

XacBank Ltd.

Audited Financial Statements
31 December 2002

AUDITORS' REPORT

To XacBank Ltd.,

We have audited the financial statements of XacBank Ltd., on pages 3 to 35.

Respective responsibilities of directors and auditors

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

Specifically, the financial statements of XacBank Ltd., have been prepared to comply with International Accounting Standards. The Board of Directors is responsible for ensuring that these financial statements, on the basis set out in the financial statements, present fairly the financial position of the Bank as at 31 December 2002 and of the profit or loss for the year to that date.

The Board of Directors is responsible for ensuring that proper accounting records are kept, which disclose at any time the financial position of the Bank and enable the Board to ensure that the financial statements comply with the requirements set out in note 3 and note 4 thereto. The Board of Directors is also responsible for safeguarding the assets of the Bank, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing in the framework of Accounting and Auditing Laws of Mongolia and rules issued by the Bank of Mongolia (the Central Bank). An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud, other irregularities or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements, the basis of which is described in note 3 and note 4.

Opinion

In our opinion, the financial statements on pages 3 to 35 present fairly, in all material respects, the financial position of XacBank Ltd., as at 31 December 2002 and the results of its operations and its cash flows for the year then ended in accordance with International Accounting Standards.

Ernst + Young Mongolia Audit Co.

7 March 2003
Ulaanbaatar

XacBank Ltd.

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2002

	Note	2002 MNT '000
Interest and similar income	5	1,826,684
Interest expense and similar charges	6	<u>(371,623)</u>
Net interest income		1,455,061
Fees and commissions	7	68,721
Foreign exchange and translation net losses	8	(1,879)
Other operating income	9	<u>62,674</u>
Non interest income		129,516
Operating profit		1,584,577
Operating expense	10	<u>(1,577,492)</u>
		7,085
Non-Operating Income	11	33,372
Other expenses	12	<u>(33,372)</u>
Loss before provisions		7,085
Provisions	13	<u>(161,533)</u>
Loss before taxation		(154,448)
Taxation	14	<u>(16,018)</u>
Loss after taxation		(170,466)
Retained profits brought forward		-
Accumulated loss carried forward		<u><u>(170,466)</u></u>

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

XacBank Ltd.**BALANCE SHEET AS AT 31 DECEMBER 2002**

	Note	2002 MNT '000	2001 MNT '000
ASSETS			
Cash and short term funds	15	3,279,302	362,333
Investment in securities	16	898,060	-
Loans and advances	17	5,514,506	2,661,984
Other assets	18	453,891	137,862
Property, plant and equipment	19	1,113,460	587,376
Amount due from Holding Company	20	101,868	-
TOTAL ASSETS		11,361,087	3,749,555
LIABILITIES AND CAPITAL FUNDS			
Deposits from customers	21	6,180,013	-
Deposits and placements of other financial institutions	22	400,000	-
Loans from local financial institution	23	280,000	500,000
Loans from foreign financial institutions	24	1,153,125	438,800
Loans from government agencies	25	245,000	-
Other liabilities	26	170,767	42,236
TOTAL LIABILITIES		8,428,905	981,036
CAPITAL FUNDS			
Statutory fund	27	3,004,000	2,704,000
Reserves		9,436	9,436
Accumulated Loss		(170,466)	-
		2,842,970	2,713,436
Grants	28	89,212	55,083
TOTAL CAPITAL FUNDS		2,932,182	2,768,519
TOTAL LIABILITIES AND CAPITAL FUNDS		11,361,087	3,749,555
COMMITMENTS, CONTINGENCIES AND OFF BALANCE SHEET ITEMS			
	29	6,876,418	-

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

XacBank Ltd.

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

	<u>Share capital</u> MNT'000	<u>Reserves</u> MNT'000	<u>Retained profit</u> MNT'000	<u>Total</u> MNT'000
At 1 January 2001	180,000	-	86,901	266,901
Profit for the year	-	-	116,635	116,635
Dividends	188,000	-	(188,000)	-
Transfer from				
UNDP funding	680,000	100,000	-	780,000
Decrease in reserves	-	(106,100)	-	(106,100)
Allocation to reserves	-	15,536	(15,536)	-
Issue of shares	1,656,000	-	-	1,656,000
At 31 December 2001	<u>2,704,000</u>	<u>9,436</u>	<u>-</u>	<u>2,713,436</u>
Loss for the year	-	-	(170,466)	(170,466)
Issue of shares	300,000	-	-	300,000
At 31 December 2002	<u><u>3,004,000</u></u>	<u><u>9,436</u></u>	<u><u>(170,466)</u></u>	<u><u>2,842,970</u></u>

During the previous financial year, there was an Memorandum of Understanding between the United Nation Development Fund ("UNDP") and XAC Co. Ltd., to capitalise part of the funding amount of MNT 680 million in the share capital of the XAC Co. Ltd., and another part of the funding amount of MNT 100 million to be capitalised as a reserve of the Company. During the merger between the XAC Co. Ltd., and Goviin Ekhlel Co. Ltd., part of the reserve was given to the holding company of the merged companies, XAC-GE Group. The remaining retained profit is to be capitalised as reserve of the Company.

