Audited Financial Statements

XACBANK LLC

31 December 2011

Ernst & Young
AF : 0039

Ernst & Young

XACBANK LLC

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XACBANK LLC

CORPORATE INFORMATION

REGISTERED OFFICE	: 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 Ms. Erdenejargal Perenley Mr. Bat-Ochir Dugersuren Mr. Michael Madden Mr. Richard Ranken Mr. Arnoldus P. J. de Vette Ms. Sarah Djari Mr. Arvid Tuerkner
CORPORATE SECRETARY	: Mr. Ashidmaa Dashuyam
AUDITORS	: Ernst & Young Mongolia Audit LLC Certified Public Accountants

STATEMENT BY DIRECTOR AND MANAGEMENT

I, BAT-OCHIR DUGERSUREN, being one of the directors of XACBANK LLC ("the Bank") and DELGERJARGAL BAYANJARGAL, 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 93 give a fair view of the financial position of the Bank as at 31 December 2011 and of its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

BAT-OCHIR DUGERSUREN
(Chief Executive Officer)

DELGERJARGAL BAYANJARGAL
(Chief Financial Officer)

Ulaanbaatar
Date: 29 FEB 2012

ERNST & YOUNG

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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 2011 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.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2011, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

REPORT OF THE INDEPENDENT AUDITORS (CONTD.)

To the shareholder of XacBank LLC

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 91 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
ЭРНСТ энд ЯНГ МОНГОЛИЯ АУДИТ ХХК

Ernst & Young Mongolia Audit LLC

Ernst & Young Mongolia Audit LLC
Certified Public Accountants

Peter Markey
Executive Director

Ulaanbaatar, Mongolia
Date: 29 FEB 2012

XACBANK LLC

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2011

	Notes	2011 MNT'000	2010 MNT'000
Interest and similar income	4	93,331,655	57,585,452
Interest and similar expenses	5	(48,020,470)	(30,830,471)
Net interest income		45,311,185	26,754,981
Fees and commission income	6	1,644,506	1,044,197
Fees and commission expenses	6	(537,551)	(284,846)
Net fees and commission income	6	1,106,955	759,351
Net trading income	7	(77,485)	353,144
Other operating income	8	1,906,425	1,236,739
Total operating income		48,247,080	29,104,215
Credit loss expense	9	(2,630,584)	(1,257,969)
Net operating income		45,616,496	27,846,246
Operating expenses	10	(30,563,030)	(19,798,823)
Amortisation of deferred grants	25	1,064,697	316,879
Profit before tax		16,118,163	8,364,302
Income tax expense	11	(3,971,649)	(1,862,868)
Profit for the year and total comprehensive income for the year (net of tax) attributable to equity holder of the Bank		12,146,514	6,501,434
Earnings per share (MNT):			
Basic earnings per share	12	792.95	489.17
Diluted earnings per share	12	792.95	489.17

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

XACBANK LLC

STATEMENT OF FINANCIAL POSITION

31 December 2011

	Notes	2011 MNT'000	2010 MNT'000
ASSETS			
Cash and balances with central bank	13	114,304,144	48,682,209
Due from banks	14	39,515,647	30,127,154
Financial investment - held-for-trading	15	123,558	-
Financial investments - available-for-sale	15	434,680	434,680
Financial investments – held-to-maturity	15	98,854,788	42,947,556
Loans and advances to customers	16	535,894,643	321,690,771
Other assets	17	5,426,077	4,019,678
Property, plant and equipment	18	19,081,961	16,645,842
Intangible assets	19	3,938,191	3,526,039
Deferred tax asset	27	-	309,547
TOTAL ASSETS		817,573,689	468,383,476
LIABILITIES AND EQUITY			
Due to banks	20	62,464,219	32,482,270
Repurchase agreements	21	48,822,587	-
Due to customers	22	365,291,454	237,193,052
Borrowed funds	23	217,087,557	146,274,827
Subordinated loans	24	37,028,367	14,103,479
Deferred grants	25	689,015	303,609
Other liabilities	26	3,352,800	3,295,320
Income tax payable		53,891	116,847
Deferred tax liability	27	198,429	-
TOTAL LIABILITIES		734,988,319	433,769,404
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK			
Ordinary shares	28	20,353,656	13,290,651
Share premium		34,989,097	5,252,103
Other reserves	29	10,531,368	10,531,368
Retained profits		16,711,249	5,539,950
TOTAL EQUITY		82,585,370	34,614,072
TOTAL LIABILITIES AND EQUITY		817,573,689	468,383,476

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

XACBANK LLC

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2011

	Ordinary shares (Note 28) MNT'000	Share premium MNT'000	Other reserves (Note 29) MNT'000	Retained earnings MNT'000	Total equity MNT'000
At 1 January 2010	13,290,651	5,252,103	8,353,389	1,598,198	28,494,341
Total comprehensive income	-	-	-	6,501,434	6,501,434
Transfer to other reserves	-	-	2,177,979	(2,177,979)	-
Dividends (Note 30)	-	-	-	(384,366)	(384,366)
Gain on disposal of treasury shares	-	-	-	2,663	2,663
At 31 December 2010 and 1 January 2011	13,290,651	5,252,103	10,531,368	5,539,950	34,614,072
Total comprehensive income	-	-	-	12,146,514	12,146,514
Dividends (Note 30)	-	-	-	(975,215)	(975,215)
Issue of ordinary shares	7,063,005	29,736,994	-	-	36,799,999
At 31 December 2011	**20,353,656**	**34,989,097**	**10,531,368**	**16,711,249**	**82,585,370**

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

XACBANK LLC

STATEMENT OF CASH FLOWS

For the year ended 31 December 2011

	Notes	2011 MNT'000	2010 MNT'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before taxation		16,118,163	8,364,302
Adjustments for:-			
Changes in fair value of held-for-trading financial instrument	7	77,485	(353,144)
(Gain)/Loss on disposal of property, plant and equipment	8	(54,904)	34,761
Unrealised foreign exchange loss/(gain)	8	590,510	(506,781)
Credit loss for loans and advances to customers	9	2,619,808	1,237,551
Credit loss for other assets	9	10,776	20,418
Depreciation of property, plant and equipment	10	2,250,890	1,898,197
Amortisation of intangible assets	10	505,544	231,269
Property, plant and equipment written off	10	15,304	-
Impairment loss on foreclosed properties	10	(205,654)	264,087
Amortisation of deferred grants	25	(1,064,697)	(316,879)
Operating profit before working capital changes		20,863,225	10,873,781
Changes in operating assets:-			
Statutory deposit with Bank of Mongolia		(31,886,502)	(2,945,600)
Due from banks		(5,140,685)	3,125,593
Loans and advances to customers		(201,240,014)	(138,947,235)
Other assets		(1,162,503)	(1,640,191)
Changes in operating liabilities:-			
Due to banks		29,873,497	10,683,921
Due to customers		122,178,387	112,180,367
Other liabilities		(951,487)	2,554,204
Cash used in operations		(67,466,082)	(4,115,160)
Income tax paid		(3,526,629)	(1,448,447)
Net cash flows used in operating activities		(70,992,711)	(5,563,607)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of financial investments		(201,043)	(139,086)
Proceeds from disposal and maturity of financial investments		-	3,505,515
Proceeds on disposal of property, plant and equipment		245,357	60,443
Purchase of property, plant and equipment		(4,892,766)	(3,444,612)
Purchase of intangible assets		(917,696)	(911,792)
Net cash flows used in investing activities		(5,766,148)	(929,532)
CASH FLOWS FROM FINANCING ACTIVITIES			
Drawdown of borrowed funds		97,203,977	38,967,406
Drawdown of subordinated loans		19,976,369	6,859,698
Proceeds from issuance of ordinary shares		36,799,999	2,663

STATEMENT OF CASH FLOWS

For the year ended 31 December 2011

	Notes	2011 MNT'000	2010 MNT'000
CASH FLOWS FROM FINANCING ACTIVITIES (CONTD.)			
Proceeds from repurchase agreement		205,587,365	235,323,248
Repayment of repurchase agreement		(156,764,778)	(235,323,248)
Repayment of borrowed funds		(39,558,207)	(10,828,911)
Dividends paid	30	(277,823)	(384,236)
Deferred grants received	25	1,450,103	236,433
Net cash flows generated from financing activities		164,417,005	34,853,053
Effect of exchange rate changes on cash and cash equivalents		6,232,327	(3,548,498)
Net increase in cash and cash equivalents		87,658,146	28,359,914
Cash and cash equivalents brought forward		97,120,581	72,309,165
Cash and cash equivalents carried forward (Note 31)		191,011,054	97,120,581

The accompanying notes form an integral part of the financial statements

1. CORPORATE INFORMATION

The Bank is principally engaged in the business of provision of banking and financial services pursuant to License No. 24 issued by the Bank of Mongolia. There have been no significant changes in the nature of these activities during the year.

The Bank is a limited liability company, incorporated and domiciled in Mongolia. The registered address and the principal place of business of the Bank is 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:

- EIT Capital Management LLC
- Blue Orchard Private Equity Fund
- International Finance Corporation (IFC)
- European Bank for Reconstruction and Development
- Mercy Corps
- Triodos Fair Share Fund
- Stichting Triodos-Doen
- Open Society Forum
- UB Rotary Club
- Mongolian Women's Federation
- Ganhuyag Hutagt
- Bold Magvan
- Ganbold Chuluun
- EIT LLC
- Delgermaa Zagd
- Otgonhuu Hishigsuh

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

2. ACCOUNTING POLICIES

2.1 Basis of preparation

The financial statements of the Bank have been prepared on a historical cost basis, except for available-for-sale and held for trading investments that 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. ACCOUNTING POLICIES (CONTD.)

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 35.

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 the 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. ACCOUNTING POLICIES (CONTD.)

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 disclosed in more detail in Note 9 and Note 16.

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.

2. ACCOUNTING POLICIES (CONTD.)

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

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 valuation of financial instruments is described in more detail in Note 33.

2.3 Changes in accounting policy and disclosures

New and amended standards and interpretations

The accounting policies adopted are consistent with those of the previous financial year, except for the following new and amended IFRS and IFRIC interpretations effective as of 1 January 2011:

- IAS 24 *Related Party Disclosures (amendment)* effective 1 January 2011
- IAS 32 *Financial Instruments: Presentation (amendment)* effective 1 February 2010
- IFRIC 14 *Prepayments of a Minimum Funding Requirement (amendment)* effective 1 January 2011
- Improvements to IFRSs (May 2010)

The adoption of the standards or interpretations is described below:

IAS 24 *Related Party Transactions* (Amendment)

The IASB issued an amendment to IAS 24 that clarifies the definitions of a related party. The new definitions emphasise a symmetrical view of related party relationships and clarifies the circumstances in which persons and key management personnel affect related party relationships of an entity. In addition, the amendment introduces an exemption from the general related party disclosure requirements for transactions with government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity. The adoption of the amendment did not have any impact on the financial position or performance of the Bank.

IAS 32 *Financial Instruments: Presentation (Amendment)*

The IASB issued an amendment that alters the definition of a financial liability in IAS 32 to enable entities to classify rights issues and certain options or warrants as equity instruments. The amendment is applicable if the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. The amendment has had no effect on the financial position or performance of the Bank because the Bank does not have these type of instruments.

2. ACCOUNTING POLICIES (CONTD.)

2.3 Changes in accounting policy and disclosures

IFRIC 14 *Prepayments of a Minimum Funding Requirement* (Amendment)

The amendment removes an unintended consequence when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover such requirements. The amendment permits a prepayment of future service cost by the entity to be recognised as a pension asset. The Bank is not subject to minimum funding requirements in Euroland, therefore the amendment of the interpretation has no effect on the financial position nor performance of the Bank.

Improvements to IFRSs

In May 2010, the IASB issued its third omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The adoption of the following amendments resulted in changes to accounting policies, but no impact on the financial position or performance of the Bank.

- IFRS 3 *Business Combinations*: The measurement options available for non-controlling interest (NCI) were amended. Only components of NCI that constitute a present ownership interest that entitles their holder to a proportionate share of the entity's net assets in the event of liquidation should be measured at either fair value or at the present ownership instruments' proportionate share of the acquiree's identifiable net assets. All other components are to be measured at their acquisition date fair value.

- IFRS 7 *Financial Instruments — Disclosures*: The amendment was intended to simplify the disclosures provided by reducing the volume of disclosures around collateral held and improving disclosures by requiring qualitative information to put the quantitative information in context. The Bank reflects the revised disclosure requirements in Note 16.

- IAS 1 *Presentation of Financial Statements*: The amendment clarifies that an entity may present an analysis of each component of other comprehensive income maybe either in the statement of changes in equity or in the notes to the financial statements.

