prepared to comply with International Accounting Standards. The Board of Directors is responsible for ensuring that these financial statements, on the basis set out in the financial statements, present fairly the financial position of the Bank as at 31 December 2002 and of the result for the year then ended.

The Board of Directors is responsible for ensuring that proper accounting records are kept, which disclose at any time the financial position of the Bank and enable the Board to ensure that the financial statements comply with the requirements set out in note 2 and note 3 thereto. The Board of Directors is also responsible for safeguarding the assets of the Bank, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Board of Directors confirm that suitable accounting policies, consistently applied and supported by reasonable and prudent judgement and estimates, have been used in the preparation of the financial statements of the Bank. Applicable accounting standards have been followed in preparing the financial statements of the Bank insofar as they are appropriate to the basis of accounting set out in the notes to the financial statements.

Basis of opinion

We conducted our audit in accordance with generally accepted auditing standards. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud, other irregularities or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements, the basis of which is described in note 2 and note 3.

Opinion

In our opinion, the financial statements on pages 1 to 28 present fairly, in all material respects, the financial position of Agricultural Bank of Mongolia as at 31 December 2002 and the results of its operations and its cash flows for the year then ended in accordance with International Accounting Standards.

The comparative figures had been audited by another firm of auditors as we were appointed as auditors only for the current year's results. Accordingly, we do not express any opinion on the comparative figures.

4 March 2003
Ulaanbaatar

Ernst + Young Mongolia Audit Co.



AGRICULTURAL BANK OF MONGOLIA

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2002

	Note	2002 MNT '000	2001 MNT '000
Interest and similar income	4	8,575,161	2,969,858
Interest expense and similar charges	5	(2,970,347)	(528,628)
Net interest income		5,604,814	2,441,230
Fees and commissions	6	2,263,571	898,952
Foreign exchange and translation (losses)/gains	7	(187,577)	36,624
Other operating income	8	139,009	90,516
Non interest income		2,215,003	1,026,092
Operating profit		7,819,817	3,467,322
Operating expense	9	(4,409,106)	(2,283,665)
Profit before provisions		3,410,711	1,183,657
Provisions	10	(156,081)	259,763
Profit before taxation		3,254,630	1,443,420
Taxation	11	1,374,678	559,981
Profit after taxation		1,879,952	883,439

The annexed notes form an integral part of these financial statements.

AGRICULTURAL BANK OF MONGOLIA

BALANCE SHEET AS AT 31 DECEMBER 2002

	Note	2002 MNT '000	2001 MNT '000
ASSETS			
Cash and short term funds		3,033,934	1,937,465
Deposits and placements with other banks and financial institutions	12	3,105,804	960,677
Investment in securities	13	13,741,533	10,597,752
Loans and advances	14	25,209,420	10,056,954
Other assets	15	627,721	292,950
Property, plant and equipment	16	4,162,032	2,791,075
		<hr/>	<hr/>
TOTAL ASSETS		49,880,444	26,636,873
LIABILITIES AND CAPITAL FUNDS			
Deposits from customers	17	37,825,656	16,840,006
Government deposits	18	7,258,576	7,527,702
Loans from Bank of Mongolia	19	318,493	-
Other liabilities	20	870,784	363,316
Taxes payable		12,330	191,196
		<hr/>	<hr/>
TOTAL LIABILITIES		46,285,839	24,922,220
CAPITAL FUNDS			
Statutory fund	21	4,574,130	4,574,130
Reserves		881,113	965,623
Accumulated loss		(1,860,638)	(3,825,100)
		<hr/>	<hr/>
TOTAL CAPITAL FUNDS		3,594,605	1,714,653
TOTAL LIABILITIES AND CAPITAL FUNDS		49,880,444	26,636,873
COMMITMENTS, CONTINGENCIES AND OFF BALANCE SHEET ITEMS			
	24	9,420,436	9,922,757
		<hr/>	<hr/>

The annexed notes form an integral part of these financial statements.

AGRICULTURAL BANK OF MONGOLIA

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2002

	Statutory fund MNT'000	Additional paid in capital MNT'000	Revaluation surplus MNT'000	Accumu- lated loss MNT'000	Total MNT'000
At 1 January 2001	2,000,000	2,200,000	-	(4,708,539)	(508,539)
Issue of shares	374,130	-	-	-	374,130
Conversation of Ministry of Finance and Economy bonds into capital	2,200,000	(2,200,000)	-	-	-
Revaluation surplus	-	-	965,623	-	965,623
Profit for the year	-	-	-	883,439	883,439
At 31 December 2001	4,574,130	-	965,623	(3,825,100)	1,714,653
Profit for the year	-	-	-	1,879,952	1,879,952
Realisation of revaluation surplus	-	-	(84,510)	-	(84,510)
At 31 December 2002	4,574,130	-	881,113	(1,860,638)	3,594,605

The annexed notes form an integral part of these financial statements.

