X A C B A N K L L C

(Incorporated in Mongolia)

Audited Financial Statements
31 December 2013

XACBANK LLC

FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2013

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XACBANK LLC

CORPORATE INFORMATION

REGISTERED ADDRESS:	XacBank Building Prime Minister Amar’s Street, Post Branch # 46, P.O Box - 721, Ulaanbaatar -14200, Mongolia
BOARD OF DIRECTORS:	Mr. Ganbold Chuluun Mr. Bold Magvan Mr. Bat-Ochir Dugersuren Ms. Erdenejargal Perenlei Mr. Michael Madden Mr. Richard Ranken Ms. Saran Binderiya Ms. Tselmuun Nyamtsaishir Ms. Sarah Djari (resigned on 29.10.2013) Mr. Shuji Irie (appointed on 10.12.2013) Mr. Arvid Tuerkner (resigned on 10.12.2013) Ms. Sabina Dziurman, (appointed on 10.12.2013)
CORPORATE SECRETARY:	Ms. Ashidmaa Dashnyam
AUDITORS	Ernst and Young Mongolia Audit LLC Certified Public Accountants

XACBANK LLC

STATEMENT BY DIRECTOR AND MANAGEMENT

We, Bat-Ochir Dugersuren, being Chief Executive Officer of XacBank LLC ("the Bank") and Erdenebayar Ganzorig, being the officer primarily responsible for the financial statements of the Bank, do hereby state that, in our opinion, the accompanying financial statements set out on pages 4 to 101 present fairly, in all material respects the financial position of the Bank as at 31 December 2013 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

BAT-OCHIR DUGERSUREN
(Chief Executive Officer)

ERDENEBAYAR GANZORIG
(Chief Financial Officer)

Ulaanbaatar
Date: 25 MAR 2014

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REPORT OF THE INDEPENDENT AUDITORS

To the shareholder of XacBank LLC

We have audited the accompanying financial statements of XacBank LLC (the "Bank"), which comprise the statement of financial position as at 31 December 2013 and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

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, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' 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 about 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 auditors consider 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.

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REPORT OF THE INDEPENDENT AUDITORS (CONTD.)

To the shareholder of XacBank LLC (Contd.)

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2013, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Restriction on use

This report is made solely to the shareholder of the Bank, as a body, in accordance with the audit requested by shareholder in accordance with Article 94 of Company Law of Mongolia and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Ernst & Young Mongolia Audit LLC
ERNST AND YOUNG MONGOLIA AUDIT LLC
Certified Public Accountants

PETER MARKEY
Executive Director

Ulaanbaatar, Mongolia
Date: 25 MAR 2014

XACBANK LLC

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	2013 MNT'000	2012 MNT'000
Interest and similar income	**4**	181,022,347	127,996,992
Interest and similar expenses	**5**	(100,332,244)	(67,972,299)
Net interest income		**80,690,103**	**60,024,693**
Fees and commission income	**6**	5,799,626	3,249,974
Fees and commission expenses	**6**	(782,369)	(595,810)
Net fees and commission income	**6**	**5,017,257**	**2,654,164**
Net trading income	**7**	2,568,294	2,222,197
Other operating income – net	**8**	4,142,363	529,468
Total operating income		**92,418,017**	**65,430,522**
Credit loss expense	**9**	(9,706,640)	(2,423,785)
Net operating income		**82,711,377**	**63,006,737**
Operating expenses	**10**	(54,142,727)	(44,108,246)
Amortisation of deferred grants	**29**	1,323,934	1,270,175
Profit before tax		**29,892,584**	**20,168,666**
Income tax expense	**11**	(5,520,275)	(4,921,301)
Profit for the year		**24,372,309**	**15,247,365**
Other comprehensive income		–	–
Total comprehensive income (net of tax) attributable to equity holders of the Bank		**24,372,309**	**15,247,365**
Earnings per share (MNT):			
Basic earnings per share	**12**	1,197.44	749.12
Diluted earnings per share	**12**	1,197.44	749.12

The accompanying notes form an integral part of the financial statements

XACBANK LLC

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2013

	Note	2013 MNT'000	2012 MNT'000
ASSETS			
Cash and balances with BoM	**13**	238,614,870	174,463,368
Due from banks	**14**	121,851,611	142,638,165
Reverse repurchase agreements	**15**	29,991,255	3,498,061
Derivative financial instruments	**16**	636,835	–
Financial investments – held-for-trading	**17**	–	79,742
Financial investments – available-for-sale	**17**	15,500,694	478,492
Financial investments – held-to-maturity	**17**	329,582,816	88,135,490
Loans and advances to customers	**18**	1,029,541,294	630,919,177
Other assets	**19**	4,361,822	6,283,343
Properties held for sale	**20**	5,105,763	1,031,577
Property and equipment	**21**	29,595,235	24,992,318
Intangible assets	**22**	5,666,416	4,498,568
Deferred tax asset	**23**	1,035,981	684,300
TOTAL ASSETS		**1,811,484,592**	**1,077,702,601**
LIABILITIES AND EQUITY			
Due to banks	**24**	141,706,978	55,931,724
Repurchase agreements	**25**	162,428,300	63,004,615
Due to customers	**26**	644,483,183	516,023,247
Derivative financial instruments	**16**	626,804	–
Borrowed funds	**27**	664,368,204	286,052,999
Subordinated loans	**28**	58,637,886	48,864,226
Deferred grants	**29**	1,957,277	1,576,638
Other liabilities	**30**	13,142,756	7,381,421
Income tax payable		1,928,160	1,034,996
TOTAL LIABILITIES		**1,689,279,548**	**979,869,866**
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK			
Ordinary shares	**31**	20,353,656	20,353,656
Share premium		34,989,097	34,989,097
Other reserves	**32**	10,531,368	10,531,368
Retained profits		56,330,923	31,958,614
TOTAL EQUITY		**122,205,044**	**97,832,735**
TOTAL LIABILITIES AND EQUITY		**1,811,484,592**	**1,077,702,601**

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

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2013

	Ordinary shares MNT'000	Share premium MNT'000	Other reserves MNT'000	Retained earnings MNT'000	Total equity MNT'000
January 2012	20,353,656	34,989,097	10,531,368	16,711,249	82,585,370
Total comprehensive income	-	-	-	15,247,365	15,247,365
At 31 December 2012	**20,353,656**	**34,989,097**	**10,531,368**	**31,958,614**	**97,832,735**
Total comprehensive income	-	-	-	24,372,309	24,372,309
At 31 December 2013	**20,353,656**	**34,989,097**	**10,531,368**	**56,330,923**	**122,205,044**

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

XACBANK LLC

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	2013 MNT'000	2012 MNT'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		29,892,584	20,168,666
Adjustments for:-			
Changes in fair value of held-for-trading financial instrument	**7**	(381,046)	41,371
Gain on disposal of property and equipment	**8**	(21,382)	(1,124)
Gain on disposal of intangible asset		(4,517)	-
Gain on disposal of properties held for sale		(9,819)	(40,768)
Unrealised foreign exchange gain	**8**	(3,479,465)	(246,531)
Credit loss for loans and advances to customers	**9**	9,681,496	2,415,178
Credit loss for other assets	**9**	25,144	8,607
Depreciation of property and equipment	**10**	3,710,494	2,828,492
Amortisation of intangible assets	**10**	816,248	540,616
Property and equipment written off	**10**	69	-
Impairment on loss on foreclosed properties	**10**	31,314	15,273
Amortisation of deferred grants	**29**	(1,323,934)	(1,270,175)
Operating profit before working capital changes		**38,937,186**	**24,459,605**
Changes in operating assets:-			
Statutory deposits with BoM		(24,441,404)	(23,376,094)
Due from banks		20,100,764	(104,241)
Reverse repurchase agreements		(26,493,194)	(3,498,061)
Loans and advances to customers		(357,110,494)	(97,350,765)
Properties held for sale		(4,064,367)	(564,517)
Other assets		2,578,714	(1,383,555)
Changes in operating liabilities:-			
Due to banks		81,954,306	(6,485,611)
Repurchase agreements		99,423,685	14,182,028
Due to customers		115,677,112	147,479,888
Other liabilities		4,682,119	4,481,674
Cash from/(used in) operations		**(48,755,573)**	**57,840,351**
Income tax paid		(4,978,793)	(4,822,925)
Net cash flows from/(used in) operating activities		**(53,734,366)**	**53,017,426**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of financial investments		(69,580,206)	(24,247,666)
Proceeds on disposal of property and equipment		253,190	260,224
Proceeds on disposal of intangible assets		6,600	-
Purchase of property, plant and equipment		(8,545,289)	(8,997,949)
Purchase of intangible assets		(1,986,179)	(1,100,993)
Net cash flows used in investing activities		**(79,851,884)**	**(34,086,384)**

XACBANK LLC

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2013

	Note	2013 MNT'000	2012 MNT'000
CASH FLOWS FROM FINANCING ACTIVITIES			
Drawdown of borrowed funds		501,497,800	111,103,740
Drawdown of subordinated loans		-	11,955,949
Repayment of borrowed funds		(165,082,378)	(42,511,454)
Dividends paid	**33**	-	(697,392)
Deferred grants received	**29**	1,704,573	2,136,771
Net cash flows generated from financing activities		**338,119,995**	**81,987,614**
Effect of exchange rate changes on cash and cash equivalents		19,548,729	3,959,599
Net increase in cash and cash equivalents		204,533,745	100,918,656
Cash and cash equivalents brought forward		295,889,309	191,011,054
Cash and cash equivalents carried forward	**34**	**519,971,783**	**295,889,309**
Operational cash flows from interest			
Interest paid		96,244,403	62,931,591
Interest received		177,687,958	127,376,968

The accompanying notes form an integral part of the financial statements

1. Corporate Information

The Bank is principally engaged in the business of providing banking and financial services pursuant to License No. 24 issued by the Bank of Mongolia ("BoM"). There have been no significant changes in the nature of the Bank's activities during the year.

The Bank is a limited liability company, incorporated and domiciled in Mongolia. The Bank's registered address and the principal place of business is at XacBank Building, Prime Minister Amar's Street, Sukhbaatar District, Ulaanbaatar, Mongolia.

The holding company of the Bank is TenGer Financial Group LLC which is incorporated in Mongolia. The shareholders of the holding company are:

- Mongolyn Alt (MAK) LLC
- International Finance Corporation (IFC)
- ORIX Corporation
- European Bank for Reconstruction and Development (EBRD)
- Ronoc Partners S.A.R.L.
- EIT Capital Management LLC
- Mercy Corps
- Triodos Fair Share Fund
- Open Society Forum
- UB Rotary Club
- Bold Magvan
- Ganbold Chuluun
- EIT LLC

The financial statements of the Bank were authorised for issue by the Board of Directors in accordance with a resolution of the Directors on 25 March 2014. .

2.1 Basis of preparation

The financial statements of the Bank have been prepared on a historical cost basis, except for derivative financial instruments, available-for-sale and held-for-trading financial investments which have been measured at fair value. The financial statements are presented in Mongolian Tugrug, which is denoted by the symbol MNT, and all values are rounded to the nearest thousands, except when otherwise indicated.

2.1 Basis of preparation (Contd.)

Statement of compliance

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

Presentation of financial statements

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 37.

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expense is not offset in the statement of comprehensive income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Bank.

2.2 Significant accounting judgments, estimates and assumptions

In the process of applying the Bank's accounting policies, management has exercised judgment and estimates in determining the amounts recognised in the financial statements. The most significant uses of judgment and estimates are as follows:

Going concern

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on a going concern basis.

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 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.

2.2 Significant accounting judgments, estimates and assumptions (Contd.)

Impairment losses on loans and advances

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

Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as levels of arrears, credit utilisation, loan to collateral ratios, etc.), and judgments to the effect of concentrations of risks and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups).

The impairment loss on loans and advances is recorded under 'Credit loss expense' and disclosed in more detail in Notes 9 and 18.

Impairment of available-for-sale investments

The Bank also records impairment charges on available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is 'significant' or 'prolonged' requires judgment. In making this judgment, the Bank evaluates, among other factors, historical share price movements and duration and extent to which the fair value of an investment is less than its cost.

Deferred tax assets

Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax planning strategies.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data are not available, judgment is required to establish fair values. The judgments include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities. The fair value financial instruments as well as its fair hierarchy are described in more detail in Note 35.

2.3 Changes in accounting policy and disclosures

The accounting policies adopted are consistent with those of the previous financial year except for the adoption of the following amended IFRS applicable to the Bank, which became effective on 1 January 2013.

New and amended standards and interpretations

- IFRS 1, *First-time Adoption of International Financial Reporting Standards (Amendment) – Government Loans - Amendments to IFRS 1*
- IFRS 7, *Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities – Amendments to IFRS7*
- IFRS 10, *Consolidated Financial Statements, IAS 27 Separate Financial Statements*
- IFRS 11, Joint *Arrangements, IAS 28 Investments in Associates and Joint Ventures*
- IFRS 12, *Disclosure of Interests in Other Entities*
- IFRS 13, *Fair Value Measurements*
- IAS 19, *Employee Benefits (Revised 2011)*
- IAS 27, *Separate Financial Statements (Revised 2011)*
- IAS 28, *Investments in Associates and Joint Ventures (Revised 2011)*

The adoption of the above standards and 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.

Standards issued but not yet effective

The Standards and Interpretations that are issued, but not yet effective, up to the date of issuance of the Company's financial statements are disclosed below. The Company intends to adopt these standards, if applicable, when they become effective.

- IFRS 9, *Financial Instruments*[3]
- IFRS 9, IFRS 7 and IAS 39 Amendments, *Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39*[3]
- IFRS 10, IFRS 12 and IAS 27 (2011), *Amendments to IFRS 10, IFRS 12 and IAS 27 (2011) – Investment Entities*[1]
- IAS 19 Amendments, *Amendments to IAS 19 Employee Benefits – Defined Benefit Plans: Employee Contributions*[2]
- IAS 32 Amendments, *Amendments to IAS 32 Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities*[1]
- IAS 39 Amendments, *Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting*[1]
- IFRIC 21, *Levies*[1]
- Annual Improvements, 2010-2012 Cycle and 2011-2013 Cycle, *Amendments to a number of IFRSs issued in December 2013*[4]

[1] Effective for annual periods beginning on or after 1 January 2014
[2] Effective for annual periods beginning on or after 1 July 2014
[3] No mandatory effective date yet determined but is available for adoption
[4] These improvements are effective for annual periods beginning on or after 1 July 2014, but early adoption is permitted.

2.3 Changes in Accounting Policies and Disclosures *continued*

The Bank is in the process of assessing if the adoption of these Standards and Interpretations in the future periods will have material impact on its financial statements.

2.4 Summary of significant accounting policies

Foreign currency translation

The financial statements of the Bank are presented in Mongolian Tugrug (MNT), which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded at the functional currency rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange at the statement of financial position date. All differences arising on non–trading activities are taken to 'Other operating income' in the statement of comprehensive income. 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.

Financial instruments – initial recognition and subsequent measurement

(i) Date of recognition

All financial assets and liabilities are initially recognised on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. This includes "regular way trades": purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

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

The Bank uses derivatives such as currency forwards and swaps to manage its exposure to market risks. 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 are included in 'Net trading income'.