Other amendments resulting from Improvements to IFRSs to the following standards did not have any impact on the accounting policies, financial position or performance of the Bank:

- IFRS 3 *Business Combinations* (Contingent consideration arising from business combination prior to adoption of IFRS 3 (as revised in 2008))
- IFRS 3 *Business Combinations* (Un-replaced and voluntarily replaced share-based payment awards)
- IAS 27 *Consolidated and Separate Financial Statements*
- IAS 34 *Interim Financial Statements*

The following interpretation and amendments to interpretations did not have any impact on the accounting policies, financial position or performance of the Bank:

- IFRIC 13 *Customer Loyalty Programmes* (determining the fair value of award credits)
- IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies

(1) 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.

(2) 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) Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on the purpose and the management's intention for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus transaction costs, except in the case of financial assets and financial liabilities recorded at fair value through profit or loss.

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

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. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

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

(iv) 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.

(v) 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.

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

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

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

(v) Available-for-sale financial investments (Contd.)

Available-for-sale investments include equity and debt securities. Equity investments classified as available-for-sale 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. 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 income statement in 'Impairment losses on financial investments' and removed from the 'Available-for-sale reserve'.

(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 income statement line 'Credit loss expense'.

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 during the following two years.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

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

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

'Due from banks' and 'Loans and advances to customers', include 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.
- 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 effective interest rate, 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 effective interest rate. The amortisation is included in 'Interest and similar income' in the income statement. The losses arising from impairment are recognised in the income statement in 'Credit loss expense'.

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).

(viii) Borrowed funds

Financial instruments issued by the Bank, that are not designated at fair value through profit or loss, are classified as liabilities under ‘Borrowed funds', where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

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

(viii) Debt issued and other borrowed funds (Contd.)

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

An analysis of the Bank's borrowed funds is disclosed in Note 23.

(ix) Reclassification of financial assets

Effective from 1 July 2008, the Bank was permitted to reclassify, in certain circumstances, non-derivative financial assets out of the 'Held-for-trading' category and into the 'Available-for-sale', 'Loans and receivables', or 'Held-to-maturity' categories. From this date it was also permitted to reclassify, in certain circumstances, financial instruments out of the 'Available-for-sale' category and into the 'Loans and receivables' category. Reclassifications are recorded at fair value at the date of reclassification, which becomes the new amortised cost.

For a financial asset reclassified out of the 'Available-for-sale' 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 effective interest rate. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the effective interest rate. 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 effective interest rate 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.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(3) 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.

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.

(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. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(4) 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 effective interest rate.

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 'Cash collateral on securities borrowed and 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 'Net interest income' and is accrued over the life of the agreement using the effective interest rate.

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'.

(5) 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.

(6) 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.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(6) Impairment of financial assets (Contd.)

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.

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 income statement. 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 effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. If the Bank has reclassified trading assets to loans and advances, the discount rate for measuring any impairment loss is the new effective interest rate 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.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(6) Impairment of financial assets (Contd.)

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

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.

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.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(6) Impairment of financial assets (Contd.)

(ii) Available-for-sale financial investments (Contd.)

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.

(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 effective interest rate 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 effective interest rate.

(7) 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.

(8) 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 fulfilment 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.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(8) Leasing (Contd.)

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.

(9) 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 effective interest rate, 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. 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 effective interest rate, 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 effective interest rate 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 effective interest rate 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.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(9) Recognition of income and expenses (Contd.)

(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 effective interest rate on the loan. 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.

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'.

(10) 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 central banks and amounts due from banks on demand or with an original maturity of three months or less.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(11) Property and equipment

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

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

Assets under construction are not depreciated. Depreciation of other property, plant and equipment is provided for on a straight-line basis to write off the cost of each asset to its residual value over the estimated useful life at the following annual rates:

Buildings	40 years
Furniture and office equipment	10 years
Computers and technical equipment	5 years
Motor vehicles	10 years
Leasehold improvements	over the term of the underlying lease

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, plant and equipment.

An item of property, plant 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.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(12) 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. 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	5-60 years

(13) 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.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(13) Impairment of non-financial assets (Contd.)

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.

(14) 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 in 'Credit loss expense'. The premium received is recognised in the statement of comprehensive income in 'Net fees and commission income' on a straight line basis over the life of the guarantee.

(15) 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.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(16) 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.

(17) 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.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(17) Taxes (Contd.)

(ii) Deferred tax (Contd.)

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.

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.

(18) Treasury shares and contracts on own shares

Own equity instruments of the Bank which are acquired by it or by any of its subsidiaries (treasury shares) are deducted from equity and accounted for at weighted average cost. Consideration paid or received on the purchase, sale, issue or cancellation of the Bank's own equity instruments is recognised directly in equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of own equity instruments.

When the Bank holds own equity instruments on behalf of its clients, those holdings are not included in the Bank's statement of financial position.

Contracts on own shares that require physical settlement of a fixed number of own shares for a fixed consideration are classified as equity and added to or deducted from equity. Contracts on own shares that require net cash settlement or provide a choice of settlement are classified as trading instruments and changes in the fair value are reported in the statement of comprehensive income in 'Net trading income'.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(19) 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.

(20) Equity reserves

The reserves recorded in equity (other comprehensive income) on the Bank's statement of financial position include:

'Available-for-sale' reserve which comprises changes in fair value of available-for-sale investments.

'Other reserves' which represent appropriations of retained earnings, based on the decision of the Bank's Board of Directors. The purpose of other reserves is not specified at present. Other reserves are used for financing the Bank's operations and cannot be used for payment of dividends.

(21) 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.

When the Bank receives non-monetary grants, the asset and the grant are recorded gross at nominal amounts and released to the income statement over the expected useful life and pattern of consumption of the benefit of the underlying asset by equal annual instalments. 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.

(22) Precious metals

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

(23) Segment reporting

The Bank's segmental reporting is based on the following operating segments: Retail banking, Business banking, Mortgage banking and Treasury.

2. ACCOUNTING POLICIES (CONTD.)

2.4 Summary of significant accounting policies (Contd.)

(24) Repossessed assets

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'.

2.5. Standards issued but not yet effective

Standards issued but not yet effective up to the date of issuance of the Bank's financial statements are listed below. This listing of standards and interpretations issued are those that the Bank reasonably expects to have an impact on disclosures, financial position or performance when applied at a future date. The Bank intends to adopt these standards when they become effective.

IAS 1 ***Financial Statement Presentation – Presentation of Items of Other Comprehensive Income***

The amendments to IAS 1 change the grouping of items presented in OCI. Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. The amendment affects presentation only and has there no impact on the Bank's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

IAS 12 ***Income Taxes – Recovery of Underlying Assets***

The amendment clarified the determination of deferred tax on investment property measured at fair value. The amendment introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. Furthermore, it introduces the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 always be measured on a sale basis of the asset. The amendment becomes effective for annual periods beginning on or after 1 January 2012.

IAS 19 ***Employee Benefits*** **(Amendment)**

The IASB has issued numerous amendments to IAS 19. These range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording. The Bank is currently assessing the full impact of the amendments. The amendment becomes effective for annual periods beginning on or after 1 January 2013.

IAS 27 ***Separate Financial Statements*** **(as revised in 2011)**

As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The Bank does not present separate financial statements. The amendment becomes effective for annual periods beginning on or after 1 January 2013.

2. ACCOUNTING POLICIES (CONTD.)

2.5. Standards issued but not yet effective (Contd.)

IAS 28 *Investments in Associates and Joint Ventures* (as revised in 2011)

As a consequence of the new IFRS 11 and IFRS 12. IAS 28 has been renamed IAS 28 *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after 1 January.

IFRS 7 *Financial Instruments: Disclosures — Enhanced Derecognition Disclosure Requirements*

The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Bank's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about continuing involvement in derecognised assets to enable the user to evaluate the nature of, and risks associated with, the entity's continuing involvement in those derecognised assets. The amendment becomes effective for annual periods beginning on or after 1 July 2011. The amendment affects disclosure only and has no impact on the Bank's financial position or performance.

IFRS 9 *Financial Instruments: Classification and Measurement*

IFRS 9 as issued reflects the first phase of the IASBs work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard is effective for annual periods beginning on or after 1 January 2013. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The completion of this project is expected over the course of 2011 or the first half of 2012. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Bank's financial assets, but will potentially have no impact on classification and measurements of financial liabilities. The Bank will quantify the effect in conjunction with the other phases, when issued, to present a comprehensive picture.

IFRS 10 *Consolidated Financial Statements*

IFRS 10 replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also includes the issues raised in SIC-12 *Consolidation —Special Purpose Entities*. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgement to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27. This standard becomes effective for annual periods beginning on or after 1 January 2013.

2. ACCOUNTING POLICIES (CONTD.)

2.5. Standards issued but not yet effective (Contd.)

IFRS 11 *Joint Arrangements*

IFRS 11 replaces IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly-controlled Entities — Non-monetary Contributions by Venturers*.

IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. The application of this new standard will not impact the financial position of the Bank since the Bank does not have investment in joint venture. This standard becomes effective for annual periods beginning on or after 1 January 2013.

IFRS 12 *Disclosure of Interests in Other Entities*

IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. This standard becomes effective for annual periods beginning on or after 1 January 2013.

IFRS 13 *Fair Value Measurement*

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Bank is currently assessing the impact that this standard will have on the financial position and performance. This standard becomes effective for annual periods beginning on or after 1 January 2013.

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 product.
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 Company 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 2011 or 2010.

3. SEGMENT INFORMATION (CONTD.)

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

	Retail Banking 2011 MNT'000	Business Banking 2011 MNT'000	Mortgage Banking 2011 MNT'000	Treasury 2011 MNT'000	Unallocated 2011 MNT'000	Total 2011 MNT'000
Income						
Third party	20,711,257	24,616,386	12,965,846	(10,395,399)	348,990	48,247,080
Inter–segment	1,300,726	(5,451,506)	(6,384,211)	10,534,991	-	-
Total operating income	22,011,983	19,164,880	6,581,635	139,592	348,990	48,247,080
Credit loss expense	(381,117)	(2,522,435)	283,744	-	(10,776)	(2,630,584)
Net operating income	**21,630,866**	**16,642,445**	**6,865,379**	**139,592**	**338,214**	**45,616,496**
Results						
Net interest income (expense)	20,403,094	23,926,632	12,856,809	(11,875,350)	-	45,311,185
Net fees and commission income	308,163	689,755	109,037	-	-	1,106,955
Depreciation of property, plant and equipment	140,711	97,772	2,581	4,174	2,005,652	2,250,890
Amortisation of intangible asset	-	-	-	-	505,544	505,544
Segment profit (loss)	**19,489,187**	**15,633,299**	**6,809,589**	**(217,249)**	**(25,596,663)**	**16,118,163**
Income tax expense					(3,971,649)	(3,971,649)
Profit for the year						**12,146,514**
Assets						
Capital expenditures						
Property and equipment	-	-	-	-	4,892,766	4,892,766
Other intangible assets	-	-	-	-	917,696	917,696
	-	-	-	-	5,810,462	5,810,462
Total assets	**206,070,763**	**231,857,392**	**97,934,834**	**128,930,198**	**152,780,502**	**817,573,689**
Total liabilities	**253,821,018**	**109,962,103**	**1,508,333**	**365,402,730**	**4,294,135**	**734,988,319**

3. SEGMENT INFORMATION (CONTD.)

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

	Retail Banking 2010 MNT'000	Business Banking 2010 MNT'000	Mortgage Banking 2010 MNT'000	Treasury 2010 MNT'000	Unallocated 2010 MNT'000	Total 2010 MNT'000
Income						
Third party	16,790,980	13,118,840	7,510,398	(8,533,398)	217,395	29,104,215
Inter–segment	(1,640,236)	(3,254,840)	(3,886,902)	8,781,978	-	-
Total operating income	15,150,744	9,864,000	3,623,496	248,580	217,395	29,104,215
Credit loss expense	106,513	(899,122)	(444,941)	-	(20,419)	(1,257,969)
Net operating income	**15,257,257**	**8,964,878**	**3,178,555**	**248,580**	**196,976**	**27,846,246**
Results						
Net interest income (expense)	16,428,470	12,769,515	7,462,882	(9,905,886)	-	26,754,981
Net fees and commission income	362,510	349,325	47,516	-	-	759,351
Depreciation of property, plant and equipment	140,466	45,940	344	4,546	1,706,901	1,898,197
Amortisation of intangible asset	-	-	-	-	231,269	231,269
Segment profit (loss)	**14,272,621**	**8,549,127**	**3,175,925**	**26,273**	**(17,659,644)**	**8,364,302**
Income tax expense					(1,862,868)	(1,862,868)
Profit for the year						**6,501,434**
Assets						
Capital expenditures						
Property and equipment	-	-	-	-	3,444,612	3,444,612
Other intangible assets	-	-	-	-	911,792	911,792
	-	-	-	-	4,356,404	4,356,404
Total assets	**144,411,922**	**124,600,049**	**52,678,800**	**62,820,894**	**83,871,811**	**468,383,476**
Total liabilities	**153,943,143**	**82,530,178**	**719,731**	**192,860,576**	**3,715,776**	**433,769,404**