AGRICULTURAL BANK OF MONGOLIA

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2002

	2002 MNT '000	2001 MNT '000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit before tax	3,254,630	1,443,420
<i>Adjustments for :-</i>		
Depreciation of property, plant and equipment	329,331	130,460
Provisions	156,081	(259,763)
Loss on disposal of property, plant and equipment	16,608	32,600
Operating profit before working capital changes	3,756,650	1,346,717
<i>(Increase) / Decrease in operating assets:-</i>		
Loans to Bank of Mongolia	-	974,128
Loans and advances	(15,247,167)	(9,668,520)
Receivable from Ministry of Finance and Economy	-	300,000
Investment securities	(3,168,228)	(3,204,843)
Other assets	(375,141)	128,501
<i>Increase (decrease) in operating liabilities</i>		
Deposits from customers	20,985,650	8,350,991
Government deposits	(269,126)	3,120,576
Loans from Bank of Mongolia	318,493	
Other liabilities	507,468	91,004
Cash generated from operations	6,508,599	1,438,554
Income tax paid	(1,550,107)	(372,222)
Net cash flow from operating activities	4,958,492	1,066,332
CASH FLOW FROM INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(1,738,466)	(695,796)
Proceeds from disposal of property, plant and equipment	21,570	12,281
Net cash flow used in investing activities	(1,716,896)	(683,515)
CASH FLOWS FROM FINANCING ACTIVITIES		
Statutory fund contribution	-	374,130
Net increase in cash and cash equivalents	3,241,596	756,947
Cash and cash equivalents at beginning of year	2,898,142	2,141,195
Cash and cash equivalents at end of year	6,139,738	2,898,142
Cash and cash equivalents comprise:		
Cash and short term funds	3,033,934	1,937,465
Deposits and placements with other banks and financial institutions	3,105,804	960,677
	6,139,738	2,898,142

The annexed notes form an integral part of these financial statements.

AGRICULTURAL BANK OF MONGOLIA

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2002

1. CORPORATE INFORMATION

The Agricultural Bank of Mongolia (the "Bank") was organised by several agricultural cooperatives, herdsmen and agricultural farmers as a privately owned commercial bank that would provide banking services to the agricultural community. It was established on 31 January 1991 and started operations on 13 February 1991. The principal activities of the Bank are that of the provision of banking and financial services, pursuant to License No. 6 issued by the Bank of Mongolia. There has been no significant changes in the nature of these activities during the year.

On 23 June 2000, pursuant to the restructuring of the Bank in accordance with the "Memorandum of Mutual Understanding on the Restructuring of the Agricultural Bank" the Government (represented by the State Property Committee) became the sole owner of the Bank.

The financial statements of the Bank for the year ended 31 December 2002 were authorised for issue in accordance with a resolution of the Directors on 4 March 2003.

2. BASIS OF PREPARATION

The Bank's financial statements have been prepared so as to present fairly the financial position of the Bank, and its income statement, cash flows and total recognised gains or losses, and in accordance with applicable International Accounting Standards ("IAS"). These financial statements have also complied with the Commercial Banks Financial Statement Reporting Rules and the Unified Accounting Principles issued by the Central Bank - the Bank of Mongolia.

The financial statements have been prepared on the historical cost basis of accounting, modified to include the revaluation of certain assets. The reporting currency used in the financial statements is the Mongolian Togrog, which is denoted by the symbol MNT, shown rounded to the nearest thousand.

Agricultural Bank of Mongolia constitutes a single business, all conducted in Mongolia. The bank has no branches or operations abroad. Accordingly, no further analysis into business or geographical segments is appropriate in the financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES

(a) Interest Income and Expense

Interest income and expense are recognised on an accruals basis.

The recognition of interest income is suspended when the probability of recoverability of either the principal or interest is ascertained as doubtful. In accordance with the requirements of Bank of Mongolia, interest is suspended when repayments are in arrears for 3 months. On commencement of suspension, previously accrued interest not received is clawed-back. Recognition of interest subsequent to suspension is on a cash basis. Interest recognition will resume on an accruals basis when the uncertainties surrounding the recoverability are removed.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(b) Fee income and commissions

Fees and commission are recorded when earned.

(c) Taxation

The Bank provides for income tax based on its income for financial reporting purposes, adjusted for items which are not assessable or deductible for income tax purposes, in accordance with the regulations of the Mongolian Government.

(d) Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated into Togrog at the rates of exchange ruling at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are stated at cost or revalued amount, being the Togrog equivalent of the foreign currency at the date of acquisition of the assets or incidence of the liabilities, or on the date of the asset or liability was revalued. Income and expenditure are translated into Togrog at the exchange rates ruling at the date of transactions.

The resulting exchange gain or loss arising from monetary assets and liabilities, and foreign currency transactions are recognised in the income statement.

The official exchange rates used at the end of the year are:-

	2002	2001
US Dollar ("USD")	1,125.00	1,102.00
Deutsche Mark ("DEM")	-	505.60
Euro ("Euro")	1,169.40	988.90
Japanese Yen ("JPY")	9.38	8.50
Chinese Yuan ("CNY")	135.90	133.10
Russian Ruble ("RUB")	35.40	36.20

(e) Investment securities

All investments in securities are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment.

After initial recognition, investments which are classified as available-for-sale are measured at fair value. Gains or losses on available-for-sale investments is recognised in the income statement.

Other long-term investments that are intended to be held-to-maturity, such as government bonds, 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 acquisition, over the period to maturity. For investments carried at amortised cost, gains or losses are recognised in income when the investments are derecognised or impaired, as well as through the amortisation process.

All regular way purchases of financial assets are recognised on the trade date i.e. the date that the group commits to purchase the asset. All regular way sales of financial assets are recognised on the settlement date i.e. the date the asset is delivered to the counterparty. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

(f) Loans and advances

Provision for loan loss is made as considered necessary having regard to both specific and general factors. In determining the need for provisions, management considers, among other things, the financial position of the borrowers, the value of any collateral and guarantees received, industry performance, current economic conditions and past experiences. Provision made (less amounts released) during the year is charged against the income statement.