Derivatives embedded in other financial instruments 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 the statement of comprehensive income.

2.4 Summary of significant accounting policies (Contd.)

Financial instruments – initial recognition and subsequent measurement (Contd.)

(iii) Financial assets or financial liabilities held-for-trading

Financial assets or financial liabilities held–for–trading 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 is 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 that have been acquired principally for the purpose of selling or repurchasing in the near term.

(iv) Financial assets and financial liabilities designed at fair value through profit or loss

Financial assets and financial liabilities classified in this category are those that have been designated by management on initial recognition. Management may only designate an instrument at fair value through profit or loss upon initial recognition when the following criteria are met, and designation is determined on an instrument by instrument basis:

- The designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis.

- 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.

- The financial instrument contains one or more embedded derivatives which significantly modify the cash flows that otherwise would be required by the contract.

2.4 Summary of significant accounting policies

Financial instruments – initial recognition and subsequent measurement (Contd.)

(iv) Financial assets and financial liabilities designed at fair value through profit or loss (Contd.)

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 trading gain'. Interest is earned or incurred is accrued in 'Interest and similar income' or 'Interest similar expense', respectively, using the EIR (EIR), while dividend income is recorded in 'Other operating income' when the right to the payment has been established.

The Bank has no financial assets or liabilities designated at fair value through profit or loss as of 31 December 2013 and 2012.

(v) Available-for-sale financial investments

Available-for-sale financial investments include equity and debt securities. Equity investments classified as available-for-sale financial investments are those which are neither classified as held-for-trading nor designated at fair value through profit or loss. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions.

The Bank has not designated any loans or receivables as available-for-sale financial investments. After initial measurement, available-for-sale financial investments are subsequently measured at fair value.

Unrealised gains and losses are recognised directly in equity (other comprehensive income) in the 'Available-for-sale reserve'. When the investment is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the income statement in 'Other operating income'. 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 EIR. Dividends earned whilst holding available-for-sale financial investments are recognised in the income statement 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 and removed from the 'Available-for-sale reserve'.

2.4 Summary of significant accounting policies (Contd.)

Financial instruments – initial recognition and subsequent measurement (Contd.)

(vi) Held-to-maturity financial investments

Held-to-maturity financial investments are non-derivative financial assets with fixed or determinable payments and fixed maturities, 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 EIR, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortisation is included in 'Interest and similar income' in the income statement. The losses arising from impairment of such investments are recognised in the statement of comprehensive income.

If the Bank were to sell or reclassify more than an insignificant amount of held-to-maturity investments before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as available-for-sale. Furthermore, the Bank would be prohibited from classifying any financial asset as held-to-maturity financial investments during the following two years.

(vii) Loans and advances

This includes 'Due from banks' and 'Loans and advances to customers' which are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- Those that the Bank intends to sell immediately or in the near term and those that the Bank upon initial recognition designates as at fair value through profit or loss.
- Those that the Bank, upon initial recognition, designates as available-for-sale financial investments.
- Those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration.

After initial measurement, amounts 'Due from banks' and 'Loans and advances to customers' are subsequently measured at amortised cost using the EIR, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The amortisation is included in 'Interest and similar income' in the income statement. The losses arising from impairment are recognised in the statement of comprehensive income.

2.4 Summary of significant accounting policies (Contd.)

Financial instruments – initial recognition and subsequent measurement (Contd.)

(viii) Loans and advances (Contd.)

The Bank may enter into certain lending commitments where the loan, on drawdown, is expected to be classified as held-for-trading because the intent is to sell the loans in the short term. These commitments to lend are recorded as derivatives and measured at fair value through profit or loss.

Where the loan, on drawdown, is expected to be retained by the Bank, and not sold in the short term, the commitment is recorded only when the commitment is an onerous contract and it is likely to give rise to a loss (for example, due to a counterparty credit event).

(ix) Borrowed funds and subordinated loans

Borrowed funds and subordinated loans are contractual obligations to local and foreign financial institutions.

After initial measurement, borrowed funds and subordinated loans are subsequently measured at amortised cost using the EIR. The amortised cost of borrowed funds and subordinated loans is calculated using EIR by taking into account any transaction costs related to the transaction.

An analysis of the Bank's borrowed funds and subordinated loans is disclosed in Note 27 and Note 28, respectively.

(x) Due to banks

This includes deposits from other banks and financial institutions in foreign currency and local currency accounts and time deposits placed by local and foreign commercial banks and BoM (Note 23).

After initial measurement, borrowings are subsequently measured at amortised cost using the EIR.

(xi) Due to customers

This includes current, savings and time deposits from customers (Note 26).

After initial measurement, due to customers are subsequently measured at amortised cost using the EIR.

2.4 Summary of significant accounting policies (Contd.)

Financial instruments – initial recognition and subsequent measurement (Contd.)

(xii) Reclassification of financial assets

For a financial asset reclassified out of the 'Available-for-sale financial investments' category, any previous gain or loss on that asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the EIR. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the EIR. If the asset is subsequently determined to be impaired then the amount recorded in equity is recycled to the statement of comprehensive income.

The Bank may reclassify a non-derivative trading asset out of the 'Held-for-trading' category and into the ‘Loans and receivables’ if it meets the definition of loans and receivables and the Bank has the intention and ability to hold the financial asset for the foreseeable future or until maturity. If a financial asset is reclassified, and if the Bank subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the EIR from the date of the change in estimate.

Reclassification is at the election of management, and is determined on an instrument by instrument basis. The Bank does not reclassify any financial instrument into the fair value through profit or loss category after initial recognition.

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 when:

- The rights to receive cash flows from the asset have expired.
- 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:
  - the Bank has transferred substantially all the risks and rewards of the asset, or
  - the Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

2.4 Summary of significant accounting policies (Contd.)

Financial instruments – initial recognition and subsequent measurement (Contd.)

Derecognition of financial assets and financial liabilities

(i) Financial assets (Contd.)

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. In that case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

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.

The Bank derecognized certain mortgage loans in 2013 (Note 18).

(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 original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in statement of comprehensive income.

2.4 Summary of significant accounting policies (Contd.)

Derecognition of financial assets and financial liabilities (Contd.)

Repurchase and reverse repurchase agreements

Securities sold under agreements to repurchase at a specified future date are not derecognised from the statement of financial position as the Bank retains substantially all the risks and rewards of ownership. The corresponding cash received is recognised in the statement of financial position as an asset with a corresponding obligation to return it, including accrued interest as a liability within 'repurchase agreements', reflecting the transaction's 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 agreement using the EIR.

Conversely, securities purchased under agreements to resell at a specified future date are not recognised in the statement of financial position. The consideration paid, including accrued interest, is recorded in the statement of financial position, within 'Reverse repurchase agreements', reflecting the transaction's economic substance as a loan by the Bank. The difference between the purchase and resale prices is recorded in 'Interest and similar income' and is accrued over the life of the agreement using the EIR.

If securities purchased under agreement to resell are subsequently sold to third parties, the obligation to return the securities is recorded as a short sale within 'Financial liabilities held-for-trading' and measured at fair value with any gains or losses included in 'Net trading income'.

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 traded in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include the discounted cash flow method, comparison to similar instruments for which market observable prices exist, options pricing models, credit models and other relevant valuation models.

2.4 Summary of significant accounting policies (Contd.)

Determination of fair value (Contd.)

Certain financial instruments are recorded at fair value using valuation techniques in which current market transactions or observable market data are not available. Their fair value is determined using a valuation model that has been tested against prices or inputs to actual market transactions and using the Bank's best estimate of the most appropriate model assumptions. Models are adjusted to reflect the spread for bid and ask prices to reflect costs to close out positions, credit and debit valuation adjustments, liquidity spread and limitations in the models. Also, profit or loss calculated when such financial instruments are first recorded ('Day 1' profit or loss) is deferred and recognised only when the inputs become observable or on derecognition of the instrument.

An analysis of fair values of financial instruments and further details as to how they are measured are provided in Note 35.

Impairment of financial assets

The Bank assesses at each statement of financial position 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, the probability that they will enter bankruptcy or other financial reorganisation, default or delinquency in interest or principal payments and where observable data indicates 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) Financial assets carried at amortised cost

For financial assets carried at amortised cost (such as amounts due from banks, loans and advances to customers as well as held-to-maturity investments), the Bank first assesses individually whether objective evidence of impairment exists 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, 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.

2.4 Summary of significant accounting policies (Contd.)

(i) Financial assets carried at amortised cost (Contd.)

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 comprehensive income. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of 'Interest and similar income'. 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. If a future write-off is later recovered, the recovery is credited to the 'Credit loss expense'.

The present value of the estimated future cash flows is discounted at the financial asset's original EIR. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR. If the Bank has reclassified trading assets to loans and advances, the discount rate for measuring any impairment loss is the new EIR determined at the reclassification date. 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.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system, that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

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.

2.4 Summary of significant accounting policies (Contd.)

(i) Financial assets carried at amortised cost (Contd.)

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) 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 is impaired.

In the case of debt instruments classified as available-for-sale, the Bank assesses individually whether there is objective evidence of impairment based on the same criteria as financial assets carried at amortised cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that investment previously recognised in the statement of comprehensive income. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of 'Interest and similar income'. If, in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to a credit 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.

In the case of equity investments classified as available-for-sale, objective evidence would also 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 income statement; increases in the fair value after impairment are recognised in other comprehensive income.

2.4 Summary of significant accounting policies (Contd.)

(iii) 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 any impairment is measured using the original EIR as calculated before the modification of terms and the loan is no longer considered past due. Management continually 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 EIR.

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, therefore, the related assets and liabilities are presented gross in statement of financial position.

'Day 1' profit or loss

When the transaction price differs from the fair value of 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 difference between the transaction price and fair value (a Day 1 profit or loss) in 'Other operating income-net'. In cases where fair value is determined using data which is not observable, the difference between the transaction price and model value is only recognised in the statement of comprehensive when the inputs become observable, or when the instrument is derecognised.

2.4 Summary of significant accounting policies (Contd.)

Leasing

The determination of whether an arrangement is a lease, or it contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Bank as a lessee

Leases which do not transfer to the Bank substantially all the risks and benefits incidental to ownership of the leased items are operating leases. Operating lease payments are recognised as an expense in the statement of comprehensive income on a straight line basis over the lease term.

Bank as a lessor

Leases where the Bank does not transfer substantially all the risk and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income.

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

(i) Interest and similar income and expense

For all financial instruments measured at amortised cost, interest bearing financial assets classified as available-for-sale and financial instruments designated at fair value through profit or loss, interest income or expense is recorded using the EIR, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability.

2.4 Summary of significant accounting policies (Contd.)

Recognition of income and expenses (Contd.)

(i) Interest and similar income and expense (Contd.)

The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses.

The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original EIR and the change in carrying amount is recorded as 'Other operating income'. However, for a reclassified financial asset for which the Bank subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the EIR from the date of the change in estimate.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(ii) Fee and commission income

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

Fee income earned from services that are provided over a certain period of time

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees.

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 EIR on the loan (ie. as interest income recorded under “Interest and similar income’). When it is unlikely that a loan will be drawn down, the loan commitment fees are recognised over the commitment period on a straight line basis.

2.4 Summary of significant accounting policies (Contd.)

Recognition of income and expenses (Contd.)

(ii) Fee and commission income (Contd.)

Fee income from providing transaction services

Fees arising from negotiating or participating in the negotiation of a transaction for a third party, such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses, are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

(iii) Net trading income

Results arising from trading activities include all gains and losses from changes in fair value and related interest income or expense and dividends for financial assets and financial liabilities 'held-for-trading'.

Cash and cash equivalents

Cash and cash equivalents as referred to in the cash flow statement comprises cash on hand, non-restricted current accounts with BoM and amounts due from banks on demand or with an original maturity of three months or less.

Property and equipment

All items of property 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 statement of comprehensive income during the financial period in which they are incurred.

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

2.4 Summary of significant accounting policies (Contd.)

Property and equipment (Contd.)

Depreciation of other property 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
Office furniture	10 years
Computers equipment	5 years
Vehicles	10 years
Leasehold improvements	Lower of lease term or useful lives

The residual values, useful life and depreciation method are reviewed at each financial year-end to ensure that the amount, method and period of depreciation are consistent with previous estimates and the expected pattern of consumption of the future economic benefits embodied in the items of property and equipment.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. The difference between the net disposal proceeds, if any and the net carrying amount is recognised in statement of comprehensive income.

Intangible assets

The Bank's other intangible assets include the value of computer software and licenses, software under development and patents and rights.

An intangible asset is recognised only when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to it will flow to the Bank.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates.

2.4 Summary of significant accounting policies (Contd.)

Intangible assets (Contd.)

The amortisation expense on intangible assets with finite lives is recognised in the statement of comprehensive income in the expense category consistent with the function of the intangible asset.

Amortisation is calculated using the straight–line method to write down the cost of intangible assets to their residual values over their estimated useful lives as follows:

Computer software (core banking software)	2-10 years
Patents and rights	3 years

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 indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset’s recoverable amount. An asset’s recoverable amount is the higher of an asset’s or cash–generating unit’s (CGU) fair value less costs to sell and its value in use. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. 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. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded subsidiaries or other available fair value indicators.

For assets excluding goodwill, 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 Bank estimates the asset's or CGU's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceeds the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the statement of comprehensive income.

2.4 Summary of significant accounting policies (Contd.)

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 (within 'Other liabilities') at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less, when appropriate, cumulative amortisation recognised in the statement of comprehensive income, 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 recorded in the statement of comprehensive income. The premium received is recognised in the statement of comprehensive income in 'Fees and commission income' on a straight line basis over the life of the guarantee.

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. The Bank also contributes to a defined contribution pension plan. The contribution paid is recorded as an expense under "Pension fund expense" in proportion to the services rendered by the employees to the Bank.

Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expense relating to any provision is presented in the statement of comprehensive income net of any reimbursement.

2.4 Summary of significant accounting policies (Contd.)

Taxes

(i) Current tax

Current tax assets and liabilities for the current and prior years are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the statement of financial position date.

(ii) Deferred tax

Deferred tax is provided on temporary differences at the statement of financial position date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognised for all taxable temporary differences, except:

- ► Where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised except:

- ► Where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

- ► In respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each statement of financial position date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

2.4 Summary of significant accounting policies (Contd.)

Taxes (Contd.)

(ii) Deferred tax (Contd.)

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the statement of financial position date.

Current tax and deferred tax relating to items recognised directly in equity are also recognised in equity and not in the statement of comprehensive income.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

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 shareholders. 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 statement of financial position date.

Equity reserves

The reserves recorded in equity on the Bank's statement of financial position include:

'Other reserves' represents appropriations of retained earnings based on the decision of the Bank’s Board of Directors. The purpose of this account is not specified at present. ‘Other reserves’ are used for financing the Bank’s operations and cannot be used for payment of dividends.

Government grants

Government grants are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. When the grant relates to an asset, it is recognised as deferred income and released to income in equal amounts over the expected useful life of the related asset.

2.4 Summary of significant accounting policies (Contd.)

Government grants (Contd.)