3. SEGMENT INFORMATION (CONTD.)

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

	2011 MNT'000	2010 MNT'000
Total segment profit before tax	41,714,816	26,023,946
Corporate personnel cost	(15,025,087)	(9,531,660)
Corporate administrative cost	(10,920,556)	(8,345,379)
Other operating income	348,990	217,395
Total profit before tax	16,118,163	8,364,302

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

	2011 MNT'000	2010 MNT'000
Total segment assets	664,793,187	384,511,665
Cash and balances with central bank	114,304,144	48,682,209
Due from banks	10,030,129	10,688,496
Other assets	5,426,077	4,019,678
Property, plant and equipment	19,081,961	16,645,842
Intangible assets	3,938,191	3,526,039
Deferred tax asset	-	309,547
Total assets as per statement of financial position	817,573,689	468,383,476

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

	2011 MNT'000	2010 MNT'000
Total segment liabilities	730,694,184	430,053,628
Deferred grants	689,015	303,609
Other liabilities	3,352,800	3,295,320
Income tax payable	53,891	116,847
Deferred tax liability	198,429	-
Total liabilities as per statement of financial position	734,988,319	433,769,404

4. INTEREST AND SIMILAR INCOME

	2011 MNT'000	2010 MNT'000
Cash and balances with central bank	26,577	15,225
Due from banks	1,444,832	1,691,405
Loans and advances to customers	86,339,877	53,485,146
Financial investments – available-for-sale	-	14,609
Financial investments – held-to-maturity	5,520,369	2,379,067
	93,331,655	57,585,452

5. INTEREST AND SIMILAR EXPENSE

	2011 MNT'000	2010 MNT'000
Due to banks	5,219,464	3,425,675
Repurchase agreements	241,431	122,787
Due to customers	29,132,801	16,771,323
Borrowed funds	12,100,547	9,697,387
Subordinated loans	1,326,227	813,299
	48,020,470	30,830,471

6. NET FEES AND COMMISSION INCOME

	2011 MNT'000	2010 MNT'000
Fees and commission income		
Account service fees and commissions	290,898	261,584
Card related fees and commissions	174,701	120,894
Credit related fees and commissions	191,435	186,693
Remittance and other service fees	987,472	475,026
	1,644,506	1,044,197
Fees and commission expenses		
Bank service charges	231,940	138,806
Foreign currency charges	12,063	7,349
Card transaction charges	293,548	138,691
	537,551	284,846
	1,106,955	759,351

7. NET TRADING INCOME

	2011 MNT'000	2010 MNT'000
Equities	(77,485)	353,144

"Equities" income includes the results of buying and selling, and changes in the fair value of equity securities

8. OTHER OPERATING INCOME

	2011 MNT'000	2010 MNT'000
Gain on disposal of property, plant and equipment	54,904	-
Realised foreign exchange gain	2,147,945	527,190
Rental income	72,719	91,348
Unrealised foreign exchange (loss)/gain	(590,510)	506,781
Other	221,367	111,420
	1,906,425	1,236,739

9. CREDIT LOSS EXPENSE

	2011 MNT'000	2010 MNT'000
Loans and advances to customers		
Small and medium enterprises (SME) loans	2,503,120	893,443
Mortgage loans	(304,868)	437,756
Micro business loans	78,760	39,204
Consumer loans	112,054	(11,044)
Finance leases	276,333	(51,958)
Other	(45,591)	(69,850)
	2,619,808	1,237,551
Other receivables (Note 17)	10,776	20,418
	2,630,584	1,257,969

10. OPERATING EXPENSES

	2011 MNT'000	2010 MNT'000
Advertising	1,610,726	1,002,772
Amortisation of intangible assets (Note 19)	505,544	231,269
Armored guard and security	1,174,440	887,278
Communications	887,468	740,814
Depreciation of property, plant and equipment (Note 18)	2,250,890	1,898,197
Donations	167,214	121,208
Entertainment	730,541	491,418
Impairment loss on foreclosed properties (Note 17)	(205,654)	264,087
Insurance	194,284	76,766
Loan collection expenses	38,293	47,740
Loss on disposal of property, plant and equipment	-	34,761
Membership and audit expenses	340,230	234,199
Other operating expenses	1,393,474	743,200
Penalty	95,884	1,070
Personnel expenses*	15,085,563	9,531,810
Professional fees	2,101,816	422,971
Property, plant and equipment written-off (Note 18)	15,304	-
Rental of premises	1,754,770	1,127,850
Repairs and maintenance	219,691	235,644
Stationery	462,748	365,737
Transportation	755,979	453,990
Travelling expenses	581,348	553,791
Utilities	402,477	332,251
	30,563,030	19,798,823

	2011 MNT'000	2010 MNT'000
*** Personnel expenses**		
Salaries, wages and bonus	13,195,015	8,340,567
Contribution to social and health fund	1,435,257	937,526
Amortisation of contribution to defined contribution pension plan	401,712	216,723
Staff training	53,579	36,994
	15,085,563	9,531,810

11. INCOME TAX EXPENSE

The components of income tax expense for the years ended 31 December 2011 and 2010 are:

	2011 MNT'000	2010 MNT'000
Current tax		
Current income tax	3,463,673	2,044,711
Deferred tax		
Relating to origination and reversal of temporary differences	507,976	(181,843)
	3,971,649	1,862,868

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% (2010: 10%) for the first MNT3 billion (2010: MNT 3 billion) of taxable income, and 25% (2010: 25%) on the excess of taxable income over MNT 3 billion (2010: 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 taxation at the statutory income tax rate to income tax expense at the effective income tax rate of the Bank for the years ended 31 December is as follows:

	2011 MNT'000	2010 MNT'000
Profit before taxation	16,118,163	8,364,302
Tax at statutory income tax rate of 25% (2010: 25%)	4,029,541	2,091,076
Effect of income subject to lower tax rate	(450,000)	(450,000)
Effect of income not subject to tax	(67,911)	(126,695)
Effect of expenses not allowable for tax purposes	460,019	348,487
Tax expense for the year	3,971,649	1,862,868

The effective income tax rate for 2011 is 24.64% (2010: 22.27%)

11. INCOME TAX EXPENSE (CONTD.)

Deferred tax

The following table shows deferred tax recorded on the statement of financial position and changes recorded in the income tax expense:

	Deferred tax liability 2011 MNT'000	Deferred tax asset 2011 MNT'000	Income statement 2011 MNT'000	Deferred tax liability 2010 MNT'000	Deferred tax asset 2010 MNT'000	Income statement 2010 MNT'000
Property, plant and equipment -accelerated tax depreciation	(335,769)	-	81,617	(254,152)	-	60,473
Loans and advances to customers -deferral of loan origination fees	-	137,340	426,359	-	563,699	(242,316)
	(335,769)	137,340	507,976	(254,152)	563,699	(181,843)

12. 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) 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.

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

	2011 MNT'000	2010 MNT'000
Profit for the year and total comprehensive income for the year (net of tax) attributable to equity holder of the Bank	12,146,514	6,501,434

	2011 MNT'000	2010 MNT'000
Weighted average number of ordinary shares for basic and diluted earnings per share	15,318,117	13,290,651

Earnings per share

Equity holder of the Bank for the year:	MNT	MNT
Basic earnings per share	792.95	489.17
Diluted earnings per share	792.95	489.17

12. EARNINGS PER SHARE (CONTD.)

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 CENTRAL BANK

	2011 MNT'000	2010 MNT'000
Cash on hand	35,787,785	13,987,138
Current account with the central bank	78,516,359	34,695,071
	114,304,144	48,682,209

Current accounts with The Bank of Mongolia, are maintained in accordance with The Bank of Mongolia's regulations. The balances maintained with The Bank of Mongolia are determined at not less than 11.0% (2010: 5.0 %) of customer deposits periods of 2 weeks. As at 31 December 2011, the average reserve required by The Bank of Mongolia for that period of 2 weeks was MNT 33,400.09 million (2010: MNT 7,881.20 million) for local currency and MNT 8,266.92 million (2010: MNT 1,899.30 million) for foreign currency maintained on current accounts with The Bank of Mongolia.

14. DUE FROM BANKS

	2011 MNT'000	2010 MNT'000
Placement with other banks and financial institutions	39,515,647	30,127,154

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

15. FINANCIAL INVESTMENTS

	2011 MNT'000	2010 MNT'000
Held-for-trading:		
Quoted equity, at fair value	123,558	-
Available-for-sale:		
Unquoted equities, at cost	434,680	434,680
Held-to-maturity:		
The Bank of Mongolia central bank and treasury bills, at amortised cost	98,854,788	42,947,556

15. FINANCIAL INVESTMENTS (CONTD.)

The Bank of Mongolia central bank and treasury bills ("BOM bills") are interest bearing short-term bills issued at a discount.

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.

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

16. LOANS AND ADVANCES TO CUSTOMERS

	2011 MNT'000	2010 MNT'000
Small and medium enterprises (SME) loans	235,680,144	125,682,320
Mortgage loans	106,858,548	58,337,747
Micro business loans	75,786,374	57,888,249
Consumer loans	69,111,290	48,231,659
Finance leases	28,466,833	21,093,904
Others	21,359,908	11,391,734
	537,263,097	322,625,613
Accrued interest receivables	5,286,511	3,275,442
Gross loans and advances	542,549,608	325,901,055
Less: Allowance for impairment losses	(6,654,965)	(4,210,284)
Net loans and advances	535,894,643	321,690,771

16. 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:

At 31 December 2011	SME MNT'000	Mortgage MNT'000	Micro Business MNT'000	Consumer MNT'000	Finance Lease MNT'000	Others MNT'000	Total MNT'000
At 1 January 2011	2,181,317	866,815	553,799	277,981	167,218	163,154	4,210,284
Charge for the year	3,860,415	367,757	319,924	207,222	355,730	25,499	5,136,547
Recoveries	(1,321,792)	(680,457)	(250,201)	(110,587)	(79,563)	(74,139)	(2,516,739)
Amounts written off	(18,937)	(12,357)	(43,038)	(71,934)	(19,168)	(9,693)	(175,127)
At 31 December 2011	4,701,003	541,758	580,484	302,682	424,217	104,821	6,654,965
Individual impairment	2,307,546	-	-	-	12,460	-	2,320,006
Collective impairment	2,393,457	541,758	580,484	302,682	411,757	104,821	4,334,959
	4,701,003	541,758	580,484	302,682	424,217	104,821	6,654,965
Gross amount of loans, individually determined to be impaired, before deducting any individually aasessed impairment allowance	6,280,748	-	-	-	149,751	-	6,430,499

At 31 December 2010	SME MNT'000	Mortgage MNT'000	Micro Business MNT'000	Consumer MNT'000	Finance Lease MNT'000	Others MNT'000	Total MNT'000
At 1 January 2010	1,289,343	421,233	566,673	325,110	233,906	322,644	3,158,909
Charge for the year	1,463,651	696,232	280,183	145,292	87,741	68,222	2,741,321
Recoveries	(556,088)	(250,650)	(245,884)	(160,345)	(142,094)	(148,709)	(1,503,770)
Amounts written off	(15,589)	-	(47,173)	(32,076)	(12,335)	(79,003)	(186,176)
At 31 December 2010	2,181,317	866,815	553,799	277,981	167,218	163,154	4,210,284
Individual impairment	2,020,682	156,399	28,057	39,376	66,206	91,852	2,402,572
Collective impairment	160,635	710,416	525,742	238,605	101,012	71,302	1,807,712
	2,181,317	866,815	553,799	277,981	167,218	163,154	4,210,284
Gross amount of loans, individually determined to be impaired, before deducting any individually aasessed impairment allowance	4,573,792	235,391	42,451	46,876	85,307	91,855	5,075,672

16. 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 2011 amounts to MNT 12,024 billion (2010: MNT 6,622 billion). These values are estimated by the management based on the latest available information. For a more detailed description, see 'Collateral and other credit enhancement' under Note 37.

Collateral repossessed

During the year, the Bank took possession of buildings with carrying amounts as at 31 December 2011 of MNT 6,000,000 (2010: MNT 236,821,000). The Bank is in the process of selling these buildings.