Based on the revised guidelines on provisions issued by Bank of Mongolia in September 2002 pertaining to provision of loan losses, there has been a change in the provision estimate for the overdue classification. Based on the new guidelines the required provisions on overdue accounts are 5% (2001: 1%).

The provision for loan loss has complied with the requirements of the Bank of Mongolia.

(g) Maturity of loans and advances

The maturity of the loan portfolio is presented in Note 22 which shows the remaining period of loans from the balance sheet date to the contractual maturity. Long-term credits are generally not available in Mongolia except for programs set up by international financial institutions and under government financing arrangements. However, in the Mongolian marketplace, short-term credits are granted with the expectation of renewing the loans at maturity. Accordingly, the effective maturity of a loan portfolio may be longer than indicated by a classification based on contractual terms.

(h) Property, plant and equipment

Property, plant and equipment are stated at cost or at revalued amount less depreciation calculated on a straight line basis over the estimated useful lives of the asset and impairment in value, if any. The costs of property, plant and equipment comprise their purchase cost and any incidental costs of acquisition.

The revaluation of the Bank's buildings in 2001 had been carried out by independent appraisers. The net appraisal increase resulting from the appraisal was credited to the revaluation surplus account.

The estimated useful lives used are as follows:

Buildings	30-40 years
Furniture and Fixtures	10 years
Computers	5 years

Assets under construction are not depreciated. Depreciation of these assets begins when the related assets are placed in service.

During the year, the Bank changed its estimate on the estimated useful life of computers from 6 years to 5 years.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(i) Impairment of assets

The Bank reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, impairment is measured by comparing the carrying values of the assets with their recoverable amounts. Recoverable amount is the higher of net selling price and value in use, which is measured by reference to discounted future cash flows. Recoverable amounts are estimated for individual assets or, if it is not possible, for the cash-generating unit to which the asset belongs.

An impairment loss is charged to the income statement immediately, unless the asset is carried at revalued amount. Any impairment loss off a revalued asset is treated as a revaluation decrease to the extent of any available previously recognised revaluation surplus for the same asset.

(j) Deposits of customers

Deposits of customers and other financial institution are initially recognised at cost. Subsequently, for time deposits with terms over one month, amounts due are stated at amortised cost and any difference between net proceeds and the redemption value is recognised in the income statement over the term of the deposit using the effective yield method.

(k) Collateral obtained from loan customers

Collateral obtained from loan customers in lieu of loans receivable are stated at the lower of the agreed value between the Bank and the customers, and the net realisable value. Net realisable value is based on estimated normal selling prices, less further costs expected to be incurred to disposal.

(l) Interest bearing borrowings

All borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing. After initial recognition, interest-bearing loans and borrowings, are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement. Gains and losses are recognised in the income statement when the liabilities are derecognised or impaired, as well as through the amortisation process.

(m) Cash and cash equivalents

Cash equivalents are short-term, highly liquid investments with maturities of three months or less from the date of acquisition and are readily convertible to cash with insignificant risk of changes in value.

(n) Statement of cash flows

The statement of cash flows classifies changes in cash and cash equivalents according to operating, investing and financing activities. The Bank does not consider any of the assets other than non-fiduciary cash and bank balances and short term deposits to meet the definition of cash and cash equivalents. The statement of cash flows is prepared using the indirect method.

(o) Repurchase agreements

Securities purchased under resale agreements are securities which the bank had purchased with a commitment to resell at future dates. The commitment to resell the securities is reflected as an asset on the balance sheet.

Conversely, obligation on securities sold under repurchase agreements are securities which the bank had sold from its portfolio, with a commitment to repurchase at future dates. Such financing transactions and corresponding obligations to purchase the securities are reflected as a liability on the balance sheet.

(p) Use of Estimates

The preparation of the financial statements in conformity with IAS requires the Directors to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

4. INTEREST AND SIMILAR INCOME	2002	2001
	MNT '000	MNT '000
Loans and advances	7,041,655	1,943,651
Deposits and placements with other financial institutions	12,400	56,960
Bank of Mongolia treasury bills	1,057,253	495,667
Government bonds and securities	463,853	473,580
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	8,575,161	2,969,858
5. INTEREST EXPENSE AND SIMILAR CHARGES	2002	2001
	MNT '000	MNT '000
Current account deposits	112,048	24,322
Time and demand deposits	2,858,299	503,401
Others	-	905
	<hr/>	<hr/>
	2,970,347	528,628
6. FEES AND COMMISSIONS	2002	2001
	MNT '000	MNT '000
Pension loan fees	1,123,962	77,722
Acceptance fees	562,178	208,751
Pension payment charge	200,801	216,608
Application fees	151,335	102,593
Others	225,295	293,278
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	2,263,571	898,952

Others include fees and commission earned from transaction fees and money transfer fees.

