XACBANK LLC

Financial Statements together with Independent Auditor’s Report for the year ended 31 December 2017

XACBANK LLC

FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017

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CORPORATE INFORMATION

REGISTERED ADDRESS:	XacBank Building Prime Minister Amar's Street, Post Branch # 46, P.O Box 721, Ulaanbaatar 14200 Mongolia
BOARD OF DIRECTORS:	Mr. Ganbold Chuluun Mr. Boldoo Magvan Ms. Tselmuun Nyamtaishir Mr. Michael Madden Mr. James Stent Mr. Ulambayar Bayansan Mr. Yoshiaki Matsuoka Mr. Julian Healy Mr. Yves Jacquot Mr. Mathew Welch Mr. Sanjay Gupta (Appointed on 30 March 2017)
CORPORATE SECRETARY:	Ms. Ashidmaa Dashnyam
AUDITORS	Deloitte Onch Audit LLC

XACBANK LLC

STATEMENT BY EXECUTIVES

We, Boldoo Magvan being Chief Executive Officer of XacBank LLC ("the Bank") and Erdenebayar Ganzorig being Chief Financial 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 1 to 85 present fairly, in all material respects the financial position of the Bank as at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

ХАСБАНК

BOLDOO MAGVAN
(Chief Executive Officer)

ERDENEBAYAR GANZORIG
(Chief Financial Officer)

Ulaanbaatar
Date: 28 March 2018

Deloitte.

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INDEPENDENT AUDITOR'S REPORT

To the Shareholder of XacBank LLC

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying financial statements of XacBank LLC (the "Bank"), which comprise the statement of financial position as at 31 December 2017, the statement of comprehensive income, the statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2017, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ("IESBA Code"), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

The directors of the Bank are responsible for the other information. The other information comprises the information included in the statement by executive, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with IFRSs 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.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Deloitte.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Norjinbat Shagdarsuren.

Норжинбат

DELOITTE ONCH AUDIT LLC

Norjinbat Shagdarsuren
Director, CPA
Deloitte Onch Audit LLC
28 March 2018

XACBANK LLC

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2017

	Note	2017 MNT'000	2016 MNT'000
Interest and similar income	4	286,627,361	260,906,917
Interest and similar expenses	5	(205,503,627)	(170,362,720)
Net interest income		**81,123,734**	**90,544,197**
Fees and commission income	6	13,557,126	10,435,265
Fees and commission expenses	6	(2,448,885)	(1,742,748)
Net fees and commission income	6	**11,108,241**	**8,692,517**
Net trading loss	7	(12,022,591)	(17,046,410)
Other operating income – net	8	6,882,691	28,229,589
Total operating income		**87,092,075**	**110,419,893**
Credit and other losses	9	706,628	(31,141,931)
Net operating income		**87,798,703**	**79,277,962**
Operating expenses	10	(67,776,345)	(56,677,699)
Amortisation of deferred grants	30	500,490	604,327
Profit before tax		**20,522,848**	**23,204,590**
Income tax expense	11	(412,832)	(1,751,137)
Profit for the year		**20,110,016**	**21,453,453**
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss			
Fair value gains of available for sale securities, net of tax		214,834	1,255,916
Total comprehensive income, (net of tax) attributable to equity holder of the Bank		**20,324,850**	**22,709,369**
Earnings per share (MNT):			
Basic earnings per share	12	988.03	1,054.03
Diluted earnings per share	12	988.03	1,054.03

The accompanying notes form an integral part of the financial statements

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2017

	Note	2017 MNT'000	2016 MNT'000
ASSETS			
Cash and balances with BoM	13	465,763,697	326,779,876
Due from banks	14	313,373,833	158,627,068
Reverse repurchase agreements	15	64,974,429	-
Derivative financial instruments	16	82,731,615	125,019,231
Financial investments – available-for-sale	17	47,366,617	28,117,332
Financial investments – held-to-maturity	17	578,348,399	355,119,924
Loans and advances to customers	18	1,344,102,813	1,157,201,583
Other assets	19	30,500,275	29,270,431
Properties held for sale	20	16,800,466	24,039,038
Property and equipment	21	37,011,094	36,619,582
Intangible assets	22	9,972,150	10,298,683
Investment property	23	50,375,520	4,860,809
Deferred tax asset	24	1,167,009	1,326,486
TOTAL ASSETS		**3,042,487,917**	**2,257,280,043**
LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks	25	230,315,541	750,413
Repurchase agreements	26	214,925,195	-
Due to customers	27	1,294,513,630	985,503,687
Derivative financial instruments	16	5,477,654	928,603
Borrowed funds	28	957,032,638	936,093,995
Subordinated loans	29	110,262,405	123,443,085
Deferred grants	30	2,997,719	1,279,902
Other liabilities	31	27,537,572	30,243,515
Income tax payable		66,142	2,272
TOTAL LIABILITIES		**2,843,128,496**	**2,078,245,472**
EQUITY			
Ordinary shares	32	55,342,753	55,342,753
Other reserves	33	10,531,368	10,531,368
Available for sale reserve		1,470,750	1,255,916
Regulatory reserve		8,530,791	8,144,440
Retained profits		123,483,759	103,760,094
TOTAL EQUITY		**199,359,421**	**179,034,571**
TOTAL LIABILITIES AND EQUITY		**3,042,487,917**	**2,257,280,043**

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

XACBANK LLC

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017

	Ordinary shares	Other reserves	Available for sale reserve	Regulatory Reserve	Retained earnings	Total equity
	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
At January 2016	**55,342,753**	**10,531,368**	**-**	**-**	**90,451,081**	**156,325,202**
Total comprehensive income	-	-	1,255,916	-	21,453,453	22,709,369
Transfer to regulatory reserve	-	-	-	8,144,440	(8,144,440)	-
At 31 December 2016	**55,342,753**	**10,531,368**	**1,255,916**	**8,144,440**	**103,760,094**	**179,034,571**
Total comprehensive income	-	-	214,834	-	20,110,016	20,324,850
Transfer to regulatory reserve	-	-	-	386,351	(386,351)	-
At 31 December 2017	**55,342,753**	**10,531,368**	**1,470,750**	**8,530,791**	**123,483,759**	**199,359,421**

The regulatory reserve is set up in compliance with Bank of Mongolia requirement and is distributable to Shareholder of the Bank subject to consultation with them.

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

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2017

	Note	2017 MNT'000	2016 MNT'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		20,522,848	23,204,590
Adjustments for:-			
(Gain)/loss on disposal of property and equipment	8	(15,282)	439
Gain on disposal of intangible assets	8	(200,000)	-
Gain on disposal of properties held for sale and foreclosed properties	8	(316,477)	(742,952)
Unrealised foreign exchange gain	8	(4,598,391)	(26,975,522)
Credit loss for loans and advances to customers	9	(4,511,577)	24,351,510
Impairment for other assets	9	913,575	429,422
Impairment reversal on properties held for sale	9	-	(108,638)
Impairment loss on financial investments	9	84,625	516,445
Impairment loss on foreclosed properties	9	2,806,749	5,953,192
Depreciation of property and equipment	10	5,352,895	5,095,793
Amortisation of intangible assets	10	1,911,039	1,633,170
Property and equipment written off	10	104,824	115,614
Intangible asset written off	10	-	1,936
Change in fair value of investment property	8	(1,186,692)	-
Utilisation of deferred grants	30	(500,490)	(604,327)
Dividend income	8	(99,329)	(50,802)
Operating profit before working capital changes		**20,268,317**	**32,819,870**
Changes in operating assets:-			
Statutory deposits with BoM		(30,321,951)	(21,789,907)
Due from banks		(110,952,112)	10,260,528
Reverse repurchase agreements		(64,974,429)	9,981,555
Loans and advances to customers		(271,969,255)	(68,245,174)
Derivative financial instruments		32,077,431	(122,711,960)
Other assets		(11,461,982)	(1,795,103)
Changes in operating liabilities:-			
Due to banks		229,565,128	(20,292,157)
Repurchase agreements		214,925,195	(100,299,411)
Due to customers		312,780,100	40,821,792
Derivative financial instruments		4,549,051	138,448,923
Other liabilities		69,970,953	75,382,529
Cash used in operations		**394,456,446**	**(27,418,515)**
Income tax paid		(261,096)	(867,618)
Net cash flows generated from/(used in) operating activities		**394,195,350**	**(28,286,133)**

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2017 (CONT'D)

	Note	2017 MNT'000	2016 MNT'000
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of financial investments		(258,767,626)	(87,330,122)
Proceeds from financial investments		369,581,974	123,840,400
Proceeds on disposal of property and equipment		129,353	195,869
Proceeds on disposal of intangible assets		200,000	-
Purchase of property and equipment	21	(6,866,683)	(7,299,388)
Purchase of intangible assets	22	(1,793,684)	(2,873,773)
Proceeds from sale of properties held for sale		7,219,320	7,935,290
Proceeds from sale of foreclosed properties		6,460,837	2,445,944
Dividends received from financial investments		99,329	50,802
Net cash flows generated from investing activities		**116,262,820**	**36,965,022**
CASH FLOWS FROM FINANCING ACTIVITIES			
Drawdown of borrowed funds		559,761,604	528,316,008
Repayment of borrowed funds		(555,567,187)	(427,898,760)
Repayment of subordinated loans		(20,176,791)	(16,250,093)
Dividends paid	34	-	(39)
Deferred grants received	30	2,218,307	429,492
Net cash flows generated from financing activities		**(13,764,067)**	**84,596,608**
Effect of exchange rate changes on cash and cash equivalents		(8,932,269)	98,219,406
Net increase in cash and cash equivalents		487,761,834	93,275,497
Cash and cash equivalents brought forward		447,341,668	255,846,765
Cash and cash equivalents carried forward	35	**935,103,502**	**447,341,668**
Operational cash flows from interest			
Interest paid		201,625,593	149,020,527
Interest received		278,047,830	237,455,127

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

1. Corporate Information

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

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

The holding company of the Bank is TenGer Financial Group LLC, (“TFG” or the “Company”) which is incorporated in Mongolia. The shareholders of the holding company are:

- Mongolyn Alt (MAK) Corporation LLC
- International Finance Corporation (IFC)
- ORIX Corporation
- European Bank for Reconstruction and Development (EBRD)
- National Bank of Canada (NBC)
- Ronoc Partners S.A.R.L.
- Mongolia Financial Services
- Triodos Fair Share Fund
- Open Society Forum
- UB Rotary Club
- Boldoo Magvan
- Ganbold Chuluun

The financial statements of the Bank were authorised for issue by the Board of Directors in accordance with a resolution of the Directors on 28 March 2018.

2.1 Basis of preparation

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

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 38.

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.

Going concern

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

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:

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.

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

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.

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

Sale of mortgage loans sold to "MIK Holding" JSC ("MIK")

The Bank has sold mortgage loan portfolios to MIK and its subsidiaries in exchange for bonds issued by MIK SPC and derecognized the loans as it is considered that the transactions meet the derecognition criteria as envisaged in IAS39:AG 39 on the basis that the Bank has transferred substantially all the risks and rewards, in conjunction with the recognition of the "Residential Mortgage Backed Securities ("RMBS"). Although there is a mandatory buy back by the Bank if the default rate of the mortgage loans purchased reaches 20%, any such buy back would be at fair value. Management judgment is required to determine that substantially all the risks and rewards have been transferred.

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 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 (Note 24).

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. The fair value of financial instruments as well as its fair hierarchy are described in more detail in Note 36.

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.

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

Tax legislation (Contd.)

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. 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.

2.3 Application of new and amendments to International Financial Reporting Standards (IFRSs)

Amendments to IFRSs and new Interpretations that are mandatorily effective for the current year

In the current year, the Bank has applied a number of amendments to IFRSs issued by the International Accounting Standards Board ('IASB') that are mandatorily effective for an accounting periods that begins on or after 1 January 2017.