17. OTHER ASSETS

	2011 MNT'000	2010 MNT'000
Other receivables	689,597	737,902
Less: Allowance for impairment losses	(30,129)	(31,614)
	659,468	706,288
Foreclosed properties	98,072	303,726
Less: Allowances for impairment losses	(98,072)	(303,726)
	-	-
Prepaid expenses	2,302,088	1,649,183
Prepaid for defined contribution pension plan	378,341	327,225
Consumables and other inventories	1,200,114	1,164,114
Deposits	179,083	104,567
Precious metals	93,128	-
Property held for sale	613,855	68,301
	4,766,609	3,313,390
	5,426,077	4,019,678
Impairment allowance for other receivables		
At 1st January	31,614	60,105
Charge for the year (Note 9)	10,776	20,418
Written off	(12,261)	(48,909)
At 31st December	30,129	31,614
Impairment allowance for foreclosed properties		
At 1st January	303,726	39,639
Charge for the year (Note 10)	-	264,087
Recoveries (Note 10)	(205,654)	-
At 31st December	98,072	303,726

18. PROPERTY, PLANT AND EQUIPMENT

At 31 December 2011	Leasehold improvements MNT'000	Premises MNT'000	Vehicles MNT'000	Office furniture MNT'000	Computer and equipment MNT'000	Others MNT'000	Construction in progress MNT'000	Total property and equipment MNT'000
At cost								
At 1 January 2011	689,105	9,946,339	2,444,558	2,058,517	6,845,936	169,536	280,885	22,434,876
Additions	442,667	55,804	605,566	558,687	1,709,383	45,737	1,474,922	4,892,766
Disposals	-	(77,659)	(252,988)	(32,814)	(178,628)	-	-	(542,089)
Write offs (Note 10)	(15,264)	-	-	(359)	(6,082)	-	-	(21,705)
Reclassification	-	650,568	-	-	-	-	(650,568)	-
At 31 December 2011	1,116,508	10,575,052	2,797,136	2,584,031	8,370,609	215,273	1,105,239	26,763,848
Accumulated depreciation								
At 1 January 2011	141,879	874,239	769,210	616,726	3,362,762	24,218	-	5,789,034
Charge for the year (Note 10)	203,358	256,119	257,268	223,178	1,292,612	18,355	-	2,250,890
Disposals	-	(15,284)	(139,472)	(19,385)	(177,495)	-	-	(351,636)
Write offs (Note 10)	-	-	-	(319)	(6,082)	-	-	(6,401)
At 31 December 2011	345,237	1,115,074	887,006	820,200	4,471,797	42,573	-	7,681,887
Net carrying amount	771,271	9,459,978	1,910,130	1,763,831	3,898,812	172,700	1,105,239	19,081,961

18. PROPERTY, PLANT AND EQUIPMENT (CONTD.)

At 31 December 2010	Leasehold improvements MNT'000	Premises MNT'000	Vehicles MNT'000	Office furniture MNT'000	Computer and equipment MNT'000	Others MNT'000	Construction in progress MNT'000	Total property and equipment MNT'000
At cost								
At 1 January 2010	471,790	8,566,963	2,064,445	1,631,005	6,305,379	118,070	249,194	19,406,846
Additions	217,315	149,929	509,548	464,543	784,834	51,466	1,266,977	3,444,612
Disposals	-	-	(129,435)	(37,031)	(244,277)	-	(5,839)	(416,582)
Transfers	-	1,229,447	-	-	-	-	(1,229,447)	-
At 31 December 2010	689,105	9,946,339	2,444,558	2,058,517	6,845,936	169,536	280,885	22,434,876
Accumulated depreciation								
At 1 January 2010	58,841	653,769	605,526	465,998	2,417,194	10,888	-	4,212,216
Charge for the year (Note 10)	83,038	220,470	228,119	175,076	1,178,164	13,330	-	1,898,197
Disposal	-	-	(64,435)	(24,348)	(232,596)	-	-	(321,379)
At 31 December 2010	141,879	874,239	769,210	616,726	3,362,762	24,218	-	5,789,034
Net carrying amount	547,226	9,072,100	1,675,348	1,441,791	3,483,174	145,318	280,885	16,645,842

19. INTANGIBLE ASSETS

At 31 December 2011	Patents and Rights MNT'000	Computer software MNT'000	Software under development MNT'000	Total MNT'000
At cost				
At 1 January 2011	90,394	3,807,432	347,327	4,245,153
Additions	25,000	242,786	649,910	917,696
Transfers	-	604,370	(604,370)	-
At 31 December 2011	115,394	4,654,588	392,867	5,162,849
Accumulated amortisation				
At 1 January 2011	22,637	696,477	-	719,114
Charge for the year (Note 10)	10,288	495,256	-	505,544
At 31 December 2011	32,925	1,191,733	-	1,224,658
Net carrying amount	82,469	3,462,855	392,867	3,938,191

At 31 December 2010	Patents and Rights MNT'000	Computer software MNT'000	Software under development MNT'000	Total MNT'000
At cost				
At 1 January 2010	88,896	1,160,747	2,083,718	3,333,361
Additions	1,498	105,573	804,721	911,792
Transfers	-	2,541,112	(2,541,112)	-
At 31 December 2010	90,394	3,807,432	347,327	4,245,153
Accumulated amortisation				
At 1 January 2010	12,891	474,954	-	487,845
Charge for the year (Note 10)	9,746	221,523	-	231,269
At 31 December 2010	22,637	696,477	-	719,114
Net carrying amount	67,757	3,110,955	347,327	3,526,039

20. DUE TO BANKS

	2011 MNT'000	2010 MNT'000
Deposits from other banks and financial institutions	57,458,316	32,482,270
Loans and advances	5,005,903	-
	62,464,219	32,482,270

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

Loans and advances represent overnight loans provided by The Bank of Mongolia.

21. REPURCHASE AGREEMENTS

	2011 MNT'000	2010 MNT'000
Repurchase agreements	48,822,587	-

The Bank sold BOM bills against future repurchase. The repurchase agreements duration were for 3 to 5 days. The fair value of the bills approximated its carrying amount at 31 December 2011.

22. DUE TO CUSTOMERS

	2011 MNT'000	2010 MNT'000
Government deposits		
- Current accounts	2,408,147	859,551
- Demand deposits	1,697,883	946,587
- Time deposits	6,922,604	6,783,088
Private sector deposits		
- Current accounts	54,851,260	23,133,568
- Demand deposits	13,068,239	6,368,905
- Time deposits	31,013,970	44,438,479
Individual deposits		
- Current accounts	8,136,953	5,999,744
- Demand deposits	67,832,208	35,455,614
- Time deposits	179,360,190	113,207,516
	365,291,454	237,193,052

Included in 'Due to customers' were deposits 2011: MNT 3.9 billion (2010: MNT 0.38 billion) held as collateral for irrevocable commitments under financial guarantees.

23. BORROWED FUNDS

	2011 MNT'000	2010 MNT'000
Borrowed funds from foreign financial institutions		
Netherland Development Finance Company	20,451,827	18,947,742
Developing World Markets (DWM)	22,046,193	14,992,966
Dexia Micro Credit Fund	5,397,261	10,293,030
ASN-Novib Funds	10,002,032	8,986,618
ResponsAbility SICAV (Lux)	11,053,676	8,684,820
Credit Suisse Microfinance Fund Management Company	12,281,793	8,531,499
BlueOrchard Finance S.A.	7,027,934	8,368,606
Triodos Sicav	6,880,124	5,939,571
Oikocredit Ecumenical Development Cooperative Society U.A	1,434,349	5,825,646
Dual Return Fund S.I.C.A.V.	6,288,512	5,789,499
European Bank for Reconstruction and Development	9,341,468	5,699,896
Stichting Triodos Doen	-	5,032,487
International Finance Corporation	2,787,238	3,754,920
Triodos Fair Share Fund	1,434,915	3,191,012
KfW, Frankfurt am Main	2,272,631	1,974,547
KIVA	1,516,450	1,533,990
Calvert Social Investment Foundation, Inc	1,700,773	1,529,899
Wallberg Invest S.A	1,408,588	1,267,464
Finethic Microfinance	1,407,716	1,266,679
Oyu Tolgoi micro business loan	1,243,820	1,243,820
Monarch Community Fund LLC	705,167	634,727
ICFund Sicav	699,683	629,601
Vittana	13,308	23,151
EMF-Microfinance Fund	2,100,615	-
Global Microfinance Facility	14,097,835	-
KCD MIKROFINANZFONDS (FIS)	4,234,492	-
MEF-Cyrano pool	14,130,089	-
VDK Spaarbank	7,010,914	-
Total borrowed funds from foreign financial institutions	168,969,403	124,142,190
Borrowed funds from government organisations		
SME Development Fund	39,322,535	6,961,212
Employment Generation Support Fund	531,000	4,641,318
Ministry of Food and Agriculture	-	2,523,000
Rural Poverty Reduction Program	2,667,331	2,436,365
Ministry of Finance/Japan Bank for International Cooperation	2,835,303	1,935,990
Micro Finance Development Fund	1,833,665	1,926,317
Ministry of Trade and Industry	-	873,123
Asian Development Bank	928,320	835,312
Total borrowed funds from government organisations	48,118,154	22,132,637
Total borrowed funds	217,087,557	146,274,827

All government organisations' borrowings stated above are related to the Government of Mongolia.

23. BORROWED FUNDS (CONTD.)

The Bank has not repurchased any of its own debt during the year (2010: Nil). The Bank has not had any defaults of principal, interest or other breaches with regards to all liabilities during 2011 and 2010.

Netherland Development Finance Company ("FMO")

The loans obtained from FMO comprise of the following:

(i) USD 5,000,000, which was converted to MNT 5,850,450,000, bears interest at a rate of 11.10% (2010: 11.83%). The loan was obtained in 2007 to finance the Bank's Housing and SME lending activities. The loan is repayable in 10 semi-annual installments commencing October 2009 and is due to be fully repaid in April 2014.

(ii) USD 5,000,000, which was converted to MNT 5,859,150,000, bears interest at a rate of 11.12% (2010: 11.83%) per annum. The loan was obtained in 2008 to finance the Bank's Housing and SME lending activities. The loan is repayable in 10 semi-annual installments commencing October 2010 and is due to be fully repaid in April 2014.

(iii) USD 7,000,000, which bears interest at a rate of 6.59% (2010: 6.45%) at the end of reporting period. The loans were obtained in 2009 (USD 2,000,000) and 2010 (USD 5,000,000) to finance the bank's Housing loan. The loan is repayable in 16 semiannual installments commencing October 2011 and is due to be fully repaid in April 2019.

(iv) USD 2,500,000, with first disbursement after converted to MNT 889,875,000 (2009) and second disbursement after converted to MNT 1,251,420,000 (2011) and third disbursement after converted to MNT 1,123,053,750 (2011) bears interest rate of 9.50% per annum at the end of reporting period. The loan was obtained in 2009-2011 to finance the Bank's Ger loan. The loan is repayable in 5 semi-annual installments commencing April 2011 and is due to be fully repaid in April 2013.

(iv) USD 2,500,000, with first disbursement after converted to MNT 889,875,000 (2009) and second disbursement after converted to MNT 312,855,000 (2011) and third disbursement after converted to MNT 2,085,671,250 (2011) bears interest rate of 9.50% per annum at the end of reporting period. The loan was obtained in 2009-2011 to finance the Bank's solar loan. The loan is repayable in 5 semi-annual installments commencing April 2011 and is due to be fully repaid in April 2013.

Developing World Markets (DWM)

The loans obtained from DWM comprise of the following:

(i) The loan obtained from DWMS, amounting to USD 2,000,000, bears interest at a rate of 8.25% (2010: 8.25%) per annum. The loan was obtained in 2006 to finance the expansion of the Bank's micro business and small-medium enterprise lending activities. The loan was fully repaid in June 2011.

(ii) The loan obtained from SNS/DWM is amounting to MNT 3,108,550,000, bears interest at a rate of 12.00% (2010:12.00%) per annum at the end of reporting period. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2012.

23. BORROWED FUNDS (CONTD.)

Developing World Markets (DWM) (Contd.)

(iii) The loan obtained from SNS II/DWM is amounting to MNT 6,217,100,000, bears interest at a rate of 12.00% (2010:12.00%) per annum at the end of reporting period. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully in December 2012.

(v) The loan obtained from DWM is amounting to MNT 3,108,550,000, bears interest at a rate of 12.00% (2010:12.00%) per annum at the end of reporting period. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2012.

(vi) The loan obtained from DWM Income Funds S.C.A-SICAF SIF is amounting to MNT 8,852,480,000, bears interest at a rate of 12.00% (2010: Nil) per annum at the end of reporting period. The loan was obtained in 2011 to increase the liquidity and working capital of the Bank and is due to be fully repaid in June 2013.

Dexia Micro Credit Fund ("DMCF")

(i) The Bank issued the promissory note in 2008 for a principal amount of USD 3,000,000 to finance the expansion of Bank's lending activities. The note bears interest at a rate of 7.25% (2010: 7.25%) per annum. The loan was fully repaid in April 2011.

