

AGRICULTURAL BANK OF MONGOLIA LLC

Audited Financial Statements

31 December 2004

AGRICULTURAL BANK OF MONGOLIA LLC

FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2004

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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

STATEMENT BY DIRECTORS AND EXECUTIVE

We, J. PETER MORROW and KHULAN DASHDAVAA, 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 36 are drawn up in accordance with applicable International Financial Reporting Standards and the Guidelines and 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 2004 and of the results and the cash flows of the Bank for the year then ended.



J. PETER MORROW



KHULAN DASHDAVAA



R. MUNKHTUYA

Ulaanbaatar
Date

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 2004 set out on pages 3 to 36. 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 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 Guidelines and 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 2004 and of the results of its operations and its cash flows for the year then ended.



Ulaanbaatar

Mongolia Audit Co.

28 MAR 2005

AGRICULTURAL BANK OF MONGOLIA LLC

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2004

	Note	2004 MNT '000	2003 MNT '000
Interest income	4	24,376,282	14,266,533
Interest expense	5	<u>(12,941,676)</u>	<u>(6,691,178)</u>
Net interest income		11,434,606	7,575,355
Non-interest income	6	<u>5,060,597</u>	<u>4,001,350</u>
Operating profit		16,495,203	11,576,705
Operating expenses	7	<u>(9,878,561)</u>	<u>(7,470,716)</u>
Profit before allowances		6,616,642	4,105,989
Allowances	8	<u>(1,966,192)</u>	<u>(726,389)</u>
Profit before taxation		4,650,450	3,379,600
Taxation	9	<u>(1,565,500)</u>	<u>(1,445,761)</u>
Profit after taxation		<u>3,084,950</u>	<u>1,933,839</u>

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

AGRICULTURAL BANK OF MONGOLIA LLC

BALANCE SHEET AS AT 31 DECEMBER 2004

	Note	2004 MNT '000	2003 MNT '000
ASSETS			
Cash and short term funds	10	5,103,550	3,936,521
Deposits and placements with other banks and financial institutions	11	17,076,792	13,321,566
Investment in securities	12	37,131,826	13,237,830
Loans and advances	13	80,321,202	52,338,374
Other assets	14	1,077,044	895,836
Property, plant and equipment	15	6,308,734	4,886,691
TOTAL ASSETS		<u>147,019,148</u>	<u>88,616,818</u>
LIABILITIES			
Deposits from customers	16	130,753,480	76,128,066
Deposits and placements of other banks and financial institutions	17	11	3,087,202
Loans from Bank of Mongolia	18	2,608,427	290,265
Subordinated loan	19	2,418,000	2,336,000
Other liabilities	20	843,651	1,186,581
Tax payable		11,500	60,260
TOTAL LIABILITIES		<u>136,635,069</u>	<u>83,088,374</u>
EQUITY			
Ordinary shares	21	5,159,130	4,574,130
Share premium		1,185,685	-
Revaluation surplus		721,687	795,238
Retained profits		3,317,577	159,076
TOTAL EQUITY		<u>10,384,079</u>	<u>5,528,444</u>
TOTAL EQUITY AND LIABILITIES		<u>147,019,148</u>	<u>88,616,818</u>
COMMITMENTS AND OFF BALANCE SHEET ITEMS			
	25	<u>9,840,835</u>	<u>9,390,391</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 2004

	← Non-distributable →			Distributable	
	Ordinary shares MNT '000	Share premium MNT '000	Revaluation surplus * MNT '000	Retained profits MNT '000	Total MNT '000
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>-</u>	<u>795,238</u>	<u>159,076</u>	<u>5,528,444</u>
At 1 January 2004	4,574,130	-	795,238	159,076	5,528,444
Profit for the year	-	-	-	3,084,950	3,084,950
Issue of ordinary shares	585,000	1,185,685	-	-	1,770,685
Realisation of revaluation surplus	-	-	(73,551)	73,551	-
At 31 December 2004	<u>5,159,130</u>	<u>1,185,685</u>	<u>721,687</u>	<u>3,317,577</u>	<u>10,384,079</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 2004