Effective Date	New Standards or amendments
1 January 2017	• Amendments to IAS 7 *Disclosure Initiative* • Amendments to IAS 12 *Recognition of Deferred tax assets for unrealised losses* • Amendment to IFRS 12 *issued in the Annual Improvements to Cycle 2014-2016*

The Bank's liabilities arising from financing activities consist of borrowed funds and subordinated loans (Note 29). A reconciliation between the opening and closing balances of these items is provided in note 28.1 and 29.1. Consistent with the transition provisions of the amendments to IAS 7, the Bank has not disclosed comparative information for the prior periods. Apart for the additional disclosure in note 28 and 29, the application of the amendments to IAS 7 has had no impact on the Bank financial statements.

The Bank has not applied the following new and amendments to IFRSs that have been issued but are not yet effective.

Effective Date	New Standards or amendments
1 January 2018	• IFRS 9 *Financial Instruments* • IFRS 15 *Revenue from Contracts with Customers and the related Amendements* • IFRS 17 *Insurance Contracts* • Amendments to IFRS 2 *Classification and Measurement of Share-based Payment Transactions* • IFRIC 22 *Foreign Currency Transactions and Advance Consideration* • Amendments to IAS 40 *Transfers of Investment Property* • Amendments to IFRS 4 Applying IFRS 9 *Financial Instruments with IFRS 4 Insurance Contracts* • Amendments to IAS 28 *As part of the Annual Improvements to IFRS Standards 2014-2016 Cycle*
1 January 2019	• IFRS 16 *Leases* • IFRIC 23 *Uncertainty over Income Tax Treatments* • Amendments to IFRS 9 *Prepayment Features with Negative Compensation* • Amendments to IAS 19 *Plan Amendment, Curtailment or Settlement* • Amendments to IAS 28 *Long-term Interests in Associates and Joint Ventures* • Amendments to IFRSs *Annual Improvements to IFRS Standards 2015-2017 Cycle*
1 January 2021	• IFRS 17 *Insurance Contracts*
To be determined	• Amendments to IFRS 10 and IAS 28 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*

2.3 Application of new and amendments to International Financial Reporting Standards (IFRSs)

Amendments to IFRSs and new Interpretations that are mandatorily effective for the current year (Contd.)

IFRS 9 Financial Instruments

Based on the Bank's financial instruments and risk management policies as at 31 December 2017, application of IFRS 9 in the future may have a material impact on the classification and measurement of the Bank's financial assets. The Bank's available-for-sale financial assets, including those currently stated at cost less impairment, will either be measured as fair value through profit or loss or be designated as FVTOCI. In addition, the expected credit loss model may result in early provision of credit losses which are not yet incurred in relation to the Bank's financial assets measured at amortized cost. Bank of Mongolia has deferred the application of IFRS 9 from January 1, 2020. The management of the Bank is in the process of reviewing the application of this standard. The determination of the impact of the financial statements is not complete yet, therefore it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until the Bank performs a detailed review.

IFRS 15 *Revenue from Contracts with Customers*

IFRS 15 was issued which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 Revenue, IAS 11 Construction Contracts and the related Interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the Standard introduces a 5-step approach to revenue recognition:

Step 1: Identify the contract(s) with a customer.
Step 2: Identify the performance obligations in the contract.
Step 3: Determine the transaction price.
Step 4: Allocate the transaction price to the performance obligations in the contract.
Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognizes revenue when (or as) a performance obligation is satisfied, i.e. when ‘control’ of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

In 2016, IASB issued clarifications to IFRS 15 in relation to the identification of performance obligations, principal versus agent considerations, as well as licensing application guidance.

The directors of the Bank anticipate that the application of IFRS 15 in the future may result in more disclosures, however, they do not anticipate that the application of IFRS 15 will have a material impact on the timing and amounts of revenue recognized in the respective reporting periods.

2.4 Summary of significant accounting policies

Foreign currency translation

The financial statements of the Bank are presented in Mongolian Togrogs (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/(loss) - net' in the statement of comprehensive income. Non–monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non–monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Financial instruments – initial recognition and subsequent measurement

(i) Date of recognition

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

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

The Bank uses derivatives such as currency forwards and swaps to manage its exposure to market risks. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are included in 'Other operating income /(loss) - net'.

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 recognised in the statement of comprehensive income.

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

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

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

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

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

2.4 Summary of significant accounting policies (Contd.)

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

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

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

The Bank has no financial assets or liabilities designated at fair value through profit or loss as at 31 December 2017 and 2016.

(v) Available-for-sale financial investments

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

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

Unrealised gains and losses are recognised directly in equity (other comprehensive income) in the 'Available-for-sale reserve'. When the investment is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the income statement in 'Other operating income - net'. 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 - net' when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the statement of comprehensive income and removed from the 'Available-for-sale reserve'.

2.4 Summary of significant accounting policies (Contd.)

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

(vi) Held-to-maturity financial investments

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

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

(vii) Loans and advances

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

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

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

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).

2.4 Summary of significant accounting policies (Contd.)

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

(viii) Borrowed funds and subordinated loans

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

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

An analysis of the Bank's borrowed funds and subordinated loans is disclosed in Note 28 and Note 29, respectively.

(ix) Due to banks

This includes deposits from other banks and financial institutions in foreign currency and local currency accounts and time deposits placed by local and foreign commercial banks and BoM (Note 25).

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

(x) Due to customers

This includes current, savings and time deposits from customers (Note 27).

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

(xi) Reclassification of financial assets

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

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

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

2.4 Summary of significant accounting policies (Contd.)

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.

The Bank derecognised certain mortgage loans in 2017 and 2016 (Note 18).

(ii) Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expired. 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 the statement of comprehensive income.

2.4 Summary of significant accounting policies (Contd.)

Repurchase and reverse repurchase agreements

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

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

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

Determination of fair value

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

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

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

An analysis of fair values of financial instruments and further details as to how they are measured are provided in Note 36.

2.4 Summary of significant accounting policies (Contd.)

Impairment of financial assets

The Bank assesses at each statement of financial position date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, the probability that they will enter bankruptcy or other financial reorganisation, default or delinquency in interest or principal payments and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

(i) Financial assets carried at amortised cost

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

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of comprehensive income. Interest income continues to be accrued on the reduced carrying amount 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 and other losses' in the statement of comprehensive income.

The present value of the estimated future cash flows is discounted at the financial asset's original EIR. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR. If the Bank has reclassified trading assets to loans and advances, the discount rate for measuring any impairment loss is the new EIR determined at the reclassification date. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

2.4 Summary of significant accounting policies (Contd.)

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.

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

2.4 Summary of significant accounting policies (Contd.)

Impairment of financial assets (Contd.)

(iii) Renegotiated loans

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

Offsetting financial instruments

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

'Day 1' profit or loss

When the transaction price differs from the fair value of other observable current market transactions in the same instrument, or based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognises the difference between the transaction price and fair value (a Day 1 profit or loss) in 'Other operating income-net'. In cases where fair value is determined using data which is not observable, the difference between the transaction price and model value is only recognised in the statement of comprehensive income when the inputs become observable, or when the instrument is derecognised.

Leasing

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

Bank as a lessee

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

Bank as a lessor

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

Amounts due from lessees under finance leases are recognised as receivables at the amount of the Bank's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect the constant periodic rate of return on the Bank's net investment outstanding in respect of the leases.

2.4 Summary of significant accounting policies (Contd.)

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 expenses

For all financial instruments measured at amortised cost, interest bearing financial assets classified as available-for-sale and financial instruments designated at fair value through profit or loss, interest income or expense is recorded using the EIR.

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

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

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

(ii) Fees and commission income

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

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

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

Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the EIR on the loan (ie. as interest income recorded under “Interest and similar income’). When it is unlikely that a loan will be drawn down, the loan commitment fees are recognised over the commitment period on a straight line basis.

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.

2.4 Summary of significant accounting policies (Contd.)

Recognition of income and expenses (Contd.)

(iii) Net trading income

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

Cash and cash equivalents

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

Property and equipment

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

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

Depreciation of other property and equipment is provided for on a straight-line basis to write off the cost of each asset to its residual value over the estimated useful life at the following annual rates:

Premises	40 years
Office furniture	10 years
Computer equipment and others	5 years
Vehicles	10 years
Leasehold improvements	Lower of lease term or useful lives

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

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

2.4 Summary of significant accounting policies (Contd.)

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	3 – 60 years

Investment property

Investment property includes property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the process of providing services or for administrative purposes.

Investment property is initially measured at cost, including transaction costs. Investment properties are subsequently measured at fair value. Fair value of investment property is the price that would be received from sale of the asset in an orderly transaction, without deduction of any transaction costs. Gains or losses arising from changes in the fair value of investment properties are recognised in the profit or loss account in the year they arise.

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.

2.4 Summary of significant accounting policies (Contd.)

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.

Financial guarantees

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

Any increase in the liability relating to financial guarantees is recorded in the statement of comprehensive income. The premium received is recognised in the statement of comprehensive income in 'Fees and commission income' on a straight line basis over the life of the guarantee.

Employee benefits

(i) Short term benefits

Wages, salaries and other salary related expenses are recognised as an expense in the year in which the associated services are rendered by employees of the Bank. Short term accumulating compensated absences such as paid annual leave are recognised when services are rendered by employees that increase their entitlement to future compensated absences, and short term non-accumulating compensated absences such as sick leave are recognised when absences occur.

(ii) Defined contribution plans

As required by law, companies in Mongolia make contributions to the government pension scheme, Social and Health Fund. Such contributions are recognised as an expense in profit or loss as incurred. The Bank also contributes to a defined contribution pension plan. The contribution paid is recorded as an expense under "Pension fund expense" in proportion to the services rendered by the employees to the Bank.

Provisions

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

2.4 Summary of significant accounting policies (Contd.)

Taxes

(i) Current tax

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

(ii) Deferred tax

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

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

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

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

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

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

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.

2.4 Summary of significant accounting policies (Contd.)

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 shareholder. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Bank.

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

Equity reserves

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

'Other reserves' which represent appropriations of retained earnings based on the decision of the Bank’s Board of Directors. The purpose of this account is not specified at present.

'Regulatory reserve' is set up in compliance with the BoM requirement and is distributable to the Shareholder of the Bank subject to consultation with BoM.

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 statement of comprehensive over the expected useful life and pattern of consumption of the benefit of the underlying asset by equal annual installments. When loans or similar assistance are provided by governments or related institutions with an interest rate below the current applicable market rate, the effect of this favourable interest is regarded as additional government grants.

Precious metals

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

Repossessed assets

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

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

2.4 Summary of significant accounting policies (Contd.)

Properties held for sale

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

Segment reporting

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

Earnings per share

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

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

Transactions with related parties

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

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

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

All material transactions and balances with the related parties are disclosed in the relevant notes to financial statements and the details are presented in Note 39.

3. SEGMENT INFORMATION

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

Retail banking	-	Individual customer's 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 including direct debit facilities, current accounts, deposits, overdrafts, loan, trade finance and other credit facilities as well as international remittances.
Treasury	-	Cash management, BoM securities, interbank loan and deposit, and financial instruments trading.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss which in certain respects is measured differently from operating profit or loss in the financial statements. Income taxes are managed on a Bank wide basis and are not allocated to operating segments.

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

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

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Bank's total revenue in 2017 nor 2016.

GEOGRAPHICAL INFORMATION

All the Bank's activities were carried out in Mongolia during the years ended 31 December 2017 and 2016. Therefore, no geographical analysis is presented.

3. SEGMENT INFORMATION (Contd.)

The following table presents income and profit and certain asset and liability information related to the Bank's operating segments for 2017.

