

AGRICULTURAL BANK OF MONGOLIA LLC

Audited Financial Statements

31 December 2003

AGRICULTURAL BANK OF MONGOLIA LLC

CORPORATE INFORMATION

REGISTERED OFFICE : Peace Avenue, P.O.Box-185
Ulaanbaatar-51, Mongolia

BOARD OF DIRECTORS : Hideo Sawada
Yoshiaki Mishima
J. Peter Morrow
Hulan Dashdava

COMPANY SECRETARY : E. Oyunbileg

AUDITORS : Ernst & Young Mongolia Audit LLC
Certified Public Accountants

AGRICULTURAL BANK OF MONGOLIA LLC

**FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2003**

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STATEMENT BY DIRECTORS AND EXECUTIVE

We, J. PETER MORROW and HULAN DASHDAVA, being two of the directors of AGRICULTURAL BANK OF MONGOLIA LLC ("the Bank"), and R MUNKHTUYA, being the officer primarily responsible for the financial management of the Bank, do hereby state that, in our opinion, the accompanying financial statements set out on pages 3 to 32 are drawn up in accordance with applicable International Financial Reporting Standards and the Regulations issued by the Bank of Mongolia so as to give a true and fair view of the financial position of the Bank as at 31 December 2003 and of the results and the cash flows of the Bank for the year then ended.



J. PETER MORROW



HULAN DASHDAVA



R MUNKHTUYA

Ulaanbaatar

Date 06 APR 2004

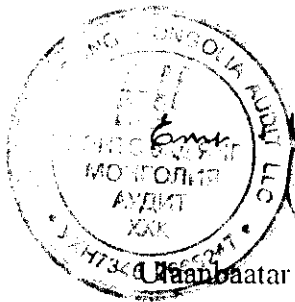
REPORT OF THE AUDITORS

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 results and the cash flows for the year then ended.



06 APR 2004

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><u>1,933,839</u></u>	<u><u>1,879,952</u></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.

AGRICULTURAL BANK OF MONGOLIA LLC

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2003**

	Non-distributable		Distributable	Total
	Statutory fund	Revaluation surplus *	(Accumulated losses)/ Retained profits	
	MNT '000	MNT '000	MNT '000	MNT '000
At 1 January 2002	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	<u>4,574,130</u>	<u>881,113</u>	<u>(1,860,638)</u>	<u>3,594,605</u>
At 1 January 2003	4,574,130	881,113	(1,860,638)	3,594,605
Profit for the year	-	-	1,933,839	1,933,839
Realisation of revaluation surplus	-	(85,875)	85,875	-
At 31 December 2003	<u>4,574,130</u>	<u>795,238</u>	<u>159,076</u>	<u>5,528,444</u>

* Revaluation surplus arises from the revaluation of the Bank's building carried out by an independent appraiser in 2001.

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

AGRICULTURAL BANK OF MONGOLIA LLC

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

	2003 MNT '000	2002 MNT '000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit before taxation	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 changes	<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 operations	<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	6,554,042	2,898,142
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 Equivalents

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 in 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 Agreements

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 Instruments

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 MNT '000	2002 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 service	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 follows:

	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 expenses	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 institutions	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 enterprises	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	<u>(2,892,765)</u>	<u>(677,323)</u>
Gross balance at end of year	937,718	196,645
Less: Specific Provision	<u>(389,251)</u>	<u>(98,875)</u>
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%
Net NPL ratio as a percentage of net total loans	1.0%	0.4%

13. LOANS AND ADVANCES (CONTD.)

Movements in the provision for loan losses are as follows:

	2003 MNT '000	2002 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 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 MNT '000	2002 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 MNT '000	2002 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 MNT '000	2002 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 MNT '000	2002 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 agreements	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 MNT '000	2002 MNT '000
Loan from H.S Investment Co. Ltd	2,336,000	-

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 MNT '000	2002 MNT '000
Payables	386,388	205,695
Accrued interest	24,800	13,277
Delay on clearing settlement	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 Shares of MNT1,000 each		Amount	
	2003	2002	2003 MNT '000	2002 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.

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.)

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	6,000	-	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	(4,956)	(9,901)	10,585	5,600	4,201	5,529
Accumulated gap	(4,956)	(14,857)	(4,272)	1,328	5,529	

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):

Assets	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
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	(14,579)	4,769	7,815	1,463	4,127	3,595
Accumulated gap	<u>(14,579)</u>	<u>(9,810)</u>	<u>(1,995)</u>	<u>(532)</u>	<u>3,595</u>	

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%	-	-

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 MNT '000	2002 MNT '000
Loans to key management personnel	<u>256,675</u>	<u>100,989</u>
Repayable		
- within one year	-	-
- one to five years	44,729	42,189
- after five years	<u>211,946</u>	<u>58,800</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)	<u>159,076</u>	<u>(1,860,638)</u>
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 follows:

	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.