



KHAN BANK

Agricultural Bank of Mongolia



ANNUAL REPORT 2003



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ХААН БАНК
Монголын Хөдөө Аж Ахуйн Банк

KHAN 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

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

- ❖ All employees of Khan 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.
- ❖ Khan 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 Khan 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.

Khan 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 Khan 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 pete@magicnet.mn



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CEO'S MESSAGE



The year 2003 was a milestone year for customers, employees and all stakeholders of Khan Bank, our new brand name in English.

In 2003 the bank earned MNT3380 million before tax and MNT1934 million after tax, both records. Among major Mongolian Banks over the past two years we have shown the highest returns on assets and equity. ROE in 2003 was 42.4%, and ROA was 2.8%.

Our balance sheet continues to be strong and liquid. Capital more than doubled during 2003 to MNT 5528.4 million, or 13.16% of adjusted risk assets, exceeding all regulatory requirements. Cash and short term investments were 29.7 billion, over a third of total assets.

In March 2003 Khan Bank was privatized through international tender to H.S. Securities of Tokyo, part of the Hideo Sawada group of companies. The cash purchase price of US\$6,850,000 was more than double the appraised value minimum, and the second largest privatization in Mongolia. H.S. Securities since has injected an additional \$2 million into the Bank's capital. Subsequent to privatization Tavan Bogd Trading of Mongolia became a shareholder and the bank is negotiating with other foreign investors to be added to the ownership group.



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With the change of ownership a new Board of Directors was elected, with Mr. Sawada as Chairman and Yoshiaki Mishima of H.S. Securities, D. Hulan of Tavan Bogd Trading and me as members.

The Board has retained Development Alternatives Inc. (DAI) of Bethesda, Md, to continue to provide management for the Bank. DAI had managed the Bank since 2000 under a turnaround program agreed among the Mongolian Government, the U.S. Government and the World Bank. I am pleased to stay on as CEO, and in June we welcomed Ben Turnbull to our Mongolian-American team as Chief Operating Officer.

Our privatization and new affiliation are leading to a significant expansion in corporate lending, international settlements and foreign exchange operations, while our programs for small businesses and consumers remain strong and are growing.

Customers all over Mongolia have responded positively to our new marketing initiatives. At the end of 2000 we re-branded the Bank as “XAAH БАНК” in Mongolian and “AG BANK” in English, in both cases a short version of our official name “Agricultural Bank of Mongolia”. At the end of 2003 the English brand “Khan Bank” was introduced to align the brand in both languages. Recent independent surveys show that 94% of Mongolians know our name and over 90% are satisfied with our service.

Khan Bank remains Mongolia’s only full-service nationwide branch bank, with 379 offices serving half of Mongolia’s households throughout the country. Our network now reaches every corner of every province in the countryside and every neighborhood of Ulaanbaatar, and we now employ over 1800 total staff.

We received numerous awards during the year, and two were noteworthy: At the beginning of the year Khan Bank was named 2002 “Bank of the Year” by the Mongolian National Chamber of Commerce and Industry. And in September 2003 the Banker Magazine of London, part of the Financial Times Group, named us the 2003 “Bank of the Year” in Mongolia.

I thank our customers for their loyalty and our employees for their hard work and professionalism. They are the reasons for our success in 2003 and give us great optimism for the future.

J. Peter Morrow

Chief Executive Officer
March 10, 2004

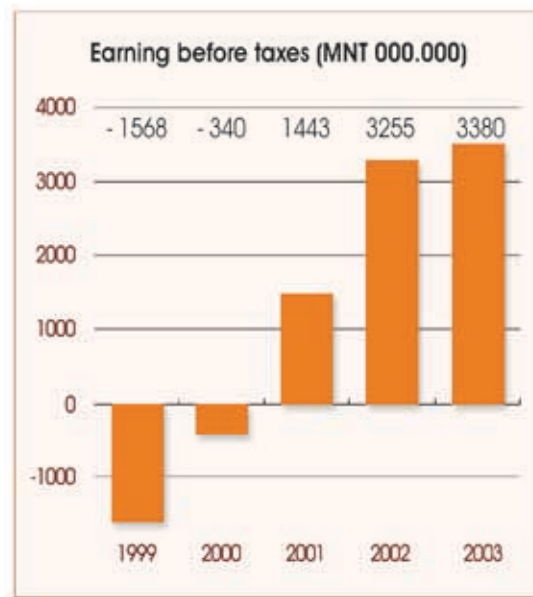


FINANCIAL HIGHLIGHTS

PROFITABILITY

The Bank achieved profitability in January 2001 for the first time since 1997, and pre tax earnings increased sharply in 2001 and 2002.

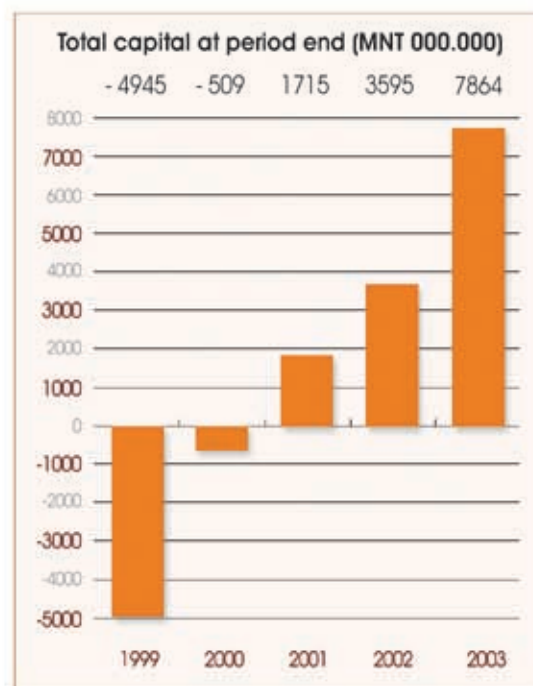
In 2003 Khan Bank continued to be the second most profitable bank in Mongolia and the most profitable among major banks in terms of return on average assets (2.79%) and average equity (42.39%).



TOTAL CAPITAL

Total capital in 2003 more than doubled to MNT 7.864 billion. This represents 13.16% of adjusted risk assets and meets all Mongol-bank prudential requirements.

Shareholder equity increased to MNT 5528 through retained earnings, and in July 2003 our shareholder H.S. Securities injected an additional \$2 million (MNT 2336 million at December 31) in the form of Tier II subordinated debt.





LIQUIDITY

Cash and short-term investments at December 31 totaled MNT 29.7 billion, resulting in a regulatory liquidity ratio of 35.54%, well above Mongolbank's required 18%.

Management's policy has been to maintain substantial liquidity in the form of cash and short term Mongolbank and GOM securities. The average investment maturity is under 60 days, and Mongolbank bills may be put to the issuer on demand with payment of an interest penalty. In addition, there is a functioning local interbank market for repurchase agreements.

LOANS

The loan portfolio continues to be diversified showing excellent liquidity and quality. The average loan amount was about MNT410.000 and an average term of six months, normally with equal monthly amortization.

At December 31, 2003 1017 loans were past due in the amount of MNT 953.400 million, representing, respectively, 0.9% and 1.8% of the portfolio.

DEPOSITS

Business and individual deposits now constitute 94% of total deposits. Current accounts from non-government sources at December 31 were MNT 10.2 billion. The Bank generally pays no interest on these accounts. Time and savings deposits from non-government sources grew to MNT 62.7 billion in 2003 from MNT 27.3 billion. Interest rates on these deposits ranged from 3.6% to 18% per annum and averaged 14.18%

Pension agency deposits were 1.6 billion at December 31, 2003. The Bank disburses approximately 5 billion in pension payments to individuals monthly.

Other government deposits totaled MNT 2.4 billion at December 31 and are declining as the government consolidates funds at the Mongol Bank under its Single Account fiscal management program.



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2003 YEAR IN REVIEW

KHAN BANK PRIVATIZATION

The Khan 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 by the international firm of KPMG at US \$ 3.28 million.