	Retail Banking	Business Banking	Treasury	Total
	2017 MNT'000	2017 MNT'000	2017 MNT'000	2017 MNT'000
Income				
Third party	24,035,902	82,031,540	(18,975,367)	87,092,075
Inter–segment	20,155,419	(42,035,772)	21,880,353	-
Total operating income	**44,191,321**	**39,995,768**	**2,904,986**	**87,092,075**
Credit and other losses	2,988,915	(2,282,287)	-	706,628
Net operating income	**47,180,236**	**37,713,481**	**2,904,986**	**87,798,703**
Results				
Net interest income/(expense)	16,571,200	76,651,445	(12,098,911)	81,123,734
Net fees and commission income	6,166,839	4,941,402	-	11,108,241
Net trading loss	-	-	(12,022,591)	(12,022,591)
Depreciation of property and equipment	(3,925,407)	(1,421,728)	(5,760)	(5,352,895)
Amortisation of intangible assets	(1,150,593)	(760,446)	-	(1,911,039)
Other operating expenses	(34,912,044)	(24,250,600)	(1,349,767)	(60,512,411)
Amortisation of deferred grants	-	500,490	-	500,490
Net other operating income	1,297,862	438,693	5,146,136	6,882,691
Credit and other losses	2,988,915	(2,282,287)	-	706,628
Inter segment	20,155,419	(42,035,772)	21,880,353	-
Segment profit for the year before tax	**7,192,191**	**11,781,197**	**1,549,460**	**20,522,848**
Income tax expense				(412,832)
Segment profit for the year after tax				**20,110,016**
Assets				
Capital expenditures:				
Property and equipment	6,708,237	158,446	-	6,866,683
Other intangible assets	954,225	839,459	-	1,793,684
	7,662,462	**997,905**	**-**	**8,660,367**
Total segment assets	**1,062,187,690**	**735,997,671**	**1,244,302,556**	**3,042,487,917**
Total segment liabilities	**963,005,429**	**651,973,884**	**1,228,149,183**	**2,843,128,496**

3. SEGMENT INFORMATION (Contd.)

The following table presents income and profit and certain asset and liability information related to the Bank's operating segments for 2016.

	Retail Banking	Business Banking	Treasury	Total
	2016 MNT'000	2016 MNT'000	2016 MNT'000	2016 MNT'000
Income				
Third party	58,206,810	51,402,792	810,291	110,419,893
Inter–segment	(1,061,053)	(3,943,651)	5,004,704	-
Total operating income	**57,145,757**	**47,459,141**	**5,814,995**	**110,419,893**
Credit and other losses	(12,150,074)	(18,991,857)	-	(31,141,931)
Net operating income	**44,995,683**	**28,467,284**	**5,814,995**	**79,277,962**
Results				
Net interest income/(expense)	52,130,865	50,318,369	(11,905,037)	90,544,197
Net fees and commission income	6,496,020	2,196,497	-	8,692,517
Net trading loss	-	-	(17,046,410)	(17,046,410)
Depreciation of property and equipment	(3,892,221)	(1,196,396)	(7,176)	(5,095,793)
Amortisation of intangible assets	(1,014,737)	(618,433)	-	(1,633,170)
Other operating expenses	(34,389,303)	(14,443,486)	(1,115,947)	(49,948,736)
Amortisation of deferred grants	-	604,327	-	604,327
Net other operating income	(420,075)	(1,112,074)	29,761,738	28,229,589
Credit and other losses	(12,150,074)	(18,991,857)	-	(31,141,931)
Inter segment	(1,061,053)	(3,943,651)	5,004,704	-
Segment profit for the year before tax	**5,699,422**	**12,813,296**	**4,691,872**	**23,204,590**
Income tax expense				(1,751,137)
Segment profit for the year after tax				**21,453,453**
Assets				
Capital expenditures:				
Property and equipment	5,611,106	1,688,282	-	7,299,388
Other intangible assets	1,614,784	1,327,980	-	2,942,764
	7,225,890	3,016,262	-	10,242,152
Total segment assets	**999,474,041**	**686,517,873**	**571,288,129**	**2,257,280,043**
Total segment liabilities	**909,376,202**	**616,014,924**	**552,854,346**	**2,078,245,472**

4. INTEREST AND SIMILAR INCOME

	2017 MNT'000	2016 MNT'000
Loans and advances to customers	212,684,116	204,459,053
Financial investments – held-to-maturity	54,553,101	38,815,411
Cash and balances with BoM	8,135,020	9,231,171
Due from banks	7,725,387	5,626,504
Financial investments – Available-for-sale	3,434,324	2,554,171
Reverse repurchase agreements	95,413	220,607
	286,627,361	260,906,917

5. INTEREST AND SIMILAR EXPENSES

	2017 MNT'000	2016 MNT'000
Due to customers	116,155,932	98,008,831
Borrowed funds	69,786,539	60,469,954
Subordinated loans	9,959,897	9,123,940
Due to banks	8,522,432	1,961,469
Repurchase agreements	316,969	264,741
Other interest expenses	761,858	533,785
	205,503,627	170,362,720

6. FEES AND COMMISSION INCOME

	2017 MNT'000	2016 MNT'000
Fees and commission income		
Remittance and other service fees	5,026,307	4,737,233
Card related fees and commissions	5,538,268	3,615,952
Account service fees and commissions	1,364,265	1,351,474
Credit related fees and commissions	1,628,286	730,606
	13,557,126	10,435,265
Fees and commission expenses		
Card transaction charges	1,820,938	1,135,895
Bank service charges	627,947	606,853
	2,448,885	1,742,748
Net fees and commission income	11,108,241	8,692,517

7. NET TRADING LOSS

	2017 MNT'000	2016 MNT'000
Foreign exchange	(12,022,591)	(17,046,410)
	(12,022,591)	**(17,046,410)**

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

8. OTHER OPERATING INCOME – NET

	2017 MNT'000	2016 MNT'000
Unrealised foreign exchange gain	4,598,391	26,975,522
Changes in the fair value of investment property (Note 23)	1,186,692	-
Gain on disposal of properties held for sale and others (Note 19 and Note 20)	316,477	742,952
Gain on disposal of land use right	200,000	-
Rental income	186,086	162,491
Dividend income	99,329	50,802
Gain/(loss) on disposal of property and equipment	15,282	(439)
Others	280,434	298,261
	6,882,691	**28,229,589**

9. CREDIT AND OTHER LOSSES - NET

	2017 MNT'000	2016 MNT'000
Loans and advances to customers (Note 18)		
Micro business loans	2,801,504	8,786,281
Consumer loans	2,239,654	(764,952)
Mortgage loans	132,945	6,280,143
Finance leases	16,827	(284,470)
Others	(164,442)	(1,328,246)
Small and medium enterprises (SME) loans	(9,538,065)	11,662,754
	(4,511,577)	**24,351,510**
Impairment loss on other assets (Note 19)	913,575	429,422
Impairment loss on financial investments	84,625	516,445
Impairment loss on foreclosed properties (Note 19)	2,806,749	5,953,192
Impairment reversal on properties held for sale (Note 20)	-	(108,638)
	(706,628)	**31,141,931**

10. OPERATING EXPENSES

	2017 MNT'000	2016 MNT'000
Personnel expenses*	32,630,493	26,228,496
Professional fees	6,089,903	4,030,659
Depreciation of property, plant and equipment (note 21)	5,352,895	5,095,793
Rental of premises	4,518,422	4,632,374
Deposit insuranse expense	2,859,415	2,340,728
Armored guard and security	2,095,068	1,985,705
Amortisation of intangible assets (note 22)	1,911,039	1,633,170
Advertising	1,833,417	1,678,018
Communications	1,384,899	1,201,729
Other operating expenses	1,345,575	1,439,245
Travelling expenses	1,323,811	1,207,075
Loan collection expenses	1,020,141	182,661
Utilities	970,860	823,645
Entertainment	965,601	1,151,529
Repairs and maintenance	848,690	551,101
Transportation	683,987	642,103
Stationary	682,199	753,921
Insurance	518,507	470,597
Membership and audit expenses	457,925	470,648
Penalty	116,273	10,913
Property, plant and equipment written-off (note 21)	104,824	115,614
Donations	62,401	30,039
Intangible asset written-off (note 22)	-	1,936
	67,776,345	**56,677,699**

*** Personnel expenses**		
Salaries, wages and bonus	28,509,533	23,003,416
Contribution to social and health fund	3,133,423	2,522,671
Contribution to defined contribution pension plan	551,112	561,425
Staff training	436,425	140,984
	32,630,493	**26,228,496**

11. INCOME TAX EXPENSE

The components of income tax expense for the years ended 31 December 2017 and 2016 are:

	2017 MNT'000	2016 MNT'000
Current tax:		
Current income tax	324,966	84,162
Deferred tax		
Relating to origination and reversal of temporary differences (Note 24)	87,866	1,666,975
	412,832	1,751,137

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% (2016: 10%) for the first MNT 3 billion (2016: MNT 3 billion) of taxable income, and 25% (2016: 25%) on the excess of taxable income over MNT 3 billion (2016: MNT 3 billion). Interest income on government bonds is not subject to income tax.

A reconciliation of income tax expense applicable to profit before tax at the statutory income tax rate to income tax expense at the effective income tax rate of the Bank for the years ended 31 December 2017 and 2016 is as follows:

	2017 MNT'000	2016 MNT'000
Profit before taxation	20,522,848	23,204,590
Tax at statutory tax rate of 25% (2016: 25%)	5,130,712	5,801,148
Effect of income tax subject to lower tax rate	(450,000)	(450,000)
Effect of income not subject to tax	(10,495,931)	(6,909,571)
Effect of expenses not deductible for tax purposes	6,228,051	3,309,560
Tax expense for the year	412,832	1,751,137

The effective income tax rate for 2017 is 2.01% (2016: 7.55%).

12. EARNINGS PER SHARE

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

	2017 MNT'000	2016 MNT'000
Profit for the year attributable to the equity holder of the Bank	20,110,016	21,453,453
Weighted average number of ordinary shares for basic and diluted earnings per share	20,353,656	20,353,656

Earnings per share

	2017 MNT	2016 MNT
Equity holder of the Bank for the year:		
Basic earnings per share	988.03	1,054.03
Diluted earnings per share	988.03	1,054.03

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

13. CASH AND BALANCES WITH BANK OF MONGOLIA (BoM)

	2017 MNT'000	2016 MNT'000
Current accounts with BoM	422,786,050	280,863,167
Cash on hand	42,977,647	45,916,709
	465,763,697	**326,779,876**

Current accounts with BoM are maintained in accordance with BoM's regulations. The balances maintained with BoM are determined at not less than 12.0% (2016: 12.0 %) of customer deposits based on average balance of two weeks before year end. As at 31 December 2017, the average reserve required by BoM for that period of 2 weeks was MNT 136,374.26 million (2016: MNT 111,685.65 million) for local currency and MNT 36,040.98 million (2016: MNT 30,407.64 million) for foreign currency maintained in current accounts with BoM.

14. DUE FROM BANKS

	2017 MNT'000	2016 MNT'000
Placements with other banks and financial institutions	313,373,833	158,627,068

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

15. REVERSE REPURCHASE AGREEMENTS

	2017 MNT'000	2016 MNT'000
Reverse repurchase agreements	64,974,429	-

The Bank purchased securities with an agreement to sell back on 2nd and 3rd of January 2018.

16. DERIVATIVE FINANCIAL INSTRUMENTS

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

	Assets 2017 MNT'000	Liabilities 2017 MNT'000	Notional amount 2017 MNT'000
Derivatives held for trading			
Currency swaps	82,731,615	5,477,654	657,585,111
	82,731,615	5,477,654	657,585,111
	2016 MNT'000	2016 MNT'000	2016 MNT'000
Derivatives held for trading			
Currency swaps	125,019,231	928,603	559,080,805
	125,019,231	928,603	559,080,805

16. DERIVATIVE FINANCIAL INSTRUMENTS (Contd.)

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

The Bank's exposure under derivative contracts is closely monitored as part of the overall management of its market risk (see also Note 40.4).

Forward contracts

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

Swaps

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

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

Fair values

Disclosures concerning the fair value of derivatives are provided in Note 36.

17. FINANCIAL INVESTMENTS

	2017 MNT'000	2016 MNT'000
Available-for-sale:		
Senior RMBS, at fair value (a)	14,465,637	-
Junior RMBS, at fair value (a)	27,324,935	22,837,304
Unquoted fund, at fair value	3,124,459	3,124,459
	44,915,031	**25,961,763**
Equity investments		
Quoted equities, at fair value	2,200,989	1,904,972
Unquoted equities, at cost (b)	250,597	250,597
	47,366,617	**28,117,332**
Held-to-maturity:		
BoM treasury bills, at amortised cost (c)	489,702,314	69,941,289
Government treasury bills, at amortised cost (c)	83,056,407	254,901,094
Government bonds, at amortised cost (d)	5,589,678	30,277,541
	578,348,399	**355,119,924**

(a) The Bank sold mortgage loan portfolio to MIK and its subsidiaries in exchange for RMBS issued by MIK SPC. The sale of mortgage loan portfolios is part of a broader scheme administered by MIK whereby 9 of the largest banks in Mongolia, including the Bank, have sold parts of their mortgage loan portfolio under a Government program. The loans have been purchased by MIK-SPCs on a non-recourse basis. The risk profile of the issued bond by MIK is different from the risk profile of the derecognized loan portfolios by the Bank as the risk profile of the bond issued is backed by collective or commingled pool of loans from various banks.