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

XacBank Ltd.

**CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2002**

	2002 MNT '000
CASH FLOWS FROM OPERATING ACTIVITIES	
Loss before tax	(154,448)
<i>Adjustments for :-</i>	
Depreciation of property, plant and equipment	96,208
Property, plant and equipment written off	5,020
Provisions for loans losses	47,591
Provision for impairment of assets	112,783
Provisions for other receivables	1,159
Loss on disposal of property, plant and equipment	5,811
Operating profit before working capital changes	<u>114,124</u>
<i>(Increase) Decrease in operating assets:-</i>	
Loans and advances	(2,900,113)
Other assets	(487,782)
<i>Increase (decrease) in operating liabilities</i>	
Deposits from customers	6,180,013
Deposits and placements of other financial institutions	400,000
Other liabilities	128,531
Cash generated from operations	<u>3,434,773</u>
Income tax paid	(60,075)
Net cash flow from operating activities	<u>3,374,698</u>
CASH FLOW FROM INVESTING ACTIVITIES	
Net (increase) / decrease in investment securities	(898,060)
Proceeds on disposal of property, plant and equipment	5,635
Purchase of property, plant and equipment	(638,758)
Net cash flow from investing activities	<u>(1,531,183)</u>
CASH FLOWS FROM FINANCING ACTIVITIES	
Net increase/ (decrease) in loans from local and foreign financial institutions	494,325
Increase in loan from government agency	245,000
Increase in paid-up share capital	300,000
Increase in grants received	34,129
Net cash flow from financing activities	<u>1,073,454</u>
Net (decrease) / increase in cash and cash equivalents	2,916,969
Cash and cash equivalents brought forward	362,333
Cash and cash equivalents carried forward (note 15)	<u><u>3,279,302</u></u>

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

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2002

1. CORPORATE INFORMATION

The financial statements of the Bank for the year ended 31 December 2002 were authorised for issue in accordance with a resolution of the Directors on 7 March 2003.

X.A.C Co., LTD commenced operations in 1999 as a non-bank financial institution. The Company first started its operation by rendering five types of loan services namely Start, Growth, Family, Development and Employee to individuals and legal entities. In October 2001, the Company entered into a merger agreement with Goviin Ekhlel Co., LTD, another non-bank financial institution, to form a holding company named XAC-GE Group. As a result of this merger agreement, in December 2001, X.A.C Co., Ltd has been upgraded to XacBank Ltd. after receiving a banking license from the Central Bank of Mongolia and becoming the operating company of the merged entities. Goviin Ekhlel Co., Ltd changed its name to XAC-GE Group and became the holding company of XacBank Ltd. The registered address of the company is Prime Minister Amar's Street, Suhbaatar District, P.O. Box-46/721, Ulaanbaatar, Mongolia.

2. PRINCIPAL ACTIVITIES

The principal activity of the Bank is the provision of banking and financial services, pursuant to License No. 24 issued by the Bank of Mongolia ("BOM"). The Bank is predominantly involved in providing Micro Financing to the General Public to develop the retail and small and medium enterprises ("SMEs"). There have been no significant change in the nature of these activities during the year.

3. BASIS OF PREPARATION

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

3. BASIS OF PREPARATION (CONTD.)

The financial statements have been prepared on the historical cost basis of accounting. 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.

In 2002, the Bank adopted IAS 39 "Financial Instrument: Recognition and Measurement". Further information is disclosed in the accounting policies and related notes.

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

4. SIGNIFICANT ACCOUNTING POLICIES

(a) Interest Income and Expense

Interest income and expense are recognised on an accruals basis. The recognition of interest income is suspended when the probability of recoverability of either the principal or interest is ascertained as doubtful. In accordance with the requirements of Bank of Mongolia, interest is suspended when repayments are in arrears for 3 months. On commencement of suspension, previously accrued interest not received is claw-backed. 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.