	2004 MNT '000	2003 MNT '000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit before taxation	4,650,450	3,379,600
<i>Adjustments for :</i>		
Depreciation of property, plant and equipment	755,745	574,543
Allowances	1,966,192	726,389
Property, plant and equipment written off	11,723	12,006
Loss on disposal of property, plant and equipment	3,358	6,360
Operating profit before working capital changes	<u>7,387,468</u>	<u>4,698,898</u>
<i>Increase in operating assets:</i>		
Loans and advances	(29,846,764)	(27,682,905)
Other assets	(297,465)	(372,069)
<i>(Decrease)/increase in operating liabilities</i>		
Deposits from customers	54,625,414	30,430,952
Deposits and placements of other banks and financial institutions	(3,087,191)	3,087,202
Other liabilities	(342,930)	435,445
Cash generated from operations	<u>28,438,532</u>	<u>10,597,523</u>
Income tax paid	(1,614,260)	(1,397,831)
Net cash flow from operating activities	<u>26,824,272</u>	<u>9,199,692</u>
CASH FLOW FROM INVESTING ACTIVITIES		
(Increase)/decrease in investment securities	(23,879,995)	514,149
Purchase of property, plant and equipment	(2,269,046)	(1,327,198)
Proceeds from disposal of property, plant and equipment	76,177	9,630
Net cash flow from investing activities	<u>(26,072,864)</u>	<u>(803,419)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in subordinated loans	82,000	2,336,000
Increase/(decrease) in loans from Bank of Mongolia	2,318,162	(28,228)
Increase in statutory funds	1,770,685	-
Net cash flow used in financing activities	<u>4,170,847</u>	<u>2,307,772</u>
Net increase in cash and cash equivalents	4,922,255	10,704,045
Cash and cash equivalents brought forward	<u>17,258,087</u>	<u>6,554,042</u>
Cash and cash equivalents carried forward	<u>22,180,342</u>	<u>17,258,087</u>

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 2004 (CONTD.)

	2004 MNT '000	2003 MNT '000
Cash and cash equivalents comprises:		
Cash and short term funds	5,103,550	3,936,521
Deposits and placement with other banks and financial institutions	17,076,792	13,321,566
	<u>22,180,342</u>	<u>17,258,087</u>

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

AGRICULTURAL BANK OF MONGOLIA LLC

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2004

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 2004 were authorised for issue by the Board of Directors in accordance with a resolution of the directors on 28 March 2005.

2. BASIS OF PRESENTATION

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

The financial statements have been prepared under the historical cost convention except for the measurement of financial assets and liabilities of fair values, where applicable, and modified to include the revaluation of property, plant and equipment. 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.

The preparation of financial statements in conformity with International Financial Reporting Standards requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting year. Although these estimates are based on management's best knowledge on current events and actions, actual results ultimately may differ from those estimates.

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. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on treasury bills and other discounted instruments.

Interest income is suspended when interest or principal on credit facilities are overdue by more than 90 days. 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.

(b) Fee and Commission Income

Fee and commission income are generally recognised on an accrual basis when the service has been provided. Pension loan and acceptance fees are recognised as income based on contractual arrangements. Fees and commission income derived by the Bank relate mainly to pension payment charges, money transfer, application, transaction and other fees 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. 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:

	2004	2003
United States Dollar	1,209.00	1,168.00
European Euro	1,647.40	1,460.20
Japanese Yen	11.65	10.92
Chinese Reminbi	146.10	141.10
Russian Ruble	43.40	39.90

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(d) Loans and Advances and Allowance for Loan Impairment

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.

Originated loans are stated at amortised cost less allowance with impairment.

An allowance for loan impairment is established if there is objective evidence that the Bank will not be able to collect all amounts due according to the original contractual terms of loans. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted at the original effective interest rate of loans.

The loan impairment allowance also covers losses where there is objective evidence that probable losses are present in components of the loan portfolio at the balance sheet date. These have been estimated based upon historical patterns of losses in each component, the credit ratings allocated to the borrowers and reflecting the current economic climate in which the borrowers operate. When a loan is uncollectable, it is written off against the related allowance for impairment or recognised as an expense in the income statement. Subsequent recoveries are credited to the allowance for loan losses in the income statement.

If the amount of the impairment subsequently decreases due to an event occurring after the writedown, the release of the allowance is credited as a reduction of the allowance for loan losses.

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 where for programs set up by international financial institutions and under government financing arrangements. However, in the Mongolian marketplace, short-term credits are granted with the expectation of renewing loans at maturity.

(e) Taxation

The Bank provides for current income tax based on its income for financial reporting purposes, adjusted for items which are not assessable or deductible for income tax purpose, in accordance with the regulations of the Mongolian Government and is measured using the tax rates that have been enacted at the balance sheet date.

Deferred tax is provided for, using the liability method, on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(e) Taxation (Contd.)

In principle, deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised for all deductible temporary differences, unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, unused tax losses and unused tax credits can be utilised. Deferred tax is not recognised if the temporary difference arises from goodwill or negative goodwill or from the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction, affects neither accounting profit nor taxable profit.

(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.

(g) Investment Securities

Investments are initially recognised at cost (which includes transaction costs). Management determines the appropriate classification of its investments at the time of the purchase, being held-to-maturity or available-for-sale. Investment securities with fixed maturity where management has both the intent and the ability to hold for yield or capital growth to maturity, are classified as held-to-maturity.

Held-to-maturity investments are carried at amortised cost using the effective yield method, less any allowance for impairment. Investment securities intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices are classified as available-for-sale.

Available-for-sale financial assets are subsequently re-measured at fair value based on quoted bid prices or amounts derived from cash flow models. Fair values for unlisted equity securities are estimated using applicable price/earnings or price/cash flow ratios refined to reflect the specific circumstances of the issuer. Unrealised gains and losses arising from changes in the fair value of securities classified as available-for-sale are recognised in equity. Equity securities for which fair values cannot be measured reliably are recognised at cost less impairment. When the securities are disposed or deemed impaired, the related accumulated fair value adjustments are included in the income statement as gains and losses from investment securities.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(g) Investment Securities (Contd.)