The bonds are split between the senior tranche ("Senior RMBS") and the junior tranche ("Junior RMBS"); the senior tranche comprises 90% of the bond and carries an interest rate of 4.5%, while the junior tranche consists of 10% of the bond and carries an interest rate of 10.5%. The principal of the junior tranche has a minimum holding period of 3 years and will only be redeemed subsequent to the full redemption of the senior tranche and payments on the junior tranche are subordinate to payments on the senior tranche. The part of Senior tranche was subsequently sold to BoM in order to repay its borrowing (See Note 18).

(b) 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.

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

(d) The Government bonds are interest bearing long term bond issued at a discount.

18. LOANS AND ADVANCES TO CUSTOMERS

	2017 MNT'000	2016 MNT'000
Small and medium enterprises (SME) loans	616,492,357	570,094,457
Consumer loans	238,546,248	124,541,795
Micro Business loans	194,661,880	216,315,568
Mortgage loans	185,008,960	200,691,580
Finance leases	15,597,264	10,393,299
Others	146,865,062	103,505,653
	1,397,171,771	**1,225,542,352**
Accrued interest receivables	27,337,852	22,505,769
Gross loans and advances	1,424,509,623	1,248,048,121
Less: Allowance for impairment losses	(80,406,810)	(90,846,538)
Net loans and advances to customers	**1,344,102,813**	**1,157,201,583**

Transferred financial assets that are derecognised in their entirety

The Bank sold the rights to 100% of the cash flows arising on a portfolio of fixed rate mortgage loans to a wholly owned special purpose company of MMC in exchange for RMBS. The Bank derecognised the loan portfolio and recognised the Senior RMBS and Junior RMBS received as financial assets. The Bank continues to service these loans and earns 2.5% servicer fee from MIK. The carrying amount of the transferred loan portfolio during the year was MNT 44,192 million (2016: MNT 40,817 million). The Senior and Junior RMBS received in exchange amounted to MNT 39,773 million (2016: MNT 36,735 million) and MNT 4,419 million (2016: MNT 4,082 million) respectively. Senior tranche amounting MNT 25,352 million (2016: MNT 36,735 million) was subsequently sold to BoM in order to repay its borrowing (See Note 17).

18. LOANS AND ADVANCES TO CUSTOMERS (Contd.)

Impairment allowance for loans and advances to customers

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

	SME	Mortgage	Micro Business	Consumer	Finance Lease	Others	Total
	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
At 31 December 2017							
At 1 January 2017	60,772,127	10,227,690	16,267,147	2,492,792	341,823	744,959	90,846,538
Charge for the year (Note 9)	17,276,668	4,401,922	8,887,171	2,987,709	140,012	93,133	33,786,615
Recoveries (Note 9)	(26,814,733)	(4,268,977)	(6,085,667)	(748,055)	(123,185)	(257,575)	(38,298,192)
Amounts written off	(4,447,741)	(340,053)	(633,459)	(419,519)	(79,905)	(7,474)	(5,928,151)
At 31 December 2017	46,786,321	10,020,582	18,435,192	4,312,927	278,745	573,043	80,406,810
Individual impairment	24,299,285	1,458,505	-	-	-	-	25,757,790
Collective impairment	22,487,036	8,562,077	18,435,192	4,312,927	278,745	573,043	54,649,020
	46,786,321	**10,020,582**	**18,435,192**	**4,312,927**	**278,745**	**573,043**	**80,406,810**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**52,361,145**	**2,773,196**	-	-	-	-	**55,134,341**

18. LOANS AND ADVANCES TO CUSTOMERS (Contd.)

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

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

	SME	Mortgage	Micro Business	Consumer	Finance Lease	Others	Total
	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
At 31 December 2016							
At 1 January 2016	49,139,509	4,183,266	7,701,065	4,105,963	929,210	2,112,263	68,171,276
Charge for the year (Note 9)	39,746,493	8,152,191	12,538,748	1,581,557	181,279	389,694	62,589,962
Recoveries (Note 9)	(28,083,739)	(1,872,048)	(3,752,467)	(2,346,509)	(465,749)	(1,717,940)	(38,238,452)
Amounts written off	(30,136)	(235,719)	(220,199)	(848,219)	(302,917)	(39,058)	(1,676,248)
At 31 December 2016	60,772,127	10,227,690	16,267,147	2,492,792	341,823	744,959	90,846,538
Individual impairment	24,721,040	195,548	-	-	-	-	24,916,588
Collective impairment	36,051,087	10,032,142	16,267,147	2,492,792	341,823	744,959	65,929,950
	60,772,127	**10,227,690**	**16,267,147**	**2,492,792**	**341,823**	**744,959**	**90,846,538**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**56,328,426**	**281,241**	-	-	-	-	**56,609,667**

18. LOANS AND ADVANCES TO CUSTOMERS (Contd.)

The fair value of the collateral that the Bank holds relating to loans individually determined to be impaired at 31 December 2017 amounts to MNT 63,071 million (2016: MNT 72,772 million). These values are estimated by management based on the latest available information. For a more detailed description, see 'Collateral and other credit enhancement' under Note 40.2.

19. OTHER ASSETS

	2017 MNT'000	2016 MNT'000
Other assets	10,228,028	5,239,934
Less: Allowance for impairment losses	(1,620,838)	(870,711)
	8,607,190	**4,369,223**
Foreclosed properties		
At beginning of the year	26,214,281	3,732,958
Add: Possession and transfer	63,079,503	52,366,027
Less: Sold during the year	(5,935,848)	(2,274,490)
Less: Transfer to investment in private fund	-	(752,796)
Less: Transfer to investment property (note 23)	(33,283,555)	-
Less: Repayment by borrower	(19,586)	(63,471)
Less: Reclassification to properties held for sale and others	(30,307,761)	(26,793,947)
	19,747,034	**26,214,281**
Less: Allowances for impairment losses	(9,204,977)	(6,398,228)
At end of the year	**10,542,057**	**19,816,053**
Prepaid expenses	8,422,866	2,400,378
Consumables and other office supplies	1,521,340	1,290,981
Deposits	1,312,383	1,299,357
Precious metals	94,439	94,439
	11,351,028	**5,085,155**
Total other assets	**30,500,275**	**29,270,431**
Impairment allowance for other assets		
At beginning of the year	870,711	453,421
Charge for the year (Note 9)	913,575	429,422
Written off	(163,448)	(12,132)
At end of the year	**1,620,838**	**870,711**
Impairment allowance for foreclosed properties		
At beginning of the year	6,398,228	445,036
Charge for the year (Note 9)	15,050,470	8,599,109
Reversal (Note 9)	(12,243,721)	(2,645,917)
At end of the year	**9,204,977**	**6,398,228**

Proceeds from the sale of foreclosed properties amounted to MNT 6,461 million (2016: MNT 2,446 million) and the gain amounted to MNT 294 million (2016: MNT 48 million).

20. PROPERTIES HELD FOR SALE

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

	2017 MNT'000	2016 MNT'000
At beginning of the year	24,039,038	20,089,341
Add: Transfer	31,513,619	26,767,847
Less: Sold during the year	(7,088,297)	(7,211,759)
Less: Transfer to investment in private fund	-	(2,910,138)
Less: Transfer to investment property (Note 23)	(11,044,464)	(4,976,156)
Less: Reclassification to foreclosed properties and others	(20,619,430)	(7,720,097)
	16,800,466	**24,039,038**
Less: Allowances for impairment losses	-	-
At end of the year	**16,800,466**	**24,039,038**

Proceeds from the sale of buildings during the year were MNT 7,219 million (2016: MNT 7,935 million). The gain from the sale of those buildings amounted to MNT 22 million (2016: MNT 695 million) and is recorded as part of 'Other operating income - net' (Note 8).

	2017 MNT'000	2016 MNT'000
At beginning of the year	-	859,359
Reversal for the year (Note 9)	-	(108,638)
Impairment reclassified to PPE and others	-	(750,721)
At end of the year	-	-

21. PROPERTY AND EQUIPMENT

	Leasehold improvements	Premises	Vehicles	Office furniture	Computer equipment and others	Land held for future development	Construc-tion in progress	Total
At 31 December 2017	**MNT'000**	**MNT'000**	**MNT'000**	**MNT'000**	**MNT'000**	**MNT'000**	**MNT'000**	**MNT'000**
At cost								
At 1 January 2017	**4,170,771**	**19,203,753**	**3,624,809**	**5,760,341**	**23,299,110**	**2,091,896**	**760,982**	**58,911,662**
Additions	485,475	457,856	-	164,055	657,100	-	5,102,197	6,866,683
Write-off	-	-	(146,484)	(107)	(661,035)	-	-	(807,626)
Disposals	-	(31,000)	(120,904)	(105,974)	(84,893)	-	-	(342,771)
Reclassification	-	-	-	94,042	3,969,225	-	(4,063,267)	-
Reclassification to properties held for sale (note 20)	-	(665,597)	(967,943)	-	-	-	-	(1,633,540)
At 31 December 2017	**4,656,246**	**18,965,012**	**2,389,478**	**5,912,357**	**27,179,507**	**2,091,896**	**1,799,912**	**62,994,408**
Accumulated depreciation								
At 1 January 2017	**2,207,131**	**2,804,541**	**1,447,314**	**1,934,738**	**13,898,356**	**-**	**-**	**22,292,080**
Charge for the year	687,075	491,757	309,760	550,426	3,313,877	-	-	5,352,895
Write-off	-	-	(97,656)	(107)	(605,039)	-	-	(702,802)
Disposals	-	(7,746)	(73,275)	(76,741)	(70,937)	-	-	(228,699)
Reclassification to properties held for sale (note 20)	-	(108,060)	(622,100)	-	-	-	-	(730,160)
At 31 December 2017	**2,894,206**	**3,180,492**	**964,043**	**2,408,316**	**16,536,257**	**-**	**-**	**25,983,314**
Net carrying amount at 31 December 2017	**1,762,040**	**15,784,520**	**1,425,435**	**3,504,041**	**10,643,250**	**2,091,896**	**1,799,912**	**37,011,094**

21. PROPERTY AND EQUIPMENT (CONTD.)

	Leasehold improvements	Premises	Vehicles	Office furniture	Computer equipment and others	Land held for future development	Construc-tion in progress	Total
At 31 December 2016	**MNT'000**	**MNT'000**	**MNT'000**	**MNT'000**	**MNT'000**	**MNT'000**	**MNT'000**	**MNT'000**
At cost								
At 1 January 2016	3,229,390	16,147,889	3,727,684	4,891,270	20,117,453	2,091,896	3,683,499	53,889,081
Additions	941,381	1,969,536	-	33,932	629,605	-	3,724,934	7,299,388
Write-off	-	-	-	(133,114)	(1,041,112)	-	-	(1,174,226)
Disposals	-	-	(542,875)	(134,832)	(355,883)	-	-	(1,033,590)
Reclassification	-	1,086,328	440,000	1,103,085	3,949,047	-	(6,578,460)	-
Reclassification to intangible assets	-	-	-	-	-	-	(68,991)	(68,991)
At 31 December 2016	4,170,771	19,203,753	3,624,809	5,760,341	23,299,110	2,091,896	760,982	58,911,662
Accumulated depreciation								
At 1 January 2016	1,564,016	2,358,297	1,462,526	1,631,837	12,075,505	-	-	19,092,181
Charge for the year	643,115	446,244	377,238	493,635	3,135,561	-	-	5,095,793
Write-off	-	-	-	(93,385)	(965,227)	-	-	(1,058,612)
Disposals	-	-	(392,450)	(97,349)	(347,483)	-	-	(837,282)
At 31 December 2016	2,207,131	2,804,541	1,447,314	1,934,738	13,898,356	-	-	22,292,080
Net carrying amount at 31 December 2016	**1,963,640**	**16,399,212**	**2,177,495**	**3,825,603**	**9,400,754**	**2,091,896**	**760,982**	**36,619,582**

