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KHAN BANK'S MISSION

Khan Bank is the nationwide leader in innovative financial services that change people's lives and benefit society. We are committed to transparency, fairness and to providing the highest level of customer service in Mongolia.



OUR COMMITMENT TO CUSTOMERS

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

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

Khan Bank customers may request the full version of the confidentiality policy from any of the Bank's offices. Any person who is disadvantaged by a Khan Bank employee who has violated these policies should call the office of the CEO in Mongolian or English at (976) 11 332-334 or send an e-mail directly to ceo@khanbank.com.



MESSAGE FROM THE CHIEF EXECUTIVE OFFICER



In an extraordinarily challenging year, Khan Bank performed well and enters 2010 stronger than ever.

Total deposits increased by 27.6%, to reach MNT 866.6 billion. As the industry grew substantially less, Khan Bank improved its deposit market share during the year from 26.4% to 27.6%. This was accomplished despite unilateral reduction in interest rates by Khan Bank twice during the year.

We issued common stock in August to our shareholders and placed USD 20 million of second tier capital, increasing our risk adjusted capital ratio from 12.4% to 19.3% at December 31. Total capital at year end stood at MNT 126.7 billion, by far the highest in Mongolia.

Strong liquidity also underscores our Bank's financial strength. Our liquidity increased from MNT 184 billion to MNT 462 billion during the year and at this writing stands at 46.4%. Our liquidity ratio at year-end was 42.4%.

Loan demand was flat throughout 2009 as Mongolia recovered from its economic and financial problems.

A complex of domestic inflation, currency devaluation, slower deposit and loan growth and government spending cuts put a damper on consumption during the first three quarters of 2009, and therefore on Mongolian business. As business slowed, so too did growth in our banking business. Khan Bank's portfolio actually dropped slightly through the year from MNT 608.4 billion to MNT 596.7 billion.

As a result of the loan contraction and conservative levels of loss provisioning, after tax earnings were MNT 10.5 billion, down from MNT 22.3 billion in 2008. Return on equity for the year was 12.0% and return on assets was 1.1%.

Fortunately, Khan Bank has a well-diversified loan portfolio. Non-performing loans have stayed in an acceptable range, and because of our preponderance of small, short term retail loans, we had a steady stream of repayments to relend. Unlike some other banks, we never stopped lending through this economic downturn and our market share of net loans

increased from 23.0% to 23.9%. The reduction in our deposit rates also allowed us to reduce our loan rates to the benefit of our customers.

At this writing there are clear signs of renewed growth. The giant Oyu Tolgoi copper and gold project was agreed between the Government of Mongolia and the sponsors Ivanhoe Mines and Rio Tinto. Several other very large mining projects have gotten underway in the last few months. The supply chains are forming, and already loan demand has increased in early 2010.

These investments will substantially boost annual growth rates and increase per capita earnings over the next decade. Some observers predict that Mongolia may be the fastest growing economy in the world for the next several years.

The Bank continued to expand its branch network, and by year-end we had 488 branches across Mongolia. In August, we completed a nine year program of automation, and now every branch is on our network in real time. We continued to invest heavily in technology, including a conversion to the latest application software offered by Tata Consultancy Services, our major vendor, and expansion of our ATM network nationwide to 133, the largest in the country.

Khan Bank continued to underscore its commitment to Mongolia's social and economic development by investing MNT 300 million in support of over thirty educational, environmental and community development projects through the Khan Bank Foundation. The Bank's corporate social responsibility efforts and contribution to society were recognized by the Mongolian National Chamber of Commerce & Industry, which granted the Bank the Excellence in Corporate and Social Responsibility Award for 2009.

In sum, through the difficulties in 2008 and 2009 Khan Bank continued to serve the 80% of Mongolia's households that use our services. We have continued to lend to our customers and operate profitably, if at reduced levels from 2008. Our capital, liquidity, asset quality and branch system position us unusually well for substantial growth.

I thank all Khan Bankers for their hard work, and our customers and friends for their trust and confidence. We remain committed to all of you, and look forward to the years ahead.

Very truly yours,



J. Peter Morrow
Chief Executive Officer

April 26, 2010

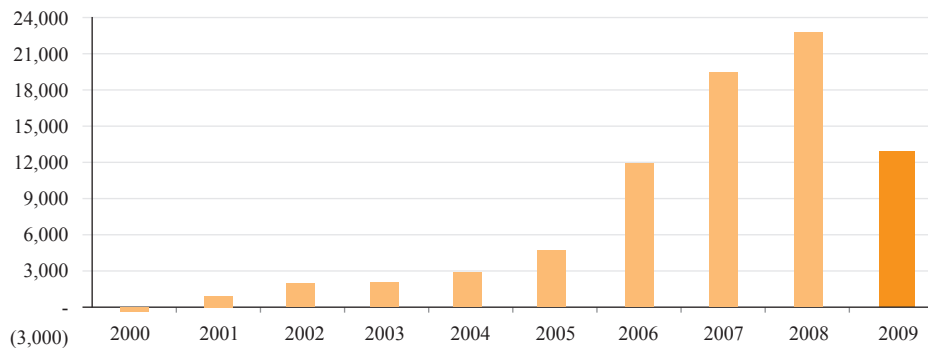


FINANCIAL HIGHLIGHTS /INDICATORS/

Khan Bank's total assets, loans, deposits and capital continued to grow in 2009. The Bank remained safe and sound, and maintained its leading position in the Mongolian banking sector with the following achievements in 2009.

Profitability

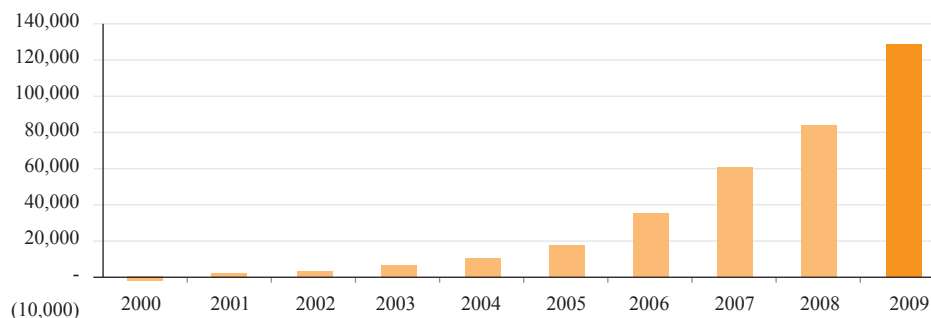
Earnings after taxes /MNT 000,000 /



After tax earnings were MNT 10.5 billion in 2009 versus MNT 22.3 billion in 2008, reflecting the economic downturn. Loan contraction while deposits continued to grow reduced the Bank's net interest income. Conservative loan loss provisioning was also a factor. Return on equity for the year was 12.0%, and return on assets was 1.1%.

Total Capital

Total capital at period end /MNT 000,000 /



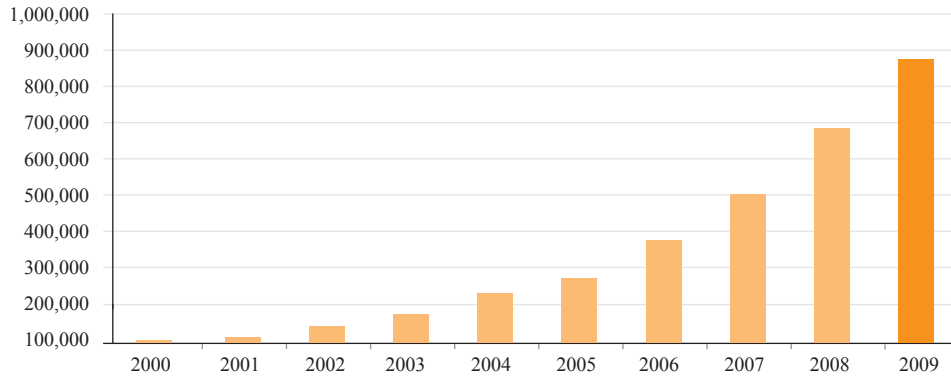
Our capital grew to MNT 126.7 billion from MNT 82.7 billion a year earlier. Shareholders added MNT 4.2 billion in new capital in August. In December, MNT 28.9 billion (USD 20 million) in subordinated debt was added to Tier 2 capital.

The Bank's capital adequacy ratio increased at 19.3% in the end of 2009 from the previous years' 12.4%, well in excess of the Mongol Bank regulatory requirement of 12%.



Deposits

Total deposits /MNT 000,000/

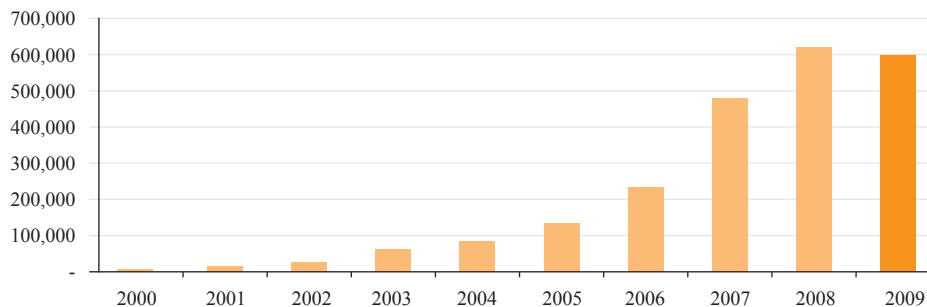


Despite the economy, total deposits grew 27.6% in 2009 reaching MNT 866.6 billion. Reflecting depositor confidence in the Bank, the growth came from both the Bank's solid retail base as well as the business sector.

At year end, liquidity was 42.4% versus 21.8% last year, underscoring the Bank's financial strength and positioning it well for expected recovery in 2010.

Loans

Total loans /MNT 000,000/



Loan demand remained weak throughout 2009. At year end, the bank's loan portfolio totaled MNT 596.7 billion, down 1.9% from MNT 608.4 billion the previous year. The portfolio remains well diversified among its business (49%), consumer (40%), and agricultural lending (11%) sectors.



STRATEGIC ACHIEVEMENTS IN 2009

In a difficult year, Khan Bank accomplished a number of important strategic objectives:

- The Bank added MNT 44.0 billion in retained earnings and new capital to bring total capital to MNT 126.7 billion. This brought capital adequacy to a strong 19.3%, providing a solid base for the Bank's existing business and a foundation for continued growth.
- A final 30 rural branches were converted from manual systems to the Bank's online network. As of August 2009, all 488 branches of the Bank are operating on a real time basis providing customers with direct access to all banking services from everywhere in Mongolia.
- Capital expenditures totaled MNT 9.2 billion for the year. This included MNT 6.8 billion in systems and technology, and MNT 2.4 billion in capital improvements for new and existing offices.
- To better support small and medium enterprises and to provide them with services specifically designed for them, the Bank has established dedicated SME/Business Loan centers: four in Ulaanbaatar, one in Darkhan and one in Erdenet.
- Total assets surpassed MNT 1 trillion for the first time due to customer confidence and deposit growth.
- The Bank issued its 5 millionth loan since the start of lending ten years ago.
- The number of Bank credit and debit card holders reached 680,075, a 30% increase over 2008. Khan Bank began acquiring Mastercard in 2009, while expanding its existing VISA and China Union Pay businesses. Usage of the cards, providing both convenience and safety to Khan Bank's clients, also continues to increase.
- In 2009, Khan Bank made a concerted effort towards being socially responsible as well as promoting corporate social responsibility in Mongolia. Khan Bank provided a total of MNT 300 million funding for 30 projects supported through the Khan Bank Foundation.
- Khan Bank is committed to advancing capacity building of its employees. In 2009, Khan Bank has involved its employees in various trainings held both locally and overseas investing MNT 258 million in training.

WHOLESALE BANKING

In 2009, Wholesale Banking added thirty new strategic clients from its target market. While loan demand was down from previous years, deposits continued to grow. Cross selling of non-loan based products such as treasury, trade finance and cash management products resulted in significant increases in volume and non-interest income.

The Wholesale Banking unit continued to fulfill its one-stop relationship management approach. This included a focus on operational improvements to insure a high level of customer service quality for corporate, mining and institutional customers throughout the Bank's nationwide network.

Despite the worldwide financial crisis and economic slowdown, the Bank's specialized Mining Banking department experienced strong business growth as this industry sector continues to expand in Mongolia. This included new clients, increased activity with existing clients, growth in deposits, new lending opportunities, and other banking services.

The department has hired two new relationship managers. Additionally, following the start-up of the Oyu Tolgoi project, the Bank established a working group with representatives from the Mining Banking, Rural Business units, Marketing and New Products to develop products and services tailored to Oyu Tolgoi and similar projects, their employees, as well as the local communities and businesses.

For the fifth year the Bank served as "Bank for the Event" for the "Discover Mongolia 2009" mining conference. The event this year gained much attention from the local and international investor communities.





SME BANKING OPERATIONS



Khan Bank announced the year 2007 as the Year of Small and Medium Enterprises (SMEs) and established the Khan Bank Incubator in order to show concrete support to these businesses.

The main focus was to provide a full range of financial services to SMEs, to organize better access to professional assistances and support, and to improve their financial knowledge and education.

The Bank, through its Incubator activities, organizes training for business entities and individuals, emphasizing the importance of reaching rural clients evenly, having reciprocal relationships with business people, linking training with practical application, and helping customers establish contacts with business partners across different industries.

During 2009, 774 individuals and SMEs received loans totalling MNT 18.1 billion that met their needs through participating in Incubator trainings and seminars, developing business plans, and attending events initiated and organized by the Incubator.

Khan Bank cooperated with the Government and international organizations in the implementation of twelve projects designed to reduce loan interest rates, the emerging issues for SME businesses, and disbursed loans with 8.8-15 percent annual interest rates which was favorable compared to market rates. The Bank also collaborated on extension of loan maturities with 5 International project organizations that provided long term funding and guarantees to borrowers with insufficient collaterals and implemented 4 programs through which 26000 borrowers with insufficient collaterals received 10 year maturity loans in amount of MNT 45.9 billion.

To support rural businesses, training programs on “Competing with Changes” and “Business Growth Management” topics were organized in the Western Region’s Khovd, Zavkhan, Khuvsgul, Bayankhongor aimags; Central Regions’s Uvurkhangai, Erdenet, Darkhan, Selenge aimags; and the Eastern Region’s Dundgovi, Dornogovi, Khentii, and Zamiin-ud aimags.



To support its clients' production trade and to coordinate their activities, the Bank organized 28 exhibitions to promote the initiative of entering into supplier and buyer relationship.

The Mongolian Government designated 2009 as the "Year of Industrial Development". In this connection, Khan Bank Incubator initiated "Domestic Production Support Campaign" to promote Khan Bank customers producing import substitute products.

The Bank implemented "Housing Program" to support its customers in the construction industry and independently organized "Construction and Apartment Loan Expo" to advertise their products and support the sale of properties.

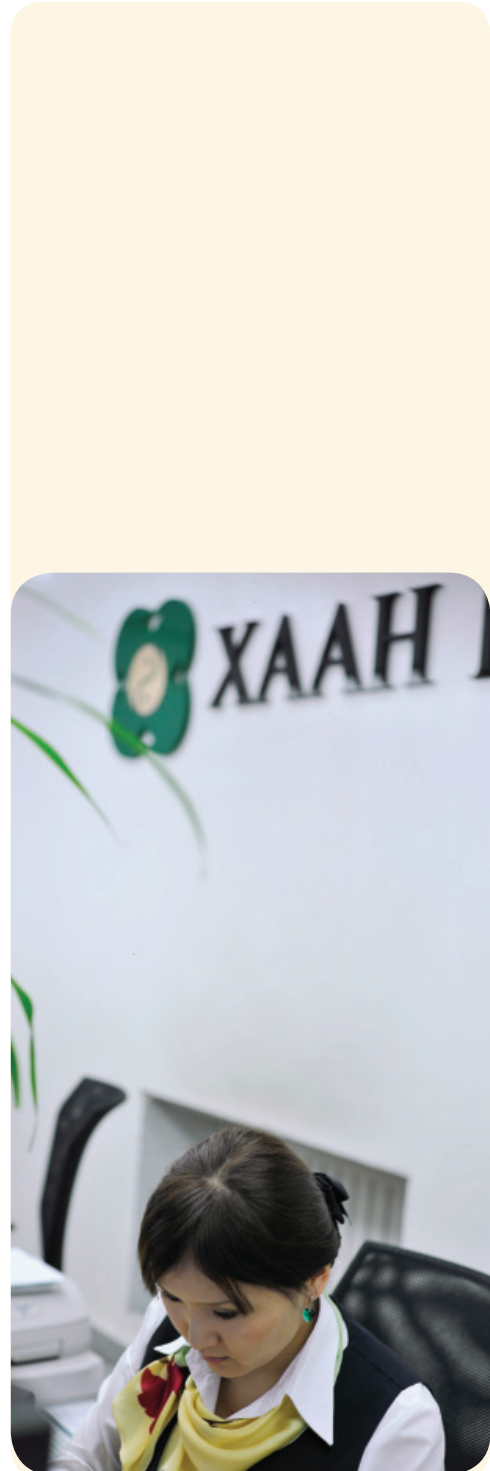
The Bank has established SME Business Centers aimed to improve its services, provide support to SMEs through offering comprehensive financial services and initiating creation of a website for SME clients.