7. FOREIGN EXCHANGE AND TRANSLATION GAINS, NET OF LOSSES

	2002	2001
	MNT '000	MNT '000
Net foreign currency transaction (loss)/gain	(186,168)	45,217
Net foreign currency translation loss	(1,409)	(8,593)
	<u>(187,577)</u>	<u>36,624</u>

8. OTHER OPERATING INCOME

	2002	2001
	MNT '000	MNT '000
Rental income	25,472	45,849
Income from penalties	41,086	14,012
Recovery of collateral previously written off	37,817	-
Other income	34,634	30,655
	<u>139,009</u>	<u>90,516</u>

9. OPERATING EXPENSE

	2002	2001
	MNT '000	MNT '000
Salaries and related expenses	1,385,681	713,321
Bonuses and allowances	635,587	327,564
Communications	339,654	162,029
Advertising	255,330	88,769
Depreciation	229,331	134,531
Employee training	232,813	83,977
Stationery	216,578	63,850
Business trip	176,279	114,563
Transportation and fuel supply	169,028	100,890
Utilities	149,161	122,090
Maintenance of property, plant and equipment	118,646	66,437
Rental expenses	83,780	30,780
Other operating expenses	317,238	274,864
	<u>4,409,106</u>	<u>2,283,665</u>

The average number of persons employed by the Bank during the year was made up as follows:

	2002	2001
	Number	Number
Directors and heads of departments	10	9
Branch managers	22	22
Sub-branch managers	342	310
Others	1,058	658
	<u>1,432</u>	<u>999</u>
Of which:		
- Head office	110	102
- Branches	1,322	897
	<u>1,432</u>	<u>999</u>

10. PROVISIONS

	2002	2001
	MNT '000	MNT '000
Provision/(Recovery of provision) for loan losses	94,701	(184,116)
Provision for securities	24,447	-
Provision/(Recovery of provision) for other receivable	36,933	(75,647)
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	156,081	(259,763)

11. TAXATION

	2002	2001
	MNT '000	MNT '000
Mongolian taxation based on results for the year		
- Current	1,292,370	559,981
- Underprovision in prior year	82,308	-
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	1,374,678	559,981

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, in accordance with the regulations of the tax authorities. The tax rate is 15% for taxable profits up to MNT 100 million and 40% for taxable profits in excess of MNT 100 million.

A reconciliation of income tax expense applicable to profit from operating activities before income tax at the statutory income tax rate to income tax expense at the Bank's effective income tax rate for the years ended 31 December was as follows:

	2002	2001
	MNT '000	MNT '000
Income tax at statutory rates based on profit before taxation	1,310,656	552,368
Tax exempt income	(200,668)	(189,432)
Non deductible expenses	182,382	197,045
Underprovision in prior year	82,308	-
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Provision for income tax	1,374,678	559,981

12. DEPOSITS AND PLACEMENTS WITH OTHER BANKS AND FINANCIAL INSTITUTIONS

	2002	2001
	MNT '000	MNT '000
Balances with Bank of Mongolia	2,793,492	771,720
Balances with other banks and financial institutions	312,312	188,957
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	3,105,804	960,677

Balances with Bank of Mongolia are maintained in accordance with Bank of Mongolia requirements and bear no interest. Foreign currency deposit accounts with Bank of Mongolia bear interest ranging from 1% to 1.9% (2001: 1.1% to 4.6%). The balances maintained with Bank of Mongolia are determined at set percentages based on 15 days average cash balances.

12. DEPOSITS AND PLACEMENTS WITH OTHER BANKS AND FINANCIAL INSTITUTIONS (CONTD.)

Balances with other banks and financial institutions represent foreign currency current accounts maintained with foreign financial institutions, which are generally denominated in US Dollars and bear no interest (2001: Nil).

On 26 November 1999 the Ministry of Finance and Economy (MOFE) and Bank of Mongolia entered into a "Special Agreement" with the Deutsche Gesellschaft Fur Technische Zusammenarbeit GmbH (GTZ) for "creation of a Rural Finance System" project (the Project). The objective of the Project is to assist in the development of the rural financial sector of Mongolia through a rural lending program to be implemented by the Bank. The Bank is responsible for the issuance and collection of loans extended under the Project.

As of 31 December 2002, GTZ has disbursed DM 1 million through the MOFE for the establishment of the loan fund, and the Bank has lent out approximately MNT 566 million (2001: MNT365.1 million). Balances with the Bank of Mongolia includes a deposit of USD Nil (MNT Nil) (2001: USD182,336 (MNT200.9 million)) representing that part of the funds received by the Bank which have not yet been loaned to the rural financial sector. The related liability (i.e. the total amount of funds received by the Bank under the Project) is recorded as part of Government deposits (see Note 18)

13. INVESTMENT IN SECURITIES

	2002 MNT '000	2001 MNT '000
Bank of Mongolia bills	10,837,299	10,604,000
Government bonds	3,005,939	-
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	13,843,238	10,604,000
Accretion of discounts		
Provision for diminution in value of government bonds	(77,258) (24,447)	(6,248) -
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	13,741,533	10,597,752
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Bank of Mongolia bills are non interest bearing short term bills with maturities of less than three months, and are issued at a discount to the fair value of the bills upon maturity. The effective annual interest rates of these bills range from 4.43% to 14.5% per annum (2001: 7.5% to 14.3% per annum).

Government bonds are issued by the Ministry of Finance and Economy with maturities ranging from 90 days to 720 days. Annual interest rates are in the range of 4.54% to 15.8% (2001 : 8.4% to 14.4%).

14. LOANS AND ADVANCES

	2002	2001
	MNT '000	MNT '000
Small business loans	14,080,079	7,013,197
Pensioner's loan	2,803,546	577,068
Herder's loans	2,874,357	946,410
Payroll loans	4,160,358	1,154,239
Staff loans	442,050	156,595
Accrued interest receivable	563,556	220,062
Others	632,309	112,237
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Gross loans and advances	25,556,255	10,179,808
Provision for loan losses	(346,835)	(122,854)
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Net loans and advances	25,209,420	10,056,954

Others include agriculture loan, investment loan and loans secured by deposit.