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

Khan Bank's privatization was the second largest privatization ever in Mongolia, and brought more than double the minimum price in a transaction that met all international standards.

BANK OF THE YEAR



In September 2003 The Banker Magazine named Agricultural Bank of Mongolia the Bank of the Year for 2003 in Mongolia. The announcement was made September 9 in London at the Banker's annual awards banquet.

Banker Magazine, founded in 1926, is part of the Financial Times Group, one of the most respected news organizations in the world. Its Best Bank awards, made annually in various categories, are among the most prestigious in world banking.

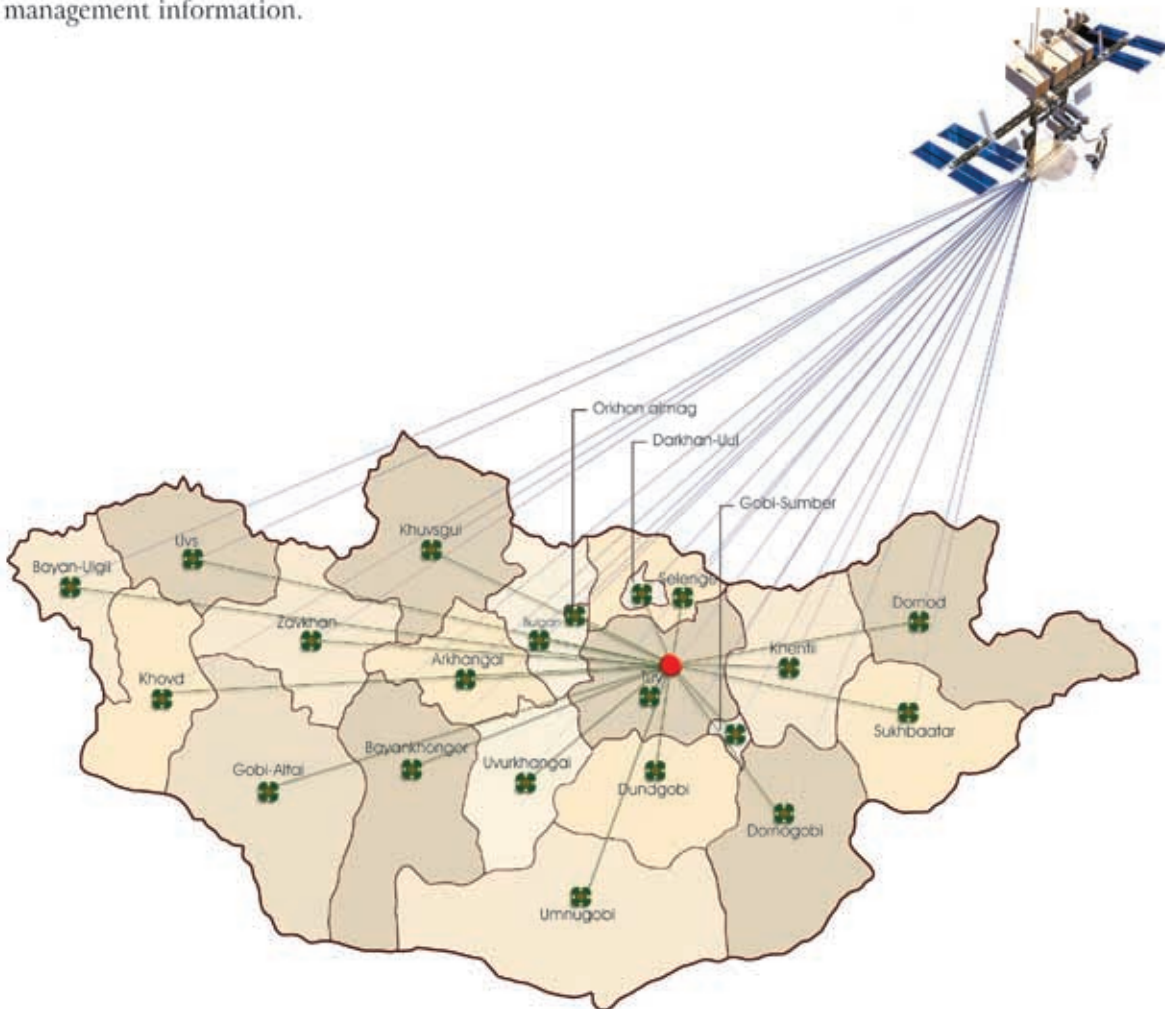


INFORMATION TECHNOLOGY

Khan Bank looks to the future when we think about IT. Our success is closely linked to accurately moving large numbers of transaction efficiently, safely and quickly. Our customers expect no less.

Already we have built the most advanced bank operating system in Mongolia. Our use of FNS software was dramatically improved through completion of a customization project in early 2004. We now have online banking available throughout the country, with a total of 50 branches connected to our central data base and able to conduct real time transactions with each other. Every aimag center, over half of our loans and over two thirds of our deposits are handled over this network. We currently have over 700 PC and laptops speeding up our work throughout the bank. Our team of IT professionals is top quality.

During 2004, Khan Bank plans to bring another 16 offices online. We will continue to invest in IT to insure the highest level of customer service, improved operating efficiency and effective management information.





UB EXPANSION PROGRAM

In April 2003 the Bank undertook a major expansion in Ulaanbaatar, the largest and fastest growing market in Mongolia, and where Khan Bank brand is widely known and has strong appeal. Thirteen new branches were opened and three were moved to new locations to new serve UB customers. Now Khan Bank operates in the busiest neighborhoods of all UB districts providing full banking services with high interest on safe deposits.



New office is opened in Bayangol duureg, 4th District, Ulaanbaatar

We have also redesigned and modified several loan products to better suit the needs of UB customers e.g., mortgage loans, real estate secured salary loans, real estate secured small business loans, small business line of credit.

KHAN BANK OFFICES IN UB

Name of offices	Managers	Phone	Address
Head office	S.Erdenechimeg	458677	Bayanzurkh duureg, 15 khoroolol
Anduud	A.Myagmar	368870	Bayangol duureg, 2 khoroo
Baruun khuree	S.Batbayar	363292	Bayangol duureg, 4 khoroolol
Bayangol	B.Gantumur	363699	Bayangol duureg, 4 khoroolol
Bayanzurkh	G.Naranchimeg	457554	Bayanzurkh duureg, 1 khoroo
Baga toiruu	Ts.Mendsaikhan	319703	Chingeltei duureg, 1 khoroo
Bayankhoshuu	Ch.Tungalag	306356	Songino-Khairkhan duureg, 9 khoroo
Ikh toiruu	S.Sukhbat	354014	Sukhbaatar duureg, 7 khoroo
Narantuul	Ts.Batsaikhan	461712	Bayanzurkh duureg, 14 khoroo
Unur	L.Oyunchimeg	680067	Songino-Khairkhan duureg, 1 khoroolol
Sansar	D.Gundegmaa	459045	Bayanzurkh duureg, 12 khoroolol
Sport complex	Kh.Bolormaa	319965	Sukhbaatar duureg, 8 khoroo
Songino-khairkhan	S.Soyolzul	632841	Songino-Khairkhan duureg, 21 khoroolol
Tavan bogd	Ts.Tsetsegmaa	345408	Khan-Uul duureg, 3 khoroo
Ulaanbaatar-tuv	Ya.Otgonjargal	456949	Bayanzurkh duureg, 13 khoroolol
Khailaast	S.Bolor-oyun	357499	Chingeltei duureg, 13 khoroo
Khan-uul	L.Khandjav	345166	Khan-Uul duureg, 1 khoroo
Huleg	Ch.Altangerel	680245	Bayangol duureg, 10 khoroolol
Tsaiz	B.Dulamsuren	460937	Bayanzurkh duureg, 16 khoroo
Chingeltei	R.Khayandarj	327323	Chingeltei duureg, 3 khoroo
Yarmag	D.Munkhuu	379167	Khan-Uul duureg, 5 khoroo



DEPOSIT PROGRAMS

We pioneered the use of direct deposit programs in Mongolia, where 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 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 76 billion at the end of the 2003 from 45 billion at the end of 2002.