RETAIL BANKING OPERATIONS

Through its 488 branches located in every corner of Mongolia and its 3,800 employees, Khan Bank delivers comprehensive financial services to Mongolian people on a timely basis.

In 2009, all branches of the Bank became 100 percent online. Customers in the Bank's 71 branches in Ulaanbaatar and 417 branches in rural areas now have access to all of the Bank's services with no difference in terms of time or fees.

To meet the needs of its clients, the Bank introduced new or renewed services and products to the market such as mobile banking services, internet banking mobile version, message payment services. The Bank also made eight major changes and alterations to its policies and products that resulted in expansion of banking services. Despite the difficulties in the banking sector in 2009, customer confidence in the Bank remained high, and the Bank's deposits increased 27.6% to MNT 866.6 billion.





The average loan interest rate declined 13% by the end of the year as a result of amendments to the Bank's Loan Policy on 124 occasions in 2009 and implementation of a policy to reduce loan interest rate as part of a strategy to improve loan product terms.

The Bank provided care to launch of affordable and innovative financial services that meet individuals' financial needs. This included new products such as apartment and house and fence secured consumer and salary card loans.

The Bank conducts services to deliver social programs implemented by the Government of Mongolia efficiently and promptly to people of Mongolia. Every month, the Bank disburses monthly pension payments to 192,100 elders and social welfare payments to an additional 105,300 people.

Based on customer demand, we have been cooperating with over twenty projects and programs to decrease interest rate, extend tenor and improve loan terms. Khan Bank has been providing prompt support and services of projects and programs such as the third campaign of Land Reclamation implemented by the Government of Mongolia, SME Development Program implemented by the Ministry of Food, Agriculture and Light Industry, and the Labor Support Fund loan implemented by Labor and Welfare Service Agency throughout Mongolia.

The bank has constructed 18 new building and renovated 68 sub branches in urban and rural areas and invested MNT 6.5 billion in 2009 in order to provide quality services in a convenient environment.

With the aim to improve the financial knowledge of our customers and to provide them with professional assistance, we have organized training in 16 aimag centers and 253 soums reaching 47,500 customers in 2009.

The Bank's representative office in Korea continued to be very active in 2009. The number of deposit accounts at Khan Bank held by Mongolians living and working in Korea increased 37.8%.

ELECTRONIC BANKING

The Bank continues to see a steady increase in the demand for electronic banking services. These include debit and credit cards, internet banking, mobile banking and ATMs.

The number of card holders increased 30% in 2009 to reach 680,075 at year end. During 2009, Khan Bank became a member of Mastercard Worldwide and began acquiring Mastercard in November. As the first bank in Mongolia to join the China Union Pay (CUP network,) Khan Bank and CUP celebrated the first anniversary in August 2009. The CUP card, accepted mainly throughout Asia, is of particular benefit to Khan Bank's customers doing business in China. In the domestic Mongolian market, Khan Bank has successfully launched co-branded cards with various organizations. The first co-branded card with a city district was with Bayangol district, one of the largest districts in Ulaanbaatar. Cards with a distinct brand representing the pride of the district will be issued to employees of business entities, organizations, public and private colleges and universities operating in Bayangol.

Importantly during the year, Khan Bank signed on to support the Bank of Mongolia in the development of an integrated interbank card network which is expected to begin operation in 2010. The Bank was the first to receive certification from Bank of Mongolia to process card payments.

As a result of efforts to promote wide use of electronic banking services, the number of internet bank users reached 17,322, a 41.2% increase from 2008. This includes 1,569 users in rural areas.

Due to an increasing number of card holders, the number of merchants in rural and urban areas is also increasing substantially. For merchants, the benefits include increased sales, reduced risk from cash payments, and greater efficiency.

The Bank's increasingly active ATM network processed a total of 2.2 million transactions during the year. Mobile banking customers increased by 55.7% to 29,367.





INVESTMENT BANKING



Moody's Investors Service

Outlook	Stable
Bank Deposits –Foreign Currency	B2/NP
Bank Deposits –Domestic Currency	Ba3/NP
Bank Financial Strength	D-
Issuer Rating	Ba3
Senior Unsecured MTN*	Ba3
Subordinate MTN	B1

* Medium Term Notes

FitchRatings

Outlook	Negative
IDR* – Foreign Currency	B
IDR – Local Currency	B
Individual rating	D/E
Support Rating	5
Support Rating Floor	B-
Sovereign Risk IDR – Foreign and Local	B

* Issuer Default Rating

The Investment Banking Department is focused to raising funds from international capital markets for the Bank as well as to exploring debt and equity financing opportunities for its corporate customers.

In 2009, Khan Bank raised USD 20 million in senior long term credit facilities to support its lending activities. This included funding from FMO, the Netherlands development bank, and Blue Orchard, a leading microfinance institution based in Switzerland.

The Bank's shareholders added MNT 4.2 billion (USD 3 million) in new equity through rights offering in August 2009. Additionally, the Bank added USD 20 million in long term subordinated debt to Tier 2 capital. The debt, from FMO and H.I.S. Co. Ltd of Japan, increased the Bank's capital adequacy to 19.3% and brought total capital to MNT 126.7 billion. Khan Bank's capital base solidifies its leading position in the market and positions the Bank for continued growth.

Khan Bank is rated by Moody's Investors Service and by Fitch Ratings.

TREASURY

Liquidity

With a view to ensuring smooth customer transactions, Khan Bank has maintained at all times sound liquidity position and has consistently complied with statutory reserve requirements. The Bank's liquidity ratio, which was 21.8% in 2008, increased to 42.4% at year end 2009, underscoring the Bank's commitment to meeting customers' transaction needs and maintaining public confidence placed in the bank amidst the economic problems.

Money Markets

Khan Bank seeks to maximize its profitability and ensure sound return on assets by placing its excess liquidity short term in Mongol Bank treasury bills and with other commercial banks. Khan Bank assumes a leading role in Bank of Mongolia bill trading and held 43% of the entire issue at the end of 2009. Khan Bank purchased a total of MNT 2.9 trillion in Bank of Mongolia bills issued during the year and earned MNT 13.7 billion in investment income, representing a three fold increase over the previous year.

Foreign Exchange

Khan Bank, with a 30% share of the Mongolian foreign exchange market, strives to deliver high quality foreign exchange services throughout its extensive branch network. The Bank expanded its correspondent banking relationships in 2009 and established Forex lines with several large banks to meet the increasing foreign exchange needs of its clients, while exploring opportunities for developing the derivative market in Mongolia. Income from Forex trading activities reached MNT 3.9 billion, a 32% increase over the previous year.

Treasury Department dealers from Khan Bank took third place in the Assets & Liabilities Management Competition organized by FMO (Netherlands development bank) and DEG, a member of Germany's KfW banking group. Teams from financial institutions in 26 countries took part in the competition. Khan Bank's success in this globally recognized competition underlined the Bank's competitiveness among its counterparts from developing countries in terms of assets and liabilities management.

RISK MANAGEMENT AND MONITORING

In 2009, the Risk Management Department focused on two main areas, market and operational risk management, which involved identifying, forecasting, measuring, evaluating risks, with the use of analysis and research tools, ensuring timely reporting to the management and that appropriate controls are in place so as to maintain risks at minimal level.

The Market Risk Management Unit ensures the Bank's foreign exchange risks are maintained at an acceptable level, determines appropriate limits for both local and foreign transactions, sets counterparty deposit limits for each local bank relative to particular risk profile, presents proposals to Assets and Liability Management committee for decision, determines derivative limits, follows-up on implementation of the approved limits, forecasts interest risk by employing GAP analysis and reports the findings to Asset and Liability management committee.

Operational Risk Management Unit conducts regular risk review of Head Office departments and branches to determine potential risks inherent in their operations and follows up on the implementation of risk mitigation measures in collaboration with the Risk Management Committee. Furthermore, the unit has developed and adopted several procedures covering operational areas, one of which is the Bank's policy and procedure on anti money laundering and terrorism financing. The unit has provided training for more than four hundred employees of the Bank to ensure awareness of the policy and Know Your Customer concepts.



In relation to the ever growing business of the bank and the 100% online network, IT risk assessment and management function has become one of the components of Operational Risk Management Unit efforts.

The Credit Risk Management Department is responsible for managing credit risks in two areas - credit control and portfolio management. The key focus of the division is to identify concentration and other potential credit risks involved in the bank's lending operation and to make sure appropriate controls are in place to mitigate them. During 2009, the Department enhanced borrower and facility risk rating for commercial loans, developed a credit scoring methodology for consumer loans, organized Credit Risk Committee for decisions on various relevant issues, and conducted seminars for bank staff concerning credit risk management.

KHAN BANK AWARDS

In 2009, the international financial magazines Euromoney and Global Finance separately named Khan Bank as "Best Bank in Mongolia", awards the Bank has won for several years in a row.

- Euromoney magazine named Khan Bank the "Best Bank of Mongolia" in 2006, 2007, 2008 and 2009.
- Global Finance named Khan Bank, the "Best Bank of Mongolia" in 2004, 2005, 2006, 2007 and 2008.
- The Banker Magazine chose Khan Bank as "Bank of the Year" in Mongolia in 2003, 2005, 2006, 2007 and 2008.
- The Mongolian Chamber of Commerce and Industry and the Government of Mongolia jointly named Khan Bank as "Top Premium Bank" in 2004, 2005, 2006, 2007, 2008 and 2009.
- The Mongolian National Chamber of Commerce and Industry awarded the Khan Bank "Excellence in Corporate Social Responsibility" award to the Bank in 2008 and 2009.



CORPORATE GOVERNANCE

The overall management and direction of the Bank is undertaken by its Board of Directors. The Board has three committees: Audit, Governance and Remuneration, and Risk Management.

BOARD OF DIRECTORS



Hideo Sawada
Chairman of Board of Directors
Chief Executive Officer
Sawada Holdings Co. Ltd



Yoshiaki Mishima
Director
Sawada Holdings Co. Ltd



Ts. Baatarsaikhan
President
Tavan Bogd Group



D. Hulan
Executive Vice President
Tavan Bogd Group



Jemal-ud-din Kassum
Managing Partner
AJK Financial Services LLC



J. Peter Morrow
Chief Executive Officer
Khan Bank

Shareholders

There were no changes in the Bank's ownership during the year which remains as follows:

• Sawada Holdings Co. Ltd. /directly and indirectly/ (Tokyo, Japan)	52.98%
• Tavan Bogd Trade Co. Ltd. (Ulaanbaatar, Mongolia)	35.32%
• International Finance Corporation (part of the World Bank)	9.07%
• Development Alternatives, Inc. (USA)	1.79%
• Mongolia Holdings Limited Partnership (USA)	0.67%
• Morrow Family Revocable Trust (USA)	0.18%



Executive Management

In December 2006, Khan Bank extended its management contract with DAI for another four years. DAI has managed the Bank since 2000; the contract for the joint Mongolian and foreign management team will continue through December 31, 2010. A succession plan for Mr. Morrow is well underway with an announcement by the Board of Directors expected this year. Mr. Morrow has already agreed to stay on with the Bank in an advisory capacity for at least two years. He will also continue as a Board member.



R. Munkhtuya
Deputy CEO

D. Batsaikhan
Deputy CEO

J. Peter Morrow
Chief Executive Officer

Executive Management (continued)



M. Erdenechimeg
*Rural Business
Executive*



E. Oyunbileg
*Corporate Governance
Executive*



U. Narantsetseg
*Ulaanbaatar
Business Executive*



N. Oyunkhand
*Wholesale Banking
Executive*



Ch. Batsaikhan
*Head of Internal
Auditing Department*



G. Munkhbayar
*Chief Financial
Officer*



D. Enkhbaatar
*Chief Credit & Risk
Officer*



CORPORATE SOCIAL RESPONSIBILITY



Embracing principles of corporate social responsibility (CSR) in its business and activities, Khan Bank has been making considerable contributions to the economic and social development of Mongolia. Khan Bank's mission statement states its commitment to make positive changes in people's lives and to benefit society while adhering to fairness and transparency. With its widest network reaching every corner of Mongolia, the Bank strives to be a good and inspiring neighbor to all the communities where Khan Bank operates.

Khan Bank pioneered in promoting corporate social responsibility in the business sector of Mongolia in the early 2000s by supporting contemporary arts and programs designed to promote English language learning. Since then the Bank has steadily increased its supports in various fields and communities throughout Mongolia. Khan Bank's CSR framework is unique in a way that the Bank engages and partners with community members, civil society organizations, other businesses and its customers in implementing its CSR activities.

KHAN BANK FOUNDATION

In early 2007, Khan Bank established the Khan Bank Foundation to provide a more organized and professional structure for Khan Bank's corporate social responsibility efforts. The Khan Bank Foundation identified education, arts and culture, mitigating social and physical disadvantage, community development and environmental protection initiatives as priorities. Since its establishment, Khan Bank Foundation has invested over MNT 1 billion to over 100 community development, education, culture and environmental projects.

In 2009, Khan Bank made a concerted effort towards being socially responsible as well as promoting corporate social responsibility in Mongolia. In particular, Khan Bank provided a total of MNT 300 million for funding 30 projects supported through the Khan Bank Foundation.

The Khan Bank Foundation's contribution in the education sector included several scholarship programs in partnership with other organizations including Friends of Mongolia (NGO), the Zorig Foundation and English Speakers' Union of Mongolia.

In particular, Khan Bank Scholarship Program awarded 265 talented students from every corner of Mongolia with a tuition fee in 2009-2010 academic year.

The Foundation set up 'Discovery center' in Dornod aimag in cooperation with the Asia Foundation. Over 30 children from 8 soums of Khentii aimag enrolled in the 'Funny English Summer Camp', learning English in a fun and relaxing atmosphere with native English speaker teachers. The Foundation also supported the 'Voice Box Youth TV program', a unique concept of learning English through TV and internet.

In 2009, Khan Bank Foundation supported a number of projects to benefit disadvantaged groups in Mongolia, including new year gifts presented to 300 children from 5 kindergartens in suburbs of Ulaanbaatar and '1000 Children's Celebration' in cooperation with the World Vision, enrolling over 600 children from orphanages and low-income families.

On December 3, 2009, the Foundation funded and organized an open day 'Life is Wonderful' in cooperation with "Khatan Duulal, an arts & cultural NGO of disabled people, the Mongolian National Chamber of Commerce & Industry (MNCCI) on the occasion of 'International Day for Persons with Disabilities'. The event was a success as it provided one-stop information for disabled people and encouraged their business initiatives.

The Foundation initiated and provided financing for a number of income generation projects. For instance, the 'Felt and Wool Incubator' project reached remote soums of Uvs and Gobi-Altai aimags to facilitate income generation for low-income, unemployed people and single mothers in the communities with limited employment opportunities through empowering them and teaching them felt production skills by using the most accessible material 'wool'.





In 2009, the Foundation continued to cooperate with the Arts Council of Mongolia through an annual grant as well as partnering in several arts and cultural programs.

Another initiative was to support the Puppet Theater of Mongolia in renovating the theater hall on the second floor to create a comfortable environment with buffet, mini-theater, seating area for children.

The Foundation supported programs designed to increase public engagement in environmental protection and preservation. Since Khan Bank Foundation launched the ‘Khan Bank Forest’ program, it has funded planting trees in over 20 secondary schools and kindergartens in suburban UB and this program contributed to creating green environment in Ulaanbaatar and improving ecological and environmental education of children. 2009, Khan Bank’s rural offices joined the ‘Khan Bank Forest’ program, planting trees in public areas along with community members.

In addition to funding projects and programs, Khan Bank Foundation played a leading role in promoting CSR in Mongolia. In particular, Khan Bank Foundation sponsored and jointly organized the Mongolian National Forum on CSR 2009 in cooperation with the MNCCI. In the forum, a presentation on Khan Bank’s strategy and experience of CSR efforts was delivered.



KHAN BANK ART GALLERY

Khan Bank is committed to promoting Mongolian arts and culture, with a particular emphasis on Mongolian fine arts, and has continued to contribute towards valuing and preserving the artworks of Mongolian artists.

Khan Bank's Art Gallery, inaugurated in December 2007, plays an important role in the Bank's support of local art and culture. Since inception, the Gallery, located in the Bank's head office and open to the general public, has successfully hosted more than 30 art exhibitions and displayed over 500 artworks by Mongolian artists. In 2009, Khan Bank hosted 13 public exhibitions of Mongolian and foreign artists. Exhibitions that particularly captured the audience's imagination included "Roerich and Me", a showcase of paintings by art students who created their pieces inspired by the works of Nicholas Roerich, and "My First Art Exhibition" featuring the works of professional artists and children from several child care shelters opened on the occasion of Children's Day.



KHAN BANK THEATER

The Khan Bank Theater hosts a variety of local and international business and cultural events as well as internal Khan Bank events. Over 50 events were held at the theater in 2009.