Loans and advances analysed by their economic purpose are as follows:-

	2002	2001
	MNT '000	MNT '000
Trade	14,541,879	7,115,030
Agriculture	22,615	6,640
Others	10,644,926	2,935,284
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	25,209,420	10,056,954

Others include pension loans, payroll loans and staff loans.

Movements in the non-performing loans are as follows:-

Gross non performing loans as at 31 December	196,645	41,945
As a percentage of gross loans and advances	0.8%	0.4%
Total net non-performing loans	97,771	18,300
As a percentage of total net loans	0.4%	0.2%

Movements in the provision for specific loan loss accounts are as follows:-

Balance at 1 January	122,854	3,004,549
Charge for the year	223,981	120,950
Recoveries	-	(305,066)
Written off	-	(2,697,579)
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Balance at 31 December	346,835	122,854

At 31 December 2002, all loans and advances to borrowers are denominated in Togrog and interest rate ranges from 5% to 72% per annum (2001: 48% to 60% per annum).

Loans and advances amounting to approximately MNT 25 billion at 31 December 2002 (2001: MNT9.9 billion) were classified as normal and provided with a 1% loss reserve. Further, loans amounting to MNT 197 million (2001: MNT42 million) were classified as non-performing loans ("NPL") as of 31 December 2002 and specific provisions of MNT 98 million (2001: MNT24 million) have been allocated against the NPLs.

14. LOANS AND ADVANCES (CONTD.)

At 31 December 2002, included in loans and advances balances are loans and advances amounting to MNT 140 million (2001: MNT39 million) for which interest income has been suspended and previously accrued interest receivable is clawed back, in accordance with Bank of Mongolia guidelines.

Included in the income statement is recovery of loans and advances previously written off amounting to MNT 129 million (2001: Nil).

The current practice of the Bank is to base the level of specific provisions on an evaluation of each customer's present situation. As such, the provisions are based on conditions prevailing and information available at the date of these financial statements. The provisions do not incorporate an assessment of the potential for future deterioration in the asset quality of the Bank.

The provision for possible loan losses is considered adequate by the management based upon their formal review and analysis of existing credits using their knowledge of prevailing and anticipated economic conditions.

15. OTHER ASSETS

	2002 MNT '000	2001 MNT '000
Consumables and inventories	527,591	204,335
Receivables	154,648	68,849
Other	95,638	46,851
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	777,877	320,035
Provision for probable losses	(150,156)	(27,085)
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	627,721	292,950
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Movements in provision for probable losses are as follows:		
Balance at 1 January	27,085	1,480,464
Charge for the year	137,595	37,641
Recoveries	(14,524)	(113,288)
Written off	-	(1,377,732)
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	150,156	27,085
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16. PROPERTY, PLANT AND EQUIPMENT

	Buildings MNT '000	Furniture, fixtures and vehicles MNT '000	Computers MNT '000	Total MNT '000
At cost/valuation :				
At 1 January 2001	4,566,380	595,220	477,117	5,638,717
Additions	261,544	554,968	921,954	1,738,466
Disposals/write off	(16,946)	(72,818)	(6,397)	(96,161)
At 31 December 2001	4,810,978	1,077,370	1,392,674	7,281,022
Accumulated depreciation:				
At 1 January 2001	2,535,233	183,575	128,834	2,847,642
Depreciation charge for the year	166,310	34,143	128,878	329,331
Disposals/write off	(15,615)	(32,275)	(10,093)	(57,983)
At 31 December 2002	2,685,928	185,443	247,619	3,118,990
Net Book Value, 31 December 2002	2,125,050	891,927	1,145,055	4,162,032
Net Book Value, 31 December 2001	2,031,147	411,645	348,2 83	2,791,075

The cost of buildings is shown at cost and valuation. Included in the cost of buildings is an amount of MNT3,389,609 thousand (2001: MNT3,389,609 thousand) carried at valuation which was done in year 2001 by a professional valuer.

17. DEPOSITS FROM CUSTOMERS

	2002 MNT '000	2001 MNT '000
Current accounts	9,501,368	5,315,216
Demand deposits	4,783,661	2,463,502
Time deposits	23,178,798	8,933,795
Other deposits	361,829	127,493
	<u>37,825,656</u>	<u>16,840,006</u>

Current accounts generally bears no interest. Demand deposits are interest bearing and may be withdrawn upon demand. Foreign currency demand deposits bear an annual interest rate ranging from 1.8% to 3.6% in 2002 (2001: 1.8% to 3.6%). MNT demand deposits bear an annual interest rate ranging from 2.4% to 9.6% in 2002 (2001: 2.4% to 4.8%)

Foreign currency time deposits bear an annual interest rate ranging from 3.6% to 7.2% (2001 : 3.6% to 7.2%), while for local currency time deposits, from 4.8% to 18% (2001 : 9.6% to 18%).

18. GOVERNMENT DEPOSITS

	2002 MNT '000	2001 MNT '000
Government deposits	<u>7,258,576</u>	<u>7,527,702</u>

Government deposits consist of deposit accounts of state and local government units and generally bear no interest. However, for balances above a prescribed limit interest is provided at annual rates ranging from 2.4% to 3.6% (2001: 1.2% to 2.4%).