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount. The amount of the impairment loss for assets carried at amortised cost is calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate. By comparison, the recoverable amount of an instrument measured at fair value is the present value of expected future cash flows discounted at the current market rate of interest for a similar financial asset.

Interest earned on investment securities is reported as interest income. Dividends receivable are included separately in dividend income when a dividend is declared.

(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).

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.

Depreciation of property, plant and equipment is provided for on a straight line basis to write off the cost of each asset to its residual value over the estimated useful life.

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

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

Assets under construction are not depreciated. Depreciation of these assets begins when the related assets are ready for intended use.

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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(i) Sale and Repurchase Agreements

Securities sold subject to linked repurchase agreements ('repos') are retained in the financial statements as available-for-sale or held-to-maturity 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 the 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.

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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTD.)

(l) Financial Instruments (Contd.)

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.

(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

	2004 MNT '000	2003 MNT '000
Loans and advances	20,892,634	13,159,885
Deposits and placements with other banks and financial institutions	266,312	60,136
Bank of Mongolia Treasury bills	2,876,766	514,145
Government bonds	340,570	532,367
	<u>24,376,282</u>	<u>14,266,533</u>

5. INTEREST EXPENSE

	2004 MNT '000	2003 MNT '000
Deposits from customers	12,685,237	6,396,207
Deposits and placements of other banks and financial institutions	108,209	233,607
Subordinated loan	148,230	61,364
	<u>12,941,676</u>	<u>6,691,178</u>

6. NON-INTEREST INCOME

	2004 MNT '000	2003 MNT '000
Fee income:		
Pension loan fees	2,335,863	1,827,995
Acceptance fees	940,851	974,400
Money transfer fees	361,916	139,583
Pension payment charges	219,158	215,324
Application fees	221,581	192,355
Transaction fees	214,485	135,308
Letter of advice charges	195,142	91,527
Other fee income	124,929	57,348
	<u>4,613,925</u>	<u>3,633,840</u>
Other income:		
Realised foreign currencies gain	165,009	58,501
Unrealised foreign currencies gain	9,070	95,497
Income from penalties	202,247	84,386
Recovery of collateral previously written off	6,846	12,053
Recovery of bad loans	21,301	65,661
Recovery of other assets previously written off	4,163	26,901
Other operating income	38,036	24,511
	<u>446,672</u>	<u>367,510</u>
Total non-interest income	<u>5,060,597</u>	<u>4,001,350</u>

7. OPERATING EXPENSES

	2004 MNT '000	2003 MNT '000
Advertising	366,781	325,036
Armoured guard and security	106,123	68,696
Business trips	357,409	181,696
Cash collection service	58,357	37,374
Communication	624,221	510,000
Computer expenses	266,574	168,640
Depreciation of property, plant and equipment	755,745	574,543
Entertainment	56,412	50,359
Insurance expense	33,099	12,483
Legal expenses	40,752	-
Balance carried forward	<u>2,665,473</u>	<u>1,928,827</u>

7. OPERATING EXPENSES (CONTD.)

Balance brought forward	2,665,473	1,928,827
Loans and collection expenses	107,085	58,022
Maintenance of property, plant and equipment	91,472	148,004
Membership and audit expenses	85,371	80,990
Other operating expenses	187,708	107,884
Personnel costs		
- Salaries	3,118,353	2,324,999
- Bonuses and allowances	1,302,417	1,058,041
- Social and health insurance	495,776	365,730
Rental expenses	488,003	243,987
Stationery	544,346	450,845
Training	249,355	290,982
Transportation and fuel supplies	315,517	227,503
Utilities	227,685	184,902
	<u>9,878,561</u>	<u>7,470,716</u>

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

	2004 Number	2003 Number
Directors and head of departments	20	16
Branch managers	19	24
Sub-branch managers	366	345
Executives and clerical staff	1,546	1,402
	<u>1,951</u>	<u>1,787</u>
Of which:		
- Head office	173	122
- Branches	1,778	1,665
	<u>1,951</u>	<u>1,787</u>

8. ALLOWANCES

	2004 MNT '000	2003 MNT '000
Allowance for loan losses	1,866,047	553,951
Allowance for impairment of other assets	114,146	103,954
Allowance for lawsuit claim	-	78,930
Writeback for investment in securities	(14,001)	(10,446)
	<u>1,966,192</u>	<u>726,389</u>

9. TAXATION

	2004 MNT '000	2003 MNT '000
Current income tax based on results for the year	<u>1,565,500</u>	<u>1,445,761</u>

The Bank provides for income taxes on the basis of its income for financial reporting purposes, adjusted for items which are not assessable or deductible for income tax purposes. The income tax rate for profits of banks is 15% for the first MNT100 million of taxable income, and 30% (2003 : 40%) on the excess of taxable income over MNT100 million. Interest income on government bonds is not subject to income tax. The allowance for loan losses is deductible for income tax purposes.