When the Bank receives non-monetary grants, the asset and the grant are recorded gross at nominal amounts and released to the statement of comprehensive over the expected useful life and pattern of consumption of the benefit of the underlying asset by equal annual installments. When loans or similar assistance are provided by governments or related institutions with an interest rate below the current applicable market rate, the effect of this favourable interest is regarded as additional government grants.

Precious metals

Coins and cultural valuables are stated at the lower of cost and net realisable value.

Repossessed assets

The Bank's policy is to determine whether a repossessed asset is best used for its internal operations or should be sold. Assets determined to be useful for the internal operations are transferred to their relevant asset category. Assets that are determined better to be sold are immediately transferred to 'Properties held for sale'. Repossessed assets where the Bank is yet to determine its use are retained under this account.

Repossessed assets are initially recognised at the lower of their fair values less costs to sell and the amortised cost of the related outstanding loans on the date of the repossession, and the related loans and advances together with the related impairment allowances are derecognised from the balance sheet. Subsequently, repossessed assets are measured at the lower of their cost and fair value less costs to sell and are included in 'Other assets'.

Properties held for sale

Properties held for sale are measured at the lower of their carrying amount and fair value less costs to sell. Repossessed assets are classified as properties held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition, management has committed to the sale, and the sale is expected to have been completed within one year from the date of classification.

Segment reporting

The Bank's segment reporting is based on the following operating segments: retail banking, business banking, mortgage banking and treasury.

2.4 Summary of significant accounting policies (Contd.)

Earnings per share

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

Diluted earnings per share is calculated by dividing the net profit attributable to ordinary equity holders of the Bank (after adjusting for interest on the convertible preference shares and interest on the convertible bond, in each case net of tax, if any) by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

Transactions with related parties

For the purposes of these financial statements, a party is considered to be related to the Bank if:

- the party has the ability, directly or indirectly through one or more intermediaries, to control the Bank or exercise significant influence over the Bank in making financial and operating policy decisions, or has joint control over the Bank;
- the Bank and the party are subject to common control;
- the party is a member of key management personnel of the Bank or the Bank's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- the party is a post-employment benefit plan which is for the benefit of employees of the Bank or of any entity that is a related party of the Bank.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

All material transactions and balances with the related parties are disclosed in the relevant notes to consolidated financial statements and the detail is presented in Note 38.

3. SEGMENT INFORMATION

For management purposes, the Bank is organised into four operating segments based on products and services as follows:

Retail banking	-	Individual customers' current accounts, savings, credit and debit cards, micro business loans, consumer loans, financial leasing, eco loans, as well as payment and remittances.
Business banking	-	Commercial banking activities for SME and corporate customers provides direct debit facilities, current accounts, deposits, overdrafts, loan, trade finance and other credit facilities as well as international remittances.
Mortgage banking	-	Mortgages for purchasing residential real estate, mortgages for purchasing commercial properties and housing deposit products.
Treasury	-	Cash management and BoM securities and interbank loan and deposit, financial instruments trading.

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 is measured differently from operating profit or loss in the financial statements. Income taxes are managed on a Bank-wide basis and are not allocated to operating segments.

Interest income is reported net as management primarily relies on net interest revenue as a performance measure, not the gross income and expense.

Transfer prices between operating segments are on an arm's length basis in a manner similar to transactions with third parties.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Bank's total revenue in 2013 or 2012.

3. SEGMENT INFORMATION (CONTD.)

The following table presents income and profit and certain asset and liability information regarding the Bank's operating segments 2013.

	Retail Banking 2013 MNT'000	Business Banking 2013 MNT'000	Mortgage Banking 2013 MNT'000	Treasury 2013 MNT'000	Unallocated 2013 MNT'000	Total 2013 MNT'000
Income						
Third party	27,190,350	57,731,724	17,970,325	(11,081,601)	607,219	92,418,017
Inter–segment	12,934,108	(18,032,086)	(5,855,172)	10,953,150	-	-
Total operating income	**40,124,458**	**39,699,638**	**12,115,153**	**(128,451)**	**607,219**	92,418,017
Credit loss expense	(876,143)	(8,667,401)	(137,952)	-	(25,144)	(9,706,640)
Net operating income	**39,248,315**	**31,032,237**	**11,977,201**	**(128,451)**	**582,075**	**82,711,377**
Results						
Net interest income (expense)	25,014,927	54,870,776	17,933,760	(17,129,360)	-	80,690,103
Net fees and commission income	2,127,841	2,852,849	36,567	-	-	5,017,257
Net trading loss	-	-	-	(2,277,076)	-	(2,277,076)
Depreciation of property and equipment	(368,636)	(130,848)	-	(3,913)	(3,207,097)	(3,710,494)
Amortisation of intangible asset	-	-	-	-	(816,248)	(816,248)
Segment profit (loss)	**34,362,176**	**29,445,687**	**11,977,201**	**(199,226)**	**(45,693,254)**	**29,892,584**
Income tax expense	-	-	-	-	(5,520,275)	(5,520,275)
Profit for the year	**34,362,176**	**29,445,687**	**11,977,201**	**(199,226)**	**(51,213,529)**	**24,372,309**
Assets						
Capital expenditures						
Property and equipment	-	-	-	-	8,545,288	8,545,288
Other intangible assets	-	-	-	-	1,986,179	1,986,179
	-	-	-	-	**10,531,467**	**10,531,467**

3. SEGMENT INFORMATION (CONTD.)

	Retail Banking 2013 MNT'000	Business Banking 2013 MNT'000	Mortgage Banking 2013 MNT'000	Treasury 2013 MNT'000	Unallocated 2013 MNT'000	Total 2013 MNT'000
Total assets	**338,228,619**	**530,366,530**	**160,946,144**	**458,484,858**	**323,458,441**	**1,811,484,592**
Total liabilities	**484,833,999**	**230,444,262**	**136,983,091**	**819,990,003**	**17,028,193**	**1,689,279,548**

The following table presents income and profit and certain asset and liability information regarding the Bank's operating segments in 2012.

	Retail Banking 2012 MNT'000	Business Banking 2012 MNT'000	Mortgage Banking 2012 MNT'000	Treasury 2012 MNT'000	Unallocated 2012 MNT'000	Total 2012 MNT'000
Income						
Third party	18,193,680	36,103,105	17,384,013	(6,533,213)	282,937	65,430,522
Inter–segment	5,228,859	(5,453,491)	(8,984,545)	9,209,177	-	-
Total operating income	**23,422,539**	**30,649,614**	**8,399,468**	**2,675,964**	**282,937**	**65,430,522**
Credit loss expense	4,506	(2,463,802)	44,118	-	(8,607)	(2,423,785)
Net operating income	**23,427,045**	**28,185,812**	**8,443,586**	**2,675,964**	**274,330**	**63,006,737**
Results						
Net interest income (expense)	17,757,147	33,912,834	17,356,653	(9,001,941)	-	60,024,693
Net fees and commission income	436,533	2,190,271	27,360	-	-	2,654,164
Net trading loss	-	-	-	(41,371)	-	(41,371)
Depreciation of property and equipment	(147,885)	(138,295)	(3,624)	(4,059)	(2,534,629)	(2,828,492)
Amortisation of intangible asset	-	-	-	-	(540,616)	(540,616)

3. SEGMENT INFORMATION (CONTD.)

	Retail Banking 2012 MNT'000	Business Banking 2012 MNT'000	Mortgage Banking 2012 MNT'000	Treasury 2012 MNT'000	Unallocated 2012 MNT'000	Total 2012 MNT'000
Segment profit (loss)	**19,003,619**	**26,957,717**	**8,416,063**	**2,278,497**	**(36,487,230)**	**20,168,666**
Income tax expense					(4,921,301)	(4,921,301)
Profit for the year	**19,003,619**	**26,957,717**	**8,416,063**	**2,278,497**	**(41,408,531)**	**15,247,365**
Assets						
Capital expenditures						
Property and equipment	-	-	-	-	8,997,949	8,997,949
Other intangible assets	-	-	-	-	1,100,993	1,100,993
Total assets	**247,904,515**	**280,495,656**	**102,519,006**	**151,162,125**	**295,621,299**	**1,077,702,601**
Total liabilities	**378,155,672**	**135,894,210**	**1,973,365**	**453,853,564**	**9,993,055**	**979,869,866**

3. SEGMENT INFORMATION (CONTD.)

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

	2013 MNT'000	2012 MNT'000
Total segment profit before tax	75,585,838	56,655,896
Corporate personnel cost	(24,381,517)	(18,599,487)
Corporate administrative cost	(21,893,811)	(18,245,171)
Other operating income	607,218	282,937
Amortisation of deferred grant	-	83,098
Impairment loss on loan and other assets	(25,144)	(8,607)
	29,892,584	**20,168,666**

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

	2013 MNT'000	2012 MNT'000
Total segment assets	1,488,026,151	782,081,302
Cash and balances with BoM	238,614,870	174,463,368
Due from banks	39,146,611	83,667,825
Other assets	4,293,565	6,283,343
Properties held for sale	5,105,763	1,031,577
Property and equipment	29,595,235	24,992,318
Intangible assets	5,666,416	4,498,568
Deferred tax asset	1,035,981	684,300
Total assets as per statement of financial position	**1,811,484,592**	**1,077,702,601**

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

	2013 MNT'000	2012 MNT'000
Total segment liabilities	1,672,251,355	969,876,811
Deferred grants	1,957,277	1,576,638
Other liabilities	13,142,756	7,381,421
Income tax payable	1,928,160	1,034,996
	1,689,279,548	**979,869,866**

4. INTEREST AND SIMILAR INCOME

	2013 MNT'000	2012 MNT'000
Loans and advances to customers	157,344,867	113,769,673
Financial investments – held-to-maturity	21,627,677	12,188,226
Due from banks	1,181,734	1,758,265
Reverse repurchase agreements	74,836	280,828
Cash and balances with BoM	793,233	–
	181,022,347	**127,996,992**

5. INTEREST AND SIMILAR EXPENSE

	2013 MNT'000	2012 MNT'000
Due to customers	55,071,947	44,743,038
Borrowed funds	27,279,114	14,738,663
Due to banks	13,251,667	4,721,113
Subordinated loans	4,372,635	2,839,897
Repurchase agreements	356,881	929,588
	100,332,244	**67,972,299**

6. NET FEES AND COMMISSION INCOME

	2013 MNT'000	2012 MNT'000
Fees and commission income		
Remittance and other service fees	3,285,223	2,509,303
Card related fees and commissions	1,520,475	272,250
Account service fees and commissions	727,600	281,728
Credit related fees and commissions	266,328	186,693
	5,799,626	**3,249,974**
Fees and commission expenses		
Bank service charges	449,359	299,138
Card transaction charges	333,010	296,672
	782,369	**595,810**
	5,017,257	**2,654,164**

7. NET TRADING INCOME

	2013 MNT'000	2012 MNT'000
Foreign exchange	2,187,248	2,263,568
Equities	(10,463)	(41,371)
Debt securities	391,509	-
	2,568,294	**2,222,197**

Foreign exchange income includes gains and losses from spot and forward contracts and other currency derivatives.

"Equities" gain/(loss) includes the results of trading, and changes in the fair value of equity securities.

Debt securities income includes the results of buying and selling and changes in the fair value of debt securities.

8. OTHER OPERATING INCOME – NET

	2013 MNT'000	2012 MNT'000
Non-trade foreign exchange gain	3,479,466	246,531
Rental income	138,669	104,521
Gain on disposal of property and equipment	21,382	1,124
Gain on disposal of property held for sale (Note 20)	9,819	40,768
Others	493,027	136,524
	4,142,363	**529,468**

9. CREDIT LOSS EXPENSE

	2013 MNT'000	2012 MNT'000
Loans and advances to customers (Note 18)		
Small and medium enterprises (SME) loans	8,676,065	2,472,557
Mortgage loans	153,017	(26,700)
Micro business loans	388,995	(66,257)
Consumer loans	559,541	125,690
Finance leases	(102,199)	(65,068)
Others	6,077	(25,044)
	9,681,496	**2,415,178**
Other assets (Note 19)	25,144	8,607
	9,706,640	**2,423,785**

10. OPERATING EXPENSES

	2013 MNT'000	2012 MNT'000
Personnel expenses*	24,381,517	18,599,487
Professional fees	6,186,215	7,615,457
Depreciation of property and equipment (Note 21)	3,710,494	2,828,492
Advertising	3,465,908	3,424,147
Rental of premises	3,273,717	2,719,964
Deposit insurance expense	1,910,682	-
Armored guard and security	1,859,445	1,644,599
Communications	1,308,366	1,085,521
Entertainment	1,261,069	921,352
Other operating expenses	1,932,759	980,591
Amortisation of intangible assets (Note 22)	816,248	540,616
Transportation	786,954	831,244
Travelling expenses	714,995	743,408
Stationery	695,697	592,884
Utilities	536,313	501,198
Repairs and maintenance	427,234	323,326
Membership and audit expenses	352,207	168,958
Insurance	259,566	205,289
Donations	123,494	290,876
Penalty	59,105	75,359
Loan collection expenses	49,359	30,751
Impairment loss on/(recovery) of foreclosed properties (Note 19)	31,314	(15,273)
Property and equipment written-off (Note 21)	69	-
	54,142,727	**44,108,246**

*** Personnel expenses**		
Salaries, wages and bonus	21,460,158	16,296,061
Contribution to social and health fund	2,170,986	1,742,969
Amortisation of contribution to defined contribution pension plan	665,024	450,013
Staff training	85,349	110,444
	24,381,517	**18,599,487**

11. INCOME TAX EXPENSES

The components of income tax expense for the years ended 31 December 2013 and 2012 are:

	2013 MNT'000	2012 MNT'000
Current tax:		
Current income tax	5,871,956	5,804,030
Deferred tax		
Relating to origination and reversal of temporary differences	(351,681)	(882,729)
	5,520,275	**4,921,301**

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% (2012: 10%) for the first MNT3 billion (2012: MNT 3 billion) of taxable income, and 25% (2012: 25%) on the excess of taxable income over MNT 3 billion (2012: MNT 3 billion). Interest income on government bonds is not subject to income tax. Impairment losses for loans and advances are deductible for income tax purposes.

A reconciliation of income tax expense applicable to profit before tax at the statutory income tax rate to income tax expense at the effective income tax rate of the Bank for the years ended 31 December is as follows:

	2013 MNT'000	2012 MNT'000
Profit before taxation	29,892,584	20,168,666
Tax at statutory tax rate of 25% (2012: 25%)	7,473,146	5,042,167
Effect of income tax subject to lower tax rate	(450,000)	(450,000)
Effect of income not subject to tax	(1,575,068)	(51,607)
Effect of expenses not deductable for tax purposes	72,197	380,741
Tax expense for the year	**5,520,275**	**4,921,301**

The effective income tax rate for 2013 is 18.47.% (2012: 24.40%)

12. EARNINGS PER SHARE

The following table shows the income and share data used in the basic and diluted earnings per share calculations:

	2013 MNT'000	2012 MNT'000
Profit for the year and total comprehensive income for the year (net of tax) attributable to equity holder of the Bank	24,372,309	15,247,365

	2013	2012
Weighted average number of ordinary shares for basic and diluted earnings per share	20,353,656	20,353,656

Earnings per share

	2013 MNT	2012 MNT
Equity holder of the Bank for the year:		
Basic earnings per share	1,197.44	749.12
Diluted earnings per share	1,197.44	749.12

There have been no transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of the completion of these financial statements which would require the restatement of earnings per share.