22. INTANGIBLE ASSETS

	Patents and rights	Computer software	Software under develop-ment	Total
	MNT'000	MNT'000	MNT'000	MNT'000
At 31 December 2017				
At cost				
At 1 January 2017	5,404,392	9,712,465	1,050,460	16,167,317
Additions	98,765	6,960	1,687,959	1,793,684
Disposals	(40,000)	-	-	(40,000)
Reclassification	250,295	1,906,450	(2,156,745)	-
Reclassification to other assets	-	-	(209,178)	(209,178)
At 31 December 2017	5,713,452	11,625,875	372,496	17,711,823
Accumulated amortisation				
At 1 January 2017	2,043,923	3,824,711	-	5,868,634
Charge for the year	706,069	1,204,970	-	1,911,039
Disposals	(40,000)	-	-	(40,000)
Reclassification	-	-	-	-
At 31 December 2017	2,709,992	5,029,681	-	7,739,673
Net carrying amount	**3,003,460**	**6,596,194**	**372,496**	**9,972,150**
At 31 December 2016				
At cost				
At 1 January 2016	4,303,256	8,518,140	427,468	13,248,864
Additions	73,999	184,968	2,683,797	2,942,764
Write-off	(93)	(19,418)	-	(19,511)
Reclassification	1,027,230	1,028,775	(2,060,805)	(4,800)
At 31 December 2016	5,404,392	9,712,465	1,050,460	16,167,317
Accumulated amortisation				
At 1 January 2016	1,461,800	2,796,039	-	4,257,839
Charge for the year	587,016	1,046,154	-	1,633,170
Write-off	(93)	(17,482)	-	(17,575)
Reclassification	(4,800)	-	-	(4,800)
At 31 December 2016	2,043,923	3,824,711	-	5,868,634
Net carrying amount	**3,360,469**	**5,887,754**	**1,050,460**	**10,298,683**

23. INVESTMENT PROPERTY

	2017 MNT'000	2016 MNT'000
Beginning of the year	4,860,809	-
Transfer from properties held for sale (Note 20)	11,044,464	4,860,809
Transfer from foreclosed properties (Note19)	33,283,555	-
Changes in the fair value of investment property	1,186,692	-
End of the year	50,375,520	4,860,809

The fair value of investment property is determined by reference to current market prices for similar properties, adjusted as necessary for condition and location, or by reference to recent transactions updated to reflect current economic conditions.

24. DEFERRED TAX ASSET

	2017 MNT'000	2016 MNT'000
At 1 January	1,326,486	3,412,101
Recognised in statement of profit or loss (note 11)	(87,866)	(1,666,975)
Recognised in other comprehensive income	(71,611)	(418,640)
At 31 December	1,167,009	1,326,486

	Deferred tax liability MNT'000	Deferred tax asset MNT'000	Net deferred asset/(liability) MNT'000
As at 31 December 2017			
Property and equipment			
-accelerated tax depreciation	506,574	-	(506,574)
Loans and advances to customers			
-deferral of loan origination fees	-	1,335,690	1,335,690
Derivative financial instruments			
-swap revaluation	2,850,578	-	(2,850,578)
Investment property	1,355,391	-	(1,355,391)
Other liabilities	-	912,660	912,660
Available for sale reserve	490,251	-	(490,251)
Tax loss	-	4,121,453	4,121,453
	5,202,794	6,369,803	1,167,009
As at 31 December 2016			
Property and equipment			
-accelerated tax depreciation	731,210	-	(731,210)
Loans and advances to customers			
-deferral of loan origination fees	-	1,289,783	1,289,783
Derivative financial instruments			
-swap revaluation	2,035,636	-	(2,035,636)
Other liabilities	-	506,731	506,731
Available for sale reserve	418,640	-	(418,640)
Tax loss	-	2,715,458	2,715,458
	3,185,486	4,511,972	1,326,486

	2017 MNT'000	2016 MNT'000
Unused tax losses for which no deferred tax assets have been recognised	3,128,772	1,765,805

The unrecognised tax credit will expire in 2018 and 2019.

25. DUE TO BANKS

	2017 MNT'000	2016 MNT'000
Deposits from other banks and financial institutions	**230,315,541**	**750,413**

26. REPURCHASE AGREEMENTS

	2017 MNT'000	2016 MNT'000
Repurchase agreements	214,925,195	-

The Bank sold BoM bills with an agreement to repurchase them in the future.

27. DUE TO CUSTOMERS

	2017 MNT'000	2016 MNT'000
Government deposits		
- Current accounts	5,878,773	6,995,461
- Demand deposits	5,266,327	364,905
- Time deposits	3,351,379	557,022
Private sector deposits		
- Current accounts	123,982,428	96,454,589
- Demand deposits	33,176,898	31,006,392
- Time deposits	64,051,100	65,069,217
Individual deposits		
- Current accounts	30,594,720	17,702,303
- Demand deposits	130,529,028	128,992,658
- Time deposits	897,682,977	638,361,140
	1,294,513,630	**985,503,687**

Included in 'Due to customers' were deposits of MNT 4,176 million (2016: MNT 3,189 million) held as collateral for irrevocable commitments under financial guarantees provided by the Bank as at 31 December 2017 and 2016 respectively.

28. BORROWED FUNDS

	2017 MNT'000	2016 MNT'000
Borrowed funds from foreign financial institutions		
International Finance Corporation ("IFC")	119,138,833	111,821,876
Cargill Financial Services international	90,120,159	94,051,794
Overseas Private Investment Corporation	59,716,797	-
Green Climate Fund ("GCF")	47,712,216	-
Global Climate Partnership Fund S.A., SICAV-SIF ("GCPF")	36,426,946	37,291,187
Women Entrepreneurs Debt Fund LP	36,193,824	36,986,149
INCOFIN CVBA	31,955,351	-
Asian Development Bank ("ADB")	31,147,317	53,178,454
Netherlands Development Finance Company ("FMO")	27,301,573	30,114,659
Stitching Fondsbeheer DGGF Lokaal MKB	24,350,811	-
responsAbility Management company S.A.	24,298,899	-
SwedFund	24,102,955	24,620,719
Finnish Fund For Industrial Cooperation Ltd	24,096,156	24,611,248
SIFEM AG	19,313,427	19,740,005
BlueOrchard Microfinace Fund	18,319,117	24,976,985
International Investment Bank ("IIB")	18,099,129	24,590,753
Micro, Small and Medium Enterprises Bonds SA	17,329,769	-
International Bank For Economic Cooperation	16,946,021	-
Cargill TSF Asia Pte Ltd	16,530,610	17,349,815
European Bank for Reconstruction and Development ("EBRD")	14,111,705	39,626,976
Triodos Custody B.V.- Triodos Fair Share Fund	13,071,767	6,482,033
Symbiotics Sicav (Lux)	12,350,376	-
Developing World Markets ("DWM")	12,150,266	12,485,988
CaixaBank	10,944,189	10,001,695
Bank Im Bistum Essen EG ("BiB")	10,391,232	28,854,174
Development Bank of Austria ("OeEB")	10,679,628	21,836,752
Societe De Promotion Et De Participation Pour La Cooperation Economique S.A ("PROPARCO")	10,509,696	21,510,166
Actiam Institutional Microfinance Fund	9,598,701	-
Microfinance Initiative for Asia ("MIFA")	9,160,219	12,489,963
DKM Mikrofinanz Fonds	8,425,253	-
Guevoura Fund	7,774,981	14,213,854
Triodos Sicav II - Triodos Microfinance Fund	-	6,482,033
Microfinance Enhancement Facility S.A SICAV -SIF (Cyrano pool) ("MEF")	-	38,228,861
Calvert Social Investment Foundation, Inc	-	12,787,782
Deutsche Investitions- Und Entwicklungsgesellschaft MBH ("DEG")	-	12,462,109
VDK Spaarbank	-	10,213,910
Kreditanstalt fuer Wiederanfbau ("KfW")	-	4,784,377
KIVA	-	440,562
	812,267,923	752,234,879

28. BORROWED FUNDS (Contd.)

	2017 MNT'000	2016 MNT'000
Borrowed funds from government organisations		
Bank of Mongolia	-	1,252,105
Government of Mongolia	81,771,173	87,994,529
SME Development Fund	39,376,012	68,504,433
Ministry of Finance/ Japan Bank for International Cooperation	14,027,069	16,443,985
Ministry of Finance	4,801,115	4,109,480
Asian Development Bank	3,799,693	1,259,720
UB City and SME development fund	458,162	1,279,559
Educational Loan Fund	376,966	1,000,000
International Fund for Agriculture Development	154,525	-
Rural Poverty Reduction Program	-	2,002,073
Employment Generation Support Fund	-	13,232
	144,764,715	183,859,116
Total borrowed funds	**957,032,638**	**936,093,995**

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

The Bank has not prepaid any debt during the year ended 31 December 2017 (As at 31 December 2016: Nil). The Bank did not have any defaults on principal or interest payments with regard to all liabilities as at 31 December 2017. (As at 31 December 2016: Nil).

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

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

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

As of 31 December 2017, the Bank has complied with debt covenants on all borrowings.

28. BORROWED FUNDS (Contd.)

28.1 Reconciliation of liabilities arising from financing activities

The table below details changes in the Bank's liabilities arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the Bank's statement of cash flows as cash flows from financing activities.

	2017 MNT'000
Opening balance	936,093,995
Financing cash flow - Inflow	559,761,604
Financing cash flow - Outflow	(555,567,187)
Non cash (Note 35)	(25,352,400)
Other changes *	61,976,739
Exchange difference	(19,880,113)
Closing balance	**957,032,638**

* Other changes include the movement of interest accrued.

29. SUBORDINATED LOANS

	2017 MNT'000	2016 MNT'000
International Finance Corporation	110,262,405	112,853,126
KfW, Frankfurt am Main	-	10,589,959
	110,262,405	**123,443,085**

Subordinated convertible loan from International Finance Corporation (IFC)

(i) On 19 August 2010, the Bank received subordinated convertible debt of USD 5,000,000 from IFC, which is due for repayment on 15 December 2018. According to the agreement, conversion option can be exercised only if the existing shareholders of the Bank's parent Company, TenGer Financial Group LLC, make a decision on the increase in share capital of TenGer Financial Group LLC and some of these shareholders decide not to use their pre-emptive rights. In such situation, IFC is entitled to purchase remaining shares of TenGer Financial Group LLC at the same price offered to shareholders. IFC is entitled to make decision on whether shares are to be purchased for cash consideration or through requesting the Bank to repay the outstanding balance of subordinated debt.

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

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

29. SUBORDINATED LOANS (Contd.)

Subordinated convertible loan from International Finance Corporation (IFC) (Contd.)

The loan carries a variable interest rate of 6-month LIBOR USD plus a margin of 6.5 % per annum. The EIR as of 31 December 2017 is 8.256% (2016: 7.799%) per annum. The debt ranks subordinated to all other senior creditors in case of liquidation.

(ii) In June 2012, the Bank entered into a Subordinated Loan Agreement in the amount of USD 40,000,000 with IFC Capitalization Fund. The Bank obtained the loan in 2 tranches: USD 9,000,000 in December 2012 at a fixed rate of 8.955% per annum, USD 31,000,000 in 2014 at a variable interest rate of 6-month LIBOR USD plus a margin of 7.40%. The EIR for USD 31,000,000 as of 31 December 2016 is 8.932% (2016: 8.663%). The loan is due for repayment in December 2020.

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% per annum.

The subordinated convertible loan was fully repaid in cash on 20 July 2017.

29.1 Reconciliation of liabilities arising from financing activities

The table below details changes in the Bank's liabilities arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the Bank's statement of cash flows as cash flows from financing activities.