(b) Fee income and commissions

Fee income and commissions are accounted for in the period when receivable, except where the fee is charged to cover the costs of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, the fee is recognised on an appropriate basis over the relevant period.

(c) Foreign Currencies

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

4. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

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

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

	<u>2002</u>	<u>2001</u>
US Dollar ("USD")	1,125.00	1,102.00
Euro ("Euro")	1,169.40	988.90
Japanese Yen ("JPY")	9.38	8.50
Chinese Yuan ("CNY")	135.90	133.10

(d) Provision for Loan Loss

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

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

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

(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 purposes, in accordance with the regulations of the Mongolian Government.

(f) Cash and cash equivalents

Cash and cash equivalents consist of cash and short term funds, deposits and placements with other financial institution that are readily convertible to cash with insignificant risk of changes in value.

4. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

(g) Investment securities

Bank of Mongolia securities are stated at cost adjusted for amortisation of premium or accretion of discount to maturity date on a straight line basis.

(h) Maturity of loans and advances

The maturity of the loan portfolio is presented in Note 17 which shows the remaining period of loans from the balance sheet date to the contractual maturity. Long-term credits are generally not available in Mongolia except for programs set up by international financial institutions and under government financing arrangements. However, in the Mongolia marketplace, short-term credits are granted with the expectation of renewing the loans at maturity. Accordingly, the effective maturity of a loan portfolio may be longer than indicated by a classification based on contractual terms.

(i) Property, Plant and Equipment

The Bank's property, plant and equipment are stated at cost, less depreciation calculated on the straight line basis to write off the assets over their estimated useful lives.

The estimate useful lives used by the Bank is as follows :-

Buildings	40 years
Office equipment and vehicles	10 years
Computers	5 years

(j) Deposits of customer and other financial institution

Deposits of customers are initially recognised at cost. Subsequently, for time deposits with terms over one month, amounts due are stated at amortised cost and any differences between net proceeds and the redemption value is recognised in the profit and loss account over the term of the deposits using the effective yield method.

4. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

(l) Impairment of assets

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

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

(m) Grants Received

Grants are recognised upon receipt and it will be credited as Grants on the financial statements. Grants are to be recognised as income on a systematic and rational basis over the periods necessary to match them with the related costs. Similarly, grants related to depreciable assets are usually recognised as income over the periods and in the proportions in which depreciation on those assets is charged.

(n) Statement of Cash Flows

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

(o) Use of estimates

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

5. INTEREST AND SIMILAR INCOME

	2002 MNT '000
Loans and advances	1,805,975
Placement with other banks	15,614
Bank of Mongolia securities	5,095
	<hr/>
	<u>1,826,684</u>

6. INTEREST EXPENSE AND SIMILAR CHARGES

	2002 MNT '000
Current account deposits	350
Time and saving account deposits	130,289
Loans	226,317
Others	14,667
	<hr/>
	<u>371,623</u>

7. FEES AND COMMISSIONS

Fees and commissions represent incomes from the application form fee, interpayment service fee, loan commission and money transfer service fee.

**8. FOREIGN EXCHANGE AND TRANSLATION
NET LOSSES**

	2002 MNT '000
Net foreign currency transaction gains	2,104
Net foreign currency translation gains/(losses)	(3,983)
	<hr/>
	<u>(1,879)</u>

9. OTHER OPERATING INCOME

	2002 MNT '000
Rental income	55,624
Penalties	37
Other income	7,013
	<hr/>
	<u>62,674</u>

10. OPERATING EXPENSE

	2002 MNT '000
Salaries and retirement benefits, and provision for staff welfare and bonus	517,426
Depreciation	95,454
Travelling	72,685
Rental of premises	254,269
Entertainment	27,714
Fuel and maintenance of vehicle	45,721
Communication	86,414
Advertising	33,540
Fixed asset maintenance	57,188
Stationary	63,054
Social insurance	110,945
Other operating expenses	213,082
	<hr/>
	<u>1,577,492</u>

Other operating expenses includes audit fee, security, training, refreshment and transportation expense for staff.