13. CASH AND BALANCES WITH BANK OF MONGOLIA

	2013 MNT'000	2012 MNT'000
Current account with BoM	202,049,732	135,272,695
Cash on hand	36,565,138	39,190,673
	238,614,870	**174,463,368**

Current accounts with BoM, are maintained in accordance with BoM's regulations. The balances maintained with BoM are determined at not less than 12.0% (2012: 12.0 %) of customer deposits based on average balance of two (2) weeks. As at 31 December 2013, the average reserve required by BoM for that period of 2 weeks was MNT 71,715.80 million (2012: MNT 46,886.75 million) for local currency and MNT 17,768.70 million (2012: MNT 18,156.35 million) for foreign currency maintained on current accounts with BoM.

14. DUE FROM BANKS

	2013 MNT'000	2012 MNT'000
Placements with other banks and financial institutions	**121,851,611**	**142,638,165**

Due from banks represent local and foreign currency current accounts and deposits maintained with foreign and local financial institutions.

15. REVERSE REPURCHASE AGREEMENTS

	2013 MNT'000	2012 MNT'000
Reverse repurchase agreements	**29,991,255**	**3,498,061**

The Bank purchased BoM securities with agreement to sell them at specific future date. The duration of the reverse repurchase agreement was 2 days. The fair value of the bills approximates its carrying amount as at 31 December 2013 and 2012.

16. DERIVATIVE FINANCIAL INSTRUMENTS

The table below shows the fair value of derivative financial instruments recorded as assets or liabilities together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are indicative of neither the market risk nor the credit risk.

	Assets 2013 MNT'000	Liabilities 2013 MNT'000	Notional amount 2013 MNT'000
Derivatives held for trading			
Currency forwards	596,833	626,804	1,140,957
Currency swaps	40,002	-	1,151,945
	636,835	**626,804**	**2,292,902**

At their inception, derivatives often involve only a mutual exchange of promises with little or no transfer of consideration. However, these instruments frequently involve a high degree of leverage and are very volatile. A relatively small movement in the value of the asset, rate or index underlying a derivative contract may have a significant impact on the profit or loss of the Bank.

16. DERIVATIVE FINANCIAL INSTRUMENTS (CONTD.)

The Bank's exposure under derivative contracts is closely monitored as part of the overall management of its market risk (see also Note 39.4).

Forward contracts

Forward contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customized contracts transacted in the over-the-counter market.

Swaps

Swaps are contractual agreements between two parties to exchange streams of payments over time based on specified notional amounts, in relation to movements in a specified underlying index such as an interest rate, foreign currency rate or equity index.

In a currency swap, the Bank pays a specified amount in one currency and receives a specified amount in another currency. Currency swaps are mostly gross-settled.

Fair values

Disclosures concerning the fair value of derivatives are provided in Note 35.

17. FINANCIAL INVESTMENTS

	2013 MNT'000	2012 MNT'000
Held-for-trading:		
Quoted equity, at fair value	**-**	**79,742**
Available-for-sale:		
Fixed income investments		
Senior residential mortgage backed securities ("RMBS"), at fair value	13,250,686	-
Junior RMBS, at fair value	1,474,508	-
	14,725,194	**-**
Equity investments		
Unquoted equities, at cost	**775,500**	**478,492**
	15,500,694	**478,492**
Held-to-maturity:		
BoM treasury bills, at amortised cost	224,745,335	88,135,490
Government treasury bills, at amortised cost	89,661,748	-
Government bonds, at amortised cost	15,175,733	-
	329,582,816	**88,135,490**

Quoted equity represents investment in equity quoted on the Hong Kong Stock Exchange.

The Senior and Junior "RMBS" are interest bearing long term securities issued by Mongolian Mortgage Corporation (See Note 18).

Unquoted equities represent investment made in unquoted companies. Investments in unquoted shares are recorded at cost as the fair value cannot be measured reliably. 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.

BoM treasury bills ("BoM bills") and Government treasury bills are interest bearing short-term bills issued at a discount.

The Government bonds are interest bearing long term bills issued at discount.

18. LOANS AND ADVANCES TO CUSTOMERS

	2013 MNT'000	2012 MNT'000
SME loans	541,851,743	293,511,086
Mortgage loans	180,158,347	112,348,667
Micro business loans	150,561,456	100,501,700
Consumer loans	100,956,245	80,162,045
Finance leases	22,992,426	19,469,689
Others	40,221,477	26,576,758
	1,036,741,694	**632,569,945**
Accrued interest receivables	11,268,515	7,277,473
Gross loans and advances	1,048,010,209	639,847,418
Less: Allowance for impairment losses	(18,468,915)	(8,928,241)
Net loans and advances	**1,029,541,294**	**630,919,177**

Transferred financial assets that are not derecognised in their entirety

In January, April and June of 2012, the Bank sold the rights to 100% of the cash flows arising on a portfolio of fixed rate mortgage loans to Mongolian Mortgage Corporation LLC ("MIK") but provided guarantees of the performance of the loans. The Bank has determined that substantially all the risks and rewards of the portfolio were retained and, consequently, the loans were not derecognised. The Bank accounted for the transaction as a collateralised borrowing and recorded the cash received as financial liability. The Bank continues to service these loans and earns 0.5% commission fee from MIK. The carrying amount of the transferred loan portfolio as at 31 December 2012 was MNT 2,298 million and that of the liability was MNT 2,298 million. On 17 July 2013, the Bank purchased back the loan portfolio at carrying amount.

Transferred financial assets that are derecognised in their entirety

On 20 December 2013, the Bank sold the rights to 100% of the cash flows arising on a portfolio of fixed rate mortgage loans to a wholly owned special purpose company of MIK in exchange for RMBS. The Bank derecognized the loan portfolio and recognized the Senior RMBS and Junior RMBS received as financial assets. The Bank continues to service these loans and earns 2.5% servicer fee from MIK. The carrying amount of the transferred loan portfolio as of the transferred date was MNT 14,725 million. The Senior and Junior RMBS recognized as financial assets amounted to MNT 13,251 million and MNT 1,474 million respectively (See Note 17). The Senior RMBS is intended to be used to pay down the soft loans owed to BoM (See Note 27).

18. LOANS AND ADVANCES TO CUSTOMERS (CONTD.)

Impairment allowance for loans and advances to customers

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

	SME MNT'000	Mortgage MNT'000	Micro Business MNT'000	Consumer MNT'000	Finance Lease MNT'000	Others MNT'000	Total MNT'000
At 31 December 2013							
At 1 January 2013	7,165,521	501,501	466,697	384,665	337,110	72,747	8,928,241
Charge for the year (Note 9)	12,716,496	486,221	598,110	674,616	71,843	29,676	14,576,962
Recoveries (Note 9)	(4,040,431)	(333,204)	(209,115)	(115,075)	(174,042)	(23,599)	(4,895,466)
Amounts written off	-	(3,113)	(42,905)	(64,141)	(30,663)	-	(140,822)
At 31 December 2013	**15,841,586**	**651,405**	**812,787**	**880,065**	**204,248**	**78,824**	**18,468,915**
Individual impairment	10,967,927	-	-	-	1,011	-	10,968,938
Collective impairment	4,873,659	651,405	812,787	880,065	203,237	78,824	7,499,977
	15,841,586	**651,405**	**812,787**	**880,065**	**204,248**	**78,824**	**18,468,915**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**17,090,777**	**-**	**-**	**-**	**18,350**	**-**	**17,109,127**

18. LOANS AND ADVANCES TO CUSTOMERS (CONTD.)

Impairment allowance for loans and advances to customers (contd.)

A reconciliation of the allowance for impairment losses for loans and advances to customers by type is as follows (contd.) :

	SME MNT'000	Mortgage MNT'000	Micro Business MNT'000	Consumer MNT'000	Finance Lease MNT'000	Others MNT'000	Total MNT'000
At 31 December 2012							
At 1 January 2012	4,701,003	541,758	580,484	302,682	424,217	104,821	6,654,965
Charge for the year (Note 9)	5,680,919	417,349	235,043	295,830	163,045	50,052	6,842,238
Recoveries (Note 9)	(3,208,362)	(444,049)	(301,300)	(170,140)	(228,113)	(75,096)	(4,427,060)
Amounts written off	(8,039)	(13,557)	(47,530)	(43,707)	(22,039)	(7,030)	(141,902)
At 31 December 2012	**7,165,521**	**501,501**	**466,697**	**384,665**	**337,110**	**72,747**	**8,928,241**
Individual impairment	3,211,584	-	-	-	108	-	3,211,692
Collective impairment	3,953,937	501,501	466,697	384,665	337,002	72,747	5,716,549
	7,165,521	**501,501**	**466,697**	**384,665**	**337,110**	**72,747**	**8,928,241**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**11,505,376**	**-**	**-**	**-**	**46,024**	**-**	**11,551,400**

18. LOANS AND ADVANCES TO CUSTOMERS (CONTD.)

The fair value of the collateral that the Bank holds relating to loans individually determined to be impaired at 31 December 2013 amounts to MNT 11,742 million (2012: MNT 19,012 million). These values are estimated by management based on the latest available information. For a more detailed description, see 'Collateral and other credit enhancement' under Note 39.

The Bank participated in a syndicated loan with foreign financial institution in 2013. This loan is included as part of SME loans. The Bank is the lead arranger of the transaction with a syndication participation of 50%.

19. OTHER ASSETS

	2013 MNT'000	2012 MNT'000
Other assets	1,224,494	972,556
Less: Allowance for impairment losses	(49,484)	(33,544)
	1,175,010	**939,012**
Foreclosed properties	328,143	55,884
Less: Allowances for impairment losses	(87,198)	(55,884)
	240,945	**-**
Consumables and other office supplies	1,249,561	1,310,943
Prepaid expenses	1,450,274	3,195,881
Prepayment for defined contribution pension plan	-	531,730
Deposits	152,904	212,649
Precious metals	93,128	93,128
	2,945,867	**5,344,331**
	4,361,822	**6,283,343**
Impairment allowance for other assets		
At 1st January	33,544	30,129
Charge for the year (Note 9)	25,144	8,607
Written off	(9,204)	(5,192)
At 31st December	**49,484**	**33,544**
Impairment allowance for foreclosed properties		
At 1st January	55,884	98,072
Charge for the year (Note 10)	56,035	83,950
Recoveries (Note 10)	(24,721)	(99,223)
Written off	-	(26,915)
At 31st December	**87,198**	**55,884**

20. PROPERTIES HELD FOR SALE

The Bank has sold or is in the process of selling certain properties and repossessed assets with details as follows:

	2013 MNT'000	2012 MNT'000
As at 1 January	1,031,577	613,855
Add: Foreclosed properties classified as held for sale	4,197,351	605,285
Less: Sold during the year	(123,165)	(187,563)
As at 31 December	**5,105,763**	**1,031,577**

Proceeds from the sale of buildings during the year were MNT 133 million (2012: MNT 228.3 million). The gain from the sale of those buildings amounted to MNT 9.8 million (2012: MNT 40.7 million) and is recorded as part of 'Other operating income' (see Note 8).

21. PROPERTY AND EQUIPMENT

	Leasehold improvements	Premises	Vehicles	Office furniture	Computer equipment and others	Land held for future development	Construction in progress	Total
	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
At 31 December 2013								
At cost								
At 1 January 2013	1,583,933	12,699,028	3,180,180	3,067,503	12,910,034	-	1,615,334	35,056,012
Additions	48,724	95,258	271,078	250,756	4,669,743	2,091,896	1,117,833	8,545,288
Write-off	-	(2,083)	(96,671)	(18,587)	(166,623)	-	(65)	(284,029)
Disposals	-	(167,900)	(92,942)	(54,018)	(160,707)	-	(27,691)	(503,258)
Reclassification	57,418	2,293,045	-	3,832	20,252	-	(2,374,547)	-
At 31 December 2013	1,690,075	14,917,348	3,261,645	3,249,486	17,272,699	2,091,896	330,864	42,814,013
Accumulated depreciation								
At 1 January 2013	644,283	1,391,422	992,567	1,013,635	6,021,787	-	-	10,063,694
Charge for the year (Note 10)	349,582	338,227	308,258	298,345	2,416,082	-	-	3,710,494
Write-off	-	(2,081)	(96,671)	(12,471)	(172,737)	-	-	(283,960)
Disposals	-	(2,449)	(66,502)	(44,118)	(158,381)	-	-	(271,450)
At 31 December 2013	993,865	1,725,119	1,137,652	1,255,391	8,106,751	-	-	13,218,778
Net carrying amount	**696,210**	**13,192,229**	**2,123,993**	**1,994,095**	**9,165,948**	**2,091,896**	**330,864**	**29,595,235**

21. PROPERTY AND EQUIPMENT (CONTD.)

	Leasehold improvements MNT'000	Premises MNT'000	Vehicles MNT'000	Office furniture MNT'000	Computer equipment and others MNT'000	Land held for future development MNT'000	Construction in progress MNT'000	Total MNT'000
At 31 December 2012								
At cost								
At 1 January 2012	1,116,508	10,575,052	2,797,136	2,584,031	8,585,882	-	1,105,239	26,763,848
Additions	483,475	226,776	669,241	608,415	4,519,674	-	2,490,368	8,997,949
Disposals	-	-	(286,197)	(140,993)	(195,522)	-	(83,073)	(705,785)
Reclassification	(16,050)	1,897,200	-	16,050	-	-	(1,897,200)	-
At 31 December 2012	1,583,933	12,699,028	3,180,180	3,067,503	12,910,034	-	1,615,334	35,056,012
Accumulated depreciation								
At 1 January 2012	345,237	1,115,074	887,006	820,200	4,514,370	-	-	7,681,887
Charge for the year (Note 10)	299,046	276,348	285,432	275,064	1,692,602	-	-	2,828,492
Disposals	-	-	(179,871)	(81,629)	(185,185)	-	-	(446,685)
At 31 December 2012	644,283	1,391,422	992,567	1,013,635	6,021,787	-	-	10,063,694
Net carrying amount	**939,650**	**11,307,606**	**2,187,613**	**2,053,868**	**6,888,247**	**-**	**1,615,334**	**24,992,318**

22. INTANGIBLE ASSETS

	Patents and Rights MNT'000	Computer software MNT'000	Software under development MNT'000	Total MNT'000
At 31 December 2013				
At cost				
At 1 January 2013	115,394	6,057,348	91,100	6,263,842
Addition	18,264	724,823	1,243,092	1,986,179
Disposal	(2,225)	-	-	(2,225)
At 31 December 2013	131,433	6,782,171	1,334,192	8,247,796
Accumulated depreciation				
At 1 January 2013	43,942	1,721,332	-	1,765,274
Charge for the year (Note 10)	10,358	805,890	-	816,248
Disposal	(142)	-	-	(142)
At 31 December 2013	54,158	2,527,222	-	2,581,380
Net carrying amount	**77,275**	**4,254,949**	**1,334,192**	**5,666,416**
At 31 December 2012				
At cost				
At 1 January 2012	115,394	4,654,588	392,867	5,162,849
Addition	-	1,009,893	91,100	1,100,993
Transfer	-	392,867	(392,867)	-
At 31 December 2012	115,394	6,057,348	91,100	6,263,842
Accumulated depreciation				
At 1 January 2012	32,925	1,191,733	-	1,224,658
Charge for the year (Note 10)	11,017	529,599	-	540,616
At 31 December 2012	43,942	1,721,332	-	1,765,274
Net carrying amount	**71,452**	**4,336,016**	**91,100**	**4,498,568**

23. DEFERRED TAX ASSET

	2013 MNT'000	2012 MNT'000
At 1 January	684,300	(198,429)
Recognised in statement of comprehensive income (Note 11)	351,681	882,729
At 31 December	**1,035,981**	**684,300**

	Deferred tax liability MNT'000	Deferred tax asset MNT'000	Net deferred asset/(liability) MNT'000
As at 31 December 2013			
Property and equipment -accelerated tax depreciation	(322,492)	-	(322,492)
Loans and advances to customers -deferral of loan origination fees		1,358,473	1,358,473
	(322,492)	**1,358,472**	**1,035,981**
As at 31 December 2012			
Property and equipment -accelerated tax depreciation	(294,827)	-	(294,827)
Loans and advances to customers -deferral of loan origination fees	-	979,127	979,127
	(294,827)	**979,127**	**684,300**

24. DUE TO BANKS

	2013 MNT'000	2012 MNT'000
Deposits from other banks and financial institutions	**141,706,978**	**55,931,724**

25. REPURCHASE AGREEMENTS

	2013 MNT'000	2012 MNT'000
Repurchase agreements	**162,428,300**	**63,004,615**

The Bank sold BoM bills with an agreement to repurchase them in the future. The repurchase agreement duration was 2 days. The fair value of the bills approximate its carrying amount at 31 December 2013 and 2012.