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 for the years ended 31 December is as follows:

	2004 MNT '000	2003 MNT '000
Profit before taxation	<u>4,650,450</u>	<u>3,379,600</u>
Tax at statutory income tax rate of 30% (2003: 40%)	1,395,134	1,351,840
Effect of income subject to lower tax rate	(15,000)	(25,000)
Effect of income not subject to tax	(120,441)	(235,868)
Effect of expenses not allowable for tax purposes	305,807	354,789
Tax expense for the year	<u>1,565,500</u>	<u>1,445,761</u>

Deferred tax is not provided for in the current and previous financial years as there are no temporary differences.

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

10. CASH AND SHORT TERM FUNDS

	2004 MNT '000	2003 MNT '000
Local currencies	3,734,428	3,015,087
Foreign currencies	1,365,561	921,172
Cash in transit	3,561	262
	<u>5,103,550</u>	<u>3,936,521</u>

11. DEPOSITS AND PLACEMENTS WITH OTHER BANKS AND FINANCIAL INSTITUTIONS

	2004 MNT '000	2003 MNT '000
Current accounts with Bank of Mongolia	5,078,518	8,209,854
Placements with other banks and financial institutions	11,998,274	3,111,712
Securities purchased under resell agreement	-	2,000,000
	<u>17,076,792</u>	<u>13,321,566</u>

Balances with Bank of Mongolia are maintained in accordance with Bank of Mongolia's requirements and bear interest at rates ranging from 0.0% to 2.1% (2003 : 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.

Placements with other banks and financial institutions represent foreign currencies current accounts maintained with foreign and local financial institutions and short term deposits with local financial institutions. Placements with foreign financial institution no bear interest (2003 : Nil). Short term deposits with local financial institution bear interest at rates ranging from 6.5% to 17% (2003 : 6.9% to 7.0%) per annum.

12. INVESTMENT IN SECURITIES

	2004 MNT '000	2003 MNT '000
Securities held-to-maturity:		
Bank of Mongolia Treasury bills	36,500,657	11,690,022
Accretion of discounts	631,169	143,942
	<u>37,131,826</u>	<u>11,833,964</u>
Government bonds	-	1,417,867
Allowance for impairment losses	-	(14,001)
	<u>-</u>	<u>1,403,866</u>
Net securities held-to-maturity	<u>37,131,826</u>	<u>13,237,830</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 4.75% to 16% (2003 : 1.3% to 18.0%) per annum.

Government bonds are issued by the Ministry of Finance and Economy with maturities ranging from 30 days to 180 days. Interest rates are in the range of 7.4% to 15.8% (2003 : 4.6% to 15.5%) per annum.

13. LOANS AND ADVANCES

	2004	2003
	MNT '000	MNT '000
Term loans	79,542,736	51,112,125
Staff loans	1,531,829	979,155
Accrued interest receivable	2,011,359	1,147,880
Gross loans and advances	<u>83,085,924</u>	<u>53,239,160</u>
Allowance for loan losses		
- specific	(1,990,022)	(389,251)
- general	(774,700)	(511,535)
Net loans and advances	<u>80,321,202</u>	<u>52,338,374</u>

	2004	2003
	MNT '000	MNT '000
Maturity structure		
Maturing within one year	73,092,965	44,837,935
One year to five years	6,840,694	6,694,015
Over five years	387,543	806,424
	<u>80,321,202</u>	<u>52,338,374</u>

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

	2004	2003
	MNT '000	MNT '000
Small and medium enterprises	45,027,680	30,907,192
Personal	15,785,933	10,009,620
Agricultural	12,598,193	6,430,280
Mortgage	6,130,930	3,765,033
Staff	1,531,829	979,155
	<u>81,074,565</u>	<u>52,091,280</u>
Accrued interest receivable	2,011,359	1,147,880
Allowance for loan losses		
- specific	(1,990,022)	(389,251)
- general	(774,700)	(511,535)
Net loans and advances	<u>80,321,202</u>	<u>52,338,374</u>

13. LOANS AND ADVANCES (CONTD.)

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

	2004	2003
	MNT '000	MNT '000
Balance at beginning of year	937,718	196,645
NPLs during the year - gross	16,202,278	3,633,838
Recoveries/regularised during the year	<u>(13,535,445)</u>	<u>(2,892,765)</u>
Gross balance at end of year	3,604,551	937,718
Allowance for loan losses	<u>(1,990,022)</u>	<u>(389,251)</u>
Net balance at end of year	<u>1,614,529</u>	<u>548,467</u>
Gross NPLs ratio as a percentage of gross loans and advances	<u>4.3%</u>	<u>1.8%</u>
Net NPLs ratio as a percentage of net loans and advances	<u>2.0%</u>	<u>1.0%</u>

Movements in the allowance for loan losses are as follows:

	2004	2003
	MNT '000	MNT '000
Specific Provision		
Balance at beginning of year	389,251	98,875
Allowance made during the year	1,606,322	297,178
Amount written off	(5,551)	-
Amount written back in respect of recoveries	-	(6,802)
Balance at end of year	<u>1,990,022</u>	<u>389,251</u>

	2004	2003
	MNT '000	MNT '000
General Provision		
Balance at beginning of year	511,535	247,960
Arising from acquisition of settlement centres of other financial institution	3,440	-
Allowance made during the year	<u>259,725</u>	<u>263,575</u>
Balance at end of year	<u>774,700</u>	<u>511,535</u>

13. LOANS AND ADVANCES (CONTD.)

At 31 December 2004, all loans and advances to borrowers are denominated in Togrog except for USD loans amounting to MNT4.4 billion (2003 : MNT2.3 billion). Interest rate ranges from 4.8% to 48.0% (2003 : 4.8% to 48.0%) per annum.

Loans and advances amounting to approximately MNT77.5 billion at 31 December 2004 (2003 : MNT51.2 billion) were classified as normal and provided with a 1% loss reserve. Further, loans amounting to MNT3.6 billion (2003 : MNT938 million) were classified as NPLs as at 31 December 2004 and allowances of MNT1.99 billion (2003 : MNT389 million) have been allocated against these NPLs.

The allowance for loan losses is considered adequate by the management based upon their formal reviews and analyses of existing credits using their knowledge of prevailing and anticipated economic conditions.

14. OTHER ASSETS

	2004 MNT '000	2003 MNT '000
Other assets	450,089	333,655
Less: Allowance for impairment of other assets	(441,090)	(333,041)
	<u>8,999</u>	<u>614</u>
Consumables and other inventories	651,610	615,389
Prepaid expenses	261,780	109,184
Others	154,655	170,649
Net other assets	<u>1,077,044</u>	<u>895,836</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	5,029,910	1,600,288	1,897,399	8,527,597
Additions	835,725	583,858	849,463	2,269,046
Disposals	(61,429)	(107,862)	(1,512)	(170,803)
Write-offs	(359)	(23,495)	(53,120)	(76,974)
Balance at end of year	<u>5,803,847</u>	<u>2,052,789</u>	<u>2,692,230</u>	<u>10,548,866</u>
Representing:				
At cost	1,316,342	2,052,789	2,692,230	6,061,361
At valuation	4,487,505	-	-	4,487,505
	<u>5,803,847</u>	<u>2,052,789</u>	<u>2,692,230</u>	<u>10,548,866</u>
Accumulated depreciation				
Balance at beginning of year	2,756,516	355,773	528,617	3,640,906
Charge for the year	114,988	228,433	412,324	755,745
Disposals	(33,904)	(55,892)	(1,472)	(91,268)
Write-offs	(107)	(15,660)	(49,484)	(65,251)
Balance at end of year	<u>2,837,493</u>	<u>512,654</u>	<u>889,985</u>	<u>4,240,132</u>
Net Book Value				
At 31 December 2004				
At cost	1,306,074	1,540,135	1,802,245	4,648,454
At valuation	1,660,280	-	-	1,660,280
	<u>2,966,354</u>	<u>1,540,135</u>	<u>1,802,245</u>	<u>6,308,734</u>
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>
Depreciation charge for 2003	<u>122,480</u>	<u>147,040</u>	<u>305,023</u>	<u>574,543</u>

15. PROPERTY, PLANT AND EQUIPMENT (CONTD.)

Details of the latest independent professional valuations of buildings at 31 December 2004 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	Market value

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 2004 would have been MNT1,762 million (2003 : MNT1,308 million).

16. DEPOSITS FROM CUSTOMERS

	2004 MNT '000	2003 MNT '000
Current account deposits	13,958,423	10,004,025
Demand deposits	16,870,959	10,192,079
Time deposits	91,276,962	50,362,852
Government deposits	6,879,168	4,990,121
Other deposits	1,767,968	578,989
	<u>130,753,480</u>	<u>76,128,066</u>

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

	2004 MNT '000	2003 MNT '000
Due within six months	57,368,724	34,923,569
Six months to one year	42,180,717	21,008,393
One year to five years	374,657	-
	<u>99,924,098</u>	<u>55,931,962</u>

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

	2004 MNT '000	2003 MNT '000
Business enterprises	19,397,079	12,726,828
Individuals	104,477,233	58,411,117
Government	6,879,168	4,990,121
	<u>130,753,480</u>	<u>76,128,066</u>

16. DEPOSITS FROM CUSTOMERS (CONTD.)

Current account deposits and other deposits generally bear no interest. Demand deposits are interest bearing and may be withdrawn upon demand. Foreign currency demand deposits bear interest of 0.8% to 3.6% (2003 : 3.6%) per annum. Local currency demand deposits bear interest of 9.6% (2003 : 9.6%) per annum.