(ii) The Bank issued the promissory note in 2010 for a principal amount of USD 5,000,000 to finance the expansion of Bank's lending activities. The note bears interest at a rate of 7.00% (2010: 7.00%) per annum. USD 1,250,000 was paid in July 2011 and the remaining principal amount is due to be fully repaid in July 2012.

ASN-Novib Funds

(i) USD 2,500,000, which bears interest at a rate of 7.75% (2010: 7.75%) per annum. The loan was obtained in 2008 to support further expansion of the Bank's micro business and SME lending activities. The loan is due to be fully repaid in December 2012.

(ii) USD 4,500,000, which bears interest interest at a rate of 7.75% (2010: 7.75%) per annum. The loan was obtained in 2008 to support further expansion of the Bank's micro business and SME lending activities. The loan is due to be fully repaid in May 2012.

ResponsAbility SICAV (Lux)

The loans obtained from ResponsAbility SICAV (Lux) is in the form of promissory notes and comprise the following:

(i) USD 1,000,000, which bears interest at a rate of 7.50% (2010: 7.50%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in July 2013.

23. BORROWED FUNDS (CONTD.)

ResponsAbility SICAV (Lux) (Contd.)

(ii) USD 2,000,000, which bears interest at a rate of 7.50% (2010: 7.50%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in July 2013.

(iii) USD 2,000,000, which bears interest at a rate of 7.50% (2010: 7.50%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in August 2013.

(iv) USD 250,000, which bears interest at a rate of 5.40% (2010: 5.48%) per annum at the statement of financial position date. The loan was obtained in 2009 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2012.

(v) USD 750,000, which bears interest at a rate of 4.89% (2010:4.96%) per annum at the statement of financial position date. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2013.

(vi) USD 750,000, which bears interest at a rate of 4.89% (2010:4.96%) per annum at the statement of financial position date. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2013.

(vii) USD 500,000, which bears interest at a rate of 6.00% per annum at the statement of financial position date. The loan was obtained in 2011 to increase the liquidity and working capital of the Bank and is due to be fully repaid in June 2014.

(viii) USD 500,000, which bears interest at a rate of 6.00% per annum at the statement of financial position date. The loan was obtained in 2011 to increase the liquidity and working capital of the Bank and is due to be fully repaid in June 2014.

Credit Suisse Microfinance Fund Management Company

The loans obtained from Credit Suisse Microfinance Fund Management Company are in the form of promissory notes and comprise of the following:

(i) USD 2,000,000, which bears interest at a rate of 7.50% (2010: 7.50%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in June 2013.

(ii) USD 1,000,000, which bears interest at a rate of 7.50% (2010: 7.50%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in August 2013.

(iii) USD 750,000, which bears interest at a rate of 5.40% (2010: 5.76%) at the statement of financial position date. The note was issued in 2009 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in December 2012.

23. BORROWED FUNDS (CONTD.)

Credit Suisse Microfinance Fund Management Company (Contd.)

(iv) USD 3,000,000, which bears interest at a rate of 4.89% (2010:4.96%) at the statement of financial position date. The note was issued in 2010 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in December 2013.

(v) USD 2,000,000, which bears interest at a rate of 6.00% at the statement of financial position date. The note was issued in 2011 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in June 2014.

BlueOrchard Finance S.A.

The loans obtained from BlueOrchard Finance S.A. comprise of the following:

(i) USD 6,500,000, which bears interest at a rate of 8.25% (2010: 8.25%) per annum. The loan was obtained in 2006 to finance the expansion of the Bank's micro business lending activities. The loan is repayable in four equal quarterly installments commencing from June 2010 and was fully repaid in March 2011.

(ii) USD 5,000,000, which bears interest at a rate of 8.00% (2010: 8.00%) per annum. The loan was obtained in 2007 to finance the expansion of the Bank's micro business lending activities. The loan is due to be fully repaid in June 2012.

Triodos Sicav

The loans obtained from Triodos Sicav comprise of the following:

(i) USD 3,000,000, which bears interest at a rate of 8.00% (2010: 8.00%) per annum. The loan was obtained in 2009 (USD 900,000) and 2010 (USD 2,100,000) to finance the expansion of the Bank's micro business loan portfolio. The loan is due to be fully repaid in January 2013.

(ii) USD 1,750,000, which bears at a rate of 7.75% (2010: 7.75%) per annum. The loan was obtained in 2010 to finance the micro business loan portfolio. The loan is due to be fully repaid in October 2013.

Oikocredit Ecumenical Development Cooperative Society U.A ("Oikocredit")

The loans obtained from Oikocredit comprise the following:

(i) USD 1,500,000 which bears interest at a rate of 3.96% (2010: 4.37%) per annum. The loan was obtained in 2007 to finance the Bank's micro business and SME lending activities. The loan is repayable in four equal semi-annual installments commencing February 2010 and was fully repaid in August 2011.

(ii) USD 1,500,000 which bears interest at a rate of 7.00% (2010: 7.00%) per annum. The loan was obtained in 2008 to finance the Bank's micro business and SME lending activities. The loan is repayable in six equal semi-annual installments commencing February 2011 and is due to be fully repaid in August 2013.

23. BORROWED FUNDS (CONTD.)

Oikocredit Ecumenical Development Cooperative Society U.A ("Oikocredit") (Contd.)

(iii) MNT4,309,320,000, which was replaced with existing EUR 2,000,000 loan in 2010 to finance the Bank's micro business and SME lending activities. The loan bears interest at a rate of 7.25% (2010: 7.25%) per annum. The loan is repayable in three equal semi-annual installments commencing August 2010 and was fully repaid in August 2011.

Dual Return Fund SICAV

The loans obtained from Dual Return Fund SICAV are in the form of promissory notes and comprise of the following:

(i) USD 1,000,000, which bears interest at a rate of 7.50% (2010: 7.50%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in May 2013.

(ii) USD 2,000,000, which bears interest at a rate of 7.50% (2010: 7.50%) per annum. The note was issued in 2008 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in August 2013.

(iii) USD 500,000, which bears interest at a rate of 7.00% (2010: 7.00%) per annum. The note was issued in 2009 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in November 2012.

(iv) USD 1,000,000, which was converted to MNT 1,286,410,000 and bears interest at rate of 12.00% (2010:12.00%) per annum. The note was issued in 2010 to increase the liquidity and working capital of the Bank. The loan is due to be fully repaid in November 2012.

European Bank for Reconstruction and Development ("EBRD")

USD 8,000,000, which was converted to MNT 10,386,199,382.98 bears interest at a rate of 14.33% (2010: 15.65%) per annum at the statement of financial position date. The loan was obtained in 2010 (MNT 5,450,040,000) and in 2011 (MNT 4,936,159,382.98) to assist the development of the micro business and SME sectors in Mongolia. The loan is repayable in seven equal semi-annual installments commencing July 2011 and is due to be fully repaid in July 2014.

Stichting Triodos Doen

The loans obtained from Stichting Triodos Doen comprise of the following:

(i) MNT 1,000,000,000, which bears interest at a rate of 14.00% (2010: 14.00%) per annum. The loan was obtained in 2006 to finance the expansion of the Bank's lending activities. The loan was fully prepaid in August 2011.

(ii) MNT 1,200,000,000, which bears interest at a rate of 14.00% (2010: 14.00%) per annum. The loan was obtained in 2007 to finance the expansion of the Bank's lending activities. The loan was fully repaid in April 2011.

23. BORROWED FUNDS (CONTD.)

Stichting Triodos Doen (Contd.)

(iii) MNT 1,400,000,000, which bears interest at a rate of 14.00% (2010: 14.00%) per annum. The loan was obtained in 2009 (MNT 980,000,000) and 2010 (MNT 420,000,000) to finance the expansion of the Bank's micro business loan portfolio. The loan was fully prepaid in January 2011.

(iv) MNT 1,400,000,000, which bears interest at a rate of 14.00% (2010: 14.00%) per annum. The loan was obtained in 2010 to finance the expansion of Bank's micro business loan portfolio. The loan was fully prepaid in August 2011.

International Finance Corporation ("IFC")

USD 5,000,000, which bears interest at a rate of 3.90% (2010: 4.25%) per annum. The loan was obtained in 2008 to finance the Bank's micro business and SME lending activities. The loan is repayable in ten semi-annual installments which commenced on June 2010 and is due to be fully repaid in December 2013.

Triodos Fair Share Fund

The loans obtained from Triodos Fair Share Fund comprise of the following:

(i) USD 500,000, which bears interest at a rate of 8.50% (2010: 8.50%) per annum. The loan was obtained in 2006 to finance the expansion of Bank's lending activities. The loan was fully repaid in July 2011.

(ii) USD 2,000,000, which bears interest at a rate of 8.25% (2010: 8.25%) per annum. The loan was obtained in 2007 to finance the expansion of Bank's lending activities. The loan was fully repaid in April 2011.

(iii) USD 2,500,000, which bears interest at a rate of 7.20% per annum. The loan was obtained in 2011 to finance the expansion of Bank's lending activities. The loan was prepaid in August 2011 and remaining principal loan is due to be fully repaid in July 2014.

KfW, Frankfurt am Main ("KfW")

The loan obtained from KfW, amounting to USD 1,371,508 equivalent of EUR 900,000, bears interest at rate of 4.25% (2010: 4.25%) per annum at the end of reporting period. The loan was obtained in 2008 to assist the development of the micro and small business sector in Mongolia, to improve the living situation of low income individuals, to promote the urban development by financing housing projects, to strengthen the Bank's equity basis and refinancing situation for business expansion and for the financing of consulting services to improve the Bank's risk management with respect to its micro business lending business. The loan is due to be fully repaid in July 2017.

KIVA

Kiva supports local lenders that provide small loans to individuals or groups in developing countries with its 0% interest rate funds. KIVA loans balance is MNT 1,516,450 thousand (2010: MNT 1,533,990 thousand) as at end of reporting period and has no stated maturity date.

23. BORROWED FUNDS (CONTD.)

Calvert Social Investment Foundation Foundation.Inc ("CSIF")

(i) The loan obtained from CSIF is in the form of promissory notes issued by the foundation for a principal amount of USD 700,000. The notes were obtained in 2004, 2005 and 2006 respectively, to finance the Bank's micro business and SME lending activities. The notes bear interest at a rate of 6.00% (2010: 6.00%) p.a. and are due to be fully repaid in December 2012.

(ii) The loan obtained from CSIF is in the form of promissory notes issued by CSIF for a principal amount of USD 500,000. The note was obtained in 2008 to finance the Bank's micro business and SME lending activities. The note bears interest at a rate of 6.30% (2010: 6.30%) per annum. The loan is due to be fully repaid in December 2012.

Wallberg Invest SA

The loan obtained from Wallberg Invest SA is in the form of a promissory note, amounting to USD 1,000,000, bears interest at a rate of 7.00% (2010: 7.00%) per annum. The loan was obtained in 2009 to finance the Bank's micro business and SME lending activities. The loan is due to be fully repaid in November 2012.

Finethic Microfinance

The loan obtained from Finethic Microfinance is in the form of a promissory note issued by the foundation for a principal amount of USD 1,000,000. The note was obtained in 2008 to increase the liquidity and expansion of the Bank's micro business and SME lending activities. The note bears interest at rate of 7.50% (2010: 7.50%) per annum. The loan is due to be fully repaid in May 2013.

Oyu Tolgoi LLC

The loan obtained from Oyu Tolgoi LLC is subsidiary loan and amount is USD 1,000,000. The loan was obtained in 2010 to support Small and Medium sized Entrepreneurs Loan Facility Project. Loan is non-interest bearing and is due to be fully repaid in October 2013.

Monarch Community Fund, LLC

The loan obtained from Monarch Community Fund, amounting to USD 500,000, bears interest at rate of 6.00% (2010: 6.00%) per annum. The loan was obtained in 2008 to finance the Bank's micro business and SME lending activities. The loan is due to be fully repaid in December 2012.

ICFund Sicav

The loan obtained from ICFund Sicav is in the form of a promissory note, amounting to USD 500,000, bears interest at a rate of 4.89% (2010:4.96%) per annum at the end of reporting period. The loan was obtained in 2010 to increase the liquidity and working capital of the Bank and is due to be fully repaid in December 2013.

23. BORROWED FUNDS (CONTD.)

Vittana

Vittana extends educational loans that provide financial assistance to students or groups of students in developing countries with its 0% interest rate funds. Vittana loans balance is MNT 13,308 thousand (2010: MNT 23,151 thousand) as at end of reporting period and has no stated maturity date.

EMF Microfinance Fund

The loans obtained from EMF Microfinance Fund are in the form of promissory notes, amounting to USD 1,500,000, bears interest at a rate of 4.40% per annum at the end of reporting period. The loan was obtained in 2011 to increase the liquidity and working capital of the Bank and is due to be fully repaid in June 2013.