26. DUE TO CUSTOMERS

	2013 MNT'000	2012 MNT'000
Government deposits		
- Current accounts	1,420,139	2,700,114
- Demand deposits	913	2,560,151
- Time deposits	-	4,883,492
Private sector deposits		
- Current accounts	78,415,377	64,076,374
- Demand deposits	20,977,697	16,229,231
- Time deposits	57,573,967	45,444,887
Individual deposits		
- Current accounts	10,265,726	10,654,295
- Demand deposits	111,788,573	88,183,087
- Time deposits	364,040,791	281,291,616
	644,483,183	**516,023,247**

Included in 'Due to customers' were deposits of MNT 8,771 million (2012: MNT 2,909 million) held as collateral for irrevocable commitments under financial guarantees as at 31 December 2013 and 2012.

27. BORROWED FUNDS

	2013 MNT'000	2012 MNT'000
Borrowed funds from foreign financial institutions		
European Bank for Reconstruction and Development ("EBRD")	49,916,201	9,328,285
Microfinance Enhancement Facility S.A. SICAV-SIF (Cyrano pool) ("MEF")	33,635,470	28,030,800
DEG-Deutsche Investitions-Und Entwicklungsgesellschaft MBH ("DEG")	32,845,067	-
Credit Suisse Microfinance Fund Management Company/ResponsAbility Global Microfinance Fund ("CSMFMC/RGMF")	24,979,728	21,070,785
Societe De Promotion Et De Participation Pour La Cooperation Economique S.A ("PROPARCO")	24,771,289	-
Global Climate Partnership Fund S.A., SICAV-SIF ("GCPF")	24,625,039	20,681,140
Oikocredit, Ecumenical Development Co-operative Society U.A ("Oikocredit")	19,788,147	7,780,926
RosEuroBank	18,221,666	14,396,532
Global Microfinance Facility	16,754,956	14,072,277
Micro, Small and Medium Enterprises Bonds SA	16,118,897	-
International Investment Bank	13,084,623	-
Triodos Sicav II – Triodos Microfinance Fund	11,097,941	6,870,680
Triodos Custody B.V.	10,983,834	-
ResponsAbility SICAV (Lux) Mikrofinanz Fonds	10,814,298	5,634,322
Netherlands Development Finance Company ("FMO")	9,192,435	13,305,732
VDK Spaarbank	8,333,673	7,001,432
Microfinance Initiative for Asia ("MIFA") Debt Fund SA, SICAV-SIF	8,307,215	-
International Netherlands Group ("ING")	7,895,362	8,669,220
SNS IMF/Triple Jump	7,616,781	6,431,573
Capital Gestion	6,625,913	5,552,117
SEB Microfinance fund/Symbiotics Sicav	5,181,402	-
KCD Mikrofinanzfonds	5,015,231	4,220,847
ASN-Novib Funds	4,151,933	3,480,989
Sumitomo Mitsui Bank	3,894,463	-
Dual Return Fund SICAV	3,073,722	6,360,493
KfW Bankengruppe	2,894,906	2,354,171
ResponsAbility SICAV (Lux) Microfinance Leaders	2,503,664	5,655,313
ResponsAbility Financial Inclusion Fund	2,492,005	2,094,573
Triodos Fair Share Fund	1,710,939	1,434,163
Finethic Microfinance	1,698,416	2,827,833
Wallberg Invest S.A	1,654,502	1,387,164
KIVA	1,560,564	1,582,334

27. BORROWED FUNDS (CONTD.)

	2013 MNT'000	2012 MNT'000
Borrowed funds from foreign financial institutions (contd.)		
Emerging Sustainable Funds	681,178	-
Atlantic Forfaitierungs AG	563,135	945,307
Vittana	52,132	12,238
Developing World Markets (DWM)	-	15,949,091
EMF-Microfinance Fund	-	2,094,191
Calvert Social Investment Foundation, Inc	-	1,696,181
International Finance Corporation	-	1,391,259
Monarch Community Fund LLC	-	703,243
ICFund Sicav	-	697,543
Total borrowed funds from foreign financial institutions	**392,736,727**	**223,712,754**
Borrowed funds from government organisations		
BoM	207,801,244	1,254,222
SME Development Fund	27,600,378	27,988,471
Ministry of Finance	11,292,746	12,039,576
Ministry of Finance/Japan Bank for International Cooperation	10,852,627	8,726,574
Asian Development Bank	4,050,048	4,908,905
Rural Poverty Reduction Program	2,728,280	2,551,262
Employment Generation Support Fund	2,470,907	-
UB City and SME development Fund	2,082,489	2,081,576
Micro Finance Development Fund	1,508,938	1,545,839
Total borrowed funds from government organisations	**270,387,657**	**61,096,425**
Borrowed funds from other company		
Oyu Tolgoi LLC	**1,243,820**	**1,243,820**
Total borrowed funds	**664,368,204**	**286,052,999**

All borrowed funds from government organisations are related to the Government of Mongolia.

27. BORROWED FUNDS (CONTD.)

The Bank has not prepaid any of its own debt during the year (2012: Nil). The Bank has not had any defaults of principal, interest or other breaches with regards to all liabilities in 2013 and 2012.

Most of the borrowing agreements require compliance with certain debt covenants, which can be grouped in the following categories:

- capital related ratios (such as risk weighted capital adequacy ratio, solvency ratio, ratio between tier 1 capital and total capital)
- financial risks related ratios (such as maturity mismatches, currency mismatches, aggregate foreign currency open position, single currency foreign exchange risk ratio, negative liquidity gap ratio, aggregate interest rate risk ratio and interest rate risk ratio);
- credit related ratios (such as portfolio at risk, open loan exposure ratio, write off ratio, single largest borrowers to the equity ratio, related party lending ratio and aggregate large exposures ratio);
- other ratios (deposits to loans ratio, interest coverage ratio, shareholding in single entity, fixed assets to total assets, fixed assets plus equity investments ratio, overhead ratio etc.).

In case of non-compliance to covenants eg., if the Bank defaults, the borrowing becomes immediately payable on demand. For this reason, quarterly monitoring of debt covenants is carried out by relevant departments and officers (Finance and Accounting Division, including Chief Finance Officer, Integrated Risk Management Division, Treasury, Credit Administration Division etc.). In case of anticipated or noted non-compliance with certain covenants, appropriate action is taken by management, such as requesting waiver letter or negotiating new agreement to change the limits (ratios).

As of 31 December 2013 and 2012, the Bank has complied with all covenants.

28. SUBORDINATED LOANS

	2013 MNT'000	2012 MNT'000
Netherland Development Finance Company	25,098,919	21,052,017
International Finance Corporation	22,328,823	18,612,193
KfW, Frankfurt am Main	6,242,365	5,027,482
Incofin Impulse Microfinance Investment Fund	4,967,779	4,172,534
	58,637,886	**48,864,226**

Subordinated convertible loan from Netherland Development Finance Company ("FMO")

On 24 October 2011, the Bank received subordinated convertible debt of USD 15,000,000 from FMO, which is due for repayment on 25 October 2016. According to the agreement, conversion option can be exercised only if the existing shareholders of TenGer make decision to increase the share capital of TenGer and the existing shareholders waive their pre-emptive rights, in part or whole or KfW and IFC waive their conversion right, in part or whole. After TenGer has determined that there are shares of TenGer available for issue to FMO pursuant to the increase in share capital, the Bank and TenGer shall, deliver a written notice to FMO notifying FMO of the extent to which it is entitled to participate in the increase in share capital by converting all or part of the outstanding principal amount of the loan together with accrued interest and the conversion price per share, which shall be fixed by the shareholders of TenGer at the time of authorizing the shares. The new shares to be acquired by FMO under the conversion option shall be common shares with full voting right that rank pari passu with all other common shares of TenGer.

The loan carries a fixed interest rate of 8.30% per annum. The debt ranks after all other creditors in case of liquidation.

28. SUBORDINATED LOANS (CONTD.)

Subordinated convertible loan from International Finance Corporation (IFC)

(i) During 2010, the Bank received subordinated convertible debt of USD 5,000,000 from IFC, which is due for repayment on 15 December 2018. According to the agreement, conversion option can be exercised only if the existing shareholders of TenGer make decision on increase in share capital of TenGer and some of these shareholders decide not to use their pre-emptive rights. In such situation, IFC is entitled to purchase remaining shares of TenGer at the same price offered to shareholders. IFC is entitled to make decision on whether shares are to be purchased for cash consideration or through requesting the Bank to repay outstanding balance of subordinated debt.

The new shares to be acquired by IFC under the conversion option shall be common shares with full voting powers, shall rank pari passu to all other shares of TenGer Financial Group LLC and shall not exceed 20% of the aggregate share capital of TenGer.

The Bank cannot repay the subordinated convertible loan prior to the maturity date, except in the case of revocation of its banking license, insolvency, liquidation or restructuring and with the prior approval of BoM.

The loan carries a variable interest rate of 6M Libor+6.5% per annum. The EIR as of 31 December 2013 is 6.915% (2012: 7.01%) per annum. The debt ranks after all other creditors in case of liquidation.

(ii) The Bank signed a subordinated loan agreement in the amount of USD 40,000,000 with IFC on 26 June 2012 and received USD 9,000,000 in 27 December 2012 at a fixed rate of 8.95% per annum. The agreement with IFC contains same conversion condition as conversion option specified in the previous agreement signed in 2010. The loan is due for repayment in December 2020.

28. SUBORDINATED LOANS (CONTD.)

Subordinated convertible loans from KfW, Frankfurt am Main ("KfW")

The Bank received USD 2,747,230 equivalent of EUR 1,800,000 under a 10-year subordinated convertible loan from KfW. The subordinated convertible loan has a maximum interest rate to be capped at 9.00% per annum. The EIR at the reporting date is 5.844% (2012: 6.00%) per annum.

The subordinated convertible loan can be fully repaid by cash on 20 July 2017 or to be converted into equity shares of the Bank's parent company TenGer Financial Group LLC. A conversion option can be exercised only if TenGer's shareholders approve issue of additional share capital and some of the existing shareholders of TenGer decide not to use their pre-emptive rights. In such case, TenGer has obligation to offer remaining shares to KfW at the same price as to the existing shareholders. The price of new shares to be issued shall be fixed by the Shareholders Meeting of TenGer that authorizes the capital increase. In such circumstances, KfW can exercise conversion option either through purchase of shares for cash consideration or through requesting the Bank to repay outstanding balance of subordinated debt, which would enable KfW to use returned funds to purchase shares of TenGer. The amount of consideration to be paid by KfW for acquisition of shares of TenGer is the same under both options.

The new shares to be acquired by KfW under the conversion option shall be common shares with full voting powers, shall rank pari passu to all other shares of TenGer Financial Group LLC and shall not exceed 20% of the aggregate shall capital of TenGer.

The Bank cannot repay the subordinated convertible loan prior to the maturity date, except in the case of revocation of its banking license, its insolvency, liquidation or restructuring and with the prior approval of BoM. The debt ranks after all other creditors in case of liquidation.

Subordinated loan from Incofin Impulse Microfinance Investment Fund

The subordinated loan is to be repaid by cash in in full amount on 84th month after the first disbursement date, which is December 2016. The loan bears interest at a rate of 9.25% (2012: 9.25%) per annum.

29. DEFERRED GRANTS

	2013 MNT'000	2012 MNT'000
Micro Energy Credit Corporation ("MEC")	954,444	875,116
Foundation EKO	657,433	696,907
Clean Air Fund	280,543	-
The Small Enterprise Education and Promotion Network ("SEEP")	59,374	-
Women's World Banking ("WWB")	2,848	2,397
Consultative Group to Assist the Poorest ("CGAP")	2,635	2,218
	1,957,277	**1,576,638**

Movements in deferred grants are presented as follows:

	2013 MNT'000	2012 MNT'000
Balance at beginning of year	1,576,638	689,015
Received during the year	1,704,573	2,136,771
Recognised in statement of comprehensive income	(1,323,934)	(1,270,175)
Others	-	21,027
Balance at end of year	**1,957,277**	**1,576,638**

30. OTHER LIABILITIES

	2013 MNT'000	2012 MNT'000
Payables	10,732,051	5,226,266
Delay on clearing settlement	2,409,462	2,153,912
Dividends payable (Note 33)	1,243	1,243
	13,142,756	**7,381,421**

31. ORDINARY SHARES

	Number of shares of MNT 1,000 each		Amount	
	2013	2012	2013 MNT'000	2012 MNT'000
At 1st January/31 December	20,353,656	20,353,656	20,353,656	20,353,656

32. OTHER RESERVES

There is no movement in other reserves during the year. At the date of this report, no policy is formalised by the Board as to the purpose of these reserves.