LOAN ACTIVITY

In 2003, 318 799 loans totaling MNT 65.0 billion disbursed covering 14 different loan products. Interest rates were lowered on our most popular loan products, including small business and herder loans. Khan Bank's loan products now range from an annual rate of 13.8% to 48%.

Once again, in 2003, loan product requirements were liberalized in order to serve customers with more flexibility and to involve a greater range of borrowers.

CUSTOMER SATISFACTION

In June 2003 a comprehensive survey of loan and deposit customers in UB was taken. According to the survey the bank's image and reputation, advertising, customer service and wide branch coverage are of the highest importance to our customers.

Over 90% rated Khan Bank overall performance as "good" or "very good".

The survey established that main reasons the customers banking with Khan Bank are "soundness and reliability" and a proximity of our branches to the customers home or businesses.

Ninety percent of respondents said our "convenience of locations" is important for them.



Khan Bank Customers in UB-Tiv branch



MANAGEMENT AND ORGANIZATION

From August 2000 until 25 March 2003 Khan Bank was operated under a special corporate governance structure agreed among the Mongolian Government, the U.S. Government and the World Bank. In these agreements, the Government agreed not to exercise its normal prerogatives of ownership and to delegate control of the Bank to an independent Board and Management.

After privatization our new ownership elected a four person Board of Directors consisting of Mr. Sawada as Chairman and Mr. Mishima of HS Securities, Ms. Hulan of Tavan Bogd Trade and Mr. Morrow, the bank's CEO, as members.

The new owners have retained Development Alternatives, Inc of Bethesda, MD, to manage the bank, and Mr. Morrow, the Chief Executive Officer, continues to head a Mongolian-American management team.

BOARD OF DIRECTORS



Hideo Sawada, Chairman
President, H.S. Securities



J. Peter Morrow
*Chief Executive Officer,
Khan Bank*



D. Hulan
*Executive Director, "Tavan Bogd"
group of companies*



Yoshiaki Mishima
*General Manager, Capital Market
Department H.S. Securities*



MANAGEMENT TEAM

J. Peter Morrow serves as Chief Executive Officer. Ben Turnbull joined the bank as Chief Operating Officer in June 2003. Vice Director S. Sukhbold is responsible for management of the Bank's branch network and staff operations. Vice Director D. Gantugs, who also joined Khan Bank in August, is responsible for loan products and policies. E. Ouynbileg, serves as Vice Director responsible for Human Resources and Administration.



(from left) D. Gantugs, Vice Director, Lending Program, Ben Turnbull, COO, J. Peter Morrow, CEO, E. Ouynbileg, Vice Director, Human Resources, S. Sukhbold, Vice Director, Branch Supervision

Under their overall direction, the Bank's management activities are delegated to the following departments.



Department Heads: (back from left) Ts. Ganzorig, Training; S. Sandagdorj, Credit; R. Munkhtuya, Financial Supervision; A. Ganchimeg, Marketing; S. Zoltuya, Special Assets; M. Unurtsetseg, Administration; M. Erdenchimeg, Branch Supervision (front from left) Ch. Batsaikhan, Internal Audit; A. Minj, Treasury; B. Doljin, User Support; B. Enkhbold, Information Technology



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KHAN BANK AND RURAL MONGOLIA

Khan Bank has built the only banking network reaching all geographic areas of Mongolia and delivers full banking services to the rural population, even in areas considered extremely remote. We are the banking leader in the country-side.

Mongolian governmental agencies, foreign governments and donor institutions such as World Bank and Asian Development Bank, and companies with a need for country-wide reach to the rural populations look to Khan Bank's network. We are cooperating in several major projects throughout rural Mongolia. Wherever banking services are needed, we are there to help.



Herder in Zavkhan receiving money aid

One example is Khan Bank's partnership with the Swiss Agency for Development and Cooperation. In 2003, the Swiss and Mongolian governments identified the rural population of Zavkhan aimag as the most distressed in the country. The winter "zud" killed almost half the Zavkhan herds.

The Swiss selected 2208 herder families to help under their "Cash for Herders in Mongolia" program and turned to Khan Bank to coordinate the distribution of MNT 200,000 to each family.

The program was evaluated as highly successful. This was the second consecutive year for this cooperation; in 2002, the program came to the aid of herders in Gobi-Altai.



KHAN BANK OFFICES

Name of branch	Name of branch manager	Phone	Number of Sub-branches
Darkhan-Uul	Ch.Chuluuntsetseg	01372 33308	12
Orkhon	E.Sodnomjamts	01352 22089	6
Arkhangai	B.Zolbayar	01332 21082	18
Bayan-Ulgii	Kh.Khurmet	01422 22513	13
Bayankhongor	B.Tomorbaatar	01442 22764	22
Bulgan	Sh.Munkhbat	01342 22018	16
Gobi-Altai	T.Tuul	01482 23373	20
Dornogobi	B.Tserendorj	01522 22724	15
Dornod	D.Baatarkhuyag	01582 21332	15
Dundgobi	O.Tomorbaatar	01592 22246	15
Zavkhan	B.Nyamsuren	01462 22251	23
Uvurkhangai	D.Enkhbat	01322 22040	21
Umnogobi	A. Idertsog	01532 22374	17
Selenge	Kh.Altangerel	01362 22181	12
Sukhbaatar	Y.Lkhagvasuren	01512 21424	14
Uvs	D.Unurtsetseg	01452 22511	20
Khovd	Sh.Batkhisig	01432 23788	17
Khuvsgul	D.Tsetsegee	01382 22364	25
Khentii	J.Gongor	01562 22413	21
Gobi-Sumber	Ya.Altantsetseg	01542 23449	3
Zamiin uud	D.Baigalimaa	1524521365	2
Zuunkharaa	D.Erdenetsetseg	2364743976	1
UB-Tuv	Y.Otgonjargal	456949	31
UB branches			20
Total			379



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COMMUNITY CONNECTIONS

Through 2003, Khan Bank continued its broad range of active involvement with 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.

In January Khan Bank hosted a fund raising event for local artists and Art Council and was named as The First Golden Benefactor by the Arts Council of Mongolia.

For the second year we donated the Khan Bank Art Calendar to all offices and schools in all aimags and soums through its 380 offices all over the country. The calendar was designed to promote Mongolian modern fine arts which represent the Khan Bank Fine Art Collection.



Khan Bank sponsored pop singer Sarantuya's "I'm happy" concert tour throughout the country and signed a cooperation contract to be exclusive sponsor to the top Mongolian singer.



Pop singer B. Sarantuya visited Khan Bank offices during her tour concerts throughout the country, sponsored by Khan Bank

More than 9000 spectators and Khan Bank customers enjoyed her 'I'm Happy' concert. As part of her cooperation program with Khan Bank, Sarantuya has participated in various Khan Bank promotions and advertisements. During 2004 she will continue play a key role in publicising our image.

Under the Bank's community support program, Khan Bank invested in the Children's intellectual development by being the co-organizer of the Children's Book Release event in December, 2003 and donated 1000 children's reading primers to rural schools in every soum.

We also continued to invest in and support younger generation of Mongolia for their educational development. Range of support activities involved the second time sponsorship of the Public Speaking Competition in English organized by English Speaking Union of Mongolia, as well as the First National Oratorical Contest.

Other major community support events included: contribution to UB development with over MNT 30 million cost road construction, general sponsor of Biz and Art Fest for the MNCCI, sponsor of First Wrestler's Basketball Tournament, "New Century-Nature' Children Movement under the patronage of Ministry of Environment.