REPORT OF THE INDEPENDENT AUDITORS To the shareholders of Khan Bank LLC

We have audited the accompanying financial statements of Khan Bank LLC, which comprise the statement of financial position as at 31 December 2009 and the statements of comprehensive income, changes in equity and cash flow for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as of 31 December 2009, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Matter

This report is made solely to the shareholders of the Bank, as a body, in accordance with Article 91 of Company Law of Mongolia and for no other purpose. We do not assume responsibility to any other person for the content of this report.



ERNST & YOUNG MONGOLIA AUDIT LLC
Certified Public Accountants



CHUNG SING PETER YONG
Partner

Ulaanbaatar, Mongolia
Date : 30 MAR 2010

KHAN BANK LLC

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2009

	Note	2009 MNT П000	2008 MNT '000
Interest and similar income	3	133,105,750	129,958,640
Interest and similar expense	4	<u>(65,801,365)</u>	<u>(52,932,154)</u>
Net interest income		<u>67,304,385</u>	<u>77,026,486</u>
Fees and commission income	5	9,822,837	8,310,666
Fees and commission expense	5	<u>(415,593)</u>	<u>(353,996)</u>
Net fees and commission income	5	<u>9,407,244</u>	<u>7,956,670</u>
Other operating income	6	<u>4,233,364</u>	<u>3,283,191</u>
Total operating income		80,944,993	88,266,347
Credit loss expense	7	<u>(12,877,094)</u>	<u>(10,248,970)</u>
Net operating income		<u>68,067,899</u>	<u>78,017,377</u>
Personnel expenses	8	(28,025,648)	(24,266,058)
Depreciation of property, plant and equipment	16	(7,610,750)	(5,651,859)
Other operating expenses	9	<u>(18,531,940)</u>	<u>(18,447,329)</u>
Total operating expenses		<u>(54,168,338)</u>	<u>(48,365,246)</u>
Profit before tax		13,899,561	29,652,131
Income tax expense	10	<u>(3,377,640)</u>	<u>(7,398,552)</u>
Profit for the year, representing total comprehensive income for the year attributable to equity holders of the Bank		<u>10,521,921</u>	<u>22,253,579</u>
Earnings per share for equity holders of the Bank (MNT):			
Basic earnings per share	11 (a)	1,672	3,611
Diluted earnings per share	11 (b)	<u>1,648</u>	<u>3,554</u>

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

KHAN BANK LLC

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2009

	Note	2009 MNT '000	2008 MNT '000
ASSETS			
Cash and balances with central bank	12	204,851,916	118,115,083
Due from banks	13	79,293,926	20,633,289
Financial investments - available-for-sale	14	330,044	45,482,342
Financial investments - held for maturity	14	178,161,207	-
Loans and advances to customers	15	580,707,524	608,653,744
Property, plant and equipment	16	41,411,221	40,193,733
Other assets	17	3,161,424	5,141,225
Tax refundable		-	752,176
TOTAL ASSETS		<u>1,087,917,262</u>	<u>838,971,592</u>
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK			
Ordinary shares	22	12,994,012	12,334,792
Share premium		13,866,079	10,242,677
Revaluation surplus	24	604,541	691,272
Share-based payment reserves		121,096	121,096
Retained profits		67,348,985	56,740,333
TOTAL EQUITY		<u>94,934,713</u>	<u>80,130,170</u>
LIABILITIES			
Due to banks	18	3,198,323	2,615,268
Due to customers	19	866,591,696	679,155,819
Debt issued and other borrowed funds	20	119,009,457	73,058,253
Other liabilities	21	3,971,119	4,012,082
Tax payable		211,954	-
TOTAL LIABILITIES		<u>992,982,549</u>	<u>758,841,422</u>
TOTAL EQUITY AND LIABILITIES		<u>1,087,917,262</u>	<u>838,971,592</u>

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

KHAN BANK LLC

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2009

	← Non-distributable Share-based →					Total MNT '000
	Ordinary shares MNT '000	Share premium MNT '000	payment reserves (Note 25) MNT'000	Revaluation surplus (Note 24) MNT '000	Distributable Retained profits MNT '000	
At 1 January 2008	12,298,792	10,194,175	142,466	786,779	34,391,247	57,813,459
Profit for the year representing total comprehensive income for the year	-	-	-	-	22,253,579	22,253,579
Depreciation transfer for land and buildings	-	-	-	(95,507)	95,507	-
Issue of ordinary shares pursuant to exercise of option (Note 22)	36,000	48,502	(21,370)	-	-	63,132
At 31 December 2008	<u>12,334,792</u>	<u>10,242,677</u>	<u>121,096</u>	<u>691,272</u>	<u>56,740,333</u>	<u>80,130,170</u>
At 1 January 2009	12,334,792	10,242,677	121,096	691,272	56,740,333	80,130,170
Profit for the year representing total comprehensive income for the year	-	-	-	-	10,521,921	10,521,921
Depreciation transfer for land and buildings	-	-	-	(86,731)	86,731	-
Issue of ordinary shares (Note 22)	659,220	3,623,402	-	-	-	4,282,622
At 31 December 2009	<u>12,994,012</u>	<u>13,866,079</u>	<u>121,096</u>	<u>604,541</u>	<u>67,348,985</u>	<u>94,934,713</u>

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

KHAN BANK LLC

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2009

	2009	2008
	MNT '000	MNT '000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit before tax	13,899,561	29,652,131
<i>Adjustments for:-</i>		
Depreciation of property, plant and equipment	7,610,750	5,651,859
Net credit loss for loans and advances	12,884,747	9,646,315
Net credit (gain)/loss for other assets	(7,653)	602,655
Net unrealised foreign exchange loss	2,429,525	1,382,391
Unwinding of discount on Share Appreciation Rights	34,450	19,062
Share Appreciation Rights	25,530	144,190
Interest income on financial investments	(12,649,409)	(1,029,616)
Interest expense on repurchase agreements	74,134	189,696
Property, plant and equipment written off	119,987	85,076
(Gain)/loss on disposal of property, plant and equipment	(170,904)	33,368
Operating profit before working capital changes	24,250,718	46,377,127
<i>Changes in operating assets:-</i>		
Statutory deposit with Bank of Mongolia	(20,070,150)	-
Loans and advances to customers	23,840,660	(128,199,503)
Other assets	1,987,454	(2,796,583)
<i>Changes in operating liabilities:-</i>		
Due to banks	583,055	(17,673,269)
Due to customers	185,006,352	184,423,063
Other liabilities	89,633	452,275
Cash generated from operations	215,687,722	82,583,110
Payment of Share Appreciation Rights	(41,689)	(8,630)
Income tax paid	(2,413,510)	(8,599,728)
Net cash flow generated from operating activities	<u>213,232,523</u>	<u>73,974,752</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of financial investments		
- available-for-sale	-	(176,797,817)
- held-to-maturity	(2,951,083,243)	-
Proceeds from maturity of financial investments		
- available-for-sale	-	141,500,000
- held-to-maturity	2,830,696,000	5,100,000
Purchase of reverse repurchase agreements	(35,206,463)	(63,874,824)
Proceeds from reverse repurchase agreements	35,300,000	64,000,000
Purchase of other investments	(65,794)	-
Proceeds on disposal of property, plant and equipment	461,002	210,397
Purchase of property, plant and equipment	(9,238,323)	(17,553,874)
Net cash flow used in investing activities	<u>(129,136,821)</u>	<u>(47,416,118)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Drawdown from repurchase agreements	54,625,866	107,523,897
Repayment of repurchase agreements	(54,700,000)	(107,713,593)
Proceeds from issuance of ordinary shares	4,282,622	-
Proceeds from exercise of options	-	63,132
Proceeds from debt issued and other borrowed funds	48,505,396	51,741,325
Repayment of debt issued and other borrowed funds	(11,482,266)	(3,981,233)
Net cash flow generated from financing activities	<u>41,231,618</u>	<u>47,633,528</u>
Net increase in cash and cash equivalents	125,327,320	74,192,162
Cash and cash equivalents brought forward (Note 28)	138,748,372	64,556,210
Cash and cash equivalents carried forward (Note 28)	<u>264,075,692</u>	<u>138,748,372</u>

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

KHAN BANK LLC

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2009

1. CORPORATE INFORMATION

The Bank is principally engaged in banking and financial services pursuant to License No. 6 issued by the 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 principal place of business of the Bank is Seoul Street-25, P.O. Box-192, Ulaanbaatar 210644, Mongolia.

The holding company of the Bank is Sawada Holdings Co. Ltd, a company incorporated in Japan and is listed on the Osaka Securities Exchange.

The financial statements of the Bank for the year ended 31 December 2009 were authorised for issue by the Board of Directors in accordance with a resolution of the directors on **30 MAR 2010**

2. ACCOUNTING POLICIES

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

The Bank presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the statement of financial position date (current) and more than 12 months after the statement of financial position date (non-current) is presented in note 26.

The financial statements have been prepared on a historical cost basis, except for buildings and available-for-sale financial investments that have been measured at fair value. The financial statements are presented in the Mongolian Tugrug, which is denoted by the symbol MNT, rounded to the nearest thousand (MNT'000), except when otherwise indicated.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Interest and similar income and expense

Interest income and expense for all interest-bearing financial instruments except those classified as held for trading or designated at fair value through profit or loss are recognised in 'Interest and similar income' and 'Interest and similar expenses' in the statement of comprehensive income using the effective interest rates of the financial assets or financial liabilities to which they relate. Interest income is recognised in the statement of comprehensive income on an accrual basis, except in the case of impaired loans and advances. Interest on impaired financial assets is recognised at the original effective interest rates of the financial assets applied to the impaired carrying amount.

(b) Fees and commission income

Fees and commission income derived by the Bank relate mainly to pension payment charges, money transfers, application, transaction and other fees. Fees and commission income are generally recognised on an accrual basis when service has been provided.

Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

(c) Foreign currency translation

The financial statements are presented in Mongolian Tugrug, which is the Bank's functional and

presentation currency. Transactions in foreign currencies are initially recorded at the rates ruling at the date of the transaction. Foreign currency monetary assets and liabilities are translated at the exchange rates ruling at the balance sheet date. All exchange differences are taken to profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(d) Income tax

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 statement of financial position date.

Deferred tax is provided for, using the liability method, on temporary differences at the statement of financial position date between the tax bases of assets and liabilities and their carrying amounts in the financial statements. 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 measured at the tax rates that are expected to apply in the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date. Deferred tax is recognised in the income statement, except when it arises from a transaction which is recognised directly in equity, in which case the deferred tax is also recognised directly in equity.

(e) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents consist of cash and balances with central banks with no restriction and due from banks.

(f) Financial Instruments - Initial Recognition and Subsequent Measurement

(i) Date of recognition

Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace are recognised on the trade date, i.e. the date that the Bank commits to purchase or sell the asset. Derivatives are recognised on trade date basis.

(ii) Initial recognition of financial instruments

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus, in the case of financial assets and financial liabilities not at fair value through profit or loss, any directly attributable incremental costs of acquisition or issue.

(iii) Derivatives recorded at fair value through profit or loss

Derivatives include cross currency swaps, forward foreign exchange contracts and options on foreign currencies. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives held for trading are included in 'Net trading income'.

Derivatives embedded in other financial instruments, such as the conversion option in an acquired convertible bond, are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair value in the trading portfolio

with changes in fair value in the trading portfolio with changes in fair value recognised in statement of comprehensive income.

(iv) Financial assets or financial liabilities held for trading

Financial assets or financial liabilities held-for-trading, comprising financial instruments held for trading other than derivatives, are recorded in the statement of financial position at fair value. Changes in fair value are recognised in 'Net trading income'. Interest and dividend income or expense are recorded in 'Net trading income' according to the terms of the contract, or when the right to the payment has been established.

Included in this classification are debt securities, equities and securities which have been acquired principally for the purpose of selling or repurchasing in the near term.

(v) Financial assets or financial liabilities designated at fair value through profit or loss

Financial assets and financial liabilities classified in this category are designated at initial recognition when the following criteria are met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing the gains or losses on them on a different basis; or
- the assets and liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- the financial instruments contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial assets and financial liabilities at fair value through profit or loss are recorded in the statement of financial position at fair value. Changes in fair value are recorded in 'Net gain or loss on financial assets and liabilities designated at fair value through profit and loss'. Interest earned or incurred is accrued in interest income or expense, respectively, according to the terms of the contract, while dividend income is recorded in 'Other operating income' when the right to the payment has been established.

(vi) 'Day 1' profit

Where the transaction price is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognises the differences between the transaction price and fair value (a 'Day 1' profit) in the statement of comprehensive income in 'Net trading income'. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognised in the statement of comprehensive income when the inputs become observable, or when the instrument is derecognised.

(vii) Held-to-maturity financial investments

Held-to-maturity financial investments are non-derivative financial assets within fixed or determinable payments and have fixed maturities and which the Bank has the intention and ability to hold to maturity. After initial measurement, held-to-maturity financial investments are subsequently measured at amortised cost using the effective interest method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in 'Interest and similar income' in the statement of comprehensive income. The losses arising from impairment of such investments are recognised in the income statement line 'Impairment losses on financial investments'.

(viii) Due from banks and loans and advances to customers

‘Due from banks’ and ‘Loans and advances to customers’ are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as ‘Financial assets held for trading’, designated as ‘Financial investment-available-for-sale’ or ‘Financial assets designated at fair value through profit or loss’. After initial measurement, amounts due from banks and loans and advances to customers are subsequently measured at amortised cost using the effective interest method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are integral part of the effective interest rate. The amortisation is included in ‘Interest and similar income’ in the statement of comprehensive income. The losses arising from impairment are recognised in the statement of comprehensive income in ‘Credit loss expense’.

(ix) Available-for-sale financial investments

Available-for-sale financial investments are those designated as such or do not qualify to be classified as designated at fair value through profit or loss, held-to-maturity or loans and advances. They include equity instruments, investments in mutual funds and money market and other debt instruments.

After initial measurement, available-for-sale financial investments are subsequently measured at fair value. Unrealised gains or losses are recognised directly in equity in the ‘Available-for-sale reserve’. When security is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the statement of comprehensive income in ‘Other operating income’ or ‘Other operating expenses’. Where the Bank holds more than one investment in the same security they are deemed to be disposed of on a first-in-first-out basis. Interest earned whilst holding available-for-sale financial investments is reported as interest income using the effective interest rate. Dividends earned whilst holding available-for-sale financial investments are recognised in the statement of comprehensive income as ‘Other operating income’ when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the statement of comprehensive income in ‘Impairment losses on financial investments’ and removed from the “Available-for-sale reserve”.

(x) Debt issued and other borrowed funds

Financial instruments or their components issued by the Bank, which are not designated at fair value through profit or loss, are classified as liabilities under ‘Debt issued and other borrowed funds’, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset for a fixed number of own equity shares. The components of compound financial instruments, that contain both liability and equity elements, are accounted for separately with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue.

After initial measurement, debt issued and other borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.

(g) Derecognition of financial assets and financial liabilities

(i) Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired; or
- the Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party

under a 'pass-through' arrangement; and

- either (a) the Bank has transferred substantially all the risks and rewards of the asset, or (b) the Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

(ii) Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the financial liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

(h) Repurchase and reverse repurchase agreements

Securities sold under agreements to repurchase at a specified future date ('repos') are not derecognised from the statement of financial position. The corresponding cash received, including accrued interest, is recognised on the statement of financial position as a 'Cash collateral on securities lent and repurchase agreements', reflecting its economic substance as a loan to the Bank. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of the agreement using the effective interest method. Where the transferee has the right to sell or pledge the asset, the asset is recorded on the balance sheet as 'Financial assets held for trading pledged as collateral'.

Conversely, securities purchased under agreements to resell at a specified future date ('reverse repo') are not recognised on the statement of financial position. The corresponding cash paid, including accrued interest, is recognised on the statement of financial position as a 'Cash collateral on securities borrowed and reverse repurchase agreements'. The difference between the purchase and resale prices is treated as interest income and is accrued over the life of the agreement using the effective interest rate method.

(i) Determination of fair value

The fair value for financial instruments traded in active markets at the statement of financial position date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

An analysis of fair value of financial instruments and further details as to how they are measured are provided in Note 23.

(j) Impairment of financial assets

The Bank assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred ‘loss event’) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

(i) Due from banks and loans and advances to customers

For amounts due from banks and loans and advances to customers carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of comprehensive income. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account.

The present value of the estimated future cash flows is discounted at the financial asset’s original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

The Bank adopted the basic approach where the impairment allowances are computed on an average of historical loss experience of each risk grouping over the outstanding balance. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(ii) Held-to-maturity financial investments

For held-to-maturity investments the Bank assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced, and the amount of the loss is recognised in the statement of comprehensive income.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, any amounts formerly charged are credited to the 'Impairment losses on financial investments'.

(iii) Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each statement of financial position date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the statement of comprehensive income - is removed from equity and recognised in the statement of comprehensive income. Impairment losses on equity investments are not reversed through the statement of comprehensive income; increases in their fair value after impairment are recognised directly in equity.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset and is recorded as part of 'Interest and similar income'. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the statement of comprehensive income, the impairment loss is reversed through the statement of comprehensive income.