Foreign currency time deposits bear interest rates ranging from 1.2% to 3.5% (2003 : 4.0% to 7.2%) per annum, while for local currency time deposits interest rates range from 9.6% to 19.2% (2003 : 9.6% to 19.2%) per annum.

Foreign currency government deposits bear interest rates ranging from 0.8% to 3.5% (2003 : 4.0% to 7.2%) per annum. Local currency government deposits bear interest rates ranging from 0.0% to 12.0% (2003 : 0.0% to 12.0%) per annum.

17. DEPOSITS AND PLACEMENTS OF OTHER BANKS AND FINANCIAL INSTITUTIONS

	2004 MNT '000	2003 MNT '000
Foreign currency deposits	-	586,688
Local currency deposits	11	500,514
Obligations on securities sold under repurchased agreements	-	2,000,000
	<u>11</u>	<u>3,087,202</u>

Foreign currency and local currency deposits are placed by local commercial banks. The foreign currency deposits bear no interest (2003 : 6% per annum) while local currency deposits bear no interest (2003 : 12.5% per annum).

18. LOANS FROM BANK OF MONGOLIA

	2004 MNT '000	2003 MNT '000
Term Loan I	72,540	93,440
Term Loan II	36,270	46,720
Term Loan III	149,825	150,105
Agricultural Sector Development Project Loan	2,349,792	-
	<u>2,608,427</u>	<u>290,265</u>

18. LOANS FROM BANK OF MONGOLIA (CONTD.)

Term Loan I

The USD100,000 loan was obtained in year 2002 and bears service fee at 1% (2003 : 1%) per annum. The principal repayments on this loan commenced in December 2003 and will be fully repaid in December 2007, with principal sum repayable by 5 equal annual installments. The loan was obtained to finance the purchase of computer equipments.

Term Loan II

The USD50,000 loan was obtained in year 2002 and bears service fee at 1% (2003 : 1%) per annum. The principal repayments on this loan commenced in December 2003 and will be fully repaid in December 2007, with principal sum repayable by 5 equal annual installments. The loan was obtained to finance the cost of additional work performed on the BANCS software implemented by the Bank.

Term Loan III

The USD137,694 loan was obtained in year 2002 and principal sum is repayable by 30 equal annual installments commencing December 2002 and full repayment on December 2032. The loan bears service fee at 1% per annum but will only commence in year 2007. The loan was for the Bank's portion of the BANCS software purchased.

Agricultural Development Sector Project Loan

The Bank obtained a new loan from the Bank of Mongolia. The purpose of this loan to provide financial aid to small and medium enterprises in the agricultural sector. The loan bears interest at 5.5% per annum, payable on a monthly basis which commences on 17 February 2004. The loan shall be due and payable in full one year after the loan has been disbursed to the borrower.

19. SUBORDINATED LOAN

	2004 MNT '000	2003 MNT '000
Loan from H.S Investment Co. Ltd	<u>2,418,000</u>	<u>2,336,000</u>

The Bank obtained the subordinated loan amounting to USD2 million from the holding company to fund its ongoing business operations. The subordinated loan bears interest at 5% (2003 : 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.

20. OTHER LIABILITIES

	2004 MNT '000	2003 MNT '000
Payables	376,646	386,388
Accrued interest on subordinated loan	25,602	24,800
Delay on clearing settlement	428,286	755,662
Other payables	13,117	19,731
	<u>843,651</u>	<u>1,186,581</u>

21. ORDINARY SHARES

	Number of Ordinary Shares of MNT1,000 each		Amount	
	2004	2003	2004 MNT '000	2003 MNT '000
At 1 January	4,574,130	4,574,130	4,574,130	4,574,130
Issued during the year	585,000	-	585,000	-
At 31 December	<u>5,159,130</u>	<u>4,574,130</u>	<u>5,159,130</u>	<u>4,574,130</u>

During the financial year, the Bank increased its ordinary shares from MNT4,574,130 thousand to MNT5,159,130 thousand by way of issuance of 585,000 ordinary shares of MNT1,000 thousand each at an issuance price of MNT3,026 thousand per share for cash, for additional working capital purposes. The share premium arising, after deducting the transaction costs, amounted to MNT1,118,685 thousand and this has been credited to the share premium account. The increase was approved by Bank of Mongolia. The new shares rank pari passu in all respects with existing shares.

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.

22. RISK MANAGEMENT POLICIES (CONTD.)

Credit risk (Contd.)

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 MNT803 million (2003 : MNT126 million) all the banking assets and liabilities were geographically concentrated in Mongolia.