33. DIVIDENDS

	2013 MNT'000	2012 MNT'000
Dividends payable at 1 January	1,243	698,635
Dividends declared during the year	-	-
Dividends paid during the year	-	(697,392)
Dividends payable at 31 December (Note 30)	**1,243**	**1,243**

34. CASH AND CASH EQUIVALENTS

		2013 MNT'000	2012 MNT'000
Cash and balances with BoM	13	238,614,870	174,463,368
Due from banks	14	121,851,611	142,638,165
BoM treasury bills	17	224,745,335	88,135,490
Government treasury bills	17	89,661,748	-
		674,873,564	**405,237,023**
Less: Minimum reserve with BoM not available to finance the Bank's day to day operations (refer Note 13)		(89,484,500)	(65,043,096)
Less: Placement with other banks with original maturities of more than three months		-	(20,100,764)
Less: BoM Bills with original maturities of more than 3 months		-	(24,203,854)
Less: Government treasury bills with original maturities of more than 3 months		(65,417,281)	-
Total cash and cash equivalents		**519,971,783**	**295,889,309**

35. FAIR VALUE OF FINANCIAL INSTRUMENTS

Determination of fair value and fair value hierarchy

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

	Level 1 MNT'000	Level 2 MNT'000	Level 3 MNT'000	Total MNT'000
At 31 December 2013				
Financial assets				
Derivative financial instruments				
Currency swaps	-	40,002	-	40,002
Forward foreign exchange contracts	-	596,833	-	596,833
	-	**636,835**	**-**	**636,835**
Financial investments -available-for-sale				
Fixed income investments	-	14,725,194	-	14,725,194
Unquoted equities	-	-	775,500	775,500
	-	**14,725,194**	**775,500**	**15,500,694**
Financial liabilities				
Derivative financial instruments				
Forward foreign exchange contracts	**-**	**626,804**	**-**	**626,804**
At 31 December 2012				
Financial assets				
Financial investment -held-for-trading				
Quoted equity	**79,742**	**-**	**-**	**79,742**
Financial investments -available-for-sale				
Unquoted equities	**-**	**-**	**478,492**	**478,492**
	79,742		**478,492**	**558,234**

35. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTD.)

Financial assets and liabilities which are not measured at fair value but whose fair values are disclosed in the fair value table

The fair value of these financial assets and liabilities are categorized under level 2 where the Bank determined the fair value based on valuation technique (eg. discounted cash flow model) using market observable inputs.

Transfers between level 1 and 2

There were no transfers between level 1 to level 2 of the fair value hierarchy for the financial assets and liabilities which are recorded at fair value.

Impact on fair value of level 3 financial instruments measured at fair value of changes to key assumptions

The impact of the reasonably possible change in the fair value assumptions for level 3 financial instruments is not quantified as the investment is recorded at cost since the fair value cannot be reliably measured.

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 deposits and variable rate financial instruments. Based on fair value assessments performed by the management, the estimated fair values of due from banks of more than one year approximate their carrying amounts as shown in the statement of financial position. This is due principally to the fact that the current market rates offered for similar deposit products do not differ significantly from market rates at inception.

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 available in Mongolia.

35. 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.
This table does not include the fair values of non-financial assets and non-financial liabilities.

As at 31 December 2013	Note	Carrying amount MNT'000	Fair value MNT'000
Financial assets			
Cash and balances with BoM	13	238,614,870	238,614,870
Due from banks	14	121,851,611	121,851,611
Reverse repurchase agreements	15	29,991,255	29,991,255
Derivative financial instruments	16	636,835	636,835
Financial investments -			
- held-for-trading		-	-
- available-for-sale	17	15,500,694	15,500,694
- held-to-maturity	17	329,582,816	329,582,816
Loans and advances to customers	18	1,029,541,294	1,042,319,028
Other assets	19	814,841	814,841
		1,766,534,216	**1,779,311,950**
Financial liabilities			
Due to banks	24	141,706,978	141,706,978
Repurchase agreement	25	162,428,300	162,428,300
Due to customers	26	644,483,183	644,483,183
Derivative financial instruments	16	626,804	626,804
Borrowed funds	27	664,368,204	663,319,039
Subordinated loans	28	58,637,886	54,742,966
Other liabilities	30	13,008,046	13,008,046
		1,685,259,401	**1,680,315,316**

35. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTD.)

As at 31 December 2012			
Financial assets			
Cash and balances with BoM	13	174,463,368	174,463,368
Due from banks	14	142,638,165	142,638,165
Reverse repurchase agreements	15	3,498,061	3,498,061
Financial investments -			
- held-for-trading	17	79,742	79,742
- available-for-sale	17	478,492	478,492
- held-to-maturity	17	88,135,490	88,135,490
Loans and advances to customers	18	630,919,177	625,421,894
Other assets	19	1,151,661	1,151,661
		1,041,364,156	**1,035,866,873**
Financial liabilities			
Due to banks	24	55,931,724	55,931,724
Repurchase agreement	25	63,004,615	63,004,615
Due to customers	26	516,023,247	516,023,247
Borrowed funds	27	286,052,999	265,805,669
Subordinated loans	28	48,864,226	48,767,462
Other liabilities	30	7,332,692	7,332,692
		977,209,503	**956,865,409**

36. CONTINGENT LIABILITIES AND COMMITMENTS

To meet the financial needs of customers, the Bank enters into various irrevocable commitments and contingent liabilities. Even though these obligations may not be recognised on the statement of financial position, they do contain credit risk and are therefore part of the overall risk of the Bank.

	2013 MNT'000	2012 MNT'000
Contingent liabilities		
Performance and tender guarantees	14,709,938	6,493,692
Financial guarantees	10,938,113	13,104,456
Letters of credit	3,815,847	7,648,208
	29,463,898	**27,246,356**
Commitments		
Undrawn commitments to lend	33,229,645	10,406,163
Total	**62,693,543**	**37,652,519**

Contingent liabilities

Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Guarantees and standby letters of credit carry the same risk as loans even though they are of a contingent nature. No material losses are anticipated as a result of these transactions.

Undrawn commitments to lend

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments 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.

The potential credit loss is less than the total unused commitments since 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

	2013 MNT'000	2012 MNT'000
Approved and contracted for:		
Property and equipment	338,156	738,634
Intangible assets	44,467	54,592
Advertisements	25,020	-
	407,643	**793,226**

36. CONTINGENT LIABILITIES AND COMMITMENTS (CONTD.)

Operating lease commitments - Bank as lessee

The Bank as lessee has entered into operating leases of various buildings under cancellable operating lease agreements. The Bank is required to give a month's notice for the termination of those agreements. The leases have no renewal option, purchase option or escalation clauses included in the agreements. There are no restrictions placed upon the Bank by entering these leases.

Operating lease commitments – Bank as lessor

The Bank acts as lessor of various buildings under cancellable operating lease agreements. The lessee is required to give a month's notice for the termination of those agreements. The leases have no renewal option, purchase option or escalation clauses included in the agreements. There are no restrictions placed upon the lessee by entering into these leases.

Legal claims

Litigation is a common occurrence in the Banking industry due to the nature of the business. The Bank has an established protocol for dealing with such legal claims. Once professional advice has been obtained and the amount of damages reasonably estimated, the Bank makes adjustments to account for any adverse effects which the claim may have on its financial standing. At the year end, the Bank had no unresolved legal claims other than litigation with tax authorities described below.

Tax legislation

Mongolian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by tax authorities.

Mongolian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged by tax authorities. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for five calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Mongolian transfer pricing legislation provides the possibility for tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of all controllable transactions, including those related to domestic transfer pricing. In case of deviation of transaction terms from market terms, the tax authorities have the right to adjust taxable items and to impose additional taxes, fines and interest penalties. Given the brief nature of the current Mongolian transfer pricing rules, the impact of any such challenge cannot be reliably estimated. However, it may be significant to the financial position and/or the overall operations of the entity.

36. CONTINGENT LIABILITIES AND COMMITMENTS (CONTD.)

Tax legislation (Contd.)

Mongolian tax legislation does not provide definitive guidance in certain areas, specifically in areas such as VAT, withholding tax, corporate income tax, personal income tax and other areas. From time to time, the Bank adopts interpretations of such uncertain areas that reduce the overall tax rate of the Bank. As noted above, such tax positions may come under heightened scrutiny as a result of recent developments in administrative and court practices. The impact of any challenge by the tax authorities cannot be reliably estimated; however, it may be significant to the financial position and/or the overall operations of the entity.

As a result of a tax inspection conducted during 2012, the Bank was involved in litigation with the tax authorities, who have challenged the Bank's tax position primarily with regard to VAT and corporate income tax. Management assessed that total possible losses that could arise from this litigation, including fines, interest and penalties in 2012 amounted to MNT 77.05 million. Though the tax authorities claim the Bank has a VAT liability related to income generated from non-banking activities, management believes that the Bank's position is appropriate and sustainable in court, since the Bank applied for registration for VAT purposes during 2009 and its application was rejected by the relevant state authority. The treatment of certain fixed assets for the purposes of calculating tax depreciation is not clear and is subject to different interpretations of parties involved in this legal case. On 20 March 2013, the Bank received a final decision from the Tax Dispute Settlement Council requiring the Bank to pay MNT 53 million. As of 31 December 2013, the Bank fully paid this tax liability.

Management performs regular re-assessment of tax risks and its position may change in the future as a result of the change in conditions that cannot be anticipated with sufficient certainty at present.

37. 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 39.3 'Liquidity risk and funding management' for the Bank's contractual undiscounted repayment obligations.

At 31 December 2013	Less than 12 months MNT'000	More than 12 months MNT'000	Total MNT'000
Financial assets			
Cash and balances with BoM	238,614,870	-	238,614,870
Due from banks	121,851,611	-	121,851,611
Reverse repurchase agreements	29,991,255	-	29,991,255
Derivative financial instruments	636,835	-	636,835
Financial investments -			
- held-for-trading	-	-	-
- available-for-sale	13,250,686	2,250,008	15,500,694
- held-to-maturity	314,407,083	15,175,733	329,582,816
Loans and advances to customers	432,757,504	596,783,790	1,029,541,294
Other assets	642,863	171,978	814,841
	1,152,152,707	**614,381,509**	**1,766,534,216**
Non financial assets			
Property and equipment	-	29,595,235	29,595,235
Intangible assets	1,334,192	4,332,224	5,666,416
Other assets	3,453,853	93,128	3,546,981
Properties held for sale	5,105,763	-	5,105,763
Deferred tax assets	-	1,035,981	1,035,981
	9,893,808	**35,056,568**	**44,950,376**
Total	**1,162,046,515**	**649,438,077**	**1,811,484,592**
Financial liabilities			
Due to banks	126,820,078	14,886,900	141,706,978
Repurchase agreements	162,428,300	-	162,428,300
Due to customer	514,686,171	129,797,012	644,483,183
Derivative financial instruments	626,804	-	626,804
Borrowed funds	319,390,992	344,977,212	664,368,204
Subordinated loans	-	58,637,886	58,637,886
Other liabilities	9,461,435	3,546,611	13,008,046
	1,133,413,780	**551,845,621**	**1,685,259,401**

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

At 31 December 2013	Less than 12 months MNT'000	More than 12 months MNT'000	Total MNT'000
Non financial liabilities			
Deferred grants	1,957,277	-	1,957,277
Other liabilities	134,710	-	134,710
Income tax payable	1,928,160	-	1,928,160
	4,020,147	**-**	**4,020,147**
Total	**1,137,433,927**	**551,845,621**	**1,689,279,548**
Net	**24,612,588**	**97,592,456**	**122,205,044**

At 31 December 2012	Less than 12 months MNT'000	More than 12 months MNT'000	Total MNT'000
Financial assets			
Cash and balances with BoM	174,463,368	-	174,463,368
Due from banks	142,638,165	-	142,638,165
Reverse repurchase agreements	3,498,061	-	3,498,061
Financial investments -			
- held-for-trading	79,742	-	79,742
- available-for-sale	-	478,492	478,492
- held-to-maturity	88,135,490	-	88,135,490
Loans and advances to customers	274,601,637	356,317,540	630,919,177
Other assets	1,151,661	-	1,151,661
	684,568,124	**356,796,032**	**1,041,364,156**
Non financial assets			
Property and equipment	-	24,992,318	24,992,318
Intangible assets	-	4,498,568	4,498,568
Other assets	5,038,554	93,128	5,131,682
Properties held for sale	1,031,577	-	1,031,577
Deferred tax assets	-	684,300	684,300
	6,070,131	**30,268,314**	**36,338,445**
Total	**690,638,255**	**387,064,346**	**1,077,702,601**

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

	Less than 12 months MNT'000	More than 12 months MNT'000	Total MNT'000
Financial liabilities			
Due to banks	34,894,097	21,037,627	55,931,724
Repurchase agreement	63,004,615	-	63,004,615
Due to customers	419,159,302	96,863,945	516,023,247
Borrowed funds	73,193,637	212,859,362	286,052,999
Subordinated loans	-	48,864,226	48,864,226
Other liabilities	4,638,539	2,694,153	7,332,692
	594,890,190	**382,319,313**	**977,209,503**
Non financial liabilities			
Deferred grants	1,576,638	-	1,576,638
Other liabilities	48,729	-	48,729
Income tax payable	1,034,996	-	1,034,996
	2,660,363	**-**	**2,660,363**
Total	**597,550,553**	**382,319,313**	**979,869,866**
Net	**93,087,702**	**4,745,033**	**97,832,735**

38. RELATED PARTY DISCLOSURES

The Bank is controlled by TenGer Financial Group LLC. TenGer Financial Group LLC is owned by shareholders as disclosed in Note 1.

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.

As at 31st December, the Bank has the following balances and transactions with related parties.

38. RELATED PARTY DISCLOSURES (CONTD.)

	2013 MNT'000	**2012 MNT'000**
a) Loans and advances to related companies:		
Holding company	7,764,896	-
Fellow subsidiaries	-	1,621,522
Shareholders of holding company	2,482,228	202,858
	10,247,124	1,824,380
Members of the Board of Directors and key management personnel of the Bank	1,349,988	471,446
	11,597,112	**2,295,826**

The loans and advances to related parties were secured, bore interest rates from 6.5% to 27.6% (2012: 5.5% to 27.6%) per annum and are repayable within one to 14 years. The interest income received from such loans during the financial year amounted to MNT 541.1 million (2012: MNT 155.6 million).

	2013 MNT'000	**2012 MNT'000**
b) Deposits from related companies:		
Holding company	899,935	481,156
Fellow subsidiaries	3,920,519	3,461,389
Shareholders of holding company	1,006,434	2,338,362
Associate of holding company	-	19,726
	5,826,888	6,300,633
Members of the Board of Directors and key management personnel of the Bank	541,406	604,215
	6,368,294	**6,904,848**

The deposits from the above related parties bore interest rates from 0% to 14.6% (2012: 0% to 15.80%) per annum. The interest expenses paid to the above depositors during the financial year amounted to MNT 324.9 million (2012: MNT 457.3 million).

38. RELATED PARTY DISCLOSURES (CONTD.)

	2013 MNT'000	2012 MNT'000
c) Loans from shareholders of TenGer Financial Group LLC:		
European Bank for Reconstruction and Development	49,916,201	9,328,285
Triodos Fair Share Fund	1,710,939	1,434,163
International Finance Corporation ("IFC")	-	1,391,259
Stichting Triodos Doen (Triodos Sicav)	-	6,870,680
	51,627,140	**19,024,387**

The loans from the above shareholders of TenGer Financial Group LLC bore interest rates from 6.59% to 16.73% (2012: 4.01% to 16.50%) per annum. The interest expenses paid to such loans during the financial year amounted to MNT 3,096.7 million (2012: MNT 2,742.4 million).

	2013 MNT'000	2012 MNT'000
d) Subordinated loan from shareholder of TenGer Financial Group LLC:		
International Finance Corporation ("IFC")	**22,328,823**	**18,612,193**

The subordinated loans from the above shareholder of TenGer Financial Group LLC bore interest rates of 6.5%+6MLibor and 8.95% (2012: 7.01% and 8.95% per annum.) The interest expenses paid to such subordinated loans during the financial year amounted to MNT 1,583.4 million (2012: MNT 494.6 million).