	2017 **MNT'000**
Opening balance	123,443,085
Financing cash flow - Inflow	-
Financing cash flow - Outflow	(20,176,791)
Other changes *	10,194,850
Exchange difference	(3,198,739)
Closing balance	**110,262,405**

* Other changes include the movement of interest accrued

30. DEFERRED GRANTS

	2017 MNT'000	2016 MNT'000
Green Climate Fund (“GCF”)	1,770,139	-
Micro Energy Credit Corporation ("MEC")	1,067,191	904,987
The Small Enterprise Education and Promotion Network (“SEEP”)	87,122	89,362
Foundation EKO	65,221	66,898
Women's World Banking ("WWB")	4,179	4,287
Consultative Group to Assist the Poorest ("CGAP")	3,867	3,966
Clean Air Fund	-	210,402
	2,997,719	1,279,902

Movements in deferred grants are presented as follows:

	2017 MNT'000	2016 MNT'000
Balance at beginning of year	1,279,902	1,454,737
Received during the year	2,218,307	429,492
Amortisation recognised in statement of comprehensive income	(500,490)	(604,327)
Balance at end of year	2,997,719	1,279,902

31. OTHER LIABILITIES

	2017 MNT'000	2016 MNT'000
Payables	23,208,741	26,873,704
Delay on clearing settlement	4,328,831	3,369,811
	27,537,572	30,243,515

32. ORDINARY SHARES

	Number of shares of MNT 2,719.06 each 2017	Number of shares of MNT 2,719.06 each 2016	Amount 2017 MNT’000	Amount 2016 MNT’000
At 1 January and 31 December	20,353,656	20,353,656	55,342,753	55,342,753

As at 31 December 2017 the Bank has 20,353,656 issued shares (2016: 20,353,656) at a par value of MNT 2,719.06 (2016: MNT 2,719.06).

The Bank has one class of shares and each share carries one voting right. The dividend proposed by the board of directors is subject to approval by the shareholder in the annual general meeting, except in the case of an interim dividend. In the event of liquidation, the equity shareholder is eligible to receive the remaining assets of the Bank after distribution of all preferential amounts.

33. OTHER RESERVES

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

34. DIVIDENDS

	2017 MNT'000	2016 MNT'000
Dividends payable at 1 January	-	39
Dividends paid during the year	-	(39)
Dividends payable at 31 December	-	-

35. CASH AND CASH EQUIVALENTS

		2017 MNT'000	2016 MNT'000
Cash and balances with BoM	13	465,763,697	326,779,876
Due from banks	14	313,373,833	158,627,068
BoM treasury bills	17	489,702,314	69,941,289
Government treasury bills	17	83,056,407	254,901,094
		1,351,896,251	**810,249,327**
Less: Minimum reserve with BoM not available to finance the Bank's day to day operations (Note 13)		(172,415,241)	(142,093,290)
Less: Placement with other banks with original maturities of more than three months		(161,321,101)	(50,368,989)
Less: Government treasury bills with original maturities of more than 3 months		(83,056,407)	(170,445,380)
Total cash and cash equivalents		**935,103,502**	**447,341,668**

NON CASH TRANSACTIONS

During the year, the Bank sold 8% mortgage loans with a carrying amount of MNT 44,192 million (2016: MNT 40,817 million) to MIK for which it received RMBS amounting to MNT 39,773 million (2016: MNT 36,735 million) senior tranche and MNT 4,419 million (2016: MNT 4,082 million) junior tranche (see also note 18).

During the year the Bank repaid 4% funding due to BoM by selling the senior tranche RMBS notes amounting to MNT 25,352 million (2016: MNT 36,735 million) (see also note 18).

36. FAIR VALUE OF FINANCIAL INSTRUMENTS

Determination of fair value and fair value hierarchy

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

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

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

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

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

	Level 1 MNT'000	Level 2 MNT'000	Level 3 MNT'000	Total MNT'000
At 31 December 2017				
Financial assets				
Derivative financial instruments				
Currency swaps	-	82,731,615	-	82,731,615
	-	**82,731,615**	**-**	**82,731,615**
Financial investments available-for-sale				
Senior RMBS, at the fair value	-	-	14,465,637	14,465,637
Junior RMBS, at the fair value	-	-	27,324,935	27,324,935
Unquoted fund, at the fair value	-	-	3,124,459	3,124,459
Quoted equities	2,200,989	-	-	2,200,989
	2,200,989	**-**	**44,915,031**	**47,116,020**
Financial liabilities				
Derivative financial instruments				
Currency swaps	-	5,477,654	-	5,477,654
	-	**5,477,654**	**-**	**5,477,654**

	Level 1 MNT'000	Level 2 MNT'000	Level 3 MNT'000	Total MNT'000
At 31 December 2016				
Financial assets				
Derivative financial instruments				
Currency swaps	-	125,019,231	-	125,019,231
	-	**125,019,231**	**-**	**125,019,231**
Financial investments available-for-sale				
Junior RMBS, at the fair value	-	-	22,837,304	22,837,304
Unquoted fund, at the fair value	-	-	3,124,459	3,124,459
Quoted equities	1,904,972	-	-	1,904,972
	1,904,972	**-**	**25,961,763**	**27,866,735**
Financial liabilities				
Derivative financial instruments				
Currency swaps	-	928,603	-	928,603
	-	**928,603**	**-**	**928,603**

36. FAIR VALUE OF FINANCIAL INSTRUMENTS (Contd.)

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

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

Transfers between level 1 and 2

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

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.

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.

36. 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 2017	Note	Carrying amount MNT'000	Fair value MNT'000
Financial assets			
Cash and balances with BoM	13	465,763,697	465,763,697
Due from banks	14	313,373,833	313,373,833
Reverse repurchase agreements	15	64,974,429	64,974,429
Financial investments held-to-maturity	17	578,348,399	578,348,399
Financial investments available-for-sale	17	250,597	250,597
Loans and advances to customers	18	1,344,102,813	1,337,306,840
Other assets	19	9,829,360	9,829,360
		2,776,643,128	**2,769,847,155**
Financial liabilities			
Due to banks	25	230,315,541	230,315,541
Repurchase agreements	26	214,925,195	214,925,195
Due to customers	27	1,294,513,630	1,294,513,630
Borrowed funds	28	957,032,638	958,206,334
Subordinated loans	29	110,262,405	111,972,252
Other liabilities	31	14,158,587	14,158,587
		2,821,207,996	**2,824,091,539**

As at 31 December 2016	Note	Carrying amount MNT'000	Fair value MNT'000
Financial assets			
Cash and balances with BoM	13	326,779,876	326,779,876
Due from banks	14	158,627,068	158,627,068
Reverse repurchase agreements	15	-	-
Financial investments held-to-maturity	17	355,119,924	355,119,924
Loans and advances to customers	18	1,157,201,583	1,154,925,751
Other assets	19	5,462,032	5,462,032
		2,003,190,483	**2,000,914,651**
Financial liabilities			
Due to banks	25	750,413	750,413
Repurchase agreements	26	-	-
Due to customers	27	985,503,687	985,503,687
Borrowed funds	28	936,093,995	935,815,861
Subordinated loans	29	123,443,085	124,996,747
Other liabilities	31	22,132,908	22,132,908
		2,067,924,088	**2,069,199,616**

37 . 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.

	2017 MNT'000	2016 MNT'000
Contingent liabilities		
Financial guarantees	31,705,404	13,208,125
Performance and tender guarantees	29,657,202	9,726,851
Letters of credit	9,417,644	18,252,843
	70,780,250	41,187,819
Commitments		
Undrawn commitments to lend	80,325,273	34,226,912
Total	**151,105,523**	**75,414,731**

Contingent liabilities

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

Undrawn commitments to lend

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

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

Other commitments

	2017 MNT'000	2016 MNT'000
Approved and contracted for:		
Property, plant and equipment	1,732,482	956,317
Intangible assets	22,385	917,354
Consulting services	268,217	2,250
Advertisement	200,000	-
Consumables and other inventories	-	12,346
	2,223,084	**1,888,267**

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.

37. CONTINGENT LIABILITIES AND COMMITMENTS (Contd.)

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.

38. 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 40.3 Liquidity risk and funding management for the Banks contractual undiscounted repayment obligations.

At 31 December 2017	Less than 12 months MNT'000	More than 12 months MNT'000	Total MNT'000
Financial assets			
Cash and balances with BoM	465,763,697	-	465,763,697
Due from banks	313,373,833	-	313,373,833
Reverse repurchase agreements	64,974,429	-	64,974,429
Derivative financial instruments	23,220,025	59,511,590	82,731,615
Financial investments -			
- held-for-trading	-	-	-
- available-for-sale	-	47,366,617	47,366,617
- held-to-maturity	573,314,385	5,034,014	578,348,399
Loans and advances to customers	535,126,823	808,975,990	1,344,102,813
Other assets	9,059,713	769,647	9,829,360
	1,984,832,905	**921,657,858**	**2,906,490,763**
Non financial assets			
Property and equipment	-	37,011,094	37,011,094
Intangible assets	193,243	9,778,907	9,972,150
Investment property		50,375,520	50,375,520
Other assets	20,576,476	94,439	20,670,915
Properties held for sale	16,800,466	-	16,800,466
Deferred tax assets	-	1,167,009	1,167,009
	37,570,185	**98,426,969**	**135,997,154**
Total	**2,022,403,090**	**1,020,084,827**	**3,042,487,917**

At 31 December 2017	Less than 12 months MNT'000	More than 12 months MNT'000	Total MNT'000
Financial liabilities			
Due to banks	230,315,541	-	230,315,541
Repurchase agreements	214,925,195	-	214,925,195
Due to customers	957,689,385	336,824,245	1,294,513,630
Derivative financial instruments	5,477,654	-	5,477,654
Borrowed funds	293,309,662	663,722,976	957,032,638
Subordinated loans	14,025,910	96,236,495	110,262,405
Other liabilities	8,536,325	5,622,262	14,158,587
	1,724,279,672	**1,102,405,978**	**2,826,685,650**
Non financial liabilities			
Deferred grants	2,997,719	-	2,997,719
Other liabilities	9,292,374	4,086,611	13,378,985
Income tax payable	66,142	-	66,142
	12,356,235	**4,086,611**	**16,442,846**
Total	**1,736,635,907**	**1,106,492,589**	**2,843,128,496**
Net Position	**285,767,183**	**(86,407,762)**	**199,359,421**

38. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (Contd.)

At 31 December 2016	Less than 12 months MNT'000	More than 12 months MNT'000	Total MNT'000
Financial assets			
Cash and balances with BoM	326,779,876	-	326,779,876
Due from banks	158,627,068	-	158,627,068
Derivative financial instruments	32,012,473	93,006,758	125,019,231
Financial investments -			
- held-for-trading	-	-	-
- available-for-sale	-	28,117,332	28,117,332
- held-to-maturity	355,117,924	2,000	355,119,924
Loans and advances to customers	426,090,378	731,111,205	1,157,201,583
Other assets	4,613,391	848,641	5,462,032
	1,303,241,110	**853,085,936**	**2,156,327,046**
Non financial assets			
Property and equipment	-	36,619,582	36,619,582
Intangible assets	100,125	10,198,558	10,298,683
Investment property	-	4,860,809	4,860,809
Other assets	23,713,960	94,439	23,808,399
Properties held for sale	24,039,038	-	24,039,038
Deferred tax assets	-	1,326,486	1,326,486
	47,853,123	**53,099,874**	**100,952,997**
Total	**1,351,094,233**	**906,185,810**	**2,257,280,043**

At 31 December 2016	Less than 12 months MNT'000	More than 12 months MNT'000	Total MNT'000
Financial liabilities			
Due to banks	750,413	-	750,413
Repurchase agreements	-	-	-
Due to customers	736,778,366	248,725,321	985,503,687
Derivative financial instruments	928,603	-	928,603
Borrowed funds	462,974,238	473,119,757	936,093,995
Subordinated loans	10,589,959	112,853,126	123,443,085
Other liabilities	5,525,528	16,607,380	22,132,908
	1,217,547,107	**851,305,584**	**2,068,852,691**
Non financial liabilities			
Deferred grants	1,279,902	-	1,279,902
Other liabilities	5,048,427	3,062,180	8,110,607
Income tax payable	2,272	-	2,272
	6,330,601	**3,062,180**	**9,392,781**
Total	**1,223,877,708**	**854,367,764**	**2,078,245,472**
Net Position	**127,216,525**	**51,818,046**	**179,034,571**

39. RELATED PARTY DISCLOSURES

The Bank is controlled by TenGer Financial Group LLC. TenGer Financial Group LLC is owned by the shareholders detailed 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 31 December 2017 and 2016, the Bank had the following balances and transactions with related parties.