CEO of Khan Bank is giving the Cup of the First Wrestlers' Basketball Tournament to G. Usukhbayar, The Champion of National Wrestling, The Commando Team Leader

REPORT OF THE AUDITORS

To the Board of Directors of Agricultural Bank of Mongolia LLC

We have audited the accompanying financial statements of Agricultural Bank of Mongolia LLC as at 31 December 2003 set out on pages 3 to 32. These financial statements are the responsibility of the Bank's directors. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements have been properly drawn up in accordance with applicable International Financial Reporting Standards and the Regulations issued by Bank of Mongolia so as to give a true and fair view of the financial position of the Bank as of 31 December 2003 and of the

Ulaanbaatar

AGRICULTURAL BANK OF MONGOLIA LLC

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2003

	Note	2003 MNT '000	2002 MNT '000
Interest income	4	14,266,533	8,575,161
Interest expense	5	<u>(6,691,178)</u>	<u>(2,970,347)</u>
Net interest income		<u>7,575,355</u>	<u>5,604,814</u>
Non-interest income	6	<u>4,001,350</u>	<u>2,215,003</u>
Operating profit		<u>11,576,705</u>	<u>7,819,817</u>
Operating expenses	7	<u>(7,470,716)</u>	<u>(4,409,106)</u>
Profit before provisions		<u>4,105,989</u>	<u>3,410,711</u>
Provisions	8	<u>(726,389)</u>	<u>(156,081)</u>
Profit before taxation		<u>3,379,600</u>	<u>3,254,630</u>
Taxation	9	<u>(1,445,761)</u>	<u>(1,374,678)</u>
Profit after taxation		<u>1,933,839</u>	<u>1,879,952</u>

The accompanying notes form an integral part of the financial statements

AGRICULTURAL BANK OF MONGOLIA LLC

BALANCE SHEET AS AT 31 DECEMBER 2003

	Note	2003 MNT '000	2002 MNT '000
ASSETS			
Cash and short term funds	10	3,936,521	3,033,934
Deposits and placements with other banks and financial institutions	11	13,321,566	3,520,108
Investment in securities	12	13,237,830	13,741,533
Loans and advances	13	52,338,374	25,209,420
Other assets	14	895,836	627,721
Property, plant and equipment	15	4,886,691	4,162,032
TOTAL ASSETS		<u>88,616,818</u>	<u>50,294,748</u>
LIABILITIES			
Deposits from customers	16	76,128,066	45,697,114
Deposits and placements of other banks and financial institutions	17	3,087,202	-
Loans from Bank of Mongolia	18	290,265	318,493
Subordinated loan	19	2,336,000	-
Other liabilities	20	1,186,581	672,206
Provision for taxation		60,260	12,330
TOTAL LIABILITIES		<u>83,088,374</u>	<u>46,700,143</u>
EQUITY			
Statutory fund	21	4,574,130	4,574,130
Revaluation surplus		795,238	881,113
Retained profits/(accumulated losses)		159,076	(1,860,638)
TOTAL EQUITY		<u>5,528,444</u>	<u>3,594,605</u>
TOTAL EQUITY AND LIABILITIES		<u>88,616,818</u>	<u>50,294,748</u>
COMMITMENTS AND OFF BALANCE SHEET ITEMS			
	25	<u>9,390,391</u>	<u>9,420,436</u>

The accompanying notes form an integral part of the financial statements

Statement of Changes in Equity

AGRICULTURAL BANK OF MONGOLIA LLC

**CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2003**

	2003	2002
	MNT '000	MNT '000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit before tax	3,379,600	3,254,630
<i>Adjustments for :-</i>		
Depreciation of property, plant and equipment	574,543	329,331
Provisions	726,389	156,081
Property, plant and equipment written off	12,006	-
Loss on disposal of property, plant and equipment	6,360	16,608
Operating profit before working capital change	<u>4,698,898</u>	<u>3,756,650</u>
<i>Increase in operating assets:-</i>		
Loans and advances	(27,682,905)	(15,247,167)
Other assets	(372,069)	(375,141)
<i>Increase in operating liabilities</i>		
Deposits from customers	30,430,952	20,710,603
Deposits and placements of other banks and financial institutions	3,087,202	-
Other liabilities	435,445	927,693
Cash generated from operation:	<u>10,597,523</u>	<u>9,772,638</u>
Income tax paid	(1,397,831)	(1,550,107)
Net cash flow from operating activities	<u>9,199,692</u>	<u>8,222,531</u>
CASH FLOW FROM INVESTING ACTIVITIES		
Decrease / (increase) in investment securities	514,149	(3,168,228)
Purchase of property, plant and equipment	(1,327,198)	(1,738,466)
Proceeds from disposal of property, plant and equipment	9,630	21,570
Net cash flow from investing activities	<u>(803,419)</u>	<u>(4,885,124)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in subordinated loans:	2,336,000	-
Loans from Bank of Mongolia	(28,228)	318,493
Net cash flow from financing activities	<u>2,307,772</u>	<u>318,493</u>
Net increase in cash and cash equivalents	10,704,045	3,655,900
Cash and cash equivalents brought forward	<u>6,554,042</u>	<u>2,898,142</u>
Cash and cash equivalents carried forward	<u>17,258,087</u>	<u>6,554,042</u>
Cash and cash equivalents comprises		
Cash and short term funds	3,936,521	3,033,934
Deposits and placement with other banks and financial institutions	13,321,566	3,520,108
	<u>17,258,087</u>	<u>6,554,042</u>

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

AGRICULTURAL BANK OF MONGOLIA LLC

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2003

1. CORPORATE INFORMATION

The Bank is principally engaged in the business of provision of banking and financial services pursuant to License No. 6 issued by Bank of Mongolia. There have been no significant changes in the nature of these activities during the year

The Bank is a limited liability company, incorporated and domiciled in Mongolia. The registered address and the principal place of business of the Bank is Peace Avenue, P.O.Box-185, Ulaanbaatar-51, Mongolia.

The holding and ultimate holding companies of the Bank are H.S. Investment Co. Ltd. and H.S.Securities Co. Ltd. respectively, both of which are incorporated in Japan.

These financial statements of the Bank for the year ended 31 December 2003 were authorised for issue by the Board of Directors in accordance with a resolution of the directors on April 6, 2004.

2. BASIS OF PREPARATION

These financial statements have been prepared in accordance with applicable International Financial Reporting Standards and the Regulations issued by Bank of Mongolia.

The financial statements have been prepared under the historical cost convention 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.

3. SIGNIFICANT ACCOUNTING POLICIES

(a) Interest Income and Expense

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective yield method based on the actual purchase price. The recognition of interest income is suspended when loans are outstanding for more than ninety days in accordance with the requirements of Bank of Mongolia. 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 and the loan is reclassified as performing.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(b) Fee and Commission Income

Pension loan fees and acceptance fees are recognised as income based on contractual arrangements. Pension payment charges, application fees, money transfer fees, transaction fees, other fee and commission income are recognised when the services have been provided.

(c) Foreign Currencies

Transactions in foreign currencies are initially recorded in Togrog at rates of exchange ruling at the date of the transaction. At each balance sheet date, foreign currency monetary items are translated into Togrog at exchange rates ruling at that date, unless hedged by forward foreign exchange contracts, in which case the rates specified in such forward contracts are used. Non-monetary items initially denominated in foreign currencies, which are carried at historical cost are translated using the historical rate as of the date of acquisition and non-monetary items which are carried at fair value are translated using the exchange rate that existed when the values were determined.

All exchange rate differences are taken to the income statement.

The principal exchange rates used for every unit of foreign currency ruling at the balance sheet date used are as follows:

	2003	2002
United States Dollar	1,168.00	1,125.00
European Euro	1,460.20	1,169.40
Japanese Yen	10.92	9.38
Chinese Yuan	141.10	135.90
Russian Ruble	39.90	35.40

(d) Loans and Advances and Provision for Loan Loss

Loans originated by the Bank by providing money directly to the borrower at draw down are categorised as loans and advances. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction.

All loans and advances are recognised when cash is advanced to borrowers.

Provisions for loan loss are 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. Provisions made during the year are charged against the income statement.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(d) Loans and Advances and Provision for Loan Loss (contd.)

The maturity of the loan portfolio is presented in Note 13 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 mortgage loan, investment loan and 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.