	2013 MNT'000	2012 MNT'000
e) Security fees paid to related company:		
Fellow subsidiary	**1,861,551**	**1,636,595**

38. RELATED PARTY DISCLOSURES (CONTD.)

	2013 MNT'000	2012 MNT'000
f) Commission income from related companies:		
Holding company	2,678	2,844
Fellow subsidiaries	3,719	1,519
Associates of holding company	-	1,471
Shareholders of holding company	39,761	191
	46,158	**6,025**
Members of the Board of Directors and key management personnel of the Bank	4,205	333
	50,363	**6,358**
g) Contract fee paid to related companies:		
Holding company	2,954,600	2,735,472
Fellow subsidiaries	297,109	380,314
Associates of holding company	-	215,916
	3,251,709	**3,331,702**
h) Rental income from related companies:		
Fellow subsidiaries	24,844	-
Associates of holding company	-	18,196
	24,844	**18,196**
i) Proceeds from disposal of property and equipment:		
Holding company	**-**	**95,381**

38. RELATED PARTY DISCLOSURES (CONTD.)

	2013 MNT'000	2012 MNT'000
j) Due from related companies:		
Fellow subsidiaries	-	253,724
Shareholders of holding company		83,099
	-	**336,823**
k) Due to related company :		
Holding company	**-**	**600,000**
l) Compensation of key management personnel:		
Short-term employee benefits		
Salaries	1,663,138	988,801
Contribution to social and health fund	182,329	108,845
	1,845,467	**1,097,646**

Terms and conditions of transactions with related parties

The above mentioned outstanding balances arose from the ordinary course of business. The interests charged to and by related parties are at normal commercial rates. Outstanding balances except for loans and advances to related parties at the year-end are unsecured. There have been no guarantees provided or received for any related party receivables or payables. For the years ended 31 December 2013 and 2012, the Bank has not made any provision for doubtful debts relating to amounts owed by related parties.

39. RISK MANAGEMENT

39.1 Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. The main risk inherent in the Bank's day to day operation involves credit risk, liquidity risk, foreign currency risk, interest rate risk, prepayment risk and operation risk. Such risk could either result in a direct loss in earnings and capital or may result in constraints on the Bank's ability to meet its objectives.

The Bank has a clearly defined risk management framework which is not designed to eliminate the risk but to optimize the risk and return trade off. The risk management framework in place is to ensure that:

(i) Individuals who manage the risks clearly understands the requirement and measurement system;
(ii) The Bank's risk exposure is within the limits established by the Board of Directors ("BOD");
(iii) The risk measured is in line with the business strategy as approved by the BOD;
(iv) The capital allocation is consistent with the risk of exposures; and
(v) The Bank's performance objectives are aligned with the risk tolerance.

Risk management structure

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles. However, there are separate independent bodies responsible for managing and monitoring risks.

Board Risk Management Committee ("BRMC") and Risk Management Committee ("RMC")

The RMC sets the comprehensive risk management policies and tolerances. RMC is responsible for anticipating and managing new and ongoing financial risk across business departments and maintaining appropriate limits on risk taking, adequate systems and standards for measuring financial risk and performance, comprehensive risk reporting and management review process. The BRMC is responsible for reviewing and approving the business strategies set by RMC.

Integrated Risk Management Division ("IRMD")

The IRMD has direct accountability for identifying, measuring, monitoring, and managing the daily financial positions and market risk. It is also primarily responsible for the credit portfolio risk, liquidity risk and operational risk of the Bank.

39. RISK MANAGEMENT (CONTD.)

39.1 Introduction (Contd.)

Internal Audit

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

Risk measurement and reporting system

The Bank’s risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

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

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Board of Directors, BRMC, RMC, and the head of each business division. The report includes aggregate credit exposure, credit metric forecasts, hold limit exceptions, VaR, liquidity ratios and risk profile changes . On a monthly basis detailed reporting of industry and customer risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Supervisory Board receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

A monthly briefing is given to the Executive Committee and all other relevant members of the Bank on the utilisation of market limits, analysis of VaR and liquidity, plus any other risk developments.

39. RISK MANAGEMENT (CONTD.)

39.1 Introduction (Contd.)

Risk mitigation

As part of its overall risk management, the Bank uses VaR and basis sensitivity analysis to manage exposures resulting from changes in interest rates, foreign currencies, credit risks, and exposures arising from forecast transactions. The Bank actively uses collateral to reduce its credit risks.

Excessive Risk Concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank’s performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Bank’s policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. At the individual basis, BoM sets the standards of a limitation as follows:

(i) The maximum amount of the overall credit exposures issued and other credit-equivalent assets to the individual and his/her related persons shall not exceed 20% of the capital of the Bank.

(ii) The maximum amount of the credit exposures issued and other credit-equivalent assets shall not exceed 5% of the capital for one related person to the bank, and the aggregation of overall lending to the related persons shall not exceed 20% of the capital of the Bank.

39.2 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, repay capital, or otherwise fulfill their contractual obligations under loan agreements, other credit facilities, or in respect of other financial instruments.

39. RISK MANAGEMENT (CONTD.)

39.2 Credit risk (Contd.)

The Bank's RMC, through the Credit Management Division ("CMD") promotes diversification of the loan portfolio of the Bank's lending activities. The CMD structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Credit limit to any single borrower and portfolio limits by loan products are approved by the Board of Directors and reviewed periodically by the CMD.

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

Credit-related commitments risks

The Bank makes available to its customers guarantees which may require that the Bank makes payments on their behalf. Such payments are collected from customers based on the terms of the letter of guarantee. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

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.

39. RISK MANAGEMENT (CONTD.)

39.2 Credit risk (Contd.)

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 statement of financial position. The maximum exposure is shown gross, before the effect of mitigation through the use of collateral agreements.

	Notes	**Gross maximum exposure 2013 MNT'000**	**Gross maximum exposure 2012 MNT'000**
Cash and balances with BoM (excluding cash on hand)	13	202,049,732	135,272,695
Due from banks	14	121,851,611	142,638,165
Reverse repurchase agreements	15	29,991,255	3,498,061
Derivative financial instruments	16	636,835	-
Financial investments – held-for-trading	17	-	79,742
Financial investments – available-for-sale	17	15,500,694	478,492
Financial investments – held-to-maturity	17	329,582,816	88,135,490
Loans and advances to customers	18	1,048,010,209	639,847,418
Other assets	19	821,338	1,151,661
Total		**1,748,444,490**	**1,011,101,724**
Contingent liabilities	36	29,463,898	27,246,356
Commitments	36	33,229,645	10,406,163
Total		**62,693,543**	**37,652,519**
Total credit risk exposure		**1,811,138,033**	**1,048,754,243**

Where financial instruments are recorded at fair value the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

39. RISK MANAGEMENT (CONTD.)

39.2 Credit risk (Contd.)

Risk concentrations by industry

The table below show the analysis per industry sector and economic purpose of the Bank's loans and advances to customers (Note 18) in gross amounts , before taking into account the fair value of the loan collateral held or other credit enhancements.

	2013 Gross maximum exposure		2012 Gross maximum exposure	
	MNT'000	%	MNT'000	%
Trading	239,755,254	22.88	138,609,000	21.66
Mortgage	160,660,934	15.33	113,160,228	17.69
Production	157,643,667	15.04	88,161,014	13.78
Services	133,135,580	12.70	98,143,502	15.34
Consumption	117,358,126	11.20	96,454,331	15.08
Construction	74,682,028	7.13	36,426,741	5.69
Other	40,807,730	3.89	22,848,414	3.57
Deposit backed	40,745,118	3.89	21,337,690	3.33
Mining	31,725,348	3.03	9,338,915	1.46
Loans to staff	25,869,567	2.47	4,611,272	0.73
Agricultural	24,276,869	2.32	10,284,865	1.61
Loans to key management	1,349,988	0.12	471,446	0.06
Total	**1,048,010,209**	**100**	**639,847,418**	**100**

Collateral and other credit enhancements

The amount and type of collateral required depends on the assessment of the credit risk of the borrower or counterparty and the type of loan granted. The Bank follows the collateral guidelines set by the Credit Management Committee in determining the type and value of collateral to be obtained.

The main types of collateral obtained are as follows:

(i) For small business, consumer, agricultural, SME and employee loans - cash, guarantees, securities and real estate properties, chattels, inventory, etc.
(ii) For mortgage loans - mortgages on residential properties and vehicles.
(iii) For wholesale loans - cash, equities and real estate properties.
(iv) For deposit backed loans - cash deposit.

The Bank performs physical inspection of the collateral and regularly monitors the market value of collateral, requests additional collateral in accordance with underlying agreement, and monitors the market value of collateral obtained during its review of adequacy of the allowance for impairment losses.

39. RISK MANAGEMENT (CONTD.)

39.2 Credit risk (Contd.)

Credit quality per class of financial assets

The credit quality of loans and advances to customers is managed by the Bank using internal credit rating.

The following table shows the description of Credit Risk Grading System of the Bank:

Credit Rating	Grade Description
A	Excellent
B	Good
C	Satisfactory
D	Substandard

The Bank's 4-Grade Risk Rating is used in order to categorize exposures according to the risk profile. The 4-Grade Risk Rating is modeled using parametric approaches (logit model) that quantify the probability of default in determining the risk grade. Both qualitative and quantitative historical experience provides background for the bank's credit risk management department for the assumptions used. The risk grading system is used for determining impairment provisions against specific credit exposures. The current risk grading framework consists of four grades which are applied in an uniform matter.

It is the Bank's policy to maintain accurate and consistent risk grades across the credit portfolio. This facilitates the management of the applicable risks and the comparison of credit exposures across all lines of loan products. The grading system is supported by a variety of financial and statistical analytics, combined with processed portfolio and market information to provide the main inputs for the measurement of counterparty risk. All risk grades are tailored to the various loans exposures and are derived in accordance with the Bank's grading policy across all risk groupings reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation.

The Bank does not rate the unquoted financial investments.

The table below shows that credit quality by class of asset for all financial assets exposed to credit risk, based on the Bank's internal credit rating system. The amounts presented are gross of impairment allowances.

39. RISK MANAGEMENT (CONTD.)

39.2 Credit risk (Contd.)

Credit quality per class of financial assets (Contd.)

		Neither past due nor impaired					Past due or individually impaired	
At 31 December 2013	**Note**	**Excellent MNT'000**	**Good MNT'000**	**Satisfactory MNT'000**	**Substandard MNT'000**	**Not rated MNT'000**	**MNT'000**	**Total MNT'000**
Cash and balances with BoM	13	238,614,870	-	-	-	-	-	238,614,870
Due from banks	14	35,697,104	1,754,191	-	84,400,316	-	-	121,851,611
Reverse repurchase agreements	15	29,991,255	-	-	-	-	-	29,991,255
Derivative financial instruments	16	636,835	-	-	-	-	-	636,835
Financial investment								
-available-for-sale	17	-	-	-	-	15,500,694	-	15,500,694
-held to maturity	17	329,582,816	-	-	-	-	-	329,582,816
Loans and advances to customers								
SME loan	18	107,827,265	105,308,640	289,050,367	20,715,050	525,026	23,682,527	547,108,875
Mortgage loan	18	51,720,506	19,216,992	102,324,465	6,689,342	260,792	931,771	181,143,868
Micro business loan	18	15,724,929	6,403,293	126,253,493	2,462,821	-	1,608,011	152,452,547
Consumer loan	18	20,815,519	35,245,535	41,994,269	2,302,918	-	1,675,412	102,033,653
Finance leases	18	10,474,830	5,612,390	6,618,053	275,857	-	304,466	23,285,596
Other	18	40,793,156	19,464	1,057,944	22,096	-	93,010	41,985,670
		247,356,205	171,806,314	567,298,591	32,468,084	785,818	28,295,197	1,048,010,209
Other assets	19	814,840	-	-	-	-	49,484	864,324
Total		**882,693,925**	**173,560,505**	**567,298,591**	**116,868,400**	**16,286,512**	**28,344,681**	**1,785,052,614**

39. RISK MANAGEMENT (CONTD.)

39.2 Credit risk (Contd.)

Credit quality per class of financial assets (Contd.)

		Neither past due nor impaired					Past due or individually impaired	
At 31 December 2012	**Note**	**Excellent MNT'000**	**Good MNT'000**	**Satisfactory MNT'000**	**Substandard MNT'000**	**Not rated MNT'000**	**MNT'000**	**Total MNT'000**
Cash and balances with BoM	13	174,463,368	-	-	-	-	-	174,463,368
Due from banks	14	45,080,763	29,124,472	13,907,666	54,525,264	-	-	142,638,165
Reverse repurchase agreements	15	3,498,061	-	-	-	-	-	3,498,061
Financial investment								
-held-for-trading	17	79,742	-	-	-	-	-	79,742
-available-for-sale	17	-	-	-	-	478,492	-	478,492
-held-to-maturity	17	88,135,490	-	-	-	-	-	88,135,490
Loans and advances to customers								
SME loan	18	76,936,402	43,294,553	151,505,839	7,619,840	717,744	16,506,373	296,580,751
Mortgage loan	18	12,496,715	41,133,256	56,010,690	1,888,724	707,186	923,658	113,160,229
Micro business loan	18	8,885,917	13,476,710	77,704,221	746,542	-	920,178	101,733,568
Consumer loan	18	29,175,000	24,654,967	24,370,238	1,983,170	-	913,896	81,097,271
Finance leases	18	9,963,635	3,551,161	4,929,360	528,177	-	734,452	19,706,785
Other	18	26,504,713	148,998	728,025	21,704	-	165,374	27,568,814
		163,962,382	126,259,645	315,248,373	12,788,157	1,424,930	20,163,931	639,847,418
Other assets	19	1,151,661	-	-	-	-	33,544	1,185,205
Total		**476,371,467**	**155,384,117**	**329,156,039**	**67,313,421**	**1,903,422**	**20,197,475**	**1,050,325,941**

39. RISK MANAGEMENT (CONTD.)

39.2 Credit risk (Contd.)

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

Aging analysis of past due but not impaired loans by class of financial assets

	Less than 30 days MNT'000	More than 31 to 60 days MNT'000	61 to 90 days MNT'000	91 days MNT'000	Total MNT'000
As at 31 December 2013					
Loan and advances to customers					
SME loan	1,795,138	2,670,233	973,836	1,152,543	6,591,750
Mortgage loan	311,179	17,449	8,709	594,434	931,771
Micro business loan	495,747	161,871	185,594	764,799	1,608,011
Consumer loan	320,764	404,213	106,893	843,542	1,675,412
Finance leases	70,488	18,365	6,568	190,695	286,116
Other	5,672	40,263	4,768	42,307	93,010
	2,998,988	**3,312,394**	**1,286,368**	**3,588,320**	**11,186,070**

	Less than 30 days MNT'000	More than 31 to 60 days MNT'000	61 to 90 days MNT'000	91 days MNT'000	Total MNT'000
As at 31 December 2012					
Loan and advances to customers					
SME loan	472,023	1,100,133	501,276	2,927,565	5,000,997
Mortgage loan	136,379	22,529	86,886	677,864	923,658
Micro business loan	178,104	92,287	84,679	565,108	920,178
Consumer loan	262,151	98,999	55,607	497,139	913,896
Finance leases	116,974	163,701	6,385	401,368	688,428
Other	38,329	38,231	764	88,050	165,374
	1,203,960	**1,515,880**	**735,597**	**5,157,094**	**8,612,531**

39. RISK MANAGEMENT (CONTD.)

39.2 Credit risk (Contd.)

Aging analysis of past due but not impaired loans by class of financial assets (Contd.)