Global Microfinance Facility

USD 10,000,000, which bears interest at a rate of 5.65% per annum. The loan was obtained in 2011 to finance the expansion of the Bank's micro business lending activities. The loan is due to be fully repaid in April 2014.

KCD Mikrofinanzfonds

USD 3,000,000, which bears interest at a rate of 6.00% per annum. The loan was obtained in 2011 to finance the expansion of the Bank's micro business lending activities. The loan is due to be fully repaid in April 2016.

Microfinance Enhancement Facility

USD 10,000,000, which bears interest at a rate of 4.43% per annum. The loan was obtained in 2011 to finance the expansion of the Bank's micro business lending activities. The loan is due to be fully repaid in April 2014.

VDK Spaarbank

The loan obtained from VDK Spaarbank is in the form of a promissory note for a principal amount of USD 5,000,000. The note was obtained in 2011 to increase the liquidity and expansion of the Bank's micro business and SME lending activities. The note bears interest at rate of 6.00% per annum. The loan is due to be fully repaid in May 2014.

SME Development Fund

The loans obtained from SME Development Fund comprise of the following:

a. MNT 873 million which is non-interest bearing. The loan was obtained in 2009 and is due to be fully repaid in 2012.

23. BORROWED FUNDS (CONTD.)

SME Development Fund (Contd.)

b. MNT 1,000 million which bears monitoring expense at a rate of 1.20% per annum. The loan was obtained in January 2011 to finance small business and entrepreneurs in order to support start-up business and expansion of old business activities. The loan is due to be fully repaid in January 2014.

c. MNT 6,710 million which is the funding of discount loan of Government Bond of Mongolia for wool and cashmere manufacturers. The 5-year collaboration agreement was concluded between the Ministry of Finance and MFALI in October 2011. The funding interest rate per annum is 0.60%.

d. MNT 1,000 million which bears monitoring expense at a rate of 1.20% per annum. The loan was obtained in December 2011 to finance investment needs of Medium and large businesses in Ulaanbaatar city. The loan is due to be fully repaid in December 2016.

e. MNT 27,120 million which bears interest rate at 1.20% per annum. The loan was obtained in 2011 to support small and medium businesses. The loan is due to be fully repaid in December 2021.

f. MNT 424 million which bears interest rate at 1.20% per annum. The loan was obtained in 2009 and 2010 respectively to support small and medium businesses. The loan is due to be fully repaid in October 2013.

g. MNT 2,112 million which bears interest rate at 1.20% per annum. The loan was obtained in 2010 and 2011 respectively to support small and medium businesses. The loan is due to be fully repaid in April 2015.

Employment Generation Support Fund (IGF)

The loans obtained from Employment Generation Support Fund comprise of the following:

(i) MNT 531 million which is non-interest bearing. If the fund was not fully disbursed within 6 months, undue loss amount of 0.30% per month will be imposed. The loan was obtained in May 2011 to finance the expansion of Bank's lending activities. The loan is due to be fully repaid in November 2012.

(ii) MNT 2,945 million which is non-interest bearing. The loan was obtained in December 2009 to finance the expansion of Bank's lending activities. The loan was fully repaid in June 2011.

(iii) MNT 1,674 million which is non-interest bearing. If the fund was not fully disbursed within 6 months, undue loss amount of 0.30% per month will be imposed. The loan was obtained in 2010 to finance the expansion of Bank's lending activities. The loan was fully repaid in September 2011.

Ministry of Food and Agriculture

The loan obtained from Ministry of Food and Agriculture in 2010 amounted to MNT 2,500 million bore interest rate of 3.6% and was fully repaid in June 2011.

23. BORROWED FUNDS (CONTD.)

Rural Poverty Reduction Program

The loans obtained from Rural Poverty Reduction Program comprise of the following:

(i) USD 1,823,380, which bears interest at a rate of 6% (2010: 6%) per annum. The loan was obtained in 2004 and is due to be fully repaid in December 2017.

(ii) MNT 120 million, which bears interest at a rate of 5% (2010: 5%) per annum. The loan was obtained in 2010 and is due to be fully repaid in April 2019.

Ministry of Finance and Japan Bank for International Cooperation ("JBIC")

The loans obtained from Ministry of Finance comprise of the following:

(i) MNT 1,922 million which bears interest rate at 4.0% (2010: 4.5%) per annum. The loan was obtained in 2010 to support micro and medium businesses. The loan will be fully repaid in January 2019.

(ii) MNT 432 million which bears interest rate at 4% per annum. The loan was obtained in 2011 to support small and medium businesses. The loan will be fully repaid in August 2021.

Microfinance development fund (MDF)

The loans obtained from Microfinance development fund comprise of the following:

(i) MNT 600 million which bears interest at a rate of 8.1% (8.1%) per annum. The loan was obtained in 2010 to finance the expansion of Bank's lending activities. The loan is due to be fully repaid in November 2012.

(ii) USD 1.0 million which bears interest at a rate of 8.1% (2010: 8.1%) per annum. The loan was obtained in March 2010 to finance the expansion of Bank's lending activities. The loan is due to be fully repaid in March 2013.

(iii) MNT 1,000 million which bears interest at a rate of 7.5% per annum. The loan was obtained in March 2011 to finance the expansion of Bank’s lending activities. The loan will be fully repaid in July 2014.

Ministry of Trade and Industry

The objective of the loan is to support micro and medium businesses. The loans comprise of the following:

(i) MNT 369 million, which bears interest at a rate of 1.2% (2010: 1.2%) per annum. The loan was obtained in 2006 and was fully repaid in June 2011.

(ii) MNT 3.0 billion which bears interest at a rate of 3.6% (2010: 3.6%) per annum. The loan was fully repaid in August 2011.

23. BORROWED FUNDS (CONTD.)

Asian Development Bank

The fund is dedicated to support "Value Added Cost Network" of Rural Development in Mongolia and the Bank signed the contract of funding in 2010. ADB funds 50% of loans with 0% interest rate and the Bank funds 50% by its own fund. There is no stated maturity date for repayment but such kind of loans have 7 years period.

Most of the borrowing agreements stated above 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, related borrowing would default i.e. the borrowing is 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 CFO, 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 with permanently changed limits (ratios).

As of 31 December 2011, the Bank complied with all covenants.

24. SUBORDINATED LOANS

	2011 MNT'000	2010 MNT'000
KfW, Frankfurt am Main	4,813,373	4,133,760
Incofin Impulse Microfinance Investment Fund	4,176,045	3,748,367
International Finance Corporation	6,930,953	6,221,352
Netherland Development Finance Company	21,107,996	-
	37,028,367	14,103,479

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 9.0% per annum. The effective interest rate at the reporting date is 6.00% (2010: 6.00%) per annum.

24. SUBORDINATED LOANS (CONTD.)

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

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 ("Tenger"). 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 exercise 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 using 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 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 the Bank of Mongolia. 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 one amount 84 months after the first disbursement date, which is December 2016. The loan bears interest at a rate of 9.25% (2010: 9.25%) per annum.

Subordinated loan from International Finance Corporation

During 2010, the Bank received subordinated convertible debt of USD 5,000,000 from International Finance Corporation (IFC), which is due for repayment on 15 December 2018. The agreement with IFC contains conversion option with the same characteristics as conversion option specified in the agreement with KfW. Accordingly, conversion option can be exercised only if the existing shareholders of TenGer make decision to increase the share capital of TenGer and some of these shareholders decide not to exercise their pre-emptive rights. In such situation, IFC is entitled to purchase remaining shares of TenGer at the same price offered to shareholders. As for KfW, 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 using 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 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 the Bank of Mongolia.

24. SUBORDINATED LOANS (CONTD.)

Subordinated loan from International Finance Corporation (Contd.)

The loan carries a variable interest rate of 6M Libor+6.5% per annum. Effective interest rate as of 31 December 2011 is 6.90% (2010: 6.92%) per annum. The debt ranks after all other creditors in case of liquidation.

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

On 24 October 2011, the Bank received subordinated convertible debt of USD 15,000,000 from Netherland Development Finance Company (FMO), which is due for repayment on 25 October 2016. The agreement with FMO contains conversion option with the similar characteristics as conversion option specified in the agreement with KfW and IFC. Accordingly, 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 using 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 8.3% per annum. The debt ranks after all other creditors in case of liquidation.

25. DEFERRED GRANTS

	2011 MNT'000	2010 MNT'000
Consultative Group to Assist the Poorest ("CGAP")	103,370	216,807
SEEP	66,953	60,545
Foundation EKO	516,288	15,070
United States Agency for International Development ("USAID")	-	6,709
International Finance Corporation ("IFC")	-	2,314
Women's World Banking ("WWB")	2,404	2,164
	689,015	303,609

Movements in deferred grants are presented as follows:

	2011 MNT'000	2010 MNT'000
Balance at beginning of year	303,609	384,055
Received during the year	1,450,103	236,433
Recognised in statement of comprehensive income	(1,064,697)	(316,879)
Balance at end of year	689,015	303,609

26. OTHER LIABILITIES

	2011 MNT'000	2010 MNT'000
Delay on clearing settlement	982,777	2,091,047
Payables	1,671,388	1,203,030
Dividends payable (Note 30)	698,635	1,243
	3,352,800	3,295,320

27. DEFERRED TAX (LIABILITY)/ASSET

	2011 MNT'000	2010 MNT'000
At 1 January	309,547	127,704
Recognised in statement of comprehensive income (Note 11)	(507,976)	181,843
At 31 December	(198,429)	309,547

28. ORDINARY SHARES

	Number of shares of MNT 1,000 each		Amount	
	2011	2010	2011 MNT'000	2010 MNT'000
At 1st January	13,290,651	13,290,651	13,290,651	13,290,651
Issue during the year	7,063,005	-	7,063,005	-
At 31st December	20,353,656	13,290,651	20,353,656	13,290,651

On 10 February 2011, 2,877,764 shares of MNT 1,000 each were issued to the shareholder of the Bank for cash at a subscription price of MNT 5,212.38 per share.

On 26 September 2011, 4,185,241 shares of MNT 1,000 each were issued to the shareholder of the Bank for cash at a subscription price of MNT 5,208.78 per share.

29. OTHER RESERVES

There is no movement in other reserves during the year whereas in 2010, the Board of Directors approved the transfer of MNT 2,177,979,000 from retained earnings to other reserves. At the date of this report, no policy is formalised by the Board as to the purpose of this reserves.

30. DIVIDENDS PAID AND PROPOSED

	2011 MNT'000	2010 MNT'000
Dividends payable at 1 January	1,243	1,113
Dividends declared during the year	975,215	384,366
Dividends paid during the year	(277,823)	(384,236)
Dividends payable at 31 December (Note 26)	698,635	1,243

31. CASH AND CASH EQUIVALENTS

	Notes	2011 MNT'000	2010 MNT'000
Cash and balances with central bank	13	114,304,144	48,682,209
Due from banks	14	39,515,647	30,127,154
The Bank of Mongolia central bank and treasury bills	15	98,854,788	42,947,556
		252,674,579	121,756,919
Less: Minimum reserve with Bank of Mongolia not available to finance the Bank's day to day operations (refer Note 13)		(41,667,002)	(9,780,500)
Less: Placement with other banks with original maturities of more than three months		(19,996,523)	(14,855,838)
Total cash and cash equivalents		191,011,054	97,120,581

32. SHARE-BASED PAYMENT

During 2010, TenGer Financial Group LLC has introduced Employee Stock Option Plan ("ESOP"), which relates to key employees (such as management team members and other high performing staff as identified by the management) of TenGer and its subsidiaries and associates. The main factors affecting the allocated number of shares of TenGer per each employee are employee's annual compensation and annual performance rating. A key employee is entitled to 30% of shares after one year of service (i.e. for services provided in period from 1 January 2010 to 31 December 2010), 30% of shares after two years of service (i.e. for services provided in period from 1 January 2011 to 31 December 2011) and 40% of shares after three years of service (i.e. for services provided in period from 1 January 2012 to 31 December 2012).

As at 31 December 2011, no shares have been granted to any employees of the Bank under the ESOP, the Bank has not therefore recognised any transactions related to share-based payments arising from the above program in these financial statements.

33. 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:

At 31 December 2011	Level 1 MNT'000	Level 2 MNT'000	Level 3 MNT'000	Total MNT'000
Financial asset				
Other financial assets held-for-trading				
Quoted equity	123,558	-	-	123,558

At 31 December 2010	Level 1 MNT'000	Level 2 MNT'000	Level 3 MNT'000	Total MNT'000
Financial asset				
Other financial assets held-for-trading				
Quoted equity	-	-	-	-

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.

33. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTD.)