(e) 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 purpose, in accordance with the regulations of the Mongolian Government and is measured using the tax rates that have been enacted at the balance sheet date.

(f) Cash and Cash Equivalent:

For the purposes of the cash flow statement, cash and cash equivalents consist of cash and short term funds, deposits and placements with other banks and financial institutions that are readily convertible to cash with insignificant risk of changes in value.

(g) Investment Securities:

Investment securities are securities that are acquired and held for yield or capital growth and are usually held to maturity.

Government bonds and Bank of Mongolia Treasury bills are stated at cost adjusted for amortisation of premiums or accretion of discounts, where applicable, to maturity dates.

On disposal of the investment securities, the differences between the net disposal proceeds and their carrying amounts are charged or credited to the income statement.

(h) Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The policy for the recognition and measurement of impairment losses is in accordance with Note 3 (j).

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(h) Property, Plant and Equipment (contd.)

Revaluations are made at least once in every five years based on a valuation by an independent valuer or an open market value basis. Any revaluation increase is credited to equity as a revaluation surplus, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense, in which case the increase is recognised the income statement to the extent of the decrease previously recognised. A revaluation decrease is first offset against an increase on unutilised earlier valuations in respect of the same asset and is thereafter recognised as an expense.

The estimated useful lives used by the Bank are as follows :-

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

Upon disposal of an item of property, plant or equipment, the difference between the net disposal proceeds and the net carrying amount is recognised in the income statement and the unutilised portion of the revaluation surplus on that item may be taken directly to retained profits.

(i) Sale and Repurchase Agreement

Securities sold subject to a linked repurchase agreements ('repos') are retained in the financial statements as trading or investment securities and the counterparty liability is included in amounts due to other financial institutions or as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as amounts due from other financial institutions as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

(j) 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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(j) Impairment of Assets (contd.)

An impairment loss is charged to the income statement immediately, unless the asset is carried at revalued amount. Any impairment loss of a revalued asset is treated as a revaluation decrease to the extent of any available previously recognised revaluation surplus for the same asset. Reversal of impairment losses recognised in prior years is recorded when there is an indication that the impairment losses recognised for the asset no longer exist or have decreased.

(k) Deposits From Customers

Deposits from customers are stated at cost which is the fair value of the consideration to be paid in the future for deposits received.

(l) Financial Instrument

Financial instruments are recognised in the balance sheet when the Bank has become a party to the contractual provisions of the instrument. The accounting policies on recognition and measurement of these items are disclosed in their respective accounting policies.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends and gains and losses relating to a financial instrument classified as a liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity. Financial instruments are offset when the Bank has a legally enforceable right to offset and intends to settle either on a net basis or to realise the asset and settle the liability simultaneously.

(i) Equity Instruments

Statutory fund is classified as equity and dividends are recognised in equity in the period in which they are declared.

(m) Employee Benefits

(i) Short Term Benefits

Wages, salaries and other salary related expenses are recognised as an expense in the year in which the associated services are rendered by employees of the Bank. Short term accumulating compensated absences such as paid annual leave are recognised when services rendered by employees that increase their entitlement to future compensated absences, and short term non-accumulating compensated absences such as sick leave are recognised when absences occur.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(m) Employee Benefits (contd.)

(ii) Defined Contribution Plans

As required by the law, companies in Mongolia make contributions to the government pension scheme, Social Security and Health Fund. Such contributions are recognised as an expense in the income statement as incurred

4. INTEREST INCOME

	2003 MNT '000	2002 MNT '000
Loans and advances	13,159,885	7,041,655
Deposits and placements with other: banks and financial institutions	60,136	12,400
Bank of Mongolia Treasury bills	514,145	1,057,253
Government bonds	532,367	463,853
	<u>14,266,533</u>	<u>8,575,161</u>

5. INTEREST EXPENSE

	2003 MNT '000	2002 MNT '000
Deposits from customers	6,396,207	2,970,347
Deposits and placements of other: banks and financial institutions	233,607	-
Subordinated loan	61,364	-
	<u>6,691,178</u>	<u>2,970,347</u>

6. NON-INTEREST INCOME

	2003 MNT '000	2002 MNT '000
Fee income:		
Pension loan fees	1,827,995	1,123,962
Acceptance fees	974,400	562,178
Pension payment charges	215,324	200,801
Application fees	192,355	151,335
Money transfer fees	139,583	22,815
Transaction fees	135,308	74,722
Letter of advice charges	91,527	56,995
Other fee income	57,348	70,763
	<u>3,633,840</u>	<u>2,263,571</u>

6. NON-INTEREST INCOME (CONTD.)

Other income:

Realised foreign currency gain/(loss)	58,501	(186,168)
Unrealised foreign currency gain/(loss)	95,497	(1,409)
Income from penalties:	84,386	41,086
Recovery of collateral previously written off:	12,053	37,817
Recovery of bad loans	65,661	-
Recovery of other assets previously written off:	26,901	-
Other operating income	24,511	60,106
	<u>367,510</u>	<u>(48,568)</u>
Total non-interest income	<u>4,001,350</u>	<u>2,215,003</u>

7. OPERATING EXPENSES

	2003	2002
	MNT '000	MNT '000
Personnel costs		
- Salaries and related expenses	2,632,337	1,385,681
- Bonuses and allowances	1,058,041	635,587
Communications	510,000	339,654
Advertising	325,036	255,330
Depreciation of property, plant and equipment	574,543	329,331
Training	290,982	232,813
Stationery	450,845	216,578
Business trips	181,696	176,279
Transportation and fuel supplies	227,503	169,028
Utilities	184,902	149,161
Maintenance of property, plant and equipment	148,004	118,646
Rental expenses	243,987	83,780
Computer expenses	168,640	78,582
Membership and audit expenses:	80,990	20,534
Armoured guard and security	68,696	40,392
Health insurance	58,392	41,835
Loans and collection expenses:	58,022	20,818
Entertainment	50,359	37,963
Cash collection services	37,374	26,099
Other operating expenses	120,367	51,015
	<u>7,470,716</u>	<u>4,409,106</u>

7. OPERATING EXPENSES (CONTD.)

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

	2003	2002
	Number	Number
Directors and head of departments	16	10
Branch managers	24	22
Sub-branch managers	345	342
Executives and clerical staff	1,402	1,058
	<u>1,787</u>	<u>1,432</u>
Of which:		
- Head office	122	110
- Branches	1,665	1,322
	<u>1,787</u>	<u>1,432</u>

8. PROVISIONS

	2003	2002
	MNT '000	MNT '000
Provision for loan losses	553,951	94,701
Provision for other assets	103,954	36,933
Provision for lawsuit claim	78,930	-
(Write back)/provision for investment in securities	(10,446)	24,447
	<u>726,389</u>	<u>156,081</u>

9. TAXATION

	2003	2002
	MNT '000	MNT '000
Mongolian taxation based on results for the year:		
- Current	1,445,761	1,292,370
- Underprovision in prior year	-	82,308
	<u>1,445,761</u>	<u>1,374,678</u>

Mongolian legal entities must individually report taxable income and remit income taxes thereon to the appropriate authorities. The income tax rate for banks profits is 15% for the first MNT100 million of taxable income, and 40% on the excess of taxable income over MNT100 million. Interest income on government bonds is not subject to income tax. The provision for probable loan losses is deductible for income tax purposes.