10. OPERATING EXPENSE (CONT'D)

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

	2002 Number
Directors and heads of departments	29
Officers	223
Clerks etc.	73
	<hr/>
	325
	<hr/> <hr/>
Of which:	
- Head office	73
- Branches	252
	<hr/>
	325
	<hr/> <hr/>

11. NON OPERATING INCOME

	2002 MNT '000
Grants	33,372
	<hr/> <hr/>

12. OTHER EXPENSES

	2002 MNT '000
Travelling	6,034
Training	16,407
Depreciation of Property, Plant & Equipment	1,931
Audit fee of 2001	9,000
	<hr/>
	33,372
	<hr/> <hr/>

13. PROVISIONS

	2002 MNT '000
Provision for loan losses	47,591
Provision for owned premises	803
Provision for other assets	356
Provision for impairment of asset	112,783
	<hr/>
	161,533

14. TAXATION

	2002 MNT '000
Current income tax	<hr/> 16,018

The current year income tax represents the total tax payments made during the year to the Mongolian Tax Authorities. Any overpayment of taxation is estimated at year end and reflected in other assets in Note 18 as Tax Recoverable from the Mongolian Tax Authorities.

The Bank provides for income taxes on the basis of its income for financial reporting purposes, adjusted for items which are not assessable or deductible for income tax purposes, in accordance with the regulations of the tax authorities. The tax rate is 15% for taxable profits up to MNT 100 million and 40% for taxable profits in excess of MNT 100 million.

15. CASH AND SHORT TERM FUNDS

	2002 MNT '000	2001 MNT '000
Balances with Bank of Mongolia	553,158	-
Cash and balances with other banks	2,726,144	362,333
	<hr/>	<hr/>
	3,279,302	362,333

Balances are maintained with Bank of Mongolia in accordance with Bank of Mongolia requirements and bear no interest. The balances maintained with Bank of Mongolia are determined at set percentages based on 15 days average cash balances

16 INVESTMENT IN SECURITIES

	2002 MNT '000	2001 MNT '000
Bank of Mongolia securities	<u>898,060</u>	<u>-</u>

Bank of Mongolia securities are non interest bearing short term bills with maturities of less than one month, and are issued at a discount to the fair value of the securities upon maturity.

17. LOANS AND ADVANCES

	2002 MNT '000	2001 MNT '000
Term loans	5,457,487	2,673,560
Staff loans	92,921	13,703
Loans to stakeholders and related parties	33,897	4,440
	<hr/>	<hr/>
Gross loans and advances	5,584,305	2,691,703
Provisions		
- specific provision	(15,314)	(3,495)
- general provision	(54,485)	(26,224)
	<hr/>	<hr/>
	(69,799)	(29,719)
	<hr/>	<hr/>
Net loans and advances	<u>5,514,506</u>	<u>2,661,984</u>
Maturity structure		
Maturing within 1 year	5,163,956	2,381,099
One year to five years	420,349	310,604
	<hr/>	<hr/>
	<u>5,584,305</u>	<u>2,691,703</u>

17. LOANS AND ADVANCES (CONT'D)

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

	2002 MNT '000	2001 MNT '000
Textile / Production	83,429	297,715
Trade	2,785,854	1,513,229
Food processing	164,728	-
Services	209,751	486,576
Consumption	1,055,433	285,914
Others	1,285,110	108,269
	<u>5,584,305</u>	<u>2,691,703</u>

Others include borrowers in industries such as construction, agriculture, mining and education.

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

	2002 MNT '000	2001 MNT '000
Balance as at 1 January	7,618	5,427
NPL during the year - gross	428,818	269,143
Recoveries	(410,058)	(257,976)
Portfolio at risk classification to NPL	27,881	-
Amount written off	(3,084)	(5,260)
Transferred to other assets	(3,739)	(3,716)
	<u>47,436</u>	<u>7,618</u>
Gross balance as at 31 December		
Less: Specific Provision	<u>(15,314)</u>	<u>(3,494)</u>
Net balance as at 31 December	<u>32,122</u>	<u>4,124</u>
Net NPL ratio as a percentage of net performing loans	0.60%	0.16%

17. LOANS AND ADVANCES (CONT'D)

Movements in the provision for bad and doubtful debts accounts are as follows:-

	2002 MNT '000	2001 MNT '000
Specific Provisions		
Balance as at 1 January	3,495	1,767
Charge for the year less write backs	19,331	6,988
Recoveries	(5,350)	-
Written off	(2,162)	(5,260)
	<hr/>	<hr/>
Balance as at 31 December	<u>15,314</u>	<u>3,495</u>
General Provisions		
Balance as at 1 January	26,225	11,155
Charge for the year less write backs	28,260	15,070
Recoveries	-	-
	<hr/>	<hr/>
Balance as at 31 December	<u>54,485</u>	<u>26,225</u>

Included in loans and advances is accrued interest totalling **MNT 113 million**.

The Bank's balance sheet credit exposures as at 31 December 2002 amounted to MNT 5.6 billion (2001 : MNT 2.7 billion), of which MNT 47.4 million (2001 : MNT 7.6 million) are due on accounts which have been classified as non-performing loans ("NPL").