Also included in Government deposits at 31 December 2002 is MNT566 million (2001: MNT566 million) representing the funded loan extended by GTZ through the MOFE (see note 12).

19. LOANS FROM BANK OF MONGOLIA

	2002 MNT '000	2001 MNT '000
Term Loan I	112,500	-
Term Loan II	56,250	-
Term Loan III	149,743	-
	<u>318,493</u>	<u>-</u>

Term Loan I

The loan is denominated in USD and bears service fee at 1% per annum, with principal sum repayable by 5 equal annual instalments commencing 1 December 2003. The loan was taken to purchase computer equipment.

Term Loan II

The loan is denominated in USD and bears service fee at 1% per annum, with principal sum repayable by 5 equal annual instalments commencing 1 December 2003. The loan was taken for additional work performed on the BANCS software implemented by the Bank.

Term Loan III

The loan is denominated in USD and bears interest at 1% per annum, with interest payment commencing in 2007 and principal sum repayable by 30 equal instalments commencing 1 December 2002, in which the loan is interest free for the first five years. The loan was for the Bank's portion of the BANCS software purchased.

20.**OTHER LIABILITIES**

	2002 MNT '000	2001 MNT '000
Payables	205,695	81,618
Accrued interest	632,080	170,949
Other payables	33,009	110,749
	<u>870,784</u>	<u>363,316</u>

21. STATUTORY FUND

	2002 MNT '000	2001 MNT '000
At 1 January	4,574,130	2,000,000
Issued during the year	-	2,574,130
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At 31 December	<u>4,574,130</u>	<u>4,574,130</u>

At 31 December 2002 the statutory fund was wholly owned by the Mongolian Government.

22. RISK MANAGEMENT POLICIES

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

Credit risk

The Bank is exposed to credit risk which is the risk that a counter party will be unable to pay amounts in full when due. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of credit risk by borrower and product are approved regularly by the Bank's management team.

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 collateral and corporate and personal guarantees.

The Bank does not enter into other related commitments such as guarantees and standby letter of credit, and documentary and commercial letter of credit.

The geographical concentration of monetary assets and liabilities are as follows.

	2002 (MNT'000)		
	Mongolia	Foreign	Total
Assets			
Cash and short term funds	3,033,934	-	3,033,934
Deposits and placements with other banks and financial institutions	2,793,492	312,312	3,105,804
Investment in securities	13,741,533	-	13,741,533
Loans and advances, net	25,209,420	-	25,209,420
	<hr/>	<hr/>	<hr/>
	44,778,379	312,312	45,090,691
Liabilities			
Deposits from customers			
Government deposits	37,825,656	-	37,825,656
Loans from Bank of Mongolia	7,258,576	-	7,258,576
	318,493	-	318,493
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	45,402,725	-	45,402,725
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Net position	(624,346)	312,312	(312,034)

22. RISK MANAGEMENT POLICIES (CONTD.)

	2001 (MNT'000)		
	Mongolia	OECD and Others	Total
Assets			
Cash and short term funds	1,937,465	-	1,937,465
Deposits and placements with other banks and financial institutions	771,720	188,957	960,677
Investment in securities	10,597,752	-	10,597,752
Loans and advances, net	10,056,954	-	10,056,954
	23,363,891	188,957	23,552,848
Liabilities			
Deposits from customers	16,840,006	-	16,840,006
Government deposits	7,527,702	-	7,527,702
	24,367,708	-	24,367,708
Net position	(1,003,817)	188,957	(814,860)

Currency risk

The Bank is exposed to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Bank's management sets limits on the level of exposure by currencies (primarily USD). These limits also comply with the minimum requirement of the Central Bank of Mongolia.

The Bank's exposure to foreign currency exchange rate risk is as follows:

	2002 (MNT'000)		
	MNT	Foreign currencies	Total
Assets			
Cash and short term funds	2,491,354	542,580	3,033,934
Deposits and placements with other banks and financial institutions	1,475,881	1,629,923	3,105,804
Investment in securities	13,741,533	-	13,741,533
Loans and advances, net	25,209,420	-	25,209,420
	42,918,188	2,172,503	45,090,691
Liabilities			
Deposits from customers	35,884,537	1,941,119	37,825,656
Government deposits	7,258,576	-	7,258,576
Loans from Bank of Mongolia	0	318,493	318,493
	43,143,113	2,259,612	45,402,725
Net position	(224,925)	(87,109)	(312,034)

22. RISK MANAGEMENT POLICIES (CONTD.)

	2001 (MNT'000)		
	MNT	Foreign currencies	Total
Assets			
Cash and short term funds	1,842,025	95,440	1,937,465
Deposits and placements with other banks and financial institutions	459,820	500,857	960,677
Investment in securities	10,597,752	-	10,597,752
Loans and advances, net	10,056,954	-	10,056,954
	22,956,551	596,297	23,552,848
Liabilities			
Deposits from customers	16,418,664	421,342	16,840,006
Government deposits	7,527,702	-	7,527,702
	23,946,366	421,342	24,367,708
Net position	(989,815)	174,955	(814,860)

Liquidity risk

The Bank is exposed to frequent calls on its available cash resources from current deposits, maturing deposits and loan drawdowns. The Bank maintains liquidity management with the objective of ensuring that funds will be available at all times to honor all cash flow obligations as they become due. The Bank's Assets and Liabilities Management Committee sets limits on the minimum proportion of maturing funds available to cover such cash outflows and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