	2017 MNT'000	2016 MNT'000
a) Loans and advances to related companies:		
Holding company	-	8,710,432
Fellow subsidiaries	9,928,820	3,403,813
	9,928,820	12,114,245
Members of the Board of Directors and key management personnel of the Bank	2,182,065	2,196,269
	12,110,885	**14,310,514**

The loans and advances to related parties are secured, bear interest rates from 6.5% to 22.9% (2016: 6.5% to 24.0%) per annum and are repayable within one to 20 years. The interest income received from such loans during the financial year amounted to MNT 1,896.0 million (2016: MNT 1,946.7 million).

	2017 MNT'000	2016 MNT'000
b) Deposits from related companies:		
Holding company	139,262	25,085
Fellow subsidiaries	2,667,193	9,755,932
Shareholders of holding company	90,827	35,191
	2,897,282	**9,816,208**
Members of the Board of Directors and key management personnel of the Bank	4,261,697	1,741,576
	7,158,979	**11,557,784**

The deposits from the above related parties bear interest rates from 0% to 16.5% (2016: 0% to 15.2%) per annum. The interest expenses paid to the above depositors during the financial year amounted to MNT 467.3 million (2016: MNT 477.5 million).

	2017 MNT'000	2016 MNT'000
c) Loans from shareholders of TenGer Financial Group LLC:		
European Bank for Reconstruction and Development	14,111,705	39,626,976
International Finance Corporation (“IFC”)	119,138,833	111,821,876
Triodos Fair Share Fund	13,071,767	6,482,033
	146,322,305	**157,930,885**

39. RELATED PARTY DISCLOSURES (Contd.)

The loans from the above shareholders of TenGer Financial Group LLC bear interest rates from 2.60% to 16.75% (2016: 2.95% to 15.46%) per annum. The interest expenses paid on such loans during the financial year amounted to MNT 11,987.3 million (2016: MNT 8,230.8 million).

	2017 MNT'000	2016 MNT'000
d) Subordinated loan from shareholder of TenGer Financial Group LLC:		
International Finance Corporation ("IFC")	**110,262,405**	**112,853,126**

The subordinated loan from the above shareholder of TenGer Financial Group LLC bears interest rates of 8.26% to 8.96% (2016: 7.25% to 8.96%) per annum. The interest expenses paid on such subordinated loan during the financial year amounted to MNT 9,710.7 million (2016: MNT 8,164.2 million).

	2017 MNT'000	2016 MNT'000
e) Finance lease from related companies		
Fellow subsidiary	52,401	65,922
	52,401	**65,922**

The finance lease from the above related parties bears interest rate 18.0% (2016: 18.0%) per annum. The interest expenses paid on the above finance lease during the financial year amounted to MNT 10.8 million (2016: MNT 13.1 million).

	2017 MNT'000	2016 MNT'000
f) Security fees paid to related company:		
Fellow subsidiary	1,910,383	1,779,785
	1,910,383	**1,779,785**

	2017 MNT'000	2016 MNT'000
g) Commission income from related companies:		
Holding company	409	891
Fellow subsidiaries	4,118	5,130
Shareholders of holding company	144	119
	4,671	**6,140**
Members of the Board of Directors and key management personnel of the Bank	3,149	2,462
	7,820	**8,602**
h) Contract fee paid to related companies:		
Fellow subsidiaries	550,046	798,940
	550,046	**798,940**

39. RELATED PARTY DISCLOSURES (Contd.)

	2017 MNT'000	2016 MNT'000
i) Rental income from related companies:		
Fellow subsidiaries	55,977	58,320
	55,977	**58,320**
j) Insurance brokerage income from related companies:		
Fellow subsidiaries	349,069	283,885
	349,069	**283,885**
k) Claims income from related companies:		
Fellow subsidiaries	10,587	5,669
	10,587	**5,669**
l) Compensation of key management personnel:		
Short-term employee benefits	7,637	4,628
Salaries and bonuses	5,952,746	2,629,083
Contribution to social and health fund	642,449	284,332
	6,602,832	**2,918,043**

Terms and conditions of transactions with related parties

The above mentioned transactions and outstanding balances arose in the ordinary course of business. The interest charged to and by related parties are at normal commercial rates. Outstanding balances except for loans and advances to related parties at the year-end are unsecured. There have been no guarantees provided or received for any related party receivables or payables. For the years ended 31 December 2017 and 2016, the Bank has not made any impairment allowance relating to amounts owed by related parties.

40. RISK MANAGEMENT

40.1 Introduction

Risk Management Approach

The primary function of the Bank's risk management is to advance the Bank's risk and control framework and to establish the risk function as a business enabler while simultaneously fostering three lines of defense. Each line of defense describes a specific set of responsibilities for risk management and controls, as follows:

- **The First Line of Defense** owns and manages risk. It has ownership of and responsibility and accountability for directly assessing, controlling, and mitigating risk within its sight of control;
- **The Second Line of Defense** oversees risk. It sets the risk management framework, policies and procedures, challenges risk limits and sets risk appetite, and monitors risk exposure. As such, the Second Line of Defense monitors the design and operation of the First Line of Defense's controls, as well as provides advice and guidance on an ongoing basis; and
- **The Third Line of Defense** provides independent assurance. The independent audit function will provide the Board with assurance of the risk-based approach, covering how effectively the Bank assess and manages its risk profile and assessing the effectiveness of the first and second lines of defense.

Risk Governance and Committees

The ultimate responsibility for setting the Bank's risk appetite and effectively managing risks rests with the Board of Directors. The Board of Directors delegated its responsibility to the Board Risk Management Committee.

The key governance committees are:

- **The Board Risk Management Committee** provides ultimate oversight and independent on risk matters on behalf of the Board of Directors. Its responsibilities include approving the Bank's Risk Management Framework, reviewing the appropriateness and effectiveness of the Bank's risk management approach and risk controlling, including the approval of material credit exposure and ratification of write-off decisions;
- **The Bank Risk Management Committee** is the management level oversight committee to review, challenge and oversee the risk function, the implementation of the Risk Management Framework and the adherence to the approved risk appetite.
- **The Credit Management Committee** focuses on selected cases, which are either of significant risk or exposure, or cannot be resolved through the delegated authorities between the First and Second Line of Defense; and
- **The Operational Risk Committee** provides oversight over the Bank's control driven Operational Risk Framework and the Operational Risk Acceptance.

40. RISK MANAGEMENT (Contd.)

40.1 Introduction (Contd.)

Risk Universe

The Bank assumes risk commensurate with its risk appetite. The Bank's risk universe defines those risk types the Bank is likely to face:

- **Credit Risk**, potential for loss due to failure of a counterparty to meet its obligation to pay the Bank in accordance with agreed terms;
- **Credit Concentration Risk**, potential for loss due to excessive credit exposure concentrations;
- **Market Risk**, potential for loss of earnings or economic value due to adverse changes in financial markets and/or prices;
- **Capital Risk**, potential inability to conduct business due to limited capitalization or short-fall against regulatory capitalization requirements, without incurring acceptable losses;
- **Liquidity Risk**, potential inability to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses;
- **Operational Risk (including fraud)**, potential for loss resulting from inadequate or failed internal processes, people and systems or from the impact of external events, including legal risks;
- **Information Security Risk**, potential for harm or loss resulting from breaches of or attacks on information systems or loss of information;
- **Conduct Risk**, potential for loss resulting from delivery of unfair customer outcomes and/or breaches of the Bank's code of conduct;
- **Compliance Risk**, potential for loss resulting for failed compliance;
- **Reputational Risk**, potential for damage to the Bank's brand and reputation, resulting in loss of earnings; and
- **Strategic Risk**, potential for opportunity loss from failure to optimize the earnings potential of the Bank's business model.

Risk Appetite, Stress Testing and Risk Reporting

The Bank's Risk Appetite is reflected through the Bank's risk appetite statement, which complements the Bank's business plan. The Bank differentiates:

- **Risk Appetite**, which defines the amount of risk the Bank is willing to take in pursuit of the Bank's business model;
- **Risk and Exposure Limits**, which implement the Bank's Risk Appetite, for example through credit exposure limits or credit concentration limits;

40. RISK MANAGEMENT (Contd.)

40.1 Introduction (Contd.)

Risk Appetite, Stress Testing and Risk Reporting (Contd)

- **Risk Capacity**, which defines the amount of risk the Bank is able to take within its regulatory constraints; and

- **Stress Performance**, which defines the acceptable financial performance under predefined levels of stress.

The Bank's Risk Function periodically monitors the compliance against its risk appetite. Bespoke scenarios are applied to assess the Bank's financial performance under a mild and severe recession scenario. The Bank reviews alternative scenarios to assess the resilience of its business model. The alternative scenarios are complemented through a comprehensive contingent risk analysis.

40.2 Credit Risk

The Bank's credit risk policy defines the framework for managing the Bank's credit risk. It describes the principles and basic practices to prudently manage credit risk in accordance with the approved credit risk appetite and in accordance with risk capacity and respective laws and applicable regulations of Mongolia.

Under the Bank's credit risk management framework, the business has ownership of and accountability for selecting customers, suggesting appropriate loan products including terms and conditions, assessing customer's ability to service debt, valuing collaterals, collecting, monitoring and reviewing the loans, detecting early warning signals, and taking appropriate measurements.

While the risk function sets credit related policies and procedures, challenges credit risk limits and sets credit risk appetite, and monitors credit risk exposures. It performs the ongoing monitoring of the design and operation of controls, as well as providing advice and guidance.

40. RISK MANAGEMENT (Contd.)

40.2 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 2017 MNT'000	Gross maximum exposure 2016 MNT'000
Cash and balances with BoM (excluding cash on hand)	13	422,786,050	280,863,167
Due from banks	14	313,373,833	158,627,068
Reverse repurchase agreements	15	64,974,429	-
Derivative financial instruments	16	82,731,615	125,019,231
Financial investments - available for sale	17	41,790,572	22,837,304
Financial investments – held-to-maturity	17	578,348,399	355,119,924
Loans and advances to customers	18	1,424,509,623	1,248,048,121
Other assets	19	9,829,360	5,462,032
Total		**2,938,343,881**	**2,195,976,847**
Contingent liabilities	37	70,780,250	41,187,819
Commitments	37	80,325,273	34,226,912
Total		**151,105,523**	**75,414,731**
Total credit risk exposure		**3,089,449,404**	**2,271,391,578**

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.

40. RISK MANAGEMENT (Contd.)

40.2 Credit Risk (Contd.)

Risk concentrations by industry

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

	2017 Gross maximum exposure		2016 Gross maximum exposure	
	MNT'000	%	MNT'000	%
Trading	285,283,531	20.03	277,248,431	22.21
Production	215,078,034	15.10	194,057,350	15.55
Mortgage	170,678,508	11.98	188,579,944	15.11
Services	127,091,810	8.92	145,617,752	11.67
Consumption	247,634,021	17.38	128,535,477	10.30
Deposit backed	158,415,613	11.12	107,859,289	8.65
Construction	88,124,480	6.19	94,207,840	7.55
Other	53,031,044	3.72	31,750,627	2.54
Agricultural	35,194,013	2.47	39,305,251	3.15
Loans to staff	22,443,745	1.58	19,384,458	1.55
Mining	19,731,860	1.39	19,617,664	1.57
Loans to key management	1,802,964	0.13	1,884,038	0.15
Total	**1,424,509,623**	**100**	**1,248,048,121**	**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's credit risk policy stipulates the eligible collaterals and loan acceptance to collateral value.