Specific and general provisions of MNT 69.8 million (2001 : MNT 29.7 million) have been allocated against the NPLs, which represents a coverage ratio of more than 100% (2001 : more than 100%) of the total NPL amount.

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

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

18. OTHER ASSETS

	2002 MNT '000	2001 MNT '000
Foreclosed properties	3,155	1,011
Prepaid expenses	289,803	7,237
Inventory	32,491	13,896
Low Value Asset	21,341	10,214
Deferred Tax	11,779	12,827
Other receivables	95,322	92,677
	<hr/> 453,891 <hr/>	<hr/> 137,862 <hr/>

Foreclosed properties are disclosed net of provisions totalling MNT 0.7 million (2001 : MNT 0.4 million). These provisions are based on guidelines by the Bank of Mongolia in the current financial year

Included in other receivables are tax recoverable amounting to approximately MNT 45 million (2001: MNT 5 million), subject to agreement with the Mongolian Tax Authorities, rental receivable of MNT 8 million, staff benefit of MNT 11 million and advances given to the staff for travelling.

19. PROPERTY, PLANT & EQUIPMENT

	Buildings MNT'000	Office Equipment and Vehicles MNT'000	Computers MNT'000	Total MNT'000
Net Book Value				
At 1 January 2002	264,030	146,742	176,604	587,376
Additions	196,810	211,645	230,303	638,758
Disposals	-	(11,446)	-	(11,446)
Expensed off	(4,119)		(901)	(5,020)
Depreciation charge	(9,998)	(25,868)	(60,342)	(96,208)
At 31 December 2002	<u>446,723</u>	<u>321,073</u>	<u>345,664</u>	<u>1,113,460</u>
At 31 December 2002				
Cost	459,451	383,048	462,491	1,304,990
Accumulated depreciation	<u>(12,728)</u>	<u>(61,975)</u>	<u>(116,827)</u>	<u>(191,530)</u>
	<u>446,723</u>	<u>321,073</u>	<u>345,664</u>	<u>1,113,460</u>
At 31 December 2001				
Cost	266,760	184,828	246,815	698,403
Accumulated depreciation	<u>(2,730)</u>	<u>(38,086)</u>	<u>(70,211)</u>	<u>(111,027)</u>
	<u>264,030</u>	<u>146,742</u>	<u>176,604</u>	<u>587,376</u>

20. AMOUNT DUE FROM HOLDING COMPANY

	2002 MNT '000	2001 MNT '000
Amount due from holding company	<u>101,868</u>	<u>-</u>

The Directors of the Bank regard XAC-GE Group as the holding company of the Bank. Included in the amount due from the holding company are two loans based on agreements signed between the Bank and the holding company. The first loan of MNT 25 million is at 14 % per annum and the interest will be accrued from January, 2003. This loan shall be fully repaid in April, 2004. The second loan of MNT 76.8 million is also at 14 % per annum and matures in January, 2004.

21. DEPOSITS OF CUSTOMERS

	2002 MNT '000	2001 MNT '000
Current accounts	3,228,979	-
Savings deposits	467,327	-
Time deposits	2,483,707	-
	<u>6,180,013</u>	<u>-</u>

Foreign currency and local currency current account bear no interest in this financial year.

Foreign currency saving deposits bear interest at an annual rate of approximately 3.6% (2001 : nil), while local currency saving deposits at approximately 9.39% (2001 : nil).

Interest rates for time deposits vary for different types of accounts. Foreign currency time deposits bear interest at an annual rate ranging from approximately 3.9% to 6.8% (2001 : nil), while for local currency time deposits, at a range of approximately 6.6% to 22.8% (2001 : nil).

22. DEPOSITS AND PLACEMENTS OF OTHER FINANCIAL INSTITUTIONS

	2002 MNT '000	2001 MNT '000
Savings deposit	<u>400,000</u>	<u>-</u>

Savings deposit represents placement by the Inter Bank in the savings account for the term of 3 months and it carries an annual interest rate of 18%.

23. LOANS FROM LOCAL FINANCIAL INSTITUTIONS

	2002 MNT '000	2001 MNT '000
Loans from local financial institutions	<u>280,000</u>	<u>500,000</u>

As at 31 December 2002, loan from local financial institution represents borrowing obtained from the Anod Bank. This loan carries an annual interest rate of 15% per annum and it matures in December, 2003.

The loans from local financial institutions in 2001 were fully repaid during the year.