(iv) Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

(k) Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

(l) Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank's board of directors. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Bank.

Dividends for the year that are approved after the statement of financial position date are disclosed as an event after the balance sheet date.

(m) Property, plant and equipment

All items of property, plant and equipment are initially recorded at cost. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. The carrying amount of any replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Subsequent to recognition, property, plant and equipment except for buildings are stated at cost less accumulated depreciation and any accumulated impairment losses.

Buildings are stated at revalued amount, which is the fair value at the date of the revaluation less any accumulated impairment losses. Fair value is determined from market-based evidence by appraisal that is undertaken by professionally qualified valuers. Revaluations are performed at least once in every five years to ensure that the fair value of a revalued asset does not differ materially from that which would be determined using fair values at the balance sheet date. Any revaluation surplus is credited to the revaluation reserve included in equity, except to the extent that it reverses a revaluation decrease for the same asset previously recognised in profit or loss, in which case the increase is recognised in profit or loss to the extent of the decrease previously recognised. A revaluation deficit is first offset against unutilised previously recognised revaluation surplus in respect of the same asset and the balance is thereafter recognised in profit or loss. Upon disposal or retirement of an asset, any revaluation reserve relating to the particular asset is transferred directly to retained earnings. An annual transfer from the asset revaluation reserve to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original costs.

Assets under construction are not depreciated. Depreciation of other 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 at the following annual rates:

Buildings	40 years
Furniture, fixtures and vehicles	10 years
Computers	3 years

(n) Impairment of non-financial assets

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Bank makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair values less costs to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. An impairment loss is recognised in profit or loss in the period in which it arises, unless the asset is carried at a revalued amount, in which case the impairment loss is accounted for as a revaluation decrease to the extent that the impairment loss does not exceed the amount held in the asset revaluation reserve for the same asset. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount, provided that this amount does not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years. A reversal of impairment loss for an asset other than goodwill is recognised in profit or loss, unless the asset is carried at revalued amount, in which case, such reversal is treated as a revaluation increase. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

(o) Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the statement of comprehensive income in 'Credit loss expense'. The premium received is recognised in the statement of comprehensive income in 'Net fees and commission income' on a straight line basis over the life of the guarantee.

(p) 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 are 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 law, companies in Mongolia make contributions to the government pension scheme, Social and Health Fund. Such contributions are recognised as an expense in profit or loss as incurred.

(q) Operating leases

Lease payments for operating leases, where substantially all risk and benefits remain with the lessor, are charged as an expense in the income statement on a straight-line basis over the term of the relevant lease.

(r) Segment reporting

The Bank segment reporting is based on the following operating segments : Ulaanbaatar Business, Rural Business, Wholesale Banking Division and Head Office.

(s) Share-based payment transactions

A corporate shareholder of the Bank who provides management services to the Bank has received part of the remuneration in the form of equity instruments ('equity-settled transactions').

(i) Equity-settled transactions

The cost of equity-settled transactions with the corporate shareholder is measured by reference to the fair value at the date on which they are granted. The fair value is determined by the Bank using a binomial model, further details of which are given in Note 25.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the service conditions are fulfilled, ending on the date on which the relevant corporate shareholder become fully entitled to the award. The cumulative expense recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Bank's best estimate of the number of equity instruments that will ultimately vest. The income statement charge or credit for a period represents the movement in cumulative expense recognised as at the beginning and end of that period.

(r) Share-based payment transactions (Contd.)

(i) Equity-settled transactions (Contd.)

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ('the vesting date'). The cumulative expense recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Bank's best estimate of the number of equity instruments that will ultimately vest.

The income statement expense or credit for a period is recorded in 'Personnel expenses' and represents the movement in cumulative expense recognised as at the beginning and end of that period. The equity amount is recognised in the share-based payment reserve until the option is exercised, upon which it will be transferred to share premium, or until the option expires, upon which it will be transferred directly to retained earnings.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, the minimum expense recognised is the expense as if the terms had not been modified. An additional expense is recognised for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

When an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The diluted effect of outstanding option is reflected as additional share dilution in the computation of diluted earnings per share (Note 11).

(r) Share Appreciation Rights

The cost of share appreciation rights ("SAR") is measured initial at fair value using the discounted future cash outflows, taking into account the term and conditions upon which the instruments were granted (Note 21). The expected cost of SAR are expensed in "Personnel Expenses" over the period of until vesting with the recognition of a corresponding liability. Until the liability is settled, the liability is remeasured at each reporting date with changes, if any, recognised in profit or loss as "personnel expenses".

2.3 CHANGE IN ACCOUNTING POLICIES

The Bank has adopted the following new and amended International Accounting Standards (IAS), IFRS and IFRIC interpretations during the year.

- * 73IFRS 1: First-time Adoption of International Financial Reporting Standards - Costs of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (Amendments)
- * IFRS 2: Share-based payments - Vesting Conditions and Cancellations (Amendment)
- * IFRS 7: Financial Instruments: Disclosures (Amendments)
- * IFRS 8: Operating Segments
- * IAS 1: Presentation of Financial Statements (Revised)
- * IAS 23: Borrowing Costs (Revised)
- * IAS 27: Consolidated and Separate Financial Statements - Cost of an Investment in a

Subsidiary, Jointly Controlled Entity or Associate (Amendments)

- * IAS 32: Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements - Puttable Financial Instruments and Obligations Arising on Liquidation (Amendments)
- * IFRIC 9: Reassessment of Embedded Derivatives and IAS 39 Financial Instruments : Recognition and Measurement - Embedded Derivatives (Amendments)
- * IFRIC 13: Customer Loyalty Programmes
- * IFRIC 15: Agreements for the Construction of Real Estate
- * IFRIC 16: Hedges of a Net Investment in a Foreign Operation
- * IFRIC 18: Transfers of Assets from Customers

Improvements to International Financial Reporting Standards, which includes:

- * IAS 1: Presentation of Financial Statements
- * IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors
- * IAS 10: Events after the Reporting Period
- * IAS 16: Property, Plant and Equipment
- * IAS 18: Revenue
- * IAS 19: Employee Benefits
- * IAS 20: Accounting for Government Grants and Disclosure of Government Assistance
- * IAS 23: Borrowing Costs
- * IAS 27: Consolidated and Separate Financial Statements
- * IAS 28: Investments in Associates
- * IAS 29: Financial Reporting in Hyperinflationary Economies
- * IAS 31: Interest in Joint Ventures
- * IAS 34: Interim Financial Reporting
- * IAS 36: Impairment of Assets
- * IAS 38: Intangible Assets
- * IAS 39: Financial Instruments: Recognition and Measurement
- * IAS 40: Investment Property
- * IAS 41: Agriculture
- * IFRS 7: Financial instruments: Disclosures

The adoption of the above interpretations did not result in significant changes to accounting policies and did not have any effect on the financial performance or position of the Bank except for those discussed below:

IAS 1: Presentation of financial statements (revised)

This standard requires an entity to present all owner changes in equity and all non-owner changes to be presented in either in one statement of comprehensive income or in two separate statements of income and comprehensive income. The revised standard also requires that the income tax effect of each component of comprehensive income be disclosed. In addition, it requires entities to present a comparative statement of financial position as at the beginning of the earliest comparative period when the entity has applied an accounting policy retrospectively, makes a retrospective restatement, or reclassifies items in the financial statements.

The Bank has elected to present comprehensive income in one single statement. Information about the individual components of comprehensive income as well as the tax effects have been disclosed in the statement of comprehensive income. The Bank has not provided a restated comparative set of financial position for the earliest comparative period, as it has not adopted any new accounting policies retrospectively, or has made a retrospective restatement, or retrospectively reclassified items in the financial statements.

Amendments to IFRS 7 Financial Instruments: Disclosures - Improving Disclosures about Financial Instruments

The amendments to IFRS 7 were issued in March 2009 to enhance fair value and liquidity disclosures.

With respect to fair value, the amendments require disclosure of a three-level fair value hierarchy, by class, for all financial instruments recognised at fair value and specific disclosures related to the transfers between levels in the hierarchy and detailed disclosures related to level 3 of the fair value hierarchy. In addition, the amendments modify the required liquidity disclosures with respect to derivative transactions and assets used for liquidity management.

Comparative information has been restated although this is not strictly required by the transition provisions of the amendment.

At the date of authorisation of these financial statements, the following standards and Interpretations were in issue but not yet effective:

- * IFRS 1: First-time Adoption of International Financial Reporting Standards - Additional Exemptions for First-time Adopters (Amendments)
- * IFRS 2: Group Cash-settled Share-based Payment Arrangements
- * IFRS 3: Business Combinations (Revised)
- * IFRS 5: Non-current Assets Held for Sale and Discontinued Operations
- * IFRS 9: Financial Instruments
- * IAS 27: Consolidated and Separate Financial Statements (Amendment)
- * IAS 39: Financial Instruments: Recognition and Measurement - Eligible hedged items (Amendment)
- * IFRIC 17: Distributions of Non-Cash Assets to Owners
- * IFRIC 19: Extinguishing Financial Liabilities with Equity Instruments
Improvements to International Financial Reporting Standards, which includes:
- * IAS 1: Presentation of Financial Statements
- * IAS 36: Impairment of Assets
- * IAS 38: Intangible Assets
- * IAS 39: Financial Instruments: Recognition and Measurement
- * IFRS 2: Share based Payments
- * IFRS 5: Non-current Assets Held for Sale and Discontinued Operations
- * IFRS 8: Operating Segments
- * IAS 7: Statement of Cash Flows
- * IAS 17: Leases
- * IAS 18: Revenue
- * IFRIC 9: Reassessment of Embedded Derivatives
- * IFRIC 16: Hedges of a Net Investment in a Foreign Operation

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Bank except that the impact of adopting the improvement to IAS 39: Financial Instruments: Recognition and Measurement and IFRS 9 which are discussed as follows:

IFRS 9: Financial Instruments

On 12 November 2009, the IASB issued IFRS 9 Financial Instruments as the first step in its project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 introduces new requirements for classifying and measuring financial assets that must be applied starting 1 January 2013, with early adoption permitted with the main changes as discussed as follows:

- (a) IFRS 9 divides all financial assets that are currently in the scope of IAS 39 into two classifications – those measured at amortised cost and those measured at fair value. Classification is made at the time the financial asset is initially recognised, namely when the entity becomes a party to the contractual provisions of the instrument. The available-for-sale and held-to-maturity categories currently in IAS 39 are eliminated.
- (b) A debt instrument that meets the ‘business model test’ and ‘cash flows characteristic test’ can be measured at amortised cost. All other debt instruments must be measured at fair value through profit or loss (FVTPL). Even if an instrument meets the two amortised cost tests, IFRS 9 contains an option to designate a financial asset as measured at FVTPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an ‘accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.
- (c) All equity investments in scope of IFRS 9 are to be measured at fair value in the balance sheet, with value changes recognised in profit or loss, except for those equity investments for which the entity has elected to report value changes in ‘other comprehensive income’. There is no ‘cost exception’ for unquoted equities.
- (d) The embedded derivative concept of IAS 39 is not included in IFRS 9. Consequently, embedded derivatives that under IAS 39 would have been separately accounted for at FVTPL because they were not closely related to the financial host asset will no longer be separated. Instead, the contractual cash flows of the financial asset are assessed in their entirety, and the asset as a whole is measured at FVTPL if any of its cash flows do not represent payments of principal and interest.

The Bank is in the process of making an assessment of the impact of this new IFRS upon initial application.

Improvement to IAS 39: Financial Instruments: Recognition and Measurement

The improvement introduced the assessment of loan prepayment penalties as embedded derivatives. A prepayment option is considered closely related to the host contract when the exercise price reimburses the lender up to the approximate present value of lost interest for the remaining term of the host contract.

The Bank is in the process of making an assessment of the impact of this amendment to IFRS upon initial application.

2.4 CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

1 Impairment losses on loans and advances to customers

The Bank reviews its problem loans and advances at each reporting date to assess whether an allowance for impairment should be recorded in the statement of comprehensive income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Severe winter weather following drought conditions last summer has resulted in the loss of livestock in more than half of Mongolia's aimags, negatively affecting some of the herders in those areas with loans from the Bank. To address an expected increase in impaired loans, the Bank provided additional allowances for impairment at year end for its herder portfolio based on the expected losses calculated after a review of the portfolio on a soum by soum basis in the affected areas. This included input from herders, local officials, and local branch personnel, and assessments of individual borrowers and their herds.

In addition to specific allowances against individually significant loans and advances, the Bank also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This takes into consideration factors such as any deterioration in industry risk and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

The impairment loss on loan and advances is disclosed in Note 7 and Note 14.

2 Depreciation of buildings

Buildings are depreciated on a straight line basis over the estimated useful life of 40 years even though the lease period of the land on which the buildings are on are shorter than 40 years. By virtue of the Law of Mongolia on Land, the Bank as a foreign investment entity enjoys the rights to request for extension of the lease period and the authority shall extend the period of lease subject to certain conditions being met. The management believes that the Bank have met the conditions set consistently and for the purpose of depreciation of buildings, the Bank estimated that a cumulative lease period of 40 years is reasonable and appropriate.

3. INTEREST AND SIMILAR INCOME

	2009	2008
	MNT '000	MNT '000
Loans and advances to customers	119,431,473	125,759,090
Due from banks	365,944	3,168,066
Financial investments		
- available-for-sale	12,555,872	864,046
- held-to-maturity	-	40,394
Reverse repurchase agreements	93,537	125,176
Cash and balances with central bank	658,924	1,868
Total interest income from financial assets		
not at fair value through profit or loss	<u>133,105,750</u>	<u>129,958,640</u>

4. INTEREST AND SIMILAR EXPENSE

	2009	2008
	MNT '000	MNT '000
Debt issued and other borrowed funds	5,192,328	3,280,430
Due to banks	272,483	2,905,760
Due to customers	60,227,970	46,537,206
Repurchase agreements	74,134	189,696
Total interest expense from financial liabilities		
not at fair value through profit or loss	65,766,915	52,913,092
Unwinding of discount on Share Appreciation Rights	34,450	19,062
	<u>65,801,365</u>	<u>52,932,154</u>

5. NET FEES AND COMMISSION INCOME

	2009	2008
	MNT '000	MNT '000
Acceptance fees	3,314,077	1,879,221
Application fees	331,399	371,428
Cash withdrawal fees	589,526	486,627
Foreign settlement service fees	480,428	394,438
Leasing service fees	331,094	650,432
Money transfer fees	1,304,223	1,442,777
Other fees income	1,515,482	877,757
Pension payment charges	463,820	619,385
Transaction fees	1,230,082	1,066,033
Transfer fees	262,706	522,568
Total fees and commission income	<u>9,822,837</u>	<u>8,310,666</u>
Foreign currency exchange fees	104,835	199,684
Bank service fees paid	232,779	91,506
SWIFT transaction fees paid	61,886	43,483
Other fees	16,093	19,323
Total fees and commission expense	<u>415,593</u>	<u>353,996</u>
Net fees and commission income from financial assets not at fair value through profit or loss	<u>9,407,244</u>	<u>7,956,670</u>

6. OTHER OPERATING INCOME

	2009	2008
	MNT '000	MNT '000
Non-trading foreign exchange		
- Net realised gain	6,282,258	4,300,059
Non-trading foreign exchange		
- Net unrealised loss	(2,429,525)	(1,382,391)
Income from penalties	1,316	3,711
Recovery of bad loans	148,954	171,087
Recovery of other assets previously written off	2,015	764
Other operating income	228,346	189,961
	<u>4,233,364</u>	<u>3,283,191</u>

7. CREDIT LOSS EXPENSE

	2009	2008
	MNT '000	MNT '000
Loans and advances to customers		
Business lending	7,324,973	7,128,758
Consumer lending	895,103	1,227,267
Agricultural lending	4,664,671	1,290,290
	<u>12,884,747</u>	<u>9,646,315</u>
Other receivables	(7,653)	602,655
	<u>12,877,094</u>	<u>10,248,970</u>

8. PERSONNEL EXPENSE

	2009	2008
	MNT '000	MNT '000
Wages and salaries	22,842,566	16,716,699
Contribution to social and health fund	2,451,055	2,103,632
Share Appreciation Rights	25,530	144,190
Bonus and allowances	2,068,339	4,326,746
Training	638,158	974,791
	<u>28,025,648</u>	<u>24,266,058</u>

9. OTHER OPERATING EXPENSE

	2009	2008
	MNT '000	MNT '000
Advertising	1,449,968	1,805,496
Armoured guard and security	769,249	680,109
Business trips	1,271,305	1,369,415
Cash collection service	127,043	169,642
Communication	815,566	1,053,517
Computer expenses	2,265,971	1,356,111
Entertainment	262,055	383,036
Global Medium Term Notes expenses	1,382,878	179,036
Insurance expenses	199,851	106,052
Janitorial expenses	443,611	651,603
Legal expenses	145,737	49,395
Loans and collection expenses	499,380	376,990
Maintenance of property, plant and equipment	474,162	541,111
Membership and audit expenses	379,922	287,277
Other operating expenses	491,161	683,338
Proposed Global Depository Receipt ("GDR") expenses	58,565	1,299,659
Rental expenses	2,924,416	2,355,262
Research expenses	214,151	400,491
Stationery	1,633,473	2,056,692
Transportation and fuel supplies	1,291,959	1,415,852
Utilities	1,431,517	1,227,245
	<u>18,531,940</u>	<u>18,447,329</u>

10. INCOME TAX EXPENSE

	2009	2008
	MNT '000	MNT '000
Current income tax:		
Based on results for the year	3,377,640	7,398,552

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 the Bank is 10% (2008 : 10%) for the first MNT 3 billion of taxable income, and 25% (2008 : 25%) on the excess of taxable income over MNT 3 billion. Interest income on government bonds is not subject to income tax. Allowance for impairment losses for loans and advances 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 year ended 31 December is as follows:

	2009	2008
	MNT '000	MNT '000
Profit before taxation	<u>13,899,561</u>	<u>29,652,131</u>
Tax at statutory tax rate of 25% (2008 : 25%)	3,474,890	7,413,033
Effect of income subject to lower tax rate	(450,000)	(450,000)
Effect of income not subject to tax	(504)	(10,099)
Effect of expenses not allowable for tax purposes	353,254	445,618
Tax expense for the year	<u>3,377,640</u>	<u>7,398,552</u>

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

11. EARNINGS PER SHARE

(a) Basic

Basic earnings per share is calculated by dividing the profit for the year attributable to ordinary equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year.