The contractual maturities of banking assets and liabilities for the year ended 31 December 2002 is as follows (MNT million):

	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
Assets						
Cash and short term funds	3,034	-	-	-	-	3,034
Deposits and placements with other banks and financial institutions	3,106	-	-	-	-	3,106
Investment in securities	11,301	345	700	1,396	-	13,742
Loans and advances	3,367	10,196	11,334	223	89	25,209
Other assets	628	-	-	-	-	628
Property, plant and equipment					4,162	4,162
	21,436	10,541	12,034	1,619	4,251	49,881
Liabilities						
Deposits from customers	27,874	5,772	4,180	-	-	37,826
Government deposits	7,259	-	-	-	-	7,259
Other liabilities	871	-	-	-	-	871
Loans from Bank of Mongolia	-	-	39	156	124	319
Tax payable	12	-	-	-	-	12
	36,016	5,772	4,219	156	124	46,287
Net position	(14,580)	4,769	7,815	1,463	4,127	3,594
Accumulated gap	(14,580)	(9,811)	(1,996)	(533)	3,594	

22. RISK MANAGEMENT POLICIES (CONTD.)

The contractual maturities of banking assets and liabilities for the year ended 31 December 2001 is as follows (MNT million):

	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
Assets						
Cash and short term funds	1,937	-	-	-	-	1,937
Deposits and placements with other banks and financial institutions	961	-	-	-	-	961
Investment in securities	10,598	-	-	-	-	10,598
Loans and advances	2,537	5,474	1,886	67	93	10,057
Other assets	293	-	-	-	-	293
Property, plant and equipment	-	-	-	-	2,791	2,791
	16,326	5,474	1,886	67	2,884	26,637
Liabilities						
Deposits from customers	8,403	7,406	1,031	-	-	16,840
Government deposits	7,528	-	-	-	-	7,528
Other liabilities	363	-	-	-	-	363
Tax payables	191	-	-	-	-	191
	16,485	7,406	1,031	-	-	24,922
Net position	(159)	(1,932)	855	67	2,884	1,715
Accumulated gap	(159)	(2,091)	(1,236)	(1,169)	1,715	

The maturity gap analysis does not reflect the historical stability of current accounts, whose liquidation has historically taken place over a longer period than indicated in the table above. The table is based upon these accounts' entitlement to withdraw on demand.

Interest rate risk

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

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

22. RISK MANAGEMENT POLICIES (CONTD.)

The Bank's interest rate policy is reviewed and approved by the Bank's Assets and Liabilities Management Committee. The Bank's average effective interest rates as of the years ended 31 December 2002 and 2001 for monetary financial instruments are as follows:

The Bank's interest rate policy is reviewed and approved by the Bank's Assets and Liability Management Committee. The Bank's average effective interest rates as of the years ended 31 December 2002 and 2001 for monetary financial instruments are as follows:

	2002		2001	
	MNT	USD	MNT	USD
Interest earning assets				
Placement with other banks	-	1% - 1.9%	-	1.1% - 4.6%
Bank of Mongolia bills	4.4% - 14.5%	-	7.5% to 14.3%	-
Government bonds	4.5% - 15.8%	-	-	-
Loans to customers	21% - 72%	-	48% to 60%	-
Interest bearing liabilities				
Demand deposits of customers	2.4% - 9.6%	1.8% - 3.6%	2.4% to 4.8%	1.8% to 3.6%
Time deposits of customers	4.8% - 18%	3.6% - 7.2%	1.2% to 2.4%	3.6% to 7.2%
Government deposits	2.4% - 3.6%	-	-	-
Loan from Bank of Mongolia	1%	-	-	-

23. TRANSACTIONS WITH RELATED PARTIES

The transactions with related parties of the Bank in 2002 and 2001 relate solely to loans to key management personnel as follows:

		2002	2001
		MNT' 000	MNT' 000
Zandanshatar G.	Vice Director	14,515	14,885
Delgermaa G.	Vice Director	7,700	-
Otgonjargal	Head of Branch	9,180	9,763
Tumen Ulzii	Head of Branch	9,038	9,759
Sukhbat S.	Chief accountant	8,958	9,423
Batsaikhan Ch.	Head of Internal Audit Department	8,875	9,315
Erdenechimeg M.	Head of Branch Supervision Department	8,234	8,655
Enkhbold D.	Head of IT Dept	2,097	-
Lkhagvasuren Ya.	Head of Branch	4,790	-
Nyamsuren B.	Head of Branch	6,851	-
Enkhbat D.	Head of Branch	6,714	-
Tuul T.	Head of Branch	5,983	-
Oyunchimeg Ts.	Head of Special Assets Department	7,307	-
Batbayar S.	Head of Branch	327	-
Nyamaa Ya.	Head of Branch	75	-
Idertsog A.	Head of Branch	245	-
Erdenechimeg S.	Head of Branch	100	-
		<hr/>	<hr/>
		100,989	61,800
Repayable			
- within 1 to 5 years		42,189	-
- over 5 years		58,800	61,800
		<hr/>	<hr/>
		100,989	61,800
Provision for probable losses		(1,010)	(618)
		<hr/>	<hr/>
Total		<u>99,979</u>	<u>61,182</u>

The loans to Bank's employees bear annual interest rates of 5% to 21% in 2002 (2001: 5% to 24%)