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:

	2004 (MNT'000)			
	MNT	USD	Foreign currencies	Total
Assets				
Cash and short term funds	3,734,428	1,151,928	217,194	5,103,550
Deposits and placements with other banks and financial institutions	9,643,057	5,645,331	1,788,404	17,076,792
Investment in securities	37,131,826	-	-	37,131,826
Loans and advances	75,883,909	4,437,293	-	80,321,202
Other assets	1,073,504	3,540	-	1,077,044
	<u>127,466,724</u>	<u>11,238,092</u>	<u>2,005,598</u>	<u>140,710,414</u>
Liabilities				
Deposits from customers	120,882,288	8,216,410	1,654,782	130,753,480
Deposits and placements of other banks and financial institutions	11	-	-	11
Loans from Bank of Mongolia	2,349,792	258,635	-	2,608,427
Subordinated loan	-	2,418,000	-	2,418,000
Other liabilities	675,885	167,766	-	843,651
Tax payable	11,500	-	-	11,500
	<u>123,919,476</u>	<u>11,060,811</u>	<u>1,654,782</u>	<u>136,635,069</u>
Net position	<u>3,547,248</u>	<u>177,281</u>	<u>350,816</u>	<u>4,075,345</u>
Commitments and off balance sheet items	9,840,835	-	-	9,840,835

22. RISK MANAGEMENT POLICIES (CONTD.)

	2003 (MNT'000)			Total
	MNT	USD	Other foreign currencies	
Assets				
Cash and short term funds	3,015,086	862,975	58,460	3,936,521
Deposits and placements with other banks and financial institutions	9,544,130	3,634,135	143,301	13,321,566
Investment in securities	13,237,830	-	-	13,237,830
Loans and advances	50,108,123	2,230,251	-	52,338,374
Other assets	858,951	36,885	-	895,836
	<u>76,764,120</u>	<u>6,764,246</u>	<u>201,761</u>	<u>83,730,127</u>
Liabilities				
Deposits from customers	72,880,557	3,242,646	4,863	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	1,137,479	49,102	-	1,186,581
Tax payable	60,260	-	-	60,260
	<u>76,578,810</u>	<u>6,504,701</u>	<u>4,863</u>	<u>83,088,374</u>
Net position	<u>185,310</u>	<u>259,545</u>	<u>196,898</u>	<u>641,753</u>
Commitments and off balance sheet items	<u>9,390,391</u>	<u>-</u>	<u>-</u>	<u>9,390,391</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. The following table analyses assets and liabilities of the Bank into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

22. RISK MANAGEMENT POLICIES (CONTD.)

Liquidity Risk (Contd.)

The contractual maturities of banking assets and liabilities for the year ended 31 December 2004 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	5,103	-	-	-	-	5,103
Deposits and placements with other banks and financial institutions	14,659	2,418	-	-	-	17,077
Investment in securities	37,132	-	-	-	-	37,132
Loans and advances	17,716	19,968	35,408	6,841	388	80,321
Other assets	2	155	920	-	-	1,077
	<u>74,612</u>	<u>22,541</u>	<u>36,328</u>	<u>6,841</u>	<u>388</u>	<u>140,710</u>
Liabilities						
Deposits from customers	59,682	28,516	42,181	375	-	130,754
Deposits and placements of other banks and financial institutions	-	-	-	-	-	-
Loans from Bank of Mongolia	-	-	2,317	169	122	2,608
Subordinated loan	-	-	-	2,418	-	2,418
Other liabilities	844	-	-	-	-	844
Tax payable	12	-	-	-	-	12
	<u>60,538</u>	<u>28,516</u>	<u>44,498</u>	<u>2,962</u>	<u>122</u>	<u>136,636</u>
Net liquidity gap	<u>14,074</u>	<u>(5,975)</u>	<u>(8,170)</u>	<u>3,879</u>	<u>266</u>	<u>4,074</u>
Accumulated gap	<u>14,074</u>	<u>8,099</u>	<u>(71)</u>	<u>3,808</u>	<u>4,074</u>	<u>4,074</u>

22. RISK MANAGEMENT POLICIES (CONTD.)

Liquidity Risk (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
	<u>29,347</u>	<u>15,171</u>	<u>31,712</u>	<u>6,694</u>	<u>806</u>	<u>83,730</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
Tax payable	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	4,231	683	642
Accumulated gap	(4,956)	(14,857)	(4,272)	(41)	642	

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 2004 and 2003 for monetary financial instruments are as follows:

	2004		2003	
	MNT	Foreign currencies	MNT	Foreign currencies
Interest earning assets				
Deposits and placements with other				
banks and financial institutions	0.0%-17%	6.3%-10.3%	0.0%-0.3%	6.9%-7.0%
Bank of Mongolia Treasury bills	4.75%-16.0%	-	1.3%-18.0%	-
Government bonds	7.4%-15.8%	-	4.6%-15.5%	-
Loans and advances	4.8%-48.0%	18%-24%	4.8%-48.0%	24.0%
Interest bearing liabilities				
Demand deposits from customers	9.6%	0.8%-3.6%	9.6%	3.6%
Time deposits from customers	9.6%-19.2%	1.2%-3.5%	9.6%-19.2%	4.0%-7.2%
Government deposits	0.0%-12.0%	0.8%-3.5%	0.0%-12.0%	2.4%-3.6%
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%	-	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.