24. LOANS FROM FOREIGN FINANCIAL INSTITUTIONS

	2002 MNT '000	2001 MNT '000
Loans from international organisations	<u>1,153,125</u>	<u>438,800</u>

Loans from international organisations represent borrowings from three institutions, namely the Deutsche Bank Microcredit Development Fund, the Dexia Micro-Credit Fund and the International Finance Corporation ("IFC"). As at 31 December 2002, the Deutsche Bank Microcredit Development Fund loan balance amounts to USD 125 thousand or MNT 140.6 million (2001 : nil), the Dexia Micro-Credit Fund loan balance amounts to USD 500 thousand or MNT 562.5 million (2001 : nil) and the IFC loan balance amounts to USD 400 thousand or MNT 450 million (2001 : nil).

The loan from the Deutsche Bank Microcredit Fund was obtained via a promissory note issued by the Bank with a principal amount of USD 125,000. The interest rate of this promissory note is fixed at an annual rate of 2%. Interest payments on this note commenced in August 2002, and the maturity date is in August 2007.

24. LOANS FROM FOREIGN FINANCIAL INSTITUTIONS (CONTD.)

While , the loan from the Dexia Micro-Credit Fund was obtained via two promissory notes issued by the Bank with the principal amount of USD 300 thousand and USD 200 thousand respectively. Both of these notes were issued in July 2002 and carry an interest at a rate per annum of 6 month USD LIBOR plus 6.5%, plus interest tax as applicable. The payment of the interest of these two notes will commence in January 2003. The maturity date for the USD 300 thousand promissory note is in July 2003 and the other USD 200 thousand promissory note is in December 2003.

The purpose of the loan provided by the IFC is to provide additional funds to the Bank to support further expansion of its microfinance and small and medium enterprise lending activities and to strengthen the Bank's technical capability. This loan carries an annual interest rate of 3.5% plus LIBOR on the Interest Determination Date for one, two, three or six months rounded upward to the three decimal places. The repayment of the loan will commence in January 2005 and the final repayment is in July 2010.

25. LOAN FROM GOVERNMENT AGENCY

	2002 MNT '000	2001 MNT '000
Loan from government agency	<u>245,000</u>	<u>-</u>

This loan was obtained from the Employment Generation Support Fund with the objective of channelling it to small business entities and individuals. The interest on this loan is at 6 percent per annum.

26. OTHER LIABILITIES

	2002 MNT '000	2000 MNT '000
Interest payable	46,351	6,842
Delay on clearing settlement	16,699	-
Fund from UNDP	3,716	3,716
MSM Project	261	1,486
Other payable	103,740	30,192
	<u>170,767</u>	<u>42,236</u>

Included in other payable are the provision for audit fee and staff salary payable.

27. STATUTORY FUND

	2002 MNT '000	2001 MNT '000
As at 1 January	2,704,000	180,000
Issued during the year	300,000	1,656,000
Transferred from the UNDP Funding	-	680,000
Allocation of stocks dividends	-	188,000
	<hr/>	<hr/>
As at 31 December	<u>3,004,000</u>	<u>2,704,000</u>

During the year, the statutory fund was increased by MNT 300 million by the creation of 300,000 ordinary shares of MNT 1,000 each. All the additional 300,000 ordinary shares were sold to the holding company, XAC-GE Group. Currently, the statutory fund is 96% owned by the XAC-GE Group and 4% by other shareholders.

28. GRANTS

	2002 MNT '000	2001 MNT '000
Grants	<u>89,212</u>	<u>55,083</u>

Included here are the grants received from the two international organisations namely International Bank for Reconstruction and Development ("IBRD") for the Consultative Group to Assist the Poorest ("CGAP") and International Finance Corporation ("IFC"). As at 31 December 2002, the CGAP grant balance amounts to MNT 21.7 million (2001 : MNT 55.1 million) and the IFC grant amounts to MNT 67.5 million (2001 : nil).

The CGAP fund was granted in the year of 2001 with the purpose of assisting the X.A.C Co., Ltd in making a successful transition to a microfinance bank and to meet the following challenges, namely in the transformation process specifically on the developing internal systems that meet the requirements and needs of a microfinance bank, securing higher standard external audits that are relevant to a microfinance institution and strengthening senior management and governance, with particular emphasis on financial management and banking skills.

While, the first tranche of the IFC grant was received during the year 2002 with the objective of providing funds for technical assistance in the following initiatives namely for hiring of a technical advisor or consultant, training or trip for senior managers to an established microfinance institution and participation of an international party in meetings of the Bank Board of Directors and training for the Bank Board members.