24. CAPITAL ADEQUACY

The Bank of Mongolia requires commercial banks to maintain a core capital adequacy ratio of 5% and risk weighted capital ratio of 10%, compiled on the basis of total equity and total assets as adjusted for their risk. As at 31 December 2001, the Bank has a core capital ratio of 8.95% (2001 : Exempted) and risk weighted capital ratio of 11.85% (2001 : Exempted), as computed below:

	2002 MNT '000
Tier I capital	
Statutory fund	4,574,130
Accumulated loss	(1,860,638)
	<hr/>
Total Tier I Capital	2,713,492
Tier II capital	
Revaluation reserve	881,113
	<hr/>
Total capital/capital base	<u>3,594,605</u>

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

	2002 MNT '000
%	19,568,959
0	-
10	312,312
20	-
50	29,915,037
100	<hr/>
Total	<u>49,796,308</u>
Core capital ratio	9.05%
Risk weighted capital ratio	11.99%

25. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities with legal recourse to its customers. No material losses are anticipated as a result of these transactions.

	2002 MNT '000	2001 MNT' 000
Ministry of Food and Agriculture Loans	1,660,864	1,743,805
Accrued interest on Loans by the Ministry of Food and Agriculture	307,222	105,081
Other off balance sheet items	7,452,350	7,905,694
Capital commitment	-	168,177
	<u>9,420,436</u>	<u>9,922,757</u>

a) Ministry of Food and Agriculture Loans

The Bank extended MNT 1.7 billion of loans to agricultural companies under Banking Service Agreement with the Ministry of Food and Agriculture (MFA) dated 7 May 2001. Under this agreement, the Bank is responsible for the distribution of the loans to the borrowers selected by the MFA, for the monitoring of the borrowers' compliance with loan agreements, and providing the MFA with timely information on the status of these loans.

The Bank earns interest income of 0.2% per month on the interest paid by the borrowers and service charge at 0.25% on the amount of loans issued. No new loans were distributed in the year ended 31 December 2002. No interest income and service charge was earned for the year ended 31 December 2002 (2001: MNT 4.6 million).

b) Other off balance sheet items

At 31 December 2002, other off balance sheet items consisted mainly of loans of MNT 4.1 billion (inclusive of interest), receivables of MNT 837 million and collateral assets obtained from customers amounting to MNT 125 million that were written off in prior years.

Also included as other off balance sheet items are "Inherited" and "Directed" loans amounting to MNT 1.2 billion along with accrued interest of MNT 1.1 billion (2001: MNT 1.3 billion plus accrued interest of MNT 1.1 billion).

c) Capital commitments

At 31 December 2002, the Directors have not authorised any capital commitments of significance.

30. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The following table summarises the carrying values and fair values of financial assets and liabilities of the Bank.

	Carrying amount MNT '000	Fair value MNT '000
Assets		
Cash and short term funds	3,033,934	3,033,934
Deposits and placements with other banks and financial institutions	3,105,804	3,105,804
Investment in securities	13,741,533	13,741,533
Loans and advances	25,209,420	25,209,420
Other assets	627,721	627,721
Property, plant and equipment	4,162,032	4,162,032
Total Assets	<u>49,880,444</u>	<u>49,880,444</u>
Liabilities		
Deposits from customers	37,825,656	37,825,656
Government deposits	7,258,576	7,258,576
Other liabilities	318,493	318,493
Loans from Bank of Mongolia	870,784	870,784
Total Liabilities	<u>46,273,509</u>	<u>46,273,509</u>

As no readily available market exist for a large part of the Bank's financial instruments, judgment is necessary in arriving at fair value, based on current economic conditions and specific risks attributable to the instrument. The estimates presented herein are not necessarily indicative of the amounts the Bank could realise in a market exchange from the sale of its full holdings of a particular instrument.

As of December 31, 2002, the following methods and assumptions were used by the Bank to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

Cash and short term funds

For these short term instruments, the carrying amount is a reasonable estimate of fair value.

Deposits and placements with other banks and financial institutions

For these short term instruments, the carrying amount is a reasonable estimate of fair value.

Investment in securities

As set out in Note 3, securities held by the Bank for investment purposes as of December 31, 2002 are carried at cost and fair value, adjusted for accretion and amortisation of discounts and premiums, respectively, less any provision for permanent diminution in value.

Loans and advances

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

30. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES (CONTD.)

Other assets

For these short term instruments, the carrying amount is a reasonable estimate of fair value.

Deposits from customers

For these short term instruments, the carrying amount is a reasonable estimate of fair value.

Government deposits

For these short term instruments, the carrying amount is a reasonable estimate of fair value.

Loans from Bank of Mongolia

The fair value of loans from Bank of Mongolia is stated at carrying amount due to the extensive period that their financial instruments are held.

26. SUBSEQUENT EVENT

Pursuant to the "Privatisation Guidelines for 2001-2004" approved by the State Ikh Hural, the Government of Mongolia adopted the Privatisation Program for 2002 in May 2002. Within the framework of this Program, the Government approved the sale of 100% of the Bank's total shares through a competitive tender. On 14 January 2003, the Government of Mongolia, through its agent, The State Property Company had entered into a sale and purchase agreement with H.S. Securities Co Ltd. for the sale of its entire stake in the Bank.

27. COMPARATIVE FIGURES

The comparative figures are based on financial statements audited by another firm of auditors as Ernst & Young Mongolia Audit Co. was appointed only for the audit of the current year's results.

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

28. MONGOLIAN TRANSLATION

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