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

As at 31 December 2011	**Note**	**Carrying amount MNT'000**	**Fair value MNT'000**
Financial assets			
Cash and balances with central bank	13	114,304,144	114,304,144
Due from banks	14	39,515,647	39,515,647
Financial investments - held-to-maturity			
The Bank of Mongolia central bank and treasury bills	15	98,854,788	98,854,788
Loans and advances to customers	16	535,894,643	528,395,996
Other receivables	17	838,551	838,551
		789,407,773	781,909,126
Financial liabilities			
Due to banks	20	62,464,219	62,464,219
Repurchase agreement	21	48,822,587	48,822,587
Due to customers	22	365,291,454	365,291,454
Borrowed funds	23	217,087,557	217,985,366
Subordinated loans	24	37,028,367	37,498,579
Other liabilities	26	3,350,297	3,350,297
		734,044,481	735,412,502

As at 31 December 2010			
Financial assets			
Cash and balances with central bank	13	48,682,209	48,682,209
Due from banks	14	30,127,154	30,127,154
Financial investments - held-to-maturity			
The Bank of Mongolia central bank and treasury bills	15	42,947,556	42,947,556
Loans and advances to customers	16	321,690,771	322,396,328
Other receivables	17	810,855	810,855
		444,258,545	444,964,102
Financial liabilities			
Due to banks	20	32,482,270	32,482,270
Due to customers	22	237,193,052	237,193,052
Borrowed funds	23	146,274,827	145,978,340
Subordinated loans	24	14,103,479	14,557,023
Other liabilities	26	3,286,999	3,286,999
		433,340,627	433,497,684

33. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTD.)

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 as disclosed in Note 33 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.

34. 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.

	2011 MNT'000	2010 MNT'000
Contingent liabilities		
Financial guarantees	1,949,450	858,379
Letters of credit	9,979,211	638,062
Performance and tender guarantees	6,453,363	628,321
	18,382,024	2,124,762

	2011 MNT'000	2010 MNT'000
Commitments		
Undrawn commitments to lend	13,399,381	5,005,906
Total	31,781,405	7,130,668

34. CONTINGENT LIABILITIES AND COMMITMENTS (CONTD.)

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.

However, 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

	2011 MNT'000	2010 MNT'000
Approved and contracted for:		
Property, plant and equipment	565,481	118,624
Intangible assets	24,200	-
	589,681	118,624

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.

34. CONTINGENT LIABILITIES AND COMMITMENTS (CONTD.)

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.

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 2010, the Bank is currently 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 five-year open period up to the date of approval of these financial statements amount to MNT 65,282,000 as at 31 December 2011 (2010: MNT 679,780,000). Though the tax authorities claim the Bank's 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. For these reasons, management believes that it is unlikely that the Bank will suffer material losses as a result of this litigation, and no provision is thus recognised in these financial statements.

The Bank's management believes that its interpretation of the relevant legislation is appropriate and the Bank's position related to tax and other legislation will be sustained. Management believes that tax and legal risks related to areas, other than those addressed in current litigation with tax authorities are remote. 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.

35. 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 37.3 'Liquidity risk and funding management' for the Bank's contractual undiscounted repayment obligations.

At 31 December 2011	Less than 12 months MNT'000	More than 12 months MNT'000	Total MNT'000
Financial assets			
Cash and balances with central bank	114,304,144	-	114,304,144
Due from banks	39,515,647	-	39,515,647
Financial investments -			
- held-for-trading	123,558	-	123,558
- available-for-sale	-	434,680	434,680
- held-to-maturity	98,854,788	-	98,854,788
Loans and advances to customers	214,686,204	321,208,439	535,894,643
Other receivables	838,551	-	838,551
	468,322,892	321,643,119	789,966,011
Non financial assets			
Property, plant and equipment	-	19,081,961	19,081,961
Intangible assets	392,866	3,545,325	3,938,191
Other assets	4,494,398	93,128	4,587,526
	4,887,264	22,720,414	27,607,678
Total	473,210,156	344,363,533	817,573,689
Financial liabilities			
Due to banks	55,188,747	7,275,472	62,464,219
Repurchase agreement	48,822,587	-	48,822,587
Due to customers	314,954,079	50,337,375	365,291,454
Borrowed funds	57,654,036	159,433,521	217,087,557
Subordinated loans	-	37,028,367	37,028,367
Other liabilities	3,085,265	265,032	3,350,297
	479,704,714	254,339,767	734,044,481
Non financial liabilities			
Deferred grants	689,015	-	689,015
Other liabilities	2,503	-	2,503
Income tax payable	53,891	-	53,891
Deferred tax liability	198,429	-	198,429
	943,838	-	943,838
Total	480,648,552	254,339,767	734,988,319
Net	(7,438,396)	90,023,766	82,585,370

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

At 31 December 2010	Less than 12 months MNT'000	More than 12 months MNT'000	Total MNT'000
Financial assets			
Cash and balances with central bank	48,682,209	-	48,682,209
Due from banks	30,127,154		30,127,154
Financial investments -			
- available-for-sale	-	434,680	434,680
- held-to-maturity	42,947,556	-	42,947,556
Loans and advances to customers	146,481,830	175,208,941	321,690,771
Other receivables	810,855	-	810,855
	269,049,604	175,643,621	444,693,225
Non financial assets			
Property, plant and equipment	-	16,645,842	16,645,842
Intangible assets	-	3,526,039	3,526,039
Other assets	3,208,823	-	3,208,823
Deferred tax asset	-	309,547	309,547
	3,208,823	20,481,428	23,690,251
Total	272,258,427	196,125,049	468,383,476
Financial liabilities			
Due to banks	18,120,311	14,361,959	32,482,270
Due to customers	198,299,151	38,893,901	237,193,052
Borrowed funds	43,330,779	102,944,048	146,274,827
Subordinated loans	-	14,103,479	14,103,479
Other liabilities	2,809,008	477,991	3,286,999
	262,559,249	170,781,378	433,340,627
Non financial liabilities			
Deferred grants	303,609	-	303,609
Other liabilities	8,321	-	8,321
Income tax payable	116,847	-	116,847
	428,777	-	428,777
Total	262,988,026	170,781,378	433,769,404
Net	9,270,401	25,343,671	34,614,072

36. 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, which are companies in which the Members of the Board of Directors have substantial financial interest, or constitute Members of the Board of Directors and key management executives.

	2011 MNT'000	2010 MNT'000
a) Loans and advances to related companies:		
Fellow subsidiaries	1,597,284	881,995
Shareholders of holding company	283,819	165,787
	1,881,103	1,047,782
Members of the Board of Directors and key management personnel of the Bank	473,877	478,000
	2,354,980	1,525,782

The loans and advances to fellow subsidiaries, Members of the Board of Directors and key management personnel were secured, bore interest rates from 0% to 24.0% (2010: 0.% to 22.2%) per annum and are repayable within one to 14 years. The interest income received from such loans during the financial year amounted to MNT 148.0 million (2010: MNT 97.8 million).

	2011 MNT'000	2010 MNT'000
b) Deposits from related companies:		
Holding company	1,538,867	2,841,053
Fellow subsidiaries	2,935,884	823,108
Associate of holding company	73,164	1,126,628
Shareholders of holding company	2,918,900	3,053,124
	7,466,815	7,843,913
Members of the Board of Directors and key management personnel of the Bank	9,769	220,685
	7,476,584	8,064,598

36. RELATED PARTY DISCLOSURES (CONTD.)

b) Deposits from related companies (Contd.):

The deposits from the above related companies, Members of the Board of Directors and key management personnel bore interest rates from 0.80% to 15.80% (2010: 0.80% to 15.80%) per annum. The interest expenses paid to the above depositors during the financial year amounted to MNT 1,772.1 million (2010: MNT 591.9 million).

	2011 MNT'000	2010 MNT'000
c) Loans from shareholders of TenGer Financial Group LLC:		
BlueOrchard Finance	7,027,934	8,368,606
Stiching Triodos Doen	-	5,032,487
Triodos Fair Share Fund	1,434,915	3,191,012
International Finance Corporation ("IFC")	2,787,238	3,754,920
European Bank for Reconstruction and Development	9,341,468	5,699,896
	20,591,555	26,046,921

The loans from the above shareholders of TenGer Financial Group LLC bore interest rates from 3.90% to 14.44% (2010: 4.25% to 15.65%) per annum. The interest expenses paid to such loans during the financial year amounted to MNT 1,170.5 million (2010: MNT 1,701.0 million).

	2011 MNT'000	2010 MNT'000
d) Deferred grant from shareholder of TenGer Financial Group LLC:		
International Finance Corporation ("IFC")	-	2,315

	2011 MNT'000	2010 MNT'000
e) Subordinated loan from shareholder of TenGer Financial Group LLC:		
International Finance Corporation ("IFC")	6,930,953	6,221,352

The subordinated loan from the above shareholder of TenGer Financial Group LLC bore interest rate is 6.90% (2010: 6.92%) per annum. The interest expenses paid to such subordinated loan during the financial year amounted to MNT 442.1 million (2010: MNT 161.8 million).

	2011 MNT'000	2010 MNT'000
f) Security fees paid to related company:		
Fellow subsidiary	1,162,069	873,294

36. RELATED PARTY DISCLOSURES (CONTD.)

g) Commission income from related companies:

	2011 MNT'000	2010 MNT'000
Holding company	20	408
Fellow subsidiaries	392	159
Associates of holding company	255	475
Shareholders of holding company	517	626
	1,184	1,668
Members of the Board of Directors and key management personnel of the Bank	889	1,790
	2,073	3,458

h) Contract fee paid to related companies:

	2011 MNT'000	2010 MNT'000
Holding company	744,185	26,189
Associates of holding company	417,066	475,644
	1,161,251	501,833

i) Rental income from related companies:

	2011 MNT'000	2010 MNT'000
Associates of holding company	40,441	29,334

j) Compensation of key management personnel:

	2011 MNT'000	2010 MNT'000
Short-term employee benefits		
Salaries	1,030,464	551,124
Contribution to social and health fund	113,351	60,624
	1,143,815	611,748

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 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 2011 and 2010, the Bank has not made any provision for doubtful debts relating to amounts owed by related parties.

37. RISK MANAGEMENT

37.1 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.

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.

37. RISK MANAGEMENT (CONTD.)

37.1 Introduction (Contd.)

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.

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.

37. RISK MANAGEMENT (CONTD.)

37.1 Introduction (Contd.)

Excessive Risk Concentration

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, the Bank of Mongolia ("Central Bank") 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.

37.2 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 fulfil their contractual obligations under loan agreements, other credit facilities, or in respect of other financial instruments.

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.

37. RISK MANAGEMENT (CONTD.)

37.2 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 2011 MNT'000	Gross maximum exposure 2010 MNT'000
Cash and balances with central bank (excluding cash on hand)	13	78,516,359	34,695,071
Due from banks	14	39,515,647	30,127,154
Financial investments – held-for-trading	15	123,558	-
Financial investments – available-for-sale	15	434,680	434,680
Financial investments – held-to-maturity	15	98,854,788	42,947,556
Loans and advances to customers	16	535,894,643	321,690,771
Other receivables	17	838,551	810,855
Total		754,178,226	430,706,087
Contingent liabilities	34	18,382,024	2,124,762
Commitments	34	13,399,381	5,005,906
Total		31,781,405	7,130,668
Total credit risk exposure		785,959,631	437,836,755

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.

37. RISK MANAGEMENT (CONTD.)

37.2 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 16) in gross amounts , before taking into account the fair value of the loan collateral held or other credit enhancements.

	2011		2010	
	Gross maximum exposure		Gross maximum exposure	
	MNT’000	%	MNT'000	%
Textile and production	49,658,614	9.2%	28,457,780	8.7%
Trading	97,080,978	17.9%	72,534,720	22.3%
Food processing	12,517,409	2.3%	11,431,176	3.5%
Services	97,976,288	18.1%	54,935,945	16.9%
Consumption	110,342,969	20.3%	66,823,711	20.5%
Agricultural	11,658,030	2.1%	8,531,060	2.6%
Mortgage	107,564,838	19.8%	58,662,396	18.0%
Deposit backed	17,015,867	3.1%	7,865,761	2.4%
Construction and education	35,005,582	6.5%	14,460,617	4.4%
Loans to staff	3,255,156	0.6%	1,719,889	0.6%
Loans to key management personnel	473,877	0.1%	478,000	0.1%
Total	542,549,608	100%	325,901,055	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.

37. RISK MANAGEMENT (CONTD.)

37.2 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

Tha 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.

		Neither past due nor impaired						
At 31 December 2011	Note	Excellent MNT'000	Good MNT'000	Satisfactory MNT'000	Substandard MNT'000	Not rated MNT'000	Past due or individually impaired MNT'000	Total MNT'000
Cash and balances with central bank	13	114,304,144	-	-	-	-	-	114,304,144
Due from banks	14	6,684,427	428,212	3,664,696	28,738,312	-	-	39,515,647
Financial investment								
-held-for-trading	15	123,558	-	-	-	-	-	123,558
-available-for-sale	15	-	-	-	-	434,680	-	434,680

37. RISK MANAGEMENT (CONTD.)

37.2 Credit risk (Contd.)

Credit quality per class of financial assets (Contd.)