29. COMMITMENTS AND CONTINGENCIES

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

	2002 MNT '000	2001 MNT '000
Loan Collateral	6,867,575	-
Other off balance sheet items	8,843	-
	<u>6,876,418</u>	<u>-</u>

Included in the other off balance sheet items held by the Bank are written off loans amounts to MNT 6 million and interest receivable for non performing loans worth MNT 2.6 million.

29. COMMITMENTS AND CONTINGENCIES (CONTD.)

- b) As at 31 December 2002 and 2001, the Directors have not authorised any capital commitments of significance

30. CAPITAL ADEQUACY

The Bank of Mongolia requires commercial banks to maintain a capital adequacy ratio of 10% compiled on the basis of total equity and total assets as adjusted for their risk. As at 31 December 2002, the Bank has a core capital ratio of 37.20% and risk weighted capital ratio of 37.92% as computed below:

	2002 MNT '000
<u>Tier I capital</u>	
Statutory fund	3,004,000
Profit and loss account	(170,466)
Reserve	9,436
	<hr/>
Total Tier I Capital	2,842,970
<u>Tier II capital</u>	
General reserve for bad and doubtful debts	54,485
	<hr/>
Total capital/capital base	<u>2,897,455</u>

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

	2002 MNT '000
%	
0	1,948,611
10	-
20	2,228,751
50	-
100	7,183,725
	<hr/>
Total	<u>11,361,087</u>

30. CAPITAL ADEQUACY (CONTD.)

Core capital ratio	37.26%
Risk weighted capital ratio	37.98%

31. TRANSACTIONS WITH RELATED PARTIES

The transactions with related parties of the Bank in 2002 relate to loans to the directors and staff.

	MNT'000
Total Loans to Director	33,897
Total Loans to Staff	92,921
	<hr/>
Gross Related Party Loans	126,818
General Provision	(1,590)
Net Related Party Loans as at 31 December 2002	<hr/> <u>125,228</u>

32 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 risk, liquidity and market movements in interest rates and foreign exchange rates. A description of the Bank's risk management policies in relation to those risk 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 level 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 risk 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 banks management team.

Exposure to credit risk is managed through regular analysis of the ability of the borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits when appropriate. Exposure to credit risk is also managed in part by obtaining collateral on and corporate and personal guarantees.

32. RISK MANAGEMENT POLICIES (CONTD.)

The geographical concentration of monetary assets and liabilities follows:

	31 DECEMBER 2002 ('MNT' 000)		
	<u>Mongolia</u>	<u>Other Countries</u>	<u>Total</u>
Cash and short term funds	3,279,302	-	3,279,302
Investment in securities	898,060	-	898,060
Loans and advances	5,514,506	-	5,514,506
Other assets	453,891	-	453,891
Property, plant and equipment	1,113,460	-	1,113,460
Amount due from Holding Company	101,868	-	101,868
	<u>11,361,087</u>	<u>-</u>	<u>11,361,087</u>
Deposits from customers	6,180,013	-	6,180,013
Deposits and placements of other financial institutions	400,000	-	400,000
Loans from local financial institution	280,000	-	280,000
Loans from foreign financial institutions	1,153,125	-	1,153,125
Loans from government agencies	245,000	-	245,000
Other liabilities	170,767	-	170,767
	<u>8,428,905</u>	<u>-</u>	<u>8,428,905</u>
	<u>2,932,182</u>	<u>-</u>	<u>2,932,182</u>

32 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 U.S Dollar). These limits also comply with the minimum requirements of the Central Bank of Mongolia. The Bank's exposure to foreign currency exchange rate risk follows:

	31 DECEMBER 2002 ('MNT' 000)		
	MNT	Foreign Currency	Total
Assets			
Cash and short term funds	2,228,477	1,050,825	3,279,302
Investment in securities	898,060	-	898,060
Loans and advances	5,094,046	420,460	5,514,506
Other assets	285,571	168,320	453,891
Property, plant and equipment	1,113,460	-	1,113,460
Amount due from Holding Company	101,868	-	101,868
Total assets	9,721,482	1,639,605	11,361,087
Liabilities			
Deposits from customers	5,875,807	-	6,180,013
Deposits and placements of other financial institutions	400,000	-	400,000
Loans from local financial institution	280,000	-	280,000
Loans from foreign financial institutions	-	1,153,125	1,153,125
Loans from government agencies	245,000	-	245,000
Other liabilities	69,531	101,236	170,767
Total liabilities	6,870,338	1,254,361	8,428,905
Statutory funds	3,004,000	-	3,004,000
Reserves	9,436	-	9,436
Retained earnings	(170,466)	-	(170,466)
Grants	-	89,212	89,212
Total capital funds	2,842,970	89,212	2,932,182
Total liabilities and capital funds	9,713,308	1,343,573	11,361,087

32. RISK MANAGEMENT POLICIES (CONTD.)

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 flows obligations as they become due.