	2009	2008
	MNT '000	MNT '000
Profit for the year attributable to equity holders of the Bank (MNT '000)	<u>10,521,921</u>	<u>22,253,579</u>
Weighted average number of ordinary shares in issue	<u>6,293,822</u>	<u>6,162,662</u>
Basic earnings per share (MNT)	<u>1,672</u>	<u>3,611</u>

(b) Diluted

For the purpose of calculating diluted earnings per share, the net profit for the year and the weighted average number of ordinary shares in issue during the financial year have been adjusted for the dilutive effects of share options granted to Development Alternatives Inc, "DAI" and share option exercised during the period as disclosed in Note 25.

	2009	2008
Profit for the year attributable to equity holders of the Bank (MNT '000)	<u>10,521,921</u>	<u>22,253,579</u>
Weighted average number of ordinary shares in issue	6,293,822	6,162,662
Effects of dilution: Share Options	89,302	98,056
Adjusted weighted average number of ordinary shares in issue and issuable	<u>6,383,124</u>	<u>6,260,718</u>
Diluted earning per share (MNT)	<u>1,648</u>	<u>3,554</u>

12. CASH AND BALANCES WITH CENTRAL BANK

	2009	2008
	MNT '000	MNT '000
Cash on hand	50,519,099	38,122,294
Current account with the Bank of Mongolia	111,047,617	47,861,410
Deposits with the Bank of Mongolia	43,285,200	32,131,379
	<u>204,851,916</u>	<u>118,115,083</u>

Current accounts with the Bank of Mongolia are maintained in accordance with Bank of Mongolia's requirements. The balances maintained with Bank of Mongolia are determined at not less than 5.0% (2008: 5.0%) of customer deposit for the period of 14 days. As at 31 December 2009, the average reserve required by Bank of Mongolia for period of 2 weeks is MNT 31,391 million (2008: MNT 22,723 million) for local currency and MNT 8,750 million (2008: MNT 8,952 million) for foreign currency on current accounts maintained with Bank of Mongolia. As a result of amendment of the Regulation on Calculating and Controlling Reserve Requirements, with effect from 27 March 2009, the Bank is no longer allowed to utilise 50% of its required reserve to finance the Bank's day to day operation.

13. DUE FROM BANKS

	2009	2008
	MNT '000	MNT '000
Placements with other banks and financial institutions	66,422,350	14,744,438
Loans and advances	12,871,576	5,888,851
	<u>79,293,926</u>	<u>20,633,289</u>

Due from banks represent local and foreign currencies current accounts maintained with foreign and local financial institutions and short term deposits with local financial institutions. As at 31 December 2009, loans and advances represents overnight USD deposits placed at Citibank, New York for liquidity purposes.

14. FINANCIAL INVESTMENTS

	2009	2008
	MNT '000	MNT '000
Available-for-sale:		
Unquoted investments		
Bank of Mongolia bills, at fair value	-	45,218,092
Equities, at cost	330,044	264,250
	<u>330,044</u>	<u>45,482,342</u>
Held-to-maturity:		
Unquoted investment		
Bank of Mongolia bills, at amortised cost	<u>178,161,207</u>	<u>-</u>

Bank of Mongolia bills are interest bearing short term bills with maturities of less than three months, and are issued at a discount.

Unquoted equities represent investment made in non-listed companies. These investments are recorded at cost since their fair value cannot be reliably estimated. The variability in the range of reasonable fair value estimates derived from valuation techniques is expected to be significant. There is no market for these investments and the Bank does not intend to dispose of these investments in the foreseeable future.

15. LOANS AND ADVANCES TO CUSTOMERS

	2009	2008
	MNT '000	MNT '000
Business lending	292,637,580	303,723,582
Consumer lending	240,142,323	215,229,445
Agricultural lending	63,931,375	89,411,697
	<u>596,711,278</u>	<u>608,364,724</u>
Accrued interest receivables	11,331,773	16,531,447
Gross loans and advances	<u>608,043,051</u>	<u>624,896,171</u>
Less: Allowance for impairment losses	<u>(27,335,527)</u>	<u>(16,242,427)</u>
	<u>580,707,524</u>	<u>608,653,744</u>

Impairment allowance for loans and advances to customers

A reconciliation of the allowance for impairment losses for loans and advances by class is as follows:

	Business lending	Consumer lending	Agricultural lending	Total
At 31 December 2009	MNT '000	MNT '000	MNT '000	MNT '000
At 1 January 2009	12,406,891	1,969,172	1,866,364	16,242,427
Charge for the year	10,228,471	3,101,291	5,434,205	18,763,967
Recoveries	(2,903,498)	(2,206,188)	(769,534)	(5,879,220)
Amounts written off	(897,889)	(158,129)	(735,629)	(1,791,647)
At 31 December 2009	<u>18,833,975</u>	<u>2,706,146</u>	<u>5,795,406</u>	<u>27,335,527</u>
Individual impairment	15,624,192	1,409,227	3,998,799	21,032,218
Collective impairment	3,209,783	1,296,919	1,796,607	6,303,309
	<u>18,833,975</u>	<u>2,706,146</u>	<u>5,795,406</u>	<u>27,335,527</u>
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	<u>87,196,906</u>	<u>3,619,585</u>	<u>8,929,236</u>	<u>99,745,727</u>

At 31 December 2008	Business lending MNT '000	Consumer lending MNT '000	Agricultural lending MNT '000	Total MNT '000
At 1 January 2008	5,720,177	884,812	827,178	7,432,167
Charge for the year	11,799,905	2,608,559	2,879,570	17,288,034
Recoveries	(4,671,147)	(1,381,292)	(1,589,280)	(7,641,719)
Amounts written off	(442,044)	(142,907)	(251,104)	(836,055)
At 31 December 2008	<u>12,406,891</u>	<u>1,969,172</u>	<u>1,866,364</u>	<u>16,242,427</u>
Individual impairment	8,054,358	425,287	1,437,405	9,917,050
Collective impairment	4,352,533	1,543,885	428,959	6,325,377
	<u>12,406,891</u>	<u>1,969,172</u>	<u>1,866,364</u>	<u>16,242,427</u>
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	<u>49,848,311</u>	<u>777,780</u>	<u>5,469,820</u>	<u>56,095,911</u>

The fair value of collateral that the Bank holds relating to loans individually determined to be impaired as at 31 December 2009 amounts to MNT 292,799 million (2008: MNT 141,361 million). These value are estimated by the management based on latest available information. For a more detailed description, see 'Collateral and other credit enhancements' in Note 32.2.

16. PROPERTY, PLANT AND EQUIPMENT

At 31 December 2009	Buildings MNT '000	Furniture, fixtures and vehicles MNT '000	Computers MNT '000	Capital work-in- progress MNT '000	Total MNT '000
At Cost/Valuation					
At 1 January 2009	23,049,441	8,764,890	18,126,100	3,462,436	53,402,867
Additions	579,287	1,310,859	6,804,774	543,403	9,238,323
Reclassifications	2,232,917	53,030	579,936	(2,865,883)	-
Disposals	(373,603)	(182,645)	(81,924)	-	(638,172)
Write-offs	(2,922)	(201,215)	(505,364)	(11,999)	(721,500)
At 31 December 2009	<u>25,485,120</u>	<u>9,744,919</u>	<u>24,923,522</u>	<u>1,127,957</u>	<u>61,281,518</u>
Representing:					
At cost	19,432,421	9,744,919	24,923,522	1,127,957	55,228,819
At valuation	6,052,699	-	-	-	6,052,699
	<u>25,485,120</u>	<u>9,744,919</u>	<u>24,923,522</u>	<u>1,127,957</u>	<u>61,281,518</u>
Accumulated Depreciation and Impairment Losses					
At 1 January 2009					
Accumulated depreciation	3,295,034	1,776,474	8,057,193	-	13,128,701
Accumulated impairment losses	80,433	-	-	-	80,433
	<u>3,375,467</u>	<u>1,776,474</u>	<u>8,057,193</u>	<u>-</u>	<u>13,209,134</u>
Depreciation charge for the year	537,090	913,628	6,160,032	-	7,610,750
Reclassifications	107	7,294	(7,401)	-	-
Disposals	(212,948)	(73,297)	(61,829)	-	(348,074)
Write-offs	(1,456)	(116,676)	(483,381)	-	(601,513)
At 31 December 2009	<u>3,698,260</u>	<u>2,507,423</u>	<u>13,664,614</u>	<u>-</u>	<u>19,870,297</u>
Analysed as:					
Accumulated depreciation	3,635,247	2,507,423	13,664,614	-	19,807,284
Accumulated impairment losses	63,013	-	-	-	63,013
	<u>3,698,260</u>	<u>2,507,423</u>	<u>13,664,614</u>	<u>-</u>	<u>19,870,297</u>
Net Book Value					
At 31 December 2009					
At cost	18,526,016	7,237,496	11,258,908	1,127,957	38,150,377
At valuation	3,260,844	-	-	-	3,260,844
	<u>21,786,860</u>	<u>7,237,496</u>	<u>11,258,908</u>	<u>1,127,957</u>	<u>41,411,221</u>

16. PROPERTY, PLANT AND EQUIPMENT (CONTD.)

At 31 December 2008	Buildings MNT '000	Furniture, fixtures and vehicles MNT '000	Computers MNT '000	Capital work-in- progress MNT '000	Total MNT '000
At Cost/Valuation					
At 1 January 2008	16,373,516	5,677,468	11,479,231	3,765,202	37,295,417
Additions	777,168	3,349,615	5,810,510	7,616,581	17,553,874
Reclassifications	6,250,258	34,057	1,635,032	(7,919,347)	-
Disposals	(351,501)	(151,381)	(44,861)	-	(547,743)
Write-offs	-	(144,869)	(753,812)	-	(898,681)
At 31 December 2008	<u>23,049,441</u>	<u>8,764,890</u>	<u>18,126,100</u>	<u>3,462,436</u>	<u>53,402,867</u>
Representing:					
At cost	16,645,988	8,764,890	18,126,100	3,462,436	46,999,414
At valuation	6,403,453	-	-	-	6,403,453
	<u>23,049,441</u>	<u>8,764,890</u>	<u>18,126,100</u>	<u>3,462,436</u>	<u>53,402,867</u>
Accumulated Depreciation and Impairment Losses					
At 1 January 2008					
Accumulated depreciation	3,080,422	1,227,762	4,286,241	-	8,594,425
Accumulated impairment losses	80,433	-	-	-	80,433
	<u>3,160,855</u>	<u>1,227,762</u>	<u>4,286,241</u>	<u>-</u>	<u>8,674,858</u>
Charge for the year	420,638	694,461	4,536,760	-	5,651,859
Reclassifications	-	(1,698)	1,698	-	-
Disposals	(206,026)	(57,921)	(40,031)	-	(303,978)
Write-offs	-	(86,130)	(727,475)	-	(813,605)
At 31 December 2008	<u>3,375,467</u>	<u>1,776,474</u>	<u>8,057,193</u>	<u>-</u>	<u>13,209,134</u>
Analysed as:					
Accumulated depreciation	3,295,034	1,776,474	8,057,193	-	13,128,701
Accumulated impairment losses	80,433	-	-	-	80,433
	<u>3,375,467</u>	<u>1,776,474</u>	<u>8,057,193</u>	<u>-</u>	<u>13,209,134</u>
Net Book Value					
At 31 December 2008					
At cost	16,125,799	6,988,416	10,068,907	3,462,436	36,645,558
At valuation	3,548,175	-	-	-	3,548,175
	<u>19,673,974</u>	<u>6,988,416</u>	<u>10,068,907</u>	<u>3,462,436</u>	<u>40,193,733</u>

Details of the latest independent professional valuations of buildings at 30 September 2006 are as follows:

Date of Valuation	Valuer	Description of Property	Valuation Amount MNT'000	Basis of Valuation
30 September 2006	Dalaivan Audit LLC	Head office and branches buildings	3,813,799	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 2009 would have been MNT 2,636 million (2008 : MNT 2,857 million).

17. OTHER ASSETS

	2009 MNT '000	2008 MNT '000
Other receivables	905,206	1,018,090
Less: Allowance for impairment	(893,826)	(992,671)
	<u>11,380</u>	<u>25,419</u>
Consumables and other inventories	1,893,071	2,107,371
Prepaid expenses	1,235,073	2,916,982
Other assets	21,900	91,453
	<u>3,161,424</u>	<u>5,141,225</u>
Allowance for impairment		
At 1 January	992,671	432,000
Charge for the year	331,082	662,147
Recoveries	(338,735)	(59,492)
Amounts written off	(91,192)	(41,984)
At 31 December	<u>893,826</u>	<u>992,671</u>

Included in prepayment for year 2008 was amount of MNT 1,313 million related to the establishment cost of the Bank's proposed USD300 Million Global Medium Term Note Program to be listed on the Singapore Exchange under which the Bank may issue notes from time to time.

18. DUE TO BANKS

	2009 MNT '000	2008 MNT '000
Deposits from other banks and financial institutions	<u>3,198,323</u>	<u>2,615,268</u>

Deposits from other banks and financial institutions represents foreign currency and local currency current accounts and time deposits placed by local and foreign commercial banks.

19. DUE TO CUSTOMERS

	2009	2008
	MNT '000	MNT '000
State enterprise		
- current account	35,782,619	20,636,107
- time deposits	224,124	49,911
- demand deposits	10,674	72,945
Business sector		
- current account	103,488,211	77,731,623
- time deposits	8,854,508	7,170,278
- demand deposits	8,253,089	7,823,637
Government		
- current account	30,370,198	31,325,967
- time deposits	119,652	16,388,129
- demand deposits	44,718	376,687
Individuals		
- current account	42,296,579	29,092,668
- time deposits	320,700,619	220,824,544
- demand deposits	257,289,266	146,132,404
Others		
- current account	19,300,357	16,406,028
- time deposits	3,842,149	57,635,421
- demand deposits	2,946,595	1,303,581
Certificate of deposits	16,314,910	42,535,996
Other deposits	16,753,428	3,649,893
	<u>866,591,696</u>	<u>679,155,819</u>

20. DEBTS ISSUED AND OTHER BORROWED FUNDS

	2009	2008
	MNT '000	MNT '000
Unsecured		
<u>Loans from Bank of Mongolia</u>		
Term Loan III	145,692	133,806
<u>Loan from International Development Association</u>		
Micro Finance Development Fund	505,750	674,471
<u>Loan from Labour Service Welfare Department</u>		
Labour Support Fund	9,255,000	6,450,000
<u>Loan from Ministry of Finance</u>		
Japan Bank of International Cooperation project	5,631,104	5,400,500
Private Enterprise Development Fund	902,623	520,000
	<u>6,533,727</u>	<u>5,920,500</u>

20. DEBTS ISSUED AND OTHER BORROWED FUNDS (CONTD.)

	2009	2008
	MNT '000	MNT '000
Promissory Notes	24,706,431	15,289,973
Loan from Asian Development Bank	13,211,151	10,167,243
Loan from European Bank for Reconstruction and Development	13,113,356	12,870,903
Loan from International Finance Corporation	16,811,387	18,974,087
Loan from Nederlandse Financierings - Maatschappij Voor Ontwikkelingslanden N.V. ("FMO")	2,889,067	-
Subordinated loans:		
- Holding company	2,933,907	2,577,270
- FMO	14,457,361	-
- H.I.S CO., LTD	14,446,628	-
	<u>31,837,896</u>	<u>2,577,270</u>
	<u>119,009,457</u>	<u>73,058,253</u>

Loans from Bank of Mongolia

Term Loan III

The Bank entered into a loan agreement for USD 137,694 with the Bank of Mongolia in 2002 for the Bank's share of BANCs banking software purchased. No interest is due for the first five years; commencing 2007 the loan bears interest of 1% per annum. The loan is payable in thirty equal annual installments, commencing December 2002. The loan matures in December 2031.