9. TAXATION (CONTD.)

A reconciliation of income tax expense applicable to profit before taxation at the statutory income tax rate to income tax expense at the effective income tax rate of the Bank is as follow:

	2003 MNT '000	2002 MNT '000
Income tax at statutory rates based on profit before taxation	1,326,840	1,310,656
Tax exempt income	(235,868)	(200,668)
Non-deductible expense:	342,288	182,382
Overprovision in current year	12,501	-
Underprovision in prior year	-	82,308
Tax expense for the year	<u>1,445,761</u>	<u>1,374,678</u>

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

10. CASH AND SHORT TERM FUNDS

	2003 MNT '000	2002 MNT '000
Cash in local currencies	3,015,087	2,491,354
Cash in foreign currencies	921,172	541,232
Cash in transit	262	1,348
	<u>3,936,521</u>	<u>3,033,934</u>

11. DEPOSITS AND PLACEMENTS WITH OTHER BANKS AND FINANCIAL INSTITUTIONS

	2003 MNT '000	2002 MNT '000
Balances with Bank of Mongolia	8,209,854	3,207,796
Placements with other banks and financial institution	3,111,712	312,312
Securities purchased under resell agreement	2,000,000	-
	<u>13,321,566</u>	<u>3,520,108</u>

Balances with Bank of Mongolia are maintained in accordance with Bank of Mongolia requirements and bear interest at rates ranging from 0.0% to 0.3% (2002 : 0.0% to 0.3%) per annum. The balances maintained with Bank of Mongolia are determined at set percentages based on 15 days average cash balances.

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

Placements with other banks and financial institutions represent foreign currency current accounts maintained with foreign and local financial institutions, which are generally denominated in United States Dollar ("USD"). Placements with foreign financial institution bear no interest (2002: Nil) and placements with local financial institution bear interest at annual ranging from 6.9% to 7.0% (2002 : Nil) per annum.

The securities purchased under resell agreement is non-interest bearing.

12. INVESTMENT IN SECURITIES

	2003	2002
	MNT '000	MNT '000
Bank of Mongolia Treasury bills	11,690,022	10,565,049
Government bonds	1,417,867	3,043,238
	<u>13,107,889</u>	<u>13,608,287</u>
Accretion of discounts	143,942	157,693
Provision for impairment losses	(14,001)	(24,447)
	<u>13,237,830</u>	<u>13,741,533</u>

Bank of Mongolia Treasury bills are interest bearing short term bills with maturities of less than three months, and are issued at a discount. The effective interest rates of these bills range from 1.3% to 18.0% (2002 : 4.4% to 14.5%) per annum.

Government bonds are issued by the Ministry of Finance and Economy with maturities ranging from 60 days to 720 days. Interest rates are in the range of 4.6% to 15.5% (2002: 4.5% to 15.8%) per annum.

13. LOANS AND ADVANCES

	2003	2002
	MNT '000	MNT '000
Loans to customers	51,112,125	24,550,649
Staff loans	979,155	442,050
Accrued interest receivable	1,147,880	563,556
Gross loans and advances	<u>53,239,160</u>	<u>25,556,255</u>
Provision for loan losses		
- specific	(389,251)	(98,875)
- general	(511,535)	(247,960)
Net loans and advances	<u>52,338,374</u>	<u>25,209,420</u>

13. LOANS AND ADVANCES (CONTD.)

	2003	2002
	MNT '000	MNT '000
Maturity structure		
Maturing within one year	44,837,935	24,897,420
One to five years	6,694,015	223,000
After five years	806,424	89,000
	<u>52,338,374</u>	<u>25,209,420</u>

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

	2003	2002
	MNT '000	MNT '000
Small and medium enterprise:	30,907,192	14,320,428
Personal	10,009,620	7,288,300
Agricultural	6,430,280	2,941,921
Mortgage	3,765,033	-
Staff	979,155	442,050
	<u>52,091,280</u>	<u>24,992,699</u>
Accrued interest receivable	1,147,880	563,556
Provision for loan losses		
- specific	(389,251)	(98,875)
- general	(511,535)	(247,960)
Net loans and advances	<u>52,338,374</u>	<u>25,209,420</u>

Movements in the non-performing loans ("NPL") are as follows:

	2003	2002
	MNT '000	MNT '000
Balance at beginning of year	196,645	41,945
NPL during the year - gross	3,633,838	832,023
Recoveries/regularised during the year	(2,892,765)	(677,323)
Gross balance at end of year	<u>937,718</u>	<u>196,645</u>
Less: Specific Provisor	(389,251)	(98,875)
Net balance at end of year	<u>548,467</u>	<u>97,770</u>

Gross NPL ratio as a percentage of gross total loans	1.8%	0.8%
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Net NPL ratio as a percentage of net total loans	1.0%	0.4%
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13. LOANS AND ADVANCES (CONTD.)

Movements in the provision for loan losses are as follows:

	2003	2002
	MNT '000	MNT '000
Specific Provision		
Balance at beginning of year	98,875	23,649
Provision made during the year	297,178	75,226
Amount written back in respect of recoveries	(6,802)	-
Balance at end of year	<u>389,251</u>	<u>98,875</u>
	2003	2002
	MNT '000	MNT '000
General Provision		
Balance at beginning of year	247,960	99,205
Provision made during the year	263,575	148,755
Balance at end of year	<u>511,535</u>	<u>247,960</u>

At 31 December 2003, all loans and advances to borrowers are denominated in Togrog except for USD loans amounting to MNT2.3 billion (2002 : Nil). Interest rate ranges from 4.8% to 48.0%(2002 : 5.0% to 72.0%) per annum.

Loans and advances amounting to approximately MNT51.2 billion at 31 December 2003 (2002 : MNT24.8 billion) were classified as normal and provided with a 1% loss reserve. Further, loans amounting to MNT937.7 million (2002 : MNT196.6 million) were classified as NPLs as at 31 December 2003 and provisions of MNT389.3 million (2002 : MNT98.9 million) have been allocated against these NPLs.

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.

14. OTHER ASSETS

	2003	2002
	MNT '000	MNT '000
Consumables and inventories	615,389	527,591
Other receivables	254,724	169,914
Prepaid expenses	109,184	77,801
Others	170,649	2,571
	<u>1,149,946</u>	<u>777,877</u>
Less: Provision for other assets	(254,110)	(150,156)
Net other assets	<u>895,836</u>	<u>627,721</u>

15. PROPERTY, PLANT AND EQUIPMENT

	Buildings MNT '000	Furniture, fixtures and vehicles MNT '000	Computers MNT '000	Total MNT '000
At cost/valuation				
Balance at beginning of year	4,810,978	1,077,370	1,392,674	7,281,022
Additions	219,502	574,425	533,271	1,327,198
Disposals	(570)	(30,509)	-	(31,079)
Write-offs	-	(20,998)	(28,546)	(49,544)
Balance at end of year	<u>5,029,910</u>	<u>1,600,288</u>	<u>1,897,399</u>	<u>8,527,597</u>
Representing:				
At cost	480,976	1,600,288	1,897,399	3,978,663
At valuation	4,548,934	-	-	4,548,934
	<u>5,029,910</u>	<u>1,600,288</u>	<u>1,897,399</u>	<u>8,527,597</u>
Accumulated depreciation				
Balance at beginning of year	2,685,928	185,443	247,619	3,118,990
Reclassification	(51,781)	51,781	-	-
Charge for the year	122,480	147,040	305,023	574,543
Disposals	(111)	(14,978)	-	(15,089)
Write-offs	-	(13,513)	(24,025)	(37,538)
Balance at end of year	<u>2,756,516</u>	<u>355,773</u>	<u>528,617</u>	<u>3,640,906</u>
Net Book Value				
At 31 December 2003				
At cost	471,866	1,244,515	1,368,782	3,085,163
At valuation	1,801,528	-	-	1,801,528
	<u>2,273,394</u>	<u>1,244,515</u>	<u>1,368,782</u>	<u>4,886,691</u>
At 31 December 2002				
At cost	209,394	891,927	1,145,055	2,246,376
At valuation	1,915,656	-	-	1,915,656
	<u>2,125,050</u>	<u>891,927</u>	<u>1,145,055</u>	<u>4,162,032</u>
Depreciation charge for 2002	<u>166,310</u>	<u>34,143</u>	<u>128,878</u>	<u>329,331</u>

Details of the latest independent professional valuations of buildings at 31 December 2003 are as follows:

Date of Valuation	Description of Property	Valuation Amount MNT'000	Basis of Valuation
31 December 2001	Head office and branches building	4,566,380	Open market value

15. PROPERTY, PLANT AND EQUIPMENT (CONTD.)

Had the revalued buildings been carried at historical cost, the net book value of the buildings that would have been included in the financial statements of the Bank as at 31 December 2003 would have been MNT1,308 million (2002 : MNT1,159 million).