Of the total aggregate amount of gross past due but not impaired loans and advances to customers, the fair value of collateral that the Bank held as at 31 December 2013 was MNT 21,552 million (2012: MNT 19,258 million). Please refer Note 18 for more detailed information with respect to allowance for impairment losses on loans and advances to customers.

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.

	2013 MNT'000	2012 MNT'000
Loans and advances to customers:		
SME loan	106,532	472,361
Mortgage loan	-	20,919
Micro business loan	72,479	93,321
Consumer loan	35,974	51,711
Finance leases	-	734
Other	15,435	51,738
	230,420	**690,784**

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days 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 reporting date, unless unforeseen circumstances require more careful attention.

39. RISK MANAGEMENT (CONTD.)

39.2 Credit risk (Contd.)

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 by the management.

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.

39.3 Liquidity risk

The Bank is exposed to liquidity risks that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. The Bank sets limits on the minimum funding composition that should be in place to cover withdrawals at unexpected levels of demand. It is the Bank's policy to maintain a prudent mix of borrowed and core deposit base. In addition, the Bank maintains a statutory deposit with BoM equal to 12% (2012: 12%) of customer deposits.

Analysis of financial liabilities by remaining contractual maturities

The table below summarizes the maturity profile of the Bank’s financial 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.

39. RISK MANAGEMENT (CONTD.)

39.3 Liquidity risk (Contd.)

Analysis of financial liabilities by remaining contractual maturities (Contd.)

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

Financial liabilities	On demand MNT'000	Less than 3 months MNT'000	3 to 6 months MNT'000	6 months to 1 year MNT'000	1 to 5 years MNT'000	Over 5 years MNT'000	Total undiscounted financial liabilities MNT'000
At 31 December 2013							
Due to banks	42,591,420	11,529,916	71,689,665	5,634,272	16,170,895	-	147,616,168
Repurchase agreement	163,376,128	-	-	-	-	-	163,376,128
Due to customers	281,748,808	81,126,184	91,892,028	76,880,988	73,311,241	134,039,344	738,998,593
Derivative financial instruments	507,866	46,626	72,312	-	-	-	626,804
Borrowed funds	7,702,394	91,029,693	98,155,226	152,556,959	340,307,803	39,198,750	728,950,825
Subordinated loans	390,745	781,489	1,172,234	2,344,467	57,548,551	16,755,173	78,992,659
Other liabilities	2,477,788	96,999	1,570	6,885,078	336,802	3,209,809	13,008,046
Total	**498,795,149**	**184,610,907**	**262,983,035**	**244,301,764**	**487,675,292**	**193,203,076**	**1,871,569,223**

39. RISK MANAGEMENT (CONTD.)

39.3 Liquidity risk (Contd.)

Analysis of financial liabilities by remaining contractual maturities (Contd.)

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

Financial liabilities	On demand MNT'000	Less than 3 months MNT'000	3 to 6 months MNT'000	6 months to 1 year MNT'000	1 to 5 years MNT'000	Over 5 years MNT'000	Total undiscounted financial liabilities MNT'000
At 31 December 2012							
Due to banks	9,989,343	5,970,739	1,283,608	22,062,352	24,639,686	-	63,945,728
Repurchase agreement	63,910,306	-	-	-	-	-	63,910,306
Due to customers	231,950,920	60,558,488	75,804,520	63,414,429	62,417,098	128,742,818	622,888,273
Borrowed funds	10,754,898	7,933,192	26,411,842	42,170,125	191,002,680	41,307,594	319,580,331
Subordinated loans	-	-	-	-	47,277,400	22,220,029	69,497,429
Other liabilities	2,194,046	714,817	-	1,729,676	2,694,153	-	7,332,692
Total	**318,799,513**	**75,177,236**	**103,499,970**	**129,376,582**	**328,031,017**	**192,270,441**	**1,147,154,759**

39. RISK MANAGEMENT (CONTD.)

39.3 Liquidity risk (Contd.)

Analysis of financial liabilities by remaining contractual maturities (Contd.)

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

	On demand MNT'000	Less than 3 months MNT'000	3 to 6 Months MNT'000	6 months to 1 year MNT'000	1 to 5 years MNT'000	Over 5 years MNT'000	Total undiscounted financial liabilities MNT'000
At 31 December 2013							
Contingent liabilities (Note 36)	2,286,623	10,807,157	3,831,072	11,211,766	1,327,280	-	29,463,898
Commitments (Note 36)	224,422	1,235,885	5,161,011	1,566,399	25,041,928	-	33,229,645
Total	**2,511,045**	**12,043,042**	**8,992,083**	**12,778,165**	**26,369,208**	**-**	**62,693,543**
At 31 December 2012							
Contingent liabilities (Note 36)	4,957,134	7,179,978	5,474,970	7,003,774	2,630,500	-	27,246,356
Commitments (Note 36)	1,312,308	1,903,354	2,170,337	1,380,227	3,569,937	70,000	10,406,163
Total	**6,269,442**	**9,083,332**	**7,645,307**	**8,384,001**	**6,200,437**	**70,000**	**37,652,519**

39. RISK MANAGEMENT (CONTD.)

39.4 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 or foreign exchange rates. The Bank manages and monitors this risk element using VaR and sensitivity analyses. Except for the concentrations within foreign currencies, the Bank has no significant concentration of market risk.

Interest rate risk

Interest rate risk arises when there is a mismatch between positions, which are subject to interest rate adjustment within a specified period. The Bank's lending, funding and investment activities give rise to interest rate risk. The immediate impact of variation in interest rate is on Bank's net interest income, while a long term impact is on the Bank's net worth since the economic value of the Bank's assets, liabilities and off-balance sheet exposures will be affected. The management has established limits on the interest rate gaps for stipulated periods. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained with the established limits.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's statement of comprehensive income. The sensitivity of the statement of comprehensive income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate financial assets and financial liabilities held at 31 December 2013 and 31 December 2012.

Currency	**Change in basis points**	**Sensitivity of net interest income MNT'000**
At 31 December 2013		
USD	+120	(1,050,786)
MNT	+120	(260,176)
USD	-120	1,050,786
MNT	-120	260,176
At 31 December 2012		
USD	+120	546,489
MNT	+120	247,230
USD	-120	(546,489)
MNT	-120	(247,230)

39. RISK MANAGEMENT (CONTD.)

39.4 Market risk (Contd.)

Currency risk

Currency risk is the possibility of financial loss to the Bank arising from adverse movements in foreign exchange rates. The Bank's management sets limits on the level of exposure by currencies, which are monitored on a frequent basis. Apart from using foreign exchange exposure mismatch, the Bank applies Value-at-Risk ("VaR") simulation model to manage and measure foreign exchange risk since March 2007. VaR is a method used in measuring financial risk by estimating the potential negative change in the market value of a portfolio at a given confidence level and over specified time horizon.

Objectives and limitations of the VaR Methodology

The VaR model is designed to measure market risk in a normal market environment. The models assume that any changes occurring in the risk factors affecting the normal market environment will follow a normal distribution. The Bank uses Variance/Covariance model to assess possible changes in foreign currency portfolio based on historical data from the past one day. The VaR methodology employed by the Bank uses a one-day period, using 99% confidence level, of the potential loss that is not expected to be exceeded if the current market risk positions were to be held unchanged for one day, and are determined by observing market data movements over a 250-day period. The use of a 99% confidence level means that, within one day horizon, losses exceeding the VaR figure should occur, on average, not more than once every hundred days.

The use of VaR has limitations because it is based on historical correlations and volatilities in market prices and assumes that future price movements will follow a statistical distribution. Due to the fact that VaR relies heavily on historical data to provide information and may not clearly predict the future changes and modifications of the risk factors, the probability of large market moves may be underestimated if changes in risk factors fail to align with the normal distribution assumption. VaR may also be under or over-estimated due to the assumptions placed on risk factors and the relationship between such factors for specific instruments. Even though positions may change throughout the day, the VaR only represents the risk of the portfolios at the close of each business day, and it does not account for any losses that may occur beyond the 99% confidence level.

VaR is an integral part of the Bank's market risk management since March 2007, VaR limits and exposures are reviewed regularly against the limits set by management. The estimated potential one-day losses on its foreign currency denominated financial instruments, as calculated in the VAR model are the following:

	Variance/ Covariance MNT'000		**Variance/ Covariance MNT'000**
2013 - 31st December	182,098	2012 - 31st December	35,340
2013 - Average Daily	163,584	2012 - Average Daily	75,450
2013 - Highest	736,814	2012 - Highest	187,865
2013 - Lowest	13,728	2012 - Lowest	15,517

39. RISK MANAGEMENT (CONTD.)

39.4 Market risk (Contd.)

Currency risk (Contd.)

The table below summarizes the Bank's exposure to foreign exchange risk as December 31, 2013 and December 31, 2012. Included in the table are the Bank's financial assets and liabilities at carrying amounts, categorized by currencies.

Concentrations of financial assets and financial liabilities	MNT MNT'000	USD MNT'000	Euro MNT'000	Other MNT'000	Total MNT'000
As at 31 December 2013					
Assets					
Cash and balances with BoM	205,488,160	27,629,100	1,678,407	3,819,203	238,614,870
Due from banks	35,346	119,217,395	787,942	1,810,928	121,851,611
Reverse repurchase agreements	29,991,255	-	-	-	29,991,255
Derivative financial instruments	636,835	-	-	-	636,835
Financial investment					
-held-for-trading	-	-	-	-	-
-available-for-sale	15,169,874	330,820	-	-	15,500,694
-held-to-maturity	329,582,816	-	-	-	329,582,816
Loans and advances to customers	644,842,284	382,214,988	2,483,473	549	1,029,541,294
Other assets	381,266	433,575	-	-	814,841
	1,226,127,836	529,825,878	4,949,822	5,630,680	1,766,534,216
Liabilities					
Due to banks	122,041,803	19,665,175	-	-	141,706,978
Repurchase agreement	162,428,300	-	-	-	162,428,300
Due to customers	555,345,295	80,043,835	3,731,877	5,362,176	644,483,183
Derivative financial instruments	626,804	-	-	-	626,804
Borrowed funds	286,527,991	376,668,159	1,172,054	-	664,368,204
Subordinated loans	-	58,637,886	-	-	58,637,886
Other liabilities	10,841,503	484,124	48,771	1,633,648	13,008,046
	1,137,811,696	535,499,179	4,952,702	6,995,824	1,685,259,401
Net position	**88,316,140**	**(5,673,301)**	**(2,880)**	**(1,365,144)**	**81,274,815**

39. RISK MANAGEMENT (CONTD.)

39.4 Market risk (Contd.)

Currency risk (Contd.)

The table below summarizes the Bank's exposure to foreign exchange risk as December 31, 2013 and December 31, 2012. Included in the table are the Bank's financial assets and liabilities at carrying amounts, categorized by currencies (Contd.).

Concentrations of financial assets and financial liabilities	MNT MNT'000	USD MNT'000	Euro MNT'000	Other MNT'000	Total MNT'000
As at 31 December 2012					
Assets					
Cash and balances with BoM	102,011,575	60,701,951	1,305,736	10,444,106	174,463,368
Due from banks	11,052,028	121,715,487	1,178,337	8,692,313	142,638,165
Reverse repurchase agreements	3,498,061	-	-	-	3,498,061
Financial investment					
-held-for-trading	79,742	-	-	-	79,742
-available-for-sale	478,492	-	-	-	478,492
-held-to-maturity	88,135,490	-	-	-	88,135,490
Loans and advances to customers	447,706,479	183,177,695	27,537	7,466	630,919,177
Other assets	512,586	630,988	-	8,087	1,151,661
	653,474,453	366,226,121	2,511,610	19,151,972	1,041,364,156
Liabilities					
Due to banks	35,359,342	20,572,382	-	-	55,931,724
Repurchase agreement	63,004,615	-	-	-	63,004,615
Due to customers	420,279,537	88,164,646	1,695,598	5,883,466	516,023,247
Borrowed funds	83,189,931	202,863,068	-	-	286,052,999
Subordinated loans	-	48,864,226	-	-	48,864,226
Other liabilities	5,724,671	930,780	16,012	661,229	7,332,692
	607,558,096	361,395,102	1,711,610	6,544,695	977,209,503
Net position	**45,916,357**	**4,831,019**	**800,000**	**12,607,277**	**64,154,653**

39. RISK MANAGEMENT (CONTD.)

39.4 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.

The Bank uses the simplified approach to project the impact of varying levels of prepayment on its net interest income.

If 20% of repayable financial instruments were prepay at the beginning of the year, with all other variables held constant, the profit before tax for the year would be reduced by MNT 31,469 million (2012: MNT 22,754 million).

Operational 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.

40. CAPITAL ADEQUACY

The Bank actively manages its capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by BoM.

During the past year, the Bank complied in full with all its externally imposed capital requirements.

Capital management

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholder's value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to the shareholder, return capital to the shareholder or issue new equity or equity related securities.

Regulatory capital

BoM requires commercial banks to maintain a minimum core capital adequacy ratio of 9% (2012: 8%) and risk weighted capital ratio of at least 14% (2012: 13%) compiled on the basis of total capital and total assets as adjusted for their intrinsic risk characteristics. The capital adequacy ratios of the Bank as at 31st December were as follows:

	2013	**2012**
Core capital ratio	11.18%	13.24%
Risk weighted capital ratio	16.54%	19.86%

	2013 MNT'000	**2012 MNT'000**
Tier I capital		
Ordinary shares	20,353,656	20,353,656
Share premium	34,989,097	34,989,097
Other reserves	10,531,368	10,531,368
Retained profit	56,330,923	31,958,614
Total Tier I Capital	122,205,044	97,832,735
Tier II capital		
Subordinated loans	58,637,886	48,864,226
Total capital /capital base	**180,842,930**	**146,696,961**

40. CAPITAL ADEQUACY (CONTD.)

Regulatory capital (Contd.)

The breakdown of risk weighted assets into the various categories of risk weights as at 31st December was as follows:

	2013		2012	
%	Risk Assets MNT'000	Weighted MNT'000	Risk Assets MNT'000	Weighted MNT'000
0	600,068,943	-	262,598,859	-
20	41,085,010	8,217,002	96,008,284	19,201,657
50	168,975,171	84,487,585	118,517,091	59,258,545
70	270,835,197	189,584,638	-	-
100	781,893,170	781,893,170	633,143,655	633,143,655
150	2,549,261	3,823,891	4,671,014	7,006,522
Adjustments:				
Operational risk ratio		15,946,833		10,568,127
Foreign exchange risk ratio		9,251,000		9,639,762
Total	**1,865,406,752**	**1,093,204,119**	**1,114,938,903**	**738,818,268**

41. 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.