Loan from International Development Association (World Bank)

The International Development Association provided this MNT loan in 2003 to support the improvement of living standards in rural areas. The Bank currently disburses the proceeds of the loan to sub-borrowers in five aimags: Arkhangai, Dundgobi, Gobi-Altai, Gobi-Sumber, and Khuvsgul. The Bank accepts the credit risk for these loans. The loan bears a fixed rate of interest of 8.1% (2008: 8%) per annum payable on a monthly basis. Principal payment commenced April 2006 with final payment due July 2011.

Loan from Labor Service Welfare Department

The Labor Service Welfare Department provides this MNT loan to support employment development. The Bank entered into three loan agreements with the Department in 2008 and two loan agreements in 2009. The loans bear no interest or service fees. Each loan agreement is for a term of 18 months. The maturity dates of the five loans are 1 March 2010, 9 April 2010, 27 May 2010, 10 December 2010 and 29 June 2011, respectively. The Bank disburses the proceeds to sub-borrowers at its own credit risk for qualifying projects which generate new jobs. The sub-loans bear reduced interest rates and have a maximum maturity of 12 months.

Loans from Ministry of Finance

(i) Japan Bank for International Cooperation (JBIC)

The Ministry of Finance, funded by JBIC for its Two-Step Loan Project for Small and Medium Scale Enterprises Development and Environmental Protection project, provides this loan. In March 2006, JBIC entered into agreement with the Government of Mongolia to loan up to JPY 2.98 billion for this project. The Bank disburses the proceeds of this loan to sub-borrowers. The Bank repays loan principal to the Ministry of Finance within six months of receiving repayment from sub-borrowers.

The loan bears interest at a margin of 1% over six-month LIBOR for USD loans with an effective interest rate of 2.11% per annum in 2009 (2008: 5.83%). For MNT, the loan bears interest at the average demand deposit rate for commercial banks with an effective interest rate of 4.8% per annum in 2009 (2008: 5.9%).

(ii) Private Enterprise Development Fund (World Bank)

The Ministry of Finance, funded by the Private Enterprise Development Fund (World Bank), provides this loan to promote private and financial sector development and to strengthen the institutional capacity of the banking sector. The loan bears interest at a margin of 1% over six-month LIBOR for USD loans with an effective interest rate of 2.56% per annum in 2009 (5.05% 2008). For MNT, the loan bears interest at the average demand deposit rate of commercial banks for an effective interest rate of 5.54% per annum in 2009 (2008: 5.75%). The loan is payable six months after repayment by sub-borrowers.

Promissory Notes

On 7 December 2007, the Bank issued six Promissory Notes to two parties: responsibility SICAV (Lux) and Credit Suisse Microfinance Fund Management Company. The purpose of the Notes is to increase the Bank's liquidity and working capital. Three of the Notes, totaling USD 6 million, bear interest at a fixed rate of 7.75% payable semi-annually and are due 7 December 2010. The remaining three Notes, totaling USD 6 million, bear interest at a fixed rate of 8.0% payable semi-annually and are due 7 December 2012"

On 18 May 2009, the Bank issued a Promissory Note for USD 5 million to Dexia Micro-Credit Fund (Sub Fund Blueorchard Debt) to increase the Bank's liquidity and working capital. The Note bears interest at a fixed rate of 8.33%, payable semi-annually. USD 2.5 million is due 12 May 2011, and the remaining USD 2.5 million is due 14 May 2012.

Loan from Asian Development Bank (ADB)

The Bank entered into a Loan Facility agreement with the ADB on 19 November 2007 for an aggregate amount not exceeding USD 10 million for a period of 72 months to finance ongoing business operations. The loan bears interest at a margin over six-month LIBOR which was converted in 2008 to a fixed rate of 6.39% for the remainder of the loan term. Repayment of the loan is in nine equal semi-annual installments commencing 16 November 2009. The final repayment date is 16 November 2013.

Loan from European Bank for Reconstruction and Development (EBRD)

The Bank entered into a Loan Agreement with the EBRD on 30 October 2007 for an aggregate amount not exceeding USD 10 million for 72 months to finance ongoing business operations. The loan bears interest at a margin over six-month LIBOR which was converted in 2008 to a fixed rate of 7.13% per annum for the remainder of the loan term. Repayment of the loan is in nine equal semi-annual installments commencing 6 September 2009. The final repayment date is 6 September 2013.

Loan from International Finance Corporation (IFC)

The Bank entered into a Loan Agreement with the IFC on 19 December 2007 in an aggregate amount not exceeding USD 15 million for a period of 66 months to finance ongoing business operations. The loan bears interest at a margin over six-month LIBOR with effective interest rate of 3.96% per annum at the statement of financial position date. Repayment of the loan is in nine equal semi-annual installments commencing 15 July 2009. The final repayment date is 15 July 2013.

Loan from Nederlandse Financierings - Maatschappij Voor Ontwikkelingslanden N.V. (FMO)

The Bank entered into a Term Facility Agreement with FMO on 15 December 2009 in an aggregate amount not exceeding USD 15 million for a period of 94 months to finance ongoing business operations. Draw down is permitted through 15 Jan 2012. The loan bears interest at a margin over six-month LIBOR with effective interest rate of 5.28% per annum at the statement of financial position date. Repayment of the loan is in twelve equal semi-annual installments commencing 15 April 2012. The final repayment date is 15 October 2017.

Subordinated loan from holding company

The Bank entered into a Subordinated Loan Agreement with the holding company on 28 July 2003 in an amount of USD 2 million to finance ongoing business operations and strengthen its capital base. The loan bears interest at 6.25% per annum to 31 July 2008 and 10% per annum thereafter until the loan is due and payable on 31 July 2013. Interest is payable on a quarterly basis beginning 31 October 2003. The loan is convertible at maturity to common shares of the Bank subject to approval of the Bank's shareholders. The loan is classified as Tier 2 capital for regulatory purposes.

Subordinated loan from FMO

The Bank entered into a Subordinated Term Facility Agreement with FMO on 15 December 2009 for the amount of USD 10 million to fund ongoing business operation and strengthen its capital base. The loan bears interest at a margin over six-month LIBOR, payable semi-annually, with effective interest rate of 9.03% at the statement of financial position date. The final repayment date is 15 January 2015. The loan is convertible at maturity to common shares of the Bank subject to approval of the Bank's shareholders. The loan is classified as Tier 2 capital for regulatory purposes.

Subordinated loan from H.I.S. Co., Ltd. (HIS)

The Bank entered into a Subordinated Loan Agreement with HIS on 28 Dec 2009 for the amount of USD 10 million to finance ongoing business operations and to strengthen its capital base. The loan terms are substantially the same as those of the subordinated loan from FMO above. The loan bears interest at a fixed rate of 11.37% per annum. The final repayment date is 15 January 2015. The loan is convertible at maturity to common shares of the Bank subject to approval of the Bank's shareholders. The loan is classified as Tier 2 capital for regulatory purposes.

The Bank has not had any defaults of principal, interest or other breaches with respect to liabilities during the financial year except for the following:

- a. Loan from EBRD. The Bank has breached one of the covenant clauses of the loan which required the Bank to fulfill the ratio of loans 30 days in arrears and written off loans to total loan portfolio to be not more than 4%. EBRD has issued waivers for the breach for all quarters, and the loan agreement was subsequently amended February 2010.
- b. Loan from IFC. The Bank has breached one of the covenant clauses of the loan which required the Bank to fulfil the open credit exposure ratio not more than 15% at 30 September 2009 and 31 December 2009. IFC issued waivers for these breaches for both quarters and amended the requirements in the loan agreement in March 2010.

21. OTHER LIABILITIES

	2009	2008
	MNT '000	MNT '000
Sundry payables	1,971,889	2,143,579
Delay of clearing settlements	1,115,884	618,859
Deferred income	883,346	1,249,644
	<u>3,971,119</u>	<u>4,012,082</u>

Included in sundry payables is the carrying amount of the liability relating to Share Appreciation Rights ("SARs") amounted to MNT 361.2 million (2008: MNT 342.9 million). On 7 December 2006 and 12 March 2008, certain key management personnel of the Bank are granted 30,000 SARs and 20,000 SARs respectively, which can only be settled in cash. Issue price of the two batches of SARs is MNT 3,680 and MNT 9,222, respectively. The exercise price is based on the net assets value, diluted for any options issued, at the exercise date. The exercise price of a SARs shall be the book value under IFRS of one ordinary share of the Bank in Mongolian Tugrug as of the last day of the financial quarter preceding the exercise date. These

SARs vest over five years, with 20% of the SARs vesting at the end of each year from the date of grant. The contractual life of the SARs is ten years expiring on 6 December 2016 and 12 March 2018 respectively. The expected costs of this incentive are accrued over the vesting period. Until the liability is settled, the liability is remeasured at each reporting date with changes, if any, recognised in profit or loss.

Deferred income represents loan interest received in advance from Ministry of Food and Agriculture to subsidise part of the interest charged on Agriculture Support Fund disbursed by the Bank to the qualified farmers.

22. ORDINARY SHARES

	Number of Ordinary Shares of		Amount	
	MNT 2,000 each		2009	2008
	2009	2008	2009	2008
			MNT '000	MNT '000
At 1 January	6,167,396	6,149,396	12,334,792	12,298,792
Issued during the year	329,610	-	659,220	-
Issued pursuant to exercise of options (Note 25)	-	18,000	-	36,000
At 31 December	<u>6,497,006</u>	<u>6,167,396</u>	<u>12,994,012</u>	<u>12,334,792</u>

On 13 August 2009, the Bank issued 329,610 ordinary share at the issue price of MNT 12,993 per share for cash. As a result, the share premium account increased by MNT 3,623 million to MNT 13,866 million for the year ended 31 December 2009.

Share option scheme

The Bank has a share option scheme under which options to subscribe for the Bank's shares have been granted to a corporate shareholder, Development Alternatives, Inc. ('DAI') who provides management and consultation services to the Bank.

23. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value of financial assets and liabilities not carried at fair value

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having short term maturity (less than one year) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, time deposit and variable rate financial instruments.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognised with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued, the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term of maturity.

23. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTD)

Set out below is a comparison, by class, of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the financial statements. This table does not include the fair values of non financial assets and non financial liabilities.

		Carrying amount	Fair value	Carrying amount	Fair value
		2009	2009	2008	2008
	Note	MNT '000	MNT '000	MNT '000	MNT '000
Financial assets					
Cash and balances with central bank	12	204,851,916	204,851,916	118,115,083	118,115,083
Due from banks	13	79,293,926	79,293,926	20,633,289	20,633,289
Financial investments - held to maturity	14	178,161,207	178,161,207	-	-
Loans and advances to customers	15	580,707,524	579,917,116	608,653,744	606,437,142
Other receivables	17	11,380	11,380	25,419	25,419
Financial liabilities					
Due to banks	18	3,198,323	3,198,323	2,615,268	2,615,268
Due to customers	19	866,591,696	866,571,295	679,155,819	679,043,564
Debt issued and other borrowed funds	20	119,009,457	117,835,095	73,058,253	72,163,628
Other liabilities, excluding deferred income	21	3,087,773	3,087,773	2,762,438	2,762,438

24. REVALUATION SURPLUS

Revaluation surplus arises from the revaluations of the Bank's buildings carried out by independent valuers in 2001 and 2006. The details of the latest revaluation in year 2006 are disclosed in Note 16 to the financial statements.

25. SHARE-BASED PAYMENTS

The Bank granted 40,000 share options each in May 2005, April 2006 and March 2007 to Development Alternatives, Inc. ('DAI') under the renewed management contract signed in 2004. The options were awarded based on meeting or exceeding performance targets approved yearly by the Bank's Board of Directors. The exercise price of the options are MNT 2,013, MNT 2,914 and MNT 5,595 respectively, which are equal to the net assets per share on the last day of the financial year with respect to which the options are granted. The options vest immediately on the date of grant and expire on 1 May 2015, 10 April 2016 and 14 March 2017 respectively. The fair value of the options granted is estimated as at the date of grant using a binomial model, taking into consideration the terms and conditions upon which the options were granted. The fair value of the option granted during the year 2007 amounted to MNT63,081,000. There have been no cancellations or modifications to any of the plans during the current year.

During the last financial year on 7 April 2008, DAI transferred 18,000 of its 120,000 options to the Morrow Family Revocable Trust. The Trust immediately exercised the options to acquire 18,000 ordinary shares of the Bank. The exercise prices were at MNT2,013, MNT2,914 and MNT5,595 respectively. This resulted in a reduction in other reserve by MNT 21.3 million and an increase in share capital and share premium of MNT36 million and MNT48.5 million respectively in the last financial year.

Movements during the year

The number and weighted average exercise price ('WAEP') of, and movements in, share options during the year are:

	2009		2008	
	Number	WAEP MNT	Number	WAEP MNT
Outstanding at the beginning the year	102,000	3,508	120,000	3,508
Exercised during the year	-	-	(18,000)	-
Outstanding at the end of the year	<u>102,000</u>	<u>3,508</u>	<u>102,000</u>	<u>3,508</u>

The weighted average remaining contractual life for the share options outstanding as at 31 December 2009 is 6.27 years (2008: 7.27 years).

26. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled. See Note 32.3 'Liquidity risk and funding management' for the Bank's contractual undiscounted repayment obligations.

	Total less than 12 months MNT '000	Total less than 12 months MNT '000	Total MNT '000
At 31 December 2009			
Financial Assets			
Cash and balances with central bank	204,851,916	-	204,851,916
Due from banks	79,293,926	-	79,293,926
Financial investment -			
- available-for-sale	-	330,044	330,044
- held-to-maturity	178,161,207	-	178,161,207
Loans and advances to customers	372,104,432	208,603,092	580,707,524
Other assets	11,380	-	11,380
	<u>834,422,861</u>	<u>208,933,136</u>	<u>1,043,355,997</u>
Non-financial Assets			
Property, plant and equipment	-	41,411,221	41,411,221
Other assets	3,150,044	-	3,150,044
	<u>3,150,044</u>	<u>41,411,221</u>	<u>44,561,265</u>
Total	<u>837,572,905</u>	<u>250,344,357</u>	<u>1,087,917,262</u>

26. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTD.)

	Total less than 12 months MNT '000	Total less than 12 months MNT '000	Total MNT '000
At 31 December 2009			
Financial liabilities			
Due to banks	3,198,323	-	3,198,323
Due to customers	865,989,178	602,518	866,591,696
Debt issued and other borrowed funds	26,130,851	92,878,606	119,009,457
Other liabilities	3,087,773	-	3,087,773
	<u>898,406,125</u>	<u>93,481,124</u>	<u>991,887,249</u>
Non-financial liabilities			
Other liabilities	883,346	-	883,346
Tax payable	211,954	-	211,954
	<u>1,095,300</u>	<u>-</u>	<u>1,095,300</u>
Total	<u>899,501,425</u>	<u>93,481,124</u>	<u>992,982,549</u>
Net	<u>(61,928,520)</u>	<u>156,863,233</u>	<u>94,934,713</u>
	Total less than 12 months MNT '000	Total less than 12 months MNT '000	Total MNT '000
At 31 December 2008			
Financial Assets			
Cash and balances with central bank	118,115,083	-	118,115,083
Due from banks	20,633,289	-	20,633,289
Financial investment - available-for-sale	45,218,092	264,250	45,482,342
Loans and advances to customers	414,703,851	193,949,893	608,653,744
Other assets	25,419	-	25,419
	<u>598,695,734</u>	<u>194,214,143</u>	<u>792,909,877</u>
Non-financial Assets			
Property, plant and equipment	-	40,193,733	40,193,733
Other assets	3,802,581	1,313,225	5,115,806
Tax refundable	752,176	-	752,176
	<u>4,554,757</u>	<u>41,506,958</u>	<u>46,061,715</u>
Total	<u>603,250,491</u>	<u>235,721,101</u>	<u>838,971,592</u>
Financial liabilities			
Due to banks	2,615,268	-	2,615,268
Due to customers	679,155,819	-	679,155,819
Debt issued and other borrowed funds	7,210,412	65,847,841	73,058,253
Other liabilities	2,762,438	-	2,762,438
	<u>691,743,937</u>	<u>65,847,841</u>	<u>757,591,778</u>
Non-financial liability			
Other liabilities	1,249,644	-	1,249,644
Total	<u>692,993,581</u>	<u>65,847,841</u>	<u>758,841,422</u>
Net	<u>(89,743,090)</u>	<u>169,873,260</u>	<u>80,130,170</u>

27. OFF BALANCE SHEET ITEMS

	2009	2008
	MNT '000	MNT '000
Loans managed by the Bank for third parties		
Ministry of Food and Agriculture Loans (i)	1,542,519	1,652,666
Solar Energy Loan from Ministry of Energy (ii)	80,705	94,679
Alimentary aid loan (iii)	311,774	404,301
Other (iv)	628,754	671,471
	<u>2,563,752</u>	<u>2,823,117</u>
Contingent liabilities		
Performance and payment guarantees	2,456,562	642,178
Letters of credit	4,213,323	4,472,087
Other	347,252	52,472
	<u>7,017,137</u>	<u>5,166,737</u>
Commitments		
Undrawn commitment to lend	10,044,906	8,362,195
Other	123,743	2,527,762
	<u>10,168,649</u>	<u>10,889,957</u>
TOTAL	<u>19,749,538</u>	<u>18,879,811</u>

Loans managed by the Bank for third parties

(i) 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 outstanding loans extended to agricultural companies amounting to MNT 1,543 million (2008 : MNT 1,653 million).