16. DEPOSITS FROM CUSTOMERS

	2003	2002
	MNT '000	MNT '000
Current deposits	10,004,025	9,495,447
Demand deposits	10,192,079	4,783,661
Time deposits	50,362,852	23,797,601
Government deposits	4,990,121	7,258,576
Other deposits	578,989	361,829
	<u>76,128,066</u>	<u>45,697,114</u>

(i) The maturity structure of time deposits, government deposits and other deposits are as follows:

	2003	2002
	MNT '000	MNT '000
Due within six months	34,923,569	26,876,177
Six months to one year	21,008,393	4,541,829
	<u>55,931,962</u>	<u>31,418,006</u>

(ii) The deposits are sourced from the following customers:

	2003	2002
	MNT '000	MNT '000
Business enterprises	12,726,828	10,994,436
Individuals	58,411,117	27,444,102
Government	4,990,121	7,258,576
	<u>76,128,066</u>	<u>45,697,114</u>

Current deposits and other deposits bear no interest. Demand deposits are interest bearing and may be withdrawn upon demand. Foreign currency demand deposits bear interest of 3.6% (2002 : 1.8% to 3.6%) per annum. MNT demand deposits bear interest of 9.6% (2002 : 2.4% to 9.6%) per annum.

Foreign currency time deposits bear annual interest rates ranging from 4.0% to 7.2% (2002 : 3.6% to 7.2%) per annum, while for local currency time deposits interest rates range from 9.6% to 19.2% (2002 : 4.8% to 18.0%) per annum.

16. DEPOSITS FROM CUSTOMERS (CONTD.)

Local currency government deposits bear interest rates ranging from 0.0% to 12.0% (2002 : 2.4% to 3.6%) per annum. Foreign currency government deposits bear interest rates ranging from 4.0% to 7.2% (2002 : Nil) per annum.

17. DEPOSITS AND PLACEMENTS OF OTHER BANKS AND FINANCIAL INSTITUTIONS

	2003 MNT '000	2002 MNT '000
Foreign currency deposits	586,688	-
Local currency deposits	500,514	-
Obligations on securities sold under repurchased agreement	2,000,000	-
	<u>3,087,202</u>	<u>-</u>

Foreign currency and local currency deposits are placed by local commercial banks. The foreign currency deposits bear interest of 6% per annum while local currency deposits bear interest of 12.5% per annum.

18. LOANS FROM BANK OF MONGOLIA

	2003 MNT '000	2002 MNT '000
Term Loan I	93,440	112,500
Term Loan II	46,720	56,250
Term Loan III	150,105	149,743
	<u>290,265</u>	<u>318,493</u>

Term Loan I

The loan is denominated in USD and bears service fee at 1% (2002 : 1%) per annum, with principal sum repayable by 5 equal annual installments commencing 1 December 2003. The loan was taken to purchase computer equipments.

Term Loan II

The loan is denominated in USD and bears service fee at 1% (2002 : 1%) per annum, with principal sum repayable by 5 equal annual installments commencing 1 December 2003. The loan was taken for additional work performed on the BANCS software implemented by the Bank.

18. LOANS FROM BANK OF MONGOLIA (CONTD.)

Term Loan III

The loan is denominated in USD and bears service fee at 1% (2002 : 1%) per annum, with service fee payment commencing in 2007 and principal sum repayable by 30 equal annual installments commencing 1 December 2002. The loan was for the Bank's portion of the BANCS software purchased.

19. SUBORDINATED LOAN

	2003	2002
	MNT '000	MNT '000
Loan from H.S Investment Co. Ltd	<u>2,336,000</u>	<u>-</u>

During the year, the Bank obtained a subordinated loan amounting to MNT2,336 million (USD2.0 million) from H.S Investment Co. Ltd., the holding company, to fund its ongoing business operations and to improve the Bank's capital adequacy ratio. This subordinated loan bears interest at 5% per annum. The interest is payable on a quarterly basis beginning 31 October 2003. The subordinated loan shall be due and payable in full on 31 July 2008. All payments are to be made in US Dollar.

20. OTHER LIABILITIES

	2003	2002
	MNT '000	MNT '000
Payables	386,388	205,695
Accrued interest	24,800	13,277
Delay on clearing settlements	755,662	420,225
Other payables	19,731	33,009
	<u>1,186,581</u>	<u>672,206</u>

21. STATUTORY FUND

	Number of Ordinary		Amount	
	Shares of MNT1,000 each			
	2003	2002	2003	2002
			MNT '000	MNT '000
At 1 January/ At 31 December	<u>4,574,130</u>	<u>4,574,130</u>	<u>4,574,130</u>	<u>4,574,130</u>

At 31 December 2003 the statutory fund was 60% owned by H.S. Investment Co. Ltd. (2002 : 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 risks 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.

The Bank has not entered into other related commitments such as guarantees and standby letter of credit.

Apart from deposits and placements with other banks and financial institutions amounting to MNT126,040,000 (2002: MNT312,312,000) all the banking assets and liabilities were geographically concentrated in Mongolia.

23. RELATED PARTY DISCLOSURES

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. The Bank is controlled by H.S. Investment Co. Ltd. (incorporated in Japan). The ultimate parent of the group is H.S. Securities Co. Ltd. (incorporated in Japan).

A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits and foreign currency transactions. These transactions were carried out on commercial terms and at market rates. The volumes of related party transactions, outstanding balances as at the year end, and relating expense for the year are listed below.

	2003	2002
	MNT '000	MNT '000
Loans to key management persone	<u>256,675</u>	<u>100,989</u>
Repayable		
- within one year	-	-
- one to five years	44,729	42,189
- after five years	211,946	58,800
	<u>256,675</u>	<u>100,989</u>
Provision for loan losses	<u>(2,567)</u>	<u>(1,010)</u>
Total	<u>254,108</u>	<u>99,979</u>

The loans to Bank's employees bear interest rates ranging from 4.8% to 18.0% (2002 : 5.0% to 21.0%) per annum.

There were no other related party transactions with the ultimate parent company or with the parent company, H.S. Investments Co. Ltd., other than the subordinated loan obtained from H.S. Investment Co. Ltd. amounting to MNT2.3 billion (2002: Nil), and the payment of interest on the subordinated loan of MNT29.2 million (2002: Nil).

24. CAPITAL ADEQUACY

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. The capital adequacy ratios of the Bank as at 31 December are as follows:

	2003	2002
Core capital ratio	7.92%	9.03%
Risk weighted capital ratio	<u>13.16%</u>	<u>11.96%</u>
<u>Tier I capital</u>		
Statutory fund	4,574,130	4,574,130
Retained profits/(accumulated losses)	159,076	(1,860,638)
Total Tier I Capital	<u>4,733,206</u>	<u>2,713,492</u>
<u>Tier II capital</u>		
Revaluation surplus	795,238	881,113
Subordinated loan	<u>2,336,000</u>	<u>-</u>
Total capital/capital base	<u>7,864,444</u>	<u>3,594,605</u>

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

	2003		2002	
	MNT '000		MNT '000	
%	Assets	Risk Weighted	Assets	Risk Weighted
0	23,997,950	-	19,983,263	-
10	-	-	-	-
20	6,497,967	1,299,593	312,312	62,462
50	-	-	-	-
100	<u>58,472,138</u>	<u>58,472,138</u>	<u>29,999,173</u>	<u>29,999,173</u>
Total	<u>88,968,055</u>	<u>59,771,731</u>	<u>50,294,748</u>	<u>30,061,635</u>

25. COMMITMENTS AND OFF BALANCE SHEET ITEMS

	2003	2002
	MNT '000	MNT '000
Ministry of Food and Agriculture Loans:	1,290,285	1,660,864
Accrued interest on Loans by the Ministry of Food and Agriculture	354,787	307,222
Other off balance sheet items:	<u>7,745,319</u>	<u>7,452,350</u>
	<u>9,390,391</u>	<u>9,420,436</u>

25. COMMITMENTS AND OFF BALANCE SHEET ITEMS (CONTD.)

a) Ministry of Food and Agriculture Loans

On 7 May 2001, the Bank entered into a Banking Service Agreement with the Ministry of Food and Agriculture (MFA). 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, acting on behalf of MFA, has extended MNT1.7 billion of loans to agricultural companies.