	2004 MNT '000	2003 MNT '000
(a) Interest expense on subordinated loans -H.S. Investment Co. Ltd.	<u>148,230</u>	<u>61,364</u>
(b) Loans to key management personnel	<u>337,566</u>	<u>256,675</u>
Repayable		
- within one year	5,011	-
- one year to five years	24,843	44,729
- over five years	<u>307,712</u>	<u>211,946</u>
	337,566	256,675
Allowance for loan losses	<u>(3,376)</u>	<u>(2,567)</u>
Total	<u>334,190</u>	<u>254,108</u>

The loans to Bank's employees bear interest rates ranging from 4.8% to 18.0% (2003 : 4.8% to 18.0%) per annum.

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:

	2004	2003
Core capital ratio	10.66%	7.94%
Risk weighted capital ratio	<u>14.12%</u>	<u>13.20%</u>
	2004	2003
	MNT '000	MNT '000
<u>Tier I capital</u>		
Statutory fund	5,159,130	4,574,130
Share premium	1,185,685	-
Retained profits	3,317,577	159,076
Total Tier I Capital	<u>9,662,392</u>	<u>4,733,206</u>
<u>Tier II capital</u>		
Revaluation surplus	721,687	795,238
Subordinated loan	2,418,000	2,336,000
Total capital/capital base	<u>12,802,079</u>	<u>7,864,444</u>

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

	2004		2003	
	MNT '000		MNT '000	
%	Assets	Risk Weighted	Assets	Risk Weighted
0	47,313,894	-	25,384,205	-
10	-	-	-	-
20	11,998,274	2,399,655	5,111,712	1,022,342
50	-	-	-	-
100	88,235,077	88,235,077	58,577,344	58,577,344
Total	<u>147,547,245</u>	<u>90,634,732</u>	<u>89,073,261</u>	<u>59,599,686</u>

25. COMMITMENTS AND OFF BALANCE SHEET ITEMS

	2004 MNT '000	2003 MNT '000
Ministry of Food and Agriculture Loans	1,627,902	1,290,285
Accrued interest on Loans by the Ministry of Food and Agriculture	458,568	354,787
Other off balance sheet items	7,754,365	7,745,319
	<u>9,840,835</u>	<u>9,390,391</u>

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 MNT1.18 billion (2003: MNT1.24 billion) of outstanding loans extended to agricultural companies.

The Bank earns interest income of 0.2% per month and service charge at 0.25% from the borrowers. No new loans were disbursed since December 2002. No commission was earned in 2004 (2003 : MNT Nil).

b) Ministry of Infrastructure Loan

On 21 October 2003, the Bank had entered into a Solar Energy Loan Agreement with the Ministry of Infrastructure (MI). Under this agreement, the Bank is responsible for the distribution of the loans to the borrowers selected by the Bank, for the monitoring of the borrowers' compliance with loan agreements and providing the MI with timely information on the status of these loans. The Bank, acting on behalf of MI, has outstanding solar energy loans to herders and farmers amounting to MNT396 million (2003 : MNT72 million).

The Bank earns application fee of MNT4,000 per loan disbursed for the administrative service of this loan. New loans amounting to MNT1 billion (2003 : MNT27 million) were disbursed during the year.

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

c) Alimentary aid loan

On 22 August 2003, the Bank entered into a Loan Disbursement and Banking Service Agreement with the French Alimentary Aid Fund (FAAF). Under this agreement, the Bank is responsible for the examination and disbursement of the loans to the borrowers recommended by the FAAF, and the monitoring of the borrowers' compliance with loan agreements. The Bank, acting on behalf of FAAF, has outstanding alimentary aid loans to farmers amounting to MNT52.2 million (2003 : MNT20 million) as at year end.

The Bank earns commission of 2% on the amount of loans issued. New loans amounting to MNT54.2 million were disbursed during the year (2003 : MNT20 million). The commission earned amounts to MNT3.2 million for the year (2003 : MNT0.4 million).

d) Other off balance sheet items

At 31 December 2004, other off balance sheet items consisted mainly of loans of MNT4.1 billion (2003 : MNT4.0 billion) (inclusive of interest), receivables of MNT1.1 billion (2003 : MNT1.1 billion) and collateral assets obtained from customers amounting to MNT130 million (2003 : MNT221 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 (2003 : MNT1.2 billion plus accrued interest of MNT1.1 billion).

e) Guarantees and letters of credit

The Bank has no guarantees and letters of credit outstanding as of 31 December 2004 (2003 : Nil).

f) Capital commitment

As at 31 December 2004 and 2003, the Directors have not authorised any capital commitment of significance.

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. Where quoted market prices are not available, the fair values are measured at discounted rates commensurate with the quality and duration of the asset or liability.

A considerable of the financial instruments as at 31 December 2004 and 2003 are short term in nature with maturities of less than one year. Based on fair value assessments as indicated above, the estimated fair values of most of the financial assets and financial liabilities, both short and long term as at the balance sheet date, approximate their carrying amounts as shown in the balance sheet.

27. CURRENCY

All amounts are in Mongolian Togrog unless otherwise stated.

28. MONGOLIAN TRANSLATION

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