At 31 December 2011	Note	Neither past due nor impaired Excellent MNT'000	Good MNT'000	Satisfactory MNT'000	Substandard MNT'000	Not rated MNT'000	Past due or individually impaired MNT'000	Total MNT'000
Financial investment								
-held-to-maturity	15	98,854,788	-	-	-	-	-	98,854,788
Loans and advances to customers								
SME loan	16	52,766,399	26,035,524	144,720,926	3,129,987	1,703,742	9,474,085	237,830,663
Mortgage loan	16	12,149,823	23,537,529	68,804,448	1,345,792	1,035,859	691,386	107,564,837
Micro business loan	16	7,285,022	5,809,085	62,075,139	449,240	2,981	987,037	76,608,504
Consumer loan	16	19,659,783	24,298,635	24,459,094	762,086	3,038	648,620	69,831,256
Finance leases	16	11,706,813	5,531,206	10,514,367	167,962	787	846,447	28,767,582
Other	16	20,856,122	95,926	816,458	23,779	-	154,481	21,946,766
		124,423,962	85,307,905	311,390,432	5,878,846	2,746,407	12,802,056	542,549,608
Other receivables	17	833,730	-	-	-	-	34,950	868,680
Total		345,224,609	85,736,117	315,055,128	34,617,158	3,181,087	12,837,006	796,651,105

At 31 December 2010	Note	Neither past due nor impaired Excellent MNT'000	Good MNT'000	Satisfactory MNT'000	Substandard MNT'000	Not rated MNT'000	Past due or individually impaired MNT'000	Total MNT'000
Cash and balances with central bank	13	48,682,209	-	-	-	-	-	48,682,209
Due from banks	14	4,352,595	1,313,968	8,260,569	16,200,022	-	-	30,127,154
Financial investment								
-available-for-sale	15	-	-	-	-	434,680	-	434,680
-held-to-maturity	15	42,947,556	-	-	-	-	-	42,947,556
Loans and advances to customers								
SME loan	16	31,022,355	13,342,386	74,346,350	584,021	1,900,453	5,585,233	126,780,798
Mortgage loan	16	3,305,691	13,762,369	39,064,269	82,810	1,771,475	675,782	58,662,396
Micro business loan	16	6,300,350	3,652,329	47,394,115	126,417	76,132	954,266	58,503,609
Consumer loan	16	14,069,881	17,771,315	16,183,437	141,790	48,662	548,726	48,763,811
Finance leases	16	9,256,917	3,852,233	7,857,761	53,592	8,489	332,321	21,361,313
Other	16	10,498,234	165,758	909,132	41,562	703	213,739	11,829,128
		74,453,428	52,546,390	185,755,064	1,030,192	3,805,914	8,310,067	325,901,055
Other receivables	17	800,955	-	-	-	-	41,514	842,469
Total		171,236,743	53,860,358	194,015,633	17,230,214	4,240,594	8,351,581	448,935,123

37. RISK MANAGEMENT (CONTD.)

37.2 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

As at 31 December 2011	Less than 30 days MNT'000	31 to 60 days MNT'000	61 to 90 days MNT'000	More than 91 days MNT'000	Total MNT'000
Loan and advances to customers					
SME loan	1,379,537	645,604	483,829	684,367	3,193,337
Mortgage loan	97,155	5,523	67,944	520,764	691,386
Micro business loan	204,373	167,697	30,622	584,345	987,037
Consumer loan	194,231	114,092	31,351	308,946	648,620
Finance leases	82,427	358,136	81,477	174,656	696,696
Other	18,024	11,668	6,920	117,869	154,481
	1,975,747	1,302,720	702,143	2,390,947	6,371,557

As at 31 December 2010	Less than 30 days MNT'000	31 to 60 days MNT'000	61 to 90 days MNT'000	More than 91 days MNT'000	Total MNT'000
Loan and advances to customers					
SME loan	680,817	272,367	10,692	47,564	1,011,440
Mortgage loan	124,327	-	18,393	297,671	440,391
Micro business loan	72,777	84,332	72,944	681,762	911,815
Consumer loan	74,809	59,075	30,205	337,761	501,850
Finance leases	54,385	30,851	17,538	144,239	247,013
Other	46,185	8,275	1,399	66,027	121,886
	1,053,300	454,900	151,171	1,575,024	3,234,395

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 2011 was MNT 9,723 million (2010: MNT 2,874 million). Please refer Note 16 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.

	2011 MNT'000	2010 MNT'000
Loans and advances to customers		
Small and medium enterprises (SME) loan	1,172,787	1,761,642
Mortgage loan	420,193	660,667
Micro business loan	904	72,146
Consumer loan	2,108	46,649
Finance leases	-	7,909
Other	-	703
	1,595,992	2,549,716

37. RISK MANAGEMENT (CONTD.)

37.2 Credit risk (Contd.)

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.

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.

37.3 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 The Bank of Mongolia (the Central Bank) equal to 11% (2010: 5%) of customer deposits.

37. RISK MANAGEMENT (CONTD.)

37.3 Liquidity risk (Contd.)

Analysis of financial liabilities by remaining contractual maturities

The table below summarizes the maturity profile of the Bank's financial liabilities at 31 December 2011 and 31 December 2010 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.

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 2011							
Due to banks	-	34,936,030	6,291,275	16,196,411	8,868,226	-	66,291,942
Repurchase agreement	-	49,358,091	-	-	-	-	49,358,091
Due to customers	170,609,072	52,317,098	41,885,486	61,610,073	32,146,797	49,184,600	407,753,126
Borrowed funds	-	16,593,846	19,346,482	24,299,087	155,982,347	35,471,010	251,692,772
Subordinated loans	-	-	-	-	-	52,168,260	52,168,260
Other liabilities	-	2,387,834	500,038	197,393	265,032	-	3,350,297
Total	170,609,072	155,592,899	68,023,281	102,302,964	197,262,402	136,823,870	830,614,488
At 31 December 2010							
Due to banks	-	5,276,364	6,282,666	7,253,620	15,369,329	-	34,181,979
Due to customers	73,097,321	28,435,808	37,471,901	69,028,638	26,648,272	32,793,925	267,475,865
Borrowed funds	-	4,637,942	16,961,547	24,575,810	120,368,629	14,589,553	181,133,481
Subordinated loans	-	-	-	-	-	21,036,876	21,036,876
Other liabilities	-	2,583,169	74,780	151,059	477,991	-	3,286,999
Total	73,097,321	40,933,283	60,790,894	101,009,127	162,864,221	68,420,354	507,115,200

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

	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 2011							
Contingent liabilities	-	12,956,076	3,416,929	1,953,016	56,003	-	18,382,024
Commitments	-	1,059,840	1,226,240	1,420,617	9,692,684	-	13,399,381
Total	-	14,015,916	4,643,169	3,373,633	9,748,687	-	31,781,405
At 31 December 2010							
Contingent liabilities	-	1,004,943	203,445	916,374	-	-	2,124,762
Commitments	-	2,182,865	106,269	341,520	2,374,403	849	5,005,906
Total	-	3,187,808	309,714	1,257,894	2,374,403	849	7,130,668

37. RISK MANAGEMENT (CONTD.)

37.4 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 income statement. The sensitivity of the income statement 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 2011 and 31 December 2010.

Currency	Change in basis points	Sensitivity of net interest income MNT'000
At 31 December 2011		
USD	+120	604,032
MNT	+120	-450,596
USD	-120	-604,032
MNT	-120	450,596
At 31 December 2010		
USD	+120	406,179
MNT	+120	-203,582
USD	-120	-406,179
MNT	-120	203,582

37. RISK MANAGEMENT (CONTD.)

37.4 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
2011 - 31st December	45,180
2011 - Average Daily	50,777
2011 - Highest	175,810
2011 - Lowest	3,426

37. RISK MANAGEMENT (CONTD.)

37.4 Market risk (Contd.)

Currency risk (Contd.)

	Variance/ Covariance MNT'000
2010 - 31st December	28,346
2010 - Average Daily	13,464
2010 - Highest	87,834
2010 - Lowest	775

The table below summarizes the Bank's exposure to foreign exchange risk as December 31, 2011 and December 31, 2010. 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 2011					
Assets					
Cash and balances with central bank	78,934,842	20,044,094	6,046,948	9,278,260	114,304,144
Due from banks	364,470	35,943,374	970,882	2,236,921	39,515,647
Financial investment-held-for-trading	-	-	-	123,558	123,558
Financial investment-available-for-sale	434,680	-	-	-	434,680
Financial investment-held-to-maturity	98,854,788	-	-	-	98,854,788
Loans and advances to customers	387,538,230	148,333,503	15,091	7,819	535,894,643
Other receivables	511,459	315,776	-	11,316	838,551
	566,638,469	204,636,747	7,032,921	11,657,874	789,966,011
Liabilities					
Due to banks	56,986,926	-	5,477,293	-	62,464,219
Repurchase agreement	48,822,587	-	-	-	48,822,587
Due to customers	317,837,581	42,635,572	1,410,858	3,407,443	365,291,454
Borrowed funds	88,870,887	128,216,670	-	-	217,087,557
Subordinated loans	-	37,028,367	-	-	37,028,367
Other liabilities	2,733,197	278,975	106,284	231,841	3,350,297
	515,251,178	208,159,584	6,994,435	3,639,284	734,044,481
Net position	51,387,291	(3,522,837)	38,486	8,018,590	55,921,530

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 2010					
Assets					
Cash and balances with central bank	30,643,529	16,616,560	698,842	723,278	48,682,209
Due from banks	279,322	25,011,550	1,536,681	3,299,601	30,127,154
Financial investment-available-for-sale	434,680	-	-	-	434,680
Financial investment-held-to-maturity	42,947,556	-	-	-	42,947,556
Loans and advances to customers	240,630,444	80,574,125	41,572	444,630	321,690,771
Other receivables	387,799	420,131	-	2,925	810,855
	315,323,330	122,622,366	2,277,095	4,470,434	444,693,225

37. RISK MANAGEMENT (CONTD.)

37.4 Market risk (Contd.)

Currency risk (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 2010					
Liabilities					
Due to banks	32,482,270	-	-		32,482,270
Due to customers	215,713,971	16,920,676	2,274,141	2,284,264	237,193,052
Borrowed funds	57,578,577	88,696,250	-	-	146,274,827
Subordinated loans	-	14,103,479	-	-	14,103,479
Other liabilities	1,078,157	2,015,627	-	193,215	3,286,999
	306,852,975	121,736,032	2,274,141	2,477,479	433,340,627
Net position	8,470,355	886,334	2,954	1,992,955	11,352,598

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. The effect on profit before tax for one year, assuming the historical annual prepayment ratio for the year, with all other variables held constant, is as follows:

	Effect on net interest income 2011 MNT'000	Effect on net interest income 2010 MNT'000
Loans and advances to customers		
Small and medium enterprises (SME) loan	2,904,023	1,670,909
Mortgage loan	2,831,748	887,851
Micro business loan	1,410,260	1,624,959
Consumer loan	3,582,176	3,085,952
Finance leases	541,841	600,949
	11,270,048	7,870,620

37. RISK MANAGEMENT (CONTD.)

37.4 Market risk (Contd.)

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.

38. COMPARATIVES

Certain comparative amounts have been reclassified to conform with current year's presentation:

39. 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 The Bank of Mongolia.

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.

39. CAPITAL ADEQUACY (CONTD.)

Regulatory capital

The Bank of Mongolia requires commercial banks to maintain a minimum core capital adequacy ratio of 6% (2010: 6%) and risk weighted capital ratio of at least 12% (2010: 12%) 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:

	2011	2010
Core capital ratio	14.38%	9.71%
Risk weighted capital ratio	20.83%	13.66%

	2011 MNT'000	2010 MNT'000
Tier I capital		
Ordinary shares	20,353,656	13,290,651
Share premium	34,989,097	5,252,103
Other reserves	10,531,368	10,531,368
Retained profit	16,711,249	5,539,950
Total Tier I Capital	82,585,370	34,614,072
Tier II capital		
Subordinated loans	37,028,367	14,103,479
Total capital /capital base	119,613,737	48,717,551

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

	2011		**2010**	
%	Risk Assets MNT'000	Weighted MNT'000	Risk Assets MNT'000	Weighted MNT'000
0	213,158,932	-	91,629,765	-
20	28,021,596	5,604,319	10,730,518	2,146,104
50	85,374,093	42,687,046	44,829,677	22,414,838
100	520,926,008	520,926,008	327,533,183	327,533,183
150	3,329,016	4,993,525	2,986,230	4,479,345
Total	850,809,645	574,210,898	477,709,373	356,573,470

40. 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.