The Bank earns a commission of 17% on the interest received from the borrowers. No new loans were disbursed in 2003 (2002 : MNT Nil). No commission was earned in 2003 (2002 : MNT Nil).

b) Other off balance sheet items

At 31 December 2003, other off balance sheet items consisted mainly of loans of MNT4.0 billion (2002 : MNT4.1 billion) (inclusive of interest), receivables of MNT1.1 billion (2002 : MNT837 million) and collateral assets obtained from customers amounting to MNT221 million (2002 : MNT125 million).

Also included as other off balance sheet items are "Inherited" and "Directed" loans amounting to MNT1.2 billion along with accrued interest of MNT1.1 billion (2002 : MNT1.2 billion plus accrued interest of MNT1.1 billion).

c) Guarantees and letters of credit

The Bank has no guarantees and letters of credit outstanding as of 31 December 2003 (2002 : Nil).

26. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

Financial instruments comprise financial assets and financial liabilities. The fair value of a financial instrument is the amount at which the instrument could be exchanged or settled between knowledgeable and willing parties in an arm's length transaction, other than in a forced or liquidation sale.

The estimated fair values of most of the financial assets and financial liabilities as at the balance sheet date approximate their carrying amounts as shown in the balance sheet.

27. COMPARATIVE FIGURES

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

	As restated MNT'000	As previously stated MNT'000
Assets		
Deposits and placements with other banks and financial institutions	3,520,108	3,105,804
Liabilities		
Deposits from customers	45,697,114	45,084,232
Other liabilities	672,206	870,784

28. CURRENCY

All amounts are in Mongolian Togrog unless otherwise stated.

29. 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.

22. RISK MANAGEMENT POLICIES (CONTD.)

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) and in total.

The Bank's concentration of assets and liabilities are as follows

	2003 (MNT'000)		
	MNT	Foreign currencies	Total
Assets			
Cash and short term funds	3,015,086	921,435	3,936,521
Deposits and placements with other banks and financial institutions	9,544,130	3,777,436	13,321,566
Investment in securities	13,237,830	-	13,237,830
Loans and advances	50,108,122	2,230,251	52,338,373
Other assets	895,837	-	895,837
Property, plant and equipment	4,886,691	-	4,886,691
	<u>81,687,696</u>	<u>6,929,122</u>	<u>88,616,818</u>
Liabilities			
Deposits from customers	72,877,868	3,250,198	76,128,066
Deposits and placements of other banks and financial institutions	2,500,514	586,688	3,087,202
Loans from Bank of Mongolia	-	290,265	290,265
Subordinated loan	-	2,336,000	2,336,000
Other liabilities	1,029,123	157,458	1,186,581
Provision for taxation	60,260	-	60,260
	<u>76,467,765</u>	<u>6,620,609</u>	<u>83,088,374</u>
Net position	<u>5,219,931</u>	<u>308,513</u>	<u>5,528,444</u>

22. RISK MANAGEMENT POLICIES (CONTD.)

	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	1,890,185	1,629,923	3,520,108
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
	<u>48,122,245</u>	<u>2,172,503</u>	<u>50,294,748</u>
	2002 (MNT'000)		
	MNT	Foreign currencies	Total
Liabilities			
Deposits from customers	43,755,995	1,941,119	45,697,114
Deposits and placements of other banks and financial institutions	-	-	-
Loans from Bank of Mongolia	-	318,493	318,493
Other liabilities	672,206	-	672,206
Provision for taxation	12,330	-	12,330
	<u>44,440,531</u>	<u>2,259,612</u>	<u>46,700,143</u>
 Net position	 <u>3,681,714</u>	 <u>(87,109)</u>	 <u>3,594,605</u>

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.

22. RISK MANAGEMENT POLICIES (CONTD.)

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.

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 per annum in 2003 and 2002 for monetary financial instruments are as follows:

	2003		2002	
	MNT	USD	MNT	USD
Interest earning assets:				
Deposits and placements with other banks and financial institutions	0.0%-0.3%	6.9%-7.0%	0.0%-0.3%	-
Bank of Mongolia Treasury bills	1.3%-18.0%	-	4.4%-14.5%	-
Government bonds	4.6%-15.5%	-	4.5%-15.8%	-
Loans and advances	4.8%-48.0%	24.0%	4.8%-72.0%	-
Interest bearing liabilities:				
Demand deposits from customers	9.6%	3.6%	2.4%-9.6%	1.8%-3.6%
Time deposits from customers	9.6%-19.2%	4.0%-7.2%	4.8%-18.0%	3.6%-7.2%
Government deposits	0.0%-12.0%	2.4%-3.6%	4.0%-7.2%	-
Deposits and placements of other banks and financial institutions	12.5%	6.0%	-	-
Loans from Bank of Mongolia	-	1.0%	-	1.0%
Subordinated loan	-	5.0%	-	-

22. RISK MANAGEMENT POLICIES (CONTD.)

The contractual maturities of banking assets and liabilities for the year ended 31 December 2003 are 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	3,936	-	-	-	-	3,936
Deposits and placements with other banks and financial institutions	13,322	-	-	-	-	13,322
Investment in securities	11,834	402	1,002	-	-	13,238
Loans and advances	254	14,599	29,985	6,694	806	52,338
Other assets	1	170	725	-	-	896
Property, plant and equipment	-	-	-	1,369	3,518	4,887
	<u>29,347</u>	<u>15,171</u>	<u>31,712</u>	<u>8,063</u>	<u>4,324</u>	<u>88,617</u>
Liabilities						
Deposits from customers	30,074	25,046	21,008	-	-	76,128
Deposits and placements of other banks and financial institutions	3,087	-	-	-	-	3,087
Loans from Bank of Mongolia	-	-	40	127	123	290
Subordinated loan	-	-	-	2,336	-	2,336
Other liabilities	1,082	26	79	-	-	1,187
Provision for taxation	60	-	-	-	-	60
	<u>34,303</u>	<u>25,072</u>	<u>21,127</u>	<u>2,463</u>	<u>123</u>	<u>83,088</u>
Net liquidity gap	<u>(4,956)</u>	<u>(9,901)</u>	<u>10,585</u>	<u>5,600</u>	<u>4,201</u>	<u>5,529</u>
Accumulated gap	<u>(4,956)</u>	<u>(14,857)</u>	<u>(4,272)</u>	<u>1,328</u>	<u>5,529</u>	

22. RISK MANAGEMENT POLICIES (CONTD.)

The contractual maturities of banking assets and liabilities for the year ended 31 December 2002 are 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	3,520	-	-	-	-	3,520
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
	<u>21,850</u>	<u>10,541</u>	<u>12,034</u>	<u>1,619</u>	<u>4,251</u>	<u>50,295</u>
Liabilities						
Deposits from customers	35,745	5,772	4,180	-	-	45,697
Deposits and placements of other banks and financial institutions	-	-	-	-	-	-
Loans from Bank of Mongolia	-	-	39	156	124	319
Other liabilities	672	-	-	-	-	672
Provision for taxation	12	-	-	-	-	12
	<u>36,429</u>	<u>5,772</u>	<u>4,219</u>	<u>156</u>	<u>124</u>	<u>46,700</u>
Net liquidity gap	<u>(14,579)</u>	<u>4,769</u>	<u>7,815</u>	<u>1,463</u>	<u>4,127</u>	<u>3,595</u>
Accumulated gap	<u>(14,579)</u>	<u>(9,810)</u>	<u>(1,995)</u>	<u>(532)</u>	<u>3,595</u>	