The contractual maturities of monetary assets and liabilities as at 31 December 2002 are as follows:

	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000
Assets						
Cash and short term funds	2,576,177		703,125			3,279,302
Investment in securities	898,060					898,060
Loans and advances	1,309,400	1,592,432	1,989,059	308,210	315,405	5,514,506
Other assets	147,340	285,209	21,342	1,113,460		453,891
Property, plant and equipment				101,868		1,113,460
Amount due from Holding Company				1,523,538	315,405	101,868
	4,930,977	1,877,641	2,713,526	1,523,538	315,405	11,361,087
Liabilities						
Deposits from customers	4,753,935	219,315	418,963		787,800	6,180,013
Deposits and placements of other financial institutions	400,000					400,000
Loans from local financial institution			280,000			280,000
Loans from foreign financial institutions			562,500	140,625	450,000	1,153,125
Loans from government agencies		245,000				245,000
Other liabilities	166,790			3,977		170,767
	5,320,725	464,315	1,261,463	144,602	1,237,800	8,428,905
	(389,748)	1,413,326	1,452,063	1,378,936	(922,395)	2,932,182
Net position						
	(389,748)	1,023,578	2,475,641	3,854,577	2,932,182	
Accumulated gap						

32. 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 interest income will increase or decrease as a result of movements in interest rates. The Bank's expected reprising and maturity dates do not differ significantly from the contract 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 policies are reviewed on a regular interval basis. The Bank's average effective interest rates as of 31 December 2002 for monetary financial instruments are as follows:

	2002	
	MNT	Foreign Currency
Interest earning assets	17.00%	6.75%
Placements with other banks	12.50%	6.75%
Bank of Mongolia securities	4.50%	-
Loan to customers	48.2%	24.7%
Interest bearing liabilities	31.00%	20.31%
Demand deposits of customers	10.00%	3.60%
Time deposits of customers	10.5% - 20.1%	3.9% - 7.2%
Time deposits of Deutsche	-	2.00%
Loans from Local financial institutions	15.00%	-
Loans from Foreign financial institutions /Dexia	-	9.37%
Loans from Foreign financial institutions /IFC	-	5.34%
Loans from other institutions	6.00%	-

33. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

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

	Carrying MNT'000	Fair value MNT'000
Assets		
Cash and short term funds	3,279,302	3,279,302
Investment in securities	898,060	898,060
Loans and advances	5,514,506	5,514,506
Other assets	453,891	453,891
Property, plant and equipment	1,113,460	1,113,460
Amount due from Holding Company	101,868	101,868
Total Assets	11,361,087	11,361,087
Liabilities		
Deposits from customers	6,180,013	6,180,013
Deposits and placements of other financial institutions	400,000	400,000
Loans from local financial institution	280,000	280,000
Loans from foreign financial institutions	1,153,125	1,153,125
Loans from government agencies	245,000	245,000
Other liabilities	170,767	170,767
Total Liabilities	8,428,905	8,428,905

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

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

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

Cash and short term funds

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

Deposits and placements with other financial institution

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

Investment in securities

As set out in Note 4, securities held by the Bank for investment purposes as of December 31, 2002 are carried at cost, adjusted for amortisation of premium or accretion of discount to maturity date on a straight line basis.

Loans and advances

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

Amount due from Holding Company

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

Other assets

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

Deposits from customers

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

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

Deposits and placements of other financial institution

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

Loans from local financial institutions

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

Loans from foreign financial institutions

The fair values of loans from foreign financial institution is stated at carrying amounts due to the extensive period that their financial instruments will be held.

Loans from government agency

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

Other Liabilities

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

34. SIGNIFICANT EVENT DURING THE YEAR

During the financial year 2002, the Bank had increased its statutory fund by MNT 300 million by issuing 300 thousand ordinary shares of MNT 1,000 each. This additional fund was injected as to fulfill the requirement by the Bank of Mongolia where the Bank has to meet the threshold of MNT 3 billion in the statutory fund in the first quarter of the year 2002.

35. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with current year's presentation, based on information available for 2002. No comparative figures for income statement and cash flow statement are available as this is the first year XacBank operates as a bank after receiving a banking license in December, 2001.

36. 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.