No new loans were disbursed since December 2002. No commission and service charge was earned in 2009 (2008 : Nil).

(ii) Solar Energy Loan

On 21 October 2003, the Bank had entered into a Solar Energy Loan Agreement with the Ministry of Energy (formerly known as Ministry of Infrastructure). 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 Ministry of Energy with timely information on the status of these loans. The Bank, acting on behalf of Ministry of Energy, has outstanding solar energy loans to herders and farmers amounting to MNT 81 million (2008 : MNT 95 million).

The Bank earns an application fee of MNT4,000 per loan disbursed for the administrative service of this loan. No new loan was extended to borrowers during the year.

(iii) 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 MNT312 million (2008 : MNT 404 million) as at year end.

The Bank earns a commission of 3% per annum (2008 : 3% per annum) on the amount of loans issued. New loans amounting to MNT 159.9 million (2008 : MNT 293 million) were disbursed during the year. The commission earned for the year amounted to MNT 4.8 million (2008 : MNT 8.8 million).

(iv) Other

Other represents loans granted to the borrowers which are funded by the private entities and managed by the Bank. The Bank earns administration fees on the management of the loans.

Contingent liabilities

Letters of credit (including standby letters of credit), performance guarantees (including tender guarantee) commit the Bank to make payments on behalf of customers. Guarantees and standby letters of credit carry the same credit risk as loans.

Undrawn commitments to lend

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed expiry dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

However, the potential credit loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific standards. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Other commitments

	2009	2008
	MNT '000	MNT '000
<u>Approved and contracted for</u>		
Property, plant and equipment	<u>123,743</u>	<u>2,527,762</u>

28. CASH AND CASH EQUIVALENTS

		2009	2008
	Note	MNT '000	MNT '000
Cash and balances with central bank	12	204,851,916	118,115,083
Due from banks	13	<u>79,293,926</u>	<u>20,633,289</u>
		284,145,842	138,748,372
Less: Minimum reserve with Bank of Mongolia not available to finance the Bank's day to day operation (see Note 12)		(20,070,150)	-
		<u>264,075,692</u>	<u>138,748,372</u>

29. RELATED PARTY DISCLOSURES

The Bank is controlled by Sawada Holdings Co. Ltd., a company incorporated in Japan. A management contract was signed with Development Alternatives Inc. (“DAI”) in year 2003 and renewed in year 2004 and again in 2006 for four years to provide management and consultation services to the Bank.

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 related expenses for the year are listed below.

	2009	2008
	MNT '000	MNT '000
(a) Interest paid on subordinated loan		
- Sawada Holdings Co. Ltd	<u>307,429</u>	<u>181,884</u>
(b) Compensations of key management personnel		
Short-term employee benefits		
- Salaries	1,219,263	1,261,830
- Bonus and allowances	298,757	88,500
- Contribution to social and health fund	134,119	83,116
- Share Appreciation Rights	25,530	144,190
	<u>1,677,669</u>	<u>1,577,636</u>
(c) Management fees paid to a corporate shareholder, DAI	<u>761,273</u>	<u>710,760</u>
(d) Loans and advances to key management personnel	<u>321,405</u>	<u>222,027</u>
Repayable		
- within one year	32,246	32,751
- one year to five years	141,291	112,491
- over five years	147,868	76,785
	<u>321,405</u>	<u>222,027</u>

The loans to key management personnel bear interest rates ranging from 3.6% - 12% (2008 : 3.6% - 12%) per annum. The interest income earned from key management personnel for the financial year amounted to MNT 7.7 million (2008 : MNT 11.5 million).

	2009	2008
	MNT '000	MNT '000
(e) Credit facilities granted to a corporate shareholder		
Credit line	3,512,118	1,057,163
Letters of credit	1,133,200	2,369,443
	<u>4,645,318</u>	<u>3,426,606</u>

The credit lines and letters of credit (including standby letters of credit) are granted to companies affiliated with Tavan Bogd Trade Co Ltd, a corporate shareholder. Letter of credits commit the Bank to make payments on behalf of customers. The interest income and commission income received from the loan amounted to MNT 337 million (2008: MNT 207 million).

	2009	2008
	MNT '000	MNT '000
(f) Deposits received from directors	505,358	11,821,107
Deposits received from related companies	1,597,884	50,723,906
	<u>2,103,242</u>	<u>62,545,013</u>

The deposits in MNT and USD received from directors bear interest rate from 3.6% to 18% (2008: 3.6% to 18%) per annum and the deposit in USD received from related companies bears interest rate from 3.6% to 10% (2008: 3.6% to 8.5%) per annum. The interest paid for the deposit amounted to MNT1,824 million (2008: MNT 2,735 million).

	2009	2008
	MNT '000	MNT '000
(g) Loans from corporate shareholders (Note 20)		
Sawada Holdings Co. Ltd	2,933,907	2,577,270
International Finance Corporation	16,811,387	18,974,087
	<u>19,745,294</u>	<u>21,551,357</u>

The interest paid on loan from corporate shareholders amounted to MNT 1,415 million (2008: MNT683 million)

- (h) Subordinated loan from a company in which a director has substantial financial interest (Note 20)

H.I.S CO., LTD	<u>14,446,628</u>	<u>-</u>
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The interest paid on subordinate loan from a fellow subsidiary amounted to MNT 18 million.

30. CAPITAL

Capital Management

The primary objectives of the Bank's capital management are to ensure that the Bank maintains a healthy capital ratio, complies with externally imposed capital requirements, and maintains strong credit ratings in order to support its business and to maximize shareholder value. During the past year, the Bank complied in full with all its externally imposed capital requirements.

The Bank manages its capital structure taking into consideration the risk characteristics of its activities, growth expectations, and changes in economic and other conditions. In order to maintain or adjust the capital structure, the Bank regularly evaluates its capital structure. The Bank's shareholders may from time to time provide additional capital. No changes have been made from previous years in the Bank's capital objectives or policies.

Regulatory capital

Bank of Mongolia requires commercial banks to maintain a core capital adequacy ratio of 6% (2008: 5%) and a risk weighted capital ratio of 12% (2008: 12%), calculated 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:

	2009	2008
Core capital ratio	14.38%	11.96%
Risk weighted capital ratio	<u>19.32%</u>	<u>12.45%</u>

	2009	2008
	MNT '000	MNT '000
<u>Tier I capital</u>		
Statutory fund	12,994,012	12,334,792
Other reserves	121,096	121,096
Share premium	13,866,079	10,242,677
Retained profits	67,348,985	56,740,333
Total Tier I capital	<u>94,330,172</u>	<u>79,438,898</u>
<u>Tier II capital</u>		
Revaluation surplus	604,541	691,272
Subordinated loan	31,742,480	2,535,020
Total Tier II capital	<u>32,347,021</u>	<u>3,226,292</u>
Total capital	<u>126,677,193</u>	<u>82,665,190</u>

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

		2009	2008
		MNT '000	MNT '000
		Risk	Risk
	Assets	Weighted	Assets
%			Weighted
0	383,013,123	-	163,333,175
20	83,507,250	16,701,450	25,105,375
50	606,030	303,015	610,490
100	638,839,931	638,839,931	658,855,353
Total	<u>1,105,966,334</u>	<u>655,844,396</u>	<u>847,904,393</u>

31. SEGMENT INFORMATION

For management purposes, the Bank is organised into four reportable operating segments based on their geographical locations as follows:

- * The head office performs treasury functions, obtaining local and foreign funded loans and providing other supporting services to other segments.
- * The Wholesale Banking division grants corporate loans and accepts corporate deposits.
- * The Ulaanbaatar branches provide lending, deposit taking, payment and other banking services at Ulaanbaatar city.
- * The Rural branches provide lending, deposit taking, payment and other banking services outside Ulaanbaatar city.

No operating segments have been aggregated to form the above reportable operating segments.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss which in certain respects, as explained in the table below, is measured differently from operating profit or loss in the amalgamated financial statements. The Bank's financing costs and income taxes are managed by head office and are not allocated to other operating segments.

Transfer prices for lending and borrowing funds between operating segments are based on average loan rate after deducting the percentage of staff cost incurred.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Bank's total revenue in 2009 or 2008.

The following tables present income and profit and certain asset and liability information regarding the Bank's operating segments.

31. SEGMENT INFORMATION (CONTD.)

	Ulaanbaatar Business 2009 MNT'000	Rural Business 2009 MNT'000	Wholesale Banking Division 2009 MNT'000	Head Office 2009 MNT'000	Unallocated 2009 MNT'000	Total 2009 MNT'000
Revenue						
Third party	33,598,555	38,577,402	9,563,728	(794,692)	-	80,944,993
Inter-segment	32,644,762	(18,916,817)	(4,328,331)	(9,399,614)	-	-
Total operating income	66,243,317	19,660,585	5,235,397	(10,194,306)	-	80,944,993
Credit loss expense	2,681,592	3,866,562	5,739,225	589,715	-	12,877,094
Net operating income	63,561,725	15,794,023	(503,828)	(10,784,021)	-	68,067,899
Results						
Net interest income (expense)	27,449,163	34,653,849	8,712,447	(3,511,074)	-	67,304,385
Net fees and commission income	2,995,705	2,530,396	169,882	3,711,261	-	9,407,244
Depreciation of property and equipment	1,480,853	3,489,419	8,814	2,053,928	577,736	7,610,750
Segment profit (loss)	19,418,959	12,309,259	3,649,172	(9,008,057)	(12,469,772)	13,899,561
Income tax expense					(3,377,640)	(3,377,640)
Profit for the year						10,521,921
Assets						
Capital expenditures						
Property and equipment	1,208,026	4,844,695	543	1,575,673	1,609,386	9,238,323
Total assets	182,464,999	335,616,170	110,204,630	449,626,433	10,005,030	1,087,917,262
Total liabilities	542,226,190	264,054,929	59,872,783	125,450,655	1,377,992	992,982,549

31. SEGMENT INFORMATION (CONTD.)

	Ulaanbaatar Business 2008	Rural Business 2008	Wholesale Banking Division 2008	Head Office 2008	Unallocated 2008	Total 2008
	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
Revenue						
Third party	32,474,925	40,751,309	8,241,798	6,798,315	-	88,266,347
Inter-segment	20,633,108	(31,761,096)	3,456,235	7,671,753	-	-
Total operating income	53,108,033	8,990,213	11,698,033	14,470,068	-	88,266,347
Credit loss expense	1,453,718	4,904,098	3,039,914	851,240	-	10,248,970
Net operating income	51,654,315	4,086,115	8,658,119	13,618,828	-	78,017,377
Results						
Net interest income (expense)	27,685,064	37,091,569	8,035,246	4,214,607	-	77,026,486
Net fees and commission income	2,741,603	2,942,774	121,655	2,150,638	-	7,956,670
Depreciation of property and equipment	1,117,034	1,898,187	10,812	2,058,396	567,430	5,651,859
Segment profit (loss)	22,287,914	18,380,026	5,018,726	(2,714,705)	(13,319,830)	29,652,131
Income tax expense					(7,398,552)	(7,398,552)
Profit for the year						22,253,579
Assets						
Capital expenditures						
Property and equipment	2,297,514	8,669,879	4,350	4,894,280	1,687,851	17,553,874
Total assets	181,778,225	354,160,110	111,392,706	179,080,552	12,559,999	838,971,592
Total liabilities	353,773,435	202,872,634	121,250,451	79,570,691	1,374,211	758,841,422

31. SEGMENT INFORMATION (CONTD.)

A reconciliation of total segment profit before tax to total profit before tax is provided as follows:

	2009	2008
	MNT '000	MNT '000
Total segment profit before tax	26,369,333	42,971,961
Corporate personnel cost	(5,358,240)	(7,640,809)
Corporate administrative cost	(7,111,532)	(5,679,021)
Total profit before tax	<u>13,899,561</u>	<u>29,652,131</u>

Reportable segments' assets are reconciled to total assets as follows:

	2009	2008
	MNT '000	MNT '000
Total segment assets	1,077,912,232	826,411,593
Tax receivable	-	752,176
Inventories	638,375	735,191
Consumables	13,718	31,523
Property and equipment	9,352,937	11,041,109
Total assets per balance sheet	<u>1,087,917,262</u>	<u>838,971,592</u>

Reportable segments' liabilities are reconciled to total liabilities as follows:

	2009	2008
	MNT '000	MNT '000
Total segment liabilities	991,604,557	757,467,211
Tax payable	211,954	-
SARs payable	361,273	342,982
Bonus and other accrual	804,765	1,031,229
Total liabilities per balance sheet	<u>992,982,549</u>	<u>758,841,422</u>

32. RISK MANAGEMENT

32.1 Introduction

Risk is inherent in the Bank's activities and managed through risk limits and a continuing process of analysis and review. This process of risk management is critical to the bank's continuing profitability and all Bank executives are accountable for the management of risks relating to their responsibilities. The Bank is exposed to a variety of risks including credit risk, liquidity risk, market risk and operational risk.

The day-to-day risk management process does not include business risks such as changes in the environment, technology and industry. These are addressed through the Bank's strategic and business planning process.

Risk management structure

The Board of Directors has ultimate responsibility for overall risk management of the bank. It receives a report on the performance of the Bank at monthly board meetings while the Board Audit Committee is specifically responsible for monitoring the activities of the Internal Audit Department.

Within the Bank there are various committees and departments responsible for managing and monitoring risks.

Senior Executive Committee

The Senior Executive Committee has weekly meetings that discuss all aspects of the Bank's operations including operational and credit risks.

Risk Management Committee

The Risk Management Committee oversees the activities of the Risk Management Department, reviewing the Department's risk reports on head office business and support units, assessing the adequacy of business and support unit management, and requiring corrective action where risk management deficiencies are identified. It ensures policies and procedures are in place to manage the risks to which the Bank is exposed. The Risk Management Committee is chaired by one of the Deputy Chief Executive Officers.

Risk Management Department

The Risk Management Department oversees the risk management process in the Bank, implementing and maintaining risk related review procedures to ensure an independent control process. It is responsible for monitoring compliance with risk policies and procedures across the Bank.

Credit Committee (CC)

The CC structure was established to manage the Bank's credit risk at various levels. This includes the Head Office Credit Committee, Ulaanbaatar and Rural Branch Credit Sub-Committees, Branch Credit Committees and Sub-Branch Credit Committees. The Head Office Credit Committee approves lending authorities for each sub-committee, branch and sub-branch. These authorities are reviewed regularly and revised as necessary. Transactions exceeding the lending authority of a committee are referred up through the committee structure for final decision by a committee with the appropriate authority. All loans and aggregate exposures over MNT 200 million are approved by the Head Office Credit Committee. The Head Office Credit Committee is chaired by one of the Deputy Chief Executive Officers.

Credit Committee (CC)(Contd.)

The Head Office Credit Committee is responsible for approving overall credit policies and procedures for the Bank, including pricing, new products and loan programs, treasury trading limits and all other credit exposures. The committee is responsible for monitoring the portfolio and credit quality, including concentrations and trends, its overall risk profile, and the adequacy of the Bank's reserves. The committee also oversees bad debt collection, loan charge-offs and recoveries.

Credit Risk Committee (CRC)

The functions of the CRC are (i) defining the portfolio quality and risk level of departments, branches, sub branches and provide assessment thereof; (ii) building quality loan portfolio and take measures to ensure portfolio growth; and (iii) review problematic loans and developing plan for recovery measures and assessing the performance thereof.

Assets & Liabilities Committee (ALCO)

ALCO was established to provide centralized asset and liability management of the funding, liquidity, foreign currency, maturity and interest rate risks to which the Bank is exposed. The main responsibilities of ALCO include establishing guidelines for the Bank's deposit and loan activities based on the Bank's funding position and liquidity, setting pricing guidelines for the Bank's deposit products, monitoring investments, interbank deposits and loans, monitoring the Bank's maturity and interest rate gaps, foreign exchange position, and ensuring compliance with all regulatory requirements. ALCO is chaired by one of the Deputy Chief Executive Officers.

IT Steering Committee

The IT Steering Committee was established to ensure that the Bank's business and IT strategies and business plans are aligned. The main responsibilities of the IT Steering Committee include approving and monitoring implementation of the IT business strategy, reviewing major expenditures for IT prior to their submission to the Board of Directors for approval, ensuring interaction between IT and business units to identify needs and priorities for systems, MIS and new and existing product enhancements and developments and to identify and resolve problems in the business which relate to IT. The IT Steering Committee is chaired by one of the Deputy Chief Executive Officers.

Internal Audit

Risk management processes throughout the Bank are audited annually by the internal audit function, which examines both the adequacy of procedures and compliance with them. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Board Audit Committee.

The Internal Audit Department consists of 49 members – 1 Director, 10 Senior Auditors, 35 Auditors and 3 specialized IT auditors. The Director directly reports to the Chairman of the Board Audit Committee and has regular monthly meetings with the Chairman. Internal Audit performs a full scale audit of each business and support unit, branch and sub-branch twice per year. Additional unannounced audits are conducted 1-2 times per year. The department maintains a yearly schedule, adding additional audits when needed.

All rural sub-branches report to an aimag (provincial centre) branch. Aimag branch staff, responsible for supervising the sub-branches, make regular quarterly visits to the sub-branches under their control to review compliance with the Bank's policies and procedures and to assess the quality of their operations and loans.

Risk measurement and reporting system

Each business unit and head office support unit is responsible for managing its identified risks and reporting on its performance to the Risk Management Committee at least once per week. The Risk Management Department together with the corresponding business or support unit identifies the risks that need to be managed, measured and reported and monitors implementation on the risk management actions determined by the Risk Management Committee.

Monitoring and controlling risks is primarily performed based on limits established by the related Management Committees of the Bank. These limits reflect the business strategy and market environment of the Bank as well as level of risk that the Bank is willing to accept. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposures across all risk types and activities.

Risk mitigation

As part of its overall risk management, the Bank uses basic sensitivity analysis to manage exposures resulting from possible changes in interest rates, foreign currencies and equity risks. Also, the individual mitigation plans for each type of risk are developed and implemented by each business unit, and the process is monitored by the Risk Management Department.

32.2 Credit risk

The Bank is exposed to credit risk which is the risk that the Bank's customers, clients or counterparties will be unable or unwilling to pay interest, principal, or otherwise fulfill their contractual obligations under loan agreements, other credit facilities, or in respect of other financial instruments. 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. Such risks are monitored on a regular basis and subject to regular review. The Bank's Credit Committee among others is responsible for oversight of the credit approval and monitoring process.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral.

Credit-related commitments risks

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans.

Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the balance sheet. The maximum exposure is shown gross, before the effect of mitigation through the use of collateral agreements.

	Notes	Gross maximum exposure 2009 MNT '000	Gross maximum exposure 2008 MNT '000
Cash and balances with central bank (excluding cash on hand)	12	154,332,817	79,992,789
Due from banks	13	79,293,926	20,633,289
Financial investments			
- available-for-sale	14	330,044	45,482,342
- held-to-maturity	14	178,161,207	-
Loans and advances to customers	15	580,707,524	608,653,744
Other receivables	17	11,380	25,419
Total		<u>992,836,898</u>	<u>754,787,583</u>
Contingent liabilities	27	7,017,137	5,166,737
Commitments	27	10,168,649	10,889,957
Total		<u>17,185,786</u>	<u>16,056,694</u>
Total credit risk exposure		<u>1,010,022,684</u>	<u>770,844,277</u>

32. RISK MANAGEMENT (CONTD.)

32.2 Credit risk (Contd.)

Risk concentrations of the maximum exposure to credit risk

Concentration of risk is managed by client/counterparty. The maximum credit exposure to any client or counterparty as of 31 December 2009 was MNT 13,060 million (2008: MNT11,770 million) before taking account of collateral or other credit enhancements.

Apart from deposits and placements with other banks and financial institutions amounting to MNT 62,501 million (2008: MNT 19,404 million), all banking assets and liabilities were concentrated in Mongolia.

An industry sector analysis of the Bank's financial assets, before taking into account collateral held or other credit enhancements, is as follows:

	Gross maximum exposure 2009 MNT '000	Gross maximum exposure 2008 MNT '000
Agricultural	71,674,391	101,815,020
Construction	21,635,498	22,286,211
Consumer loan	166,733,926	145,823,818
Education	1,889,960	1,303,953
Food manufacturing	16,202,397	24,617,751
Financial services	412,334,420	146,483,674
Health and Pharmaceutical	3,250,748	3,319,853
Hotels and restaurant	15,002,574	17,253,522
Industrial manufacturing	32,849,346	35,633,296
Mining and exploration	13,720,032	11,104,882
Petroleum	12,110,974	13,465,175
Real estate	103,988,027	98,842,333
Telecommunication	643,333	443,661
Transportation	6,187,928	6,866,128
Utility services	26,229,522	18,537,286
Vehicles	5,519,554	21,254,093
Wholesale and retail business (trade)	99,567,681	99,355,691
Other	482,373	2,437,930
	<u>1,010,022,684</u>	<u>770,844,277</u>

32.2 Credit risk (Contd.)

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The Bank accepts the following types of collateral in combination of immovable and movable assets.

Immovable assets include: production plant, building for service/commercial use, privatized apartment, “khashaa baishin” (building with fence) and land with ownership title.

Movable assets include: shipping container, motor vehicle, equipment, assets for personal use (jewelry, electronic appliance etc.), business inventory, bank deposits, livestock, mineral resources mining license, stocks, business income and other assets owned by borrower.

Market value of immovable collateral is determined by referencing sales price of comparable property in the same local area as well as in consideration of location, marketability, quality/condition of the collateral. The Bank calculates collateral value as Free Market Value and Forced Sale Value and bases its coverage requirement on Forced Sale Value.

Forced sale value (FSV) = market value * forced sale discount rate (FSV%). Forced sale value may be up to 100% of market value.

Therefore the Bank works to ensure that loans are secured by sufficient collateral. If loan defaults and collateral liquidation is required to recover the loan, the Bank files a court claim. Based on court judgment, the Bank liquidates the collateral in conjunction with the Bailiff’s office (Executor of court order)

It is the Bank’s policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank using internal credit ratings. The table below shows the credit quality by class of asset for loan-related balance sheet lines, based on the Bank’s credit rating system.

	Note	Neither past due nor impaired			Past due or	Total
		High grade	Standard grade	Sub-standard grade	individually impaired	
At 31 December 2009		MNT '000	MNT '000	MNT '000	MNT '000	MNT '000
Due from banks	13	79,293,926	-	-	-	79,293,926
Financial Investments						
Unquoted - Bank of Mongolia bills	14	178,161,207	-	-	-	178,161,207
Unquoted - Equities	14	-	330,044	-	-	330,044
		178,161,207	330,044	-	-	178,491,251
Loans and advances to customers						
Business lending	15	89,569,619	104,979,914	10,463,362	87,703,532	292,716,427
Consumer lending	15	141,414,546	102,970,793	1,761,504	4,059,410	250,206,253
Agricultural lending	15	44,536,834	7,761,870	617,906	12,203,761	65,120,371
		275,520,999	215,712,577	12,842,772	103,966,703	608,043,051
Total		532,976,132	216,042,621	12,842,772	103,966,703	865,828,228

32. RISK MANAGEMENT (CONTD.)

32.2 Credit risk (Contd.)

Credit quality per class of financial assets (Contd.)

	Note	Neither past due nor impaired			Past due or	Total
		High grade	Standard grade	Sub-standard grade	individually impaired	
At 31 December 2008		MNT '000	MNT '000	MNT '000	MNT '000	MNT '000
Due from banks	13	20,633,289	-	-	-	20,633,289
Financial Investments						
Unquoted - Bank of Mongolia bills	14	45,218,092	-	-	-	45,218,092
Unquoted - Equities	14	-	264,250	-	-	264,250
		<u>45,218,092</u>	<u>264,250</u>	<u>-</u>	<u>-</u>	<u>45,482,342</u>
Loans and advances to customers						
Business lending	15	112,550,062	127,527,548	16,936,268	50,413,064	307,426,942
Consumer lending	15	118,059,408	99,986,067	666,146	1,257,724	219,969,345
Agricultural lending	15	65,998,388	23,658,219	101,449	7,741,828	97,499,884
		<u>296,607,858</u>	<u>251,171,834</u>	<u>17,703,863</u>	<u>59,412,616</u>	<u>624,896,171</u>
Total		<u>362,459,239</u>	<u>251,436,084</u>	<u>17,703,863</u>	<u>59,412,616</u>	<u>691,011,802</u>

Past due loans and advances include those that are only past due by a few days. An analysis of past due loans by age is provided as follows. The majority of the past due loans are not considered to be impaired.

Aging analysis of past due but not individually impaired loans:

	Less than 30			More than 91		Total
	days	31 to 60 days	61 to 90 days	days		
At 31 December 2009	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000
Loans and advances to customers						
Business lending	136,830	89,452	74,418	205,926		506,626
Consumer lending	103,728	86,479	53,105	196,513		439,825
Agricultural lending	1,054,548	634,971	338,114	1,246,892		3,274,525
	<u>1,295,106</u>	<u>810,902</u>	<u>465,637</u>	<u>1,649,331</u>		<u>4,220,976</u>
At 31 December 2008						
Loans and advances to customers						
Business lending	204,647	135,437	67,655	57,014		564,753
Consumer lending	193,073	118,189	60,028	108,654		479,944
Agricultural lending	849,023	444,899	336,485	641,601		2,272,008
	<u>1,246,743</u>	<u>698,525</u>	<u>464,168</u>	<u>907,269</u>		<u>3,316,705</u>

Of the total aggregate amount of gross past due but not impaired loan and advances to customers, the fair value of collateral that the Bank held as at 31 December 2009 was MNT13,728 million (2008: MNT11,850 million). Please see note 14 for more detailed information with respect to allowance for impairment losses on loans and advances to customers.

Collateral repossessed

During the year, the Bank took possession of immovable properties with carrying amounts as at 31 December 2009 of MNT 564 million (2008: 100 million). The Bank is in the process of selling these immovable properties.

Carrying amount per class of financial assets whose terms have been renegotiated

The table below shows the carrying amount for renegotiated financial assets, by class.

	2009	2008
	MNT '000	MNT '000
Loans and advances to customers		
Business lending	7,946,110	3,861,823
Consumer lending	862,585	181,183
Agricultural lending	6,001,551	4,022,363
	<u>14,810,246</u>	<u>8,065,369</u>

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan or advance on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of the other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each month end.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans and advances that are not individually significant and for individually significant loans and advances where there is not yet objective evidence of individual impairment. Allowances are evaluated quarterly with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

32.3 Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposits, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. The Bank takes into account seasonality in customer loans and deposits.

The liquidity position is assessed and managed by maintaining the Bank's Liquidity ratio at an adequate level. The Liquidity ratio is the ratio of net liquid assets to customer liabilities. Net liquid assets consist of cash, deposits at the Bank of Mongolia and other banks, and Bank of Mongolia bills. The ratio at year end 2009 and 2008 was as follows:

	2009	2008
	%	%
31 December	42.40%	21.85%
Average during the year	30.86%	19.34%
Highest	42.40%	23.53%
Lowest	21.65%	12.62%

The Bank maintains statutory reserve deposits with the Bank of Mongolia equal to not less than 5.0% of customer deposits. Reserves are managed on a daily basis and reported twice monthly to the Bank of Mongolia.

Analysis of financial liabilities by remaining contractual maturities

The table below summarizes the maturity profile of the Bank's financial liabilities at 31 December 2009 and 31 December 2008 based on contractual undiscounted repayment obligations. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

32. RISK MANAGEMENT (CONTD.)

32.3 Liquidity risk and funding management (Contd.)

Financial Liabilities	On demand	Less than 3 months	3-12 months	1-5 years	Over 5 years	Total
	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000
At 31 December 2009						
Due to banks	245,742	-	3,410,232	-	-	3,655,974
Due to customers	531,421,172	154,089,892	203,866,761	785,522	-	890,163,347
Debt issued and other borrowed funds	2,032,813	18,602,049	14,894,691	75,956,976	33,779,024	145,265,553
Other liabilities	-	1,843,288	929,958	388,375	273,375	3,434,996
Total undiscounted financial liabilities	<u>533,699,727</u>	<u>172,691,941</u>	<u>223,101,642</u>	<u>76,742,498</u>	<u>33,779,024</u>	<u>1,039,084,874</u>

At 31 December 2008

Due to banks	115,413	-	2,650,675	-	-	2,766,088
Due to customers	337,709,964	187,448,226	169,100,682	-	-	694,258,872
Debt issued and other borrowed funds	440,312	-	7,095,087	74,149,595	3,549,028	85,234,022
Other liabilities	-	618,859	1,838,951	293,174	616,710	3,367,694
Total undiscounted financial liabilities	<u>338,265,689</u>	<u>188,067,085</u>	<u>180,685,395</u>	<u>74,442,769</u>	<u>4,165,738</u>	<u>785,626,676</u>

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments.

At 31 December 2009	On demand	Less than 3 months	3-12 months	1-5 years	Over 5 years	Total
	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000	MNT '000
Contingent liabilities	347,252	3,971,227	2,698,658	-	-	7,017,137
Commitments	<u>10,044,906</u>	<u>123,743</u>	-	-	-	<u>10,168,649</u>
Total	<u>10,392,158</u>	<u>4,094,970</u>	<u>2,698,658</u>	-	-	<u>17,185,786</u>

At 31 December 2008

Contingent liabilities	250,855	2,548,775	1,969,198	397,909	-	5,166,737
Commitments	<u>8,362,195</u>	<u>2,037,721</u>	<u>490,041</u>	-	-	<u>10,889,957</u>
Total	<u>8,613,050</u>	<u>4,586,496</u>	<u>2,459,239</u>	<u>397,909</u>	-	<u>16,056,694</u>

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

32. RISK MANAGEMENT (CONTD.)

32.4 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates and foreign currency exchange rates. The Bank manages and monitors its market risk using sensitivity analysis on its main market risk areas. The sensitivity analysis measures the impact of possible changes of market variables in profit and equity of the Bank.

The Bank has no significant concentration of market risk.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. Assets and liabilities of the Bank are predominantly fixed rate. A small percentage of the Bank's loan portfolio is on a floating rate basis; these loans, however, are funded with floating rate loans or deposits with like tenors and currency. The Bank manages its spread or Net Interest Margin (Net Interest Income less Net Interest Expense) through rate setting of loan and deposit products. The Bank's broad based market, customer and product diversity reduce the risk of declining interest spreads due to competitive and other factors.

Interest rate sensitivity

Based on the interest rate sensitivity analysis on the financial assets and liabilities as at year end, a reasonable possible change in interest rate would have no impact on the statement of comprehensive income and equity.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Under Bank of Mongolia's regulation, the Bank may hold an overall open position equal up to 40% of equity and an open position up to 15% for any single currency.

The Bank does not speculate in foreign currencies and seeks to minimize its open position to the extent possible. The Bank buys and sells currencies with its customers, with other banks and with the Bank of Mongolia. High inflation in 2008 resulted in the devaluation of the MNT against the USD beginning in the fourth quarter and accelerating into the first quarter of 2009. The MNT declined against the USD more than 25% before stabilizing due to IMF support and monetary policy. The MNT/USD rate has remained stable since then.

32. RISK MANAGEMENT (CONTD.)

32.4 Market risk (Contd.)

The table below indicates currencies to which the Bank has significant exposure at 31 December 2009 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the MNT, with all other variables held constant on the statement of comprehensive income and equity. A negative amount in the table reflects a potential net reduction in statement of comprehensive income or equity, while a positive amount reflects a net potential increase.

Currency	Change in currency rate in % 2009	Effect on profit before tax 2009 MNT '000	Effect on equity 2009 MNT '000
USD	+5.6	(580,225)	-
USD	-4.2	445,650	-
CNY	+5.8	428,800	-
CNY	-4	(304,362)	-
EUR	+8.8	(164,348)	-
EUR	-8.4	157,294	-

Currency	Change in currency rate in % 2008	Effect on profit before tax 2008 MNT '000	Effect on equity 2008 MNT '000
USD	+37	(1,364,078)	-
USD	-13	488,377	-
EUR	+41	10,220	-
EUR	-10	(2,630)	-

32. RISK MANAGEMENT (CONTD.)

32.4 Market risk (Contd.)

Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

The Bank uses the simplified approach to project the impact of varying levels of prepayment on its net interest income. The effect on profit before tax for one year and on equity, assuming the historical annual and fourth quarter prepayment ratio for the year, with all other variables held constant, is as follows:

	Currency Prepayment rate	Effect on net interest income	Effect on equity
	%	MNT '000	MNT '000
At 31 December 2009			
MNT			
Average for 12 months	9.20%	11,257,638	-
Average for fourth quarter	8.74%	10,696,977	-
At 31 December 2008			
MNT			
Average for 12 months	1.42%	1,822,782	-
Average for fourth quarter	1.19%	1,527,543	-

32.5 Operation risk

Operational risk is the risk of loss arising from systems failure, human errors, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, and lead to financial loss. The Bank cannot expect to eliminate all operational risk, but through a dual control framework, segregation of duties between front-office and back office functions, controlled access to systems, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit, the Bank seeks to manage operational risk.

33. 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.