The main types of the Bank's eligible collaterals obtained are as follows:

(i) For immovable assets, the buildings , facilities, affordable houses and lands
(ii) For movable assets, the vehicles, equipment, cash, animals, inventory, future guaranteed funds and intangible assets.

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.

40. RISK MANAGEMENT (Contd.)

40.2 Credit Risk (Contd.)

Credit quality per class of financial assets

The Bank uses the basic credit grading approach to categorize exposures according to the risk profiles, as follows:

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

This grading approach uses the risk parameters i.e. repayment pattern, collateral value and credit facility purpose to quantify the risk grade. It allows the management to compare the exposures across all lines of loans and advances to customers.

Apart from using this grading approach, the Bank applies the credit ratings assigned by the international rating agencies to the exposures for due from banks and financial investments. The Bank does not rate the unquoted financial investments.

The table below shows that all financial assets exposed to credit risk in terms of credit grading. The amounts presented are gross of impairment allowances.

40. RISK MANAGEMENT (Contd.)

40.2 Credit Risk (Contd.)
Credit quality per class of financial assets (Contd.)

At 31 December 2017	Note	Neither past due nor impaired					Past due or individually	
		Excellent	Good	Satisfactory	Substan-dard	Not rated	impaired	Total
		MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
Cash and balances with BoM	13	465,763,697	-	-	-	-	-	465,763,697
Due from banks	14	7,604,583	62,360,637	1,200,103	242,208,510	-	-	313,373,833
Reverse repurchase agreements	15	64,974,429	-	-	-	-	-	64,974,429
Derivative financial instruments	16	82,731,615	-	-	-	-	-	82,731,615
Financial investments								
-available-for-sale	17	-	-	-	-	41,790,572	-	41,790,572
-held to maturity	17	578,348,399	-	-	-	-	-	578,348,399
Loans and advances to customers								
SME loans	18	41,223,350	26,429,646	401,069,206	27,534,890	3,809,844	123,213,880	623,280,816
Mortgage loans	18	41,000,086	25,903,994	92,816,436	11,826,199	72,640	14,434,772	186,054,127
Micro business loans	18	24,094,332	21,702,567	124,063,478	695,870	476,127	25,624,926	196,657,300
Consumer loans	18	91,638,694	35,442,002	107,031,287	262,613	6,526	6,365,571	240,746,693
Finance leases	18	9,564,965	1,974,097	3,436,393	37	58,817	743,850	15,778,159
Other	18	158,277,150	-	63,096	2,213,202	-	1,439,080	161,992,528
		365,798,577	111,452,306	728,479,896	42,532,811	4,423,954	171,822,079	1,424,509,623
Other assets	19	9,829,360	-	-	-	-	-	9,829,360
Total		**1,575,050,660**	**173,812,943**	**729,679,999**	**284,741,321**	**46,214,526**	**171,822,079**	**2,981,321,528**

40. RISK MANAGEMENT (Contd.)

40.2 Credit Risk (Contd.)
Credit quality per class of financial assets (Contd.)

At 31 December 2016	Note	Neither past due nor impaired Excellent MNT'000	Good MNT'000	Satisfactory MNT'000	Substan-dard MNT'000	Not rated MNT'000	Past due or individually impaired MNT'000	Total MNT'000
Cash and balances with BoM	13	326,779,876	-	-	-	-	-	326,779,876
Due from banks	14	1,130,444	151,167,666	3,659,078	-	2,669,880	-	158,627,068
Derivative financial instruments	16	125,019,231	-	-	-	-	-	125,019,231
Financial investments								
-available-for-sale	17	-	-	-	-	22,837,304	-	22,837,304
-held to maturity	17	355,119,924	-	-	-	-	-	355,119,924
Loans and advances to customers								
SME loans	18	44,316,901	43,685,817	335,639,341	19,673,643	-	135,979,587	579,295,289
Mortgage loans	18	48,619,224	9,257,691	123,994,306	5,001,550	-	15,216,005	202,088,776
Micro business loans	18	43,563,204	18,841,529	124,108,172	689,959	-	32,167,035	219,369,899
Consumer loans	18	9,787,118	71,372,223	37,058,330	1,348,450	-	6,269,715	125,835,836
Finance leases	18	4,381,383	1,600,423	3,451,896	24,076	-	1,075,343	10,533,121
Other	18	107,800,586	50,833	520,079	8,510	-	2,545,192	110,925,200
		258,468,416	144,808,516	624,772,124	26,746,188	-	193,252,877	1,248,048,121
Other assets	19	5,462,032	-	-	-	-	-	5,462,032
Total		**1,071,979,923**	**295,976,182**	**628,431,202**	**26,746,188**	**25,507,184**	**193,252,877**	**2,241,893,556**

40. RISK MANAGEMENT (Contd.)

40.2 Credit Risk (Contd.)

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

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

	Less than 30 days MNT'000	31 to 60 days MNT'000	61 to 90 days MNT'000	More than 90 days MNT'000	Total MNT'000
As at 31 December 2017					
Loan and advances to customers					
SME loans	30,582,005	1,825,818	2,509,175	35,935,737	70,852,735
Mortgage loans	2,148,015	1,182,808	751,582	7,579,171	11,661,576
Micro business loans	1,435,424	1,345,156	1,189,413	21,654,933	25,624,926
Consumer loans	1,188,202	601,238	356,562	4,219,569	6,365,571
Finance leases	280,827	21,159	6,421	435,443	743,850
Other	8,751	25,039	11,378	1,393,912	1,439,080
	35,643,224	**5,001,218**	**4,824,531**	**71,218,765**	**116,687,738**

	Less than 30 days MNT'000	31 to 60 days MNT'000	61 to 90 days MNT'000	More than 90 days MNT'000	Total MNT'000
As at 31 December 2016					
Loan and advances to customers					
SME loans	25,281,196	2,656,065	20,095,361	31,618,539	79,651,161
Mortgage loans	2,032,279	1,845,416	1,103,162	9,953,907	14,934,764
Micro business loans	3,573,860	3,500,743	2,522,491	22,569,941	32,167,035
Consumer loans	791,103	566,161	242,753	4,669,698	6,269,715
Finance leases	84,124	48,706	29,961	912,552	1,075,343
Other	116,056	193,590	10,639	2,224,907	2,545,192
	31,878,618	**8,810,681**	**24,004,367**	**71,949,544**	**136,643,210**

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 2017 was MNT 188,551 million (2016: MNT 247,975 million). Please refer Note 18 for more detailed information with respect to allowance for impairment losses on loans and advances to customers.

40. RISK MANAGEMENT (Contd.)

40.2 Credit Risk (Contd.)

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.

	2017 MNT'000	2016 MNT'000
Loans and advances to customers:		
SME loans	47,816,182	24,832,590
Micro business loans	9,289,657	2,854,057
Mortgage loans	1,726,838	788,730
Customer loan	613,926	-
Finance leases	98,764	112,193
Other	379,960	-
	59,925,327	28,587,570

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, 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 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.

40. RISK MANAGEMENT (Contd.)

40.2 Credit Risk (Contd.)

Collectively assessed allowances

Allowances are assessed collectively for losses on loans and advances that are not individually significant and for individually significant loans and advances where there is not yet objective evidence of individual impairment. Allowances are evaluated semi-annually 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.

The impairment allowance is then reviewed by Chief Risk Officer and Chief Financial Officer to ensure compliance with the Bank's overall policy.

40.3 Liquidity Risk

The Bank's liquidity risk refers to potential inability to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses. The Bank sets risk appetite on the liquidity metrics that should be in place to cover withdrawals at unexpected levels of demand. It is the Bank's policy to maintain a prudent mix of borrowed and core deposit base. In addition, the Bank maintains a statutory deposit with BoM equal to 12% (2016: 12%) of customer deposits.

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities 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.

40. RISK MANAGEMENT (Contd.)

40.3 Liquidity Risk (Contd.)

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

Financial liabilities	On demand MNT'000	Less than 3 months MNT'000	3 to 6 months MNT'000	6 months to 1 year MNT'000	1 to 5 years MNT'000	Over 5 years MNT'000	Total undiscounted financial liabilities MNT'000
At 31 December 2017							
Due to banks	341,215	202,423,941	30,825,000	-	-	-	233,590,156
Repurchase agreement	-	214,925,195	-	-	-	-	214,925,195
Due to customers	399,628,635	121,794,537	172,220,394	308,778,372	163,628,294	355,719,469	1,521,769,701
Derivative financial instruments	-	3,928,970	1,548,684	-	-	-	5,477,654
Borrowed funds	-	28,718,088	92,891,778	227,104,543	710,003,554	15,971,516	1,074,689,479
Subordinated loans	-	2,355,183	2,355,184	18,736,278	113,185,047	-	136,631,692
Other liabilities	-	8,315,065	112,724	108,536	2,815,783	2,806,479	14,158,587
Total	**399,969,850**	**582,460,979**	**299,953,764**	**554,727,729**	**989,632,678**	**374,497,464**	**3,201,242,464**

40. RISK MANAGEMENT (Contd.)

40.3 Liquidity Risk (Contd.)

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

Financial liabilities	On demand MNT'000	Less than 3 months MNT'000	3 to 6 months MNT'000	6 months to 1 year MNT'000	1 to 5 years MNT'000	Over 5 years MNT'000	Total undiscounted financial liabilities MNT'000
At 31 December 2016							
Due to banks	753,668	-	-	-	-	-	753,668
Repurchase agreement	-	-	-	-	-	-	-
Due to customers	283,306,374	150,127,015	138,638,220	196,445,304	127,941,688	263,409,541	1,159,868,142
Derivative financial instruments	-	625,968	302,635	-	-	-	928,603
Borrowed funds	4,902,840	61,711,024	183,183,952	261,645,219	514,167,227	11,343,055	1,036,953,317
Subordinated loans	843,716	1,687,432	2,531,147	15,459,898	139,900,351	-	160,422,544
Other liabilities	-	4,650,279	6,800	868,450	12,780,330	3,827,049	22,132,908
Total	**289,806,598**	**218,801,718**	**324,662,754**	**474,418,871**	**794,789,596**	**278,579,645**	**2,381,059,182**

40. RISK MANAGEMENT (Contd.)

40.3 Liquidity Risk (Contd.)

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

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

	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 2017							
Contingent liabilities (Note 37)	10,986,941	17,480,643	6,733,875	10,210,163	25,368,628	-	70,780,250
Commitments (Note 37)	541,054	5,081,977	3,846,178	20,425,248	50,415,268	15,548	80,325,273
Total	**11,527,995**	**22,562,620**	**10,580,053**	**30,635,411**	**75,783,896**	**15,548**	**151,105,523**
At 31 December 2016							
Contingent liabilities (Note 37)	4,898,943	6,374,101	10,470,013	8,668,244	10,776,518	-	41,187,819
Commitments (Note 37)	7,032,817	1,155,310	4,318,470	15,572,164	6,148,151	-	34,226,912
Total	**11,931,760**	**7,529,411**	**14,788,483**	**24,240,408**	**16,924,669**	**-**	**75,414,731**

40. RISK MANAGEMENT (Contd.)

40.4 Market Risk

The Bank defines the market risk as potential for loss of earnings or economic value due to adverse changes in financial markets and/or prices. The Bank's financial risk policy is ensure the Bank's financial risks, i.e. Market risk, Capital risk and Liquidity risk are adequately managed and the Bank's capital and liquidity resources are deployed as efficiently and effectively as possible.

Interest Rate Risk

The Bank defines interest rate risk as potential loss due to a negative impact from adverse changes in interest rates and their implied volatility. 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 Bank's Risk Function periodically monitors the compliance against its risk appetite on the Bank's interest rate position.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's statement of comprehensive income. The sensitivity of the statement of comprehensive income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate financial assets and financial liabilities held at 31 December 2017 and 31 December 2016.

Currency	Change in basis points	Sensitivity of net interest income MNT'000
At 31 December 2017		
USD	+120	(9,269,820)
MNT	+120	(1,342,970)
USD	-120	9,269,820
MNT	-120	1,342,970
At 31 December 2016		
USD	+120	(6,683,975)
MNT	+120	204,486
USD	-120	6,683,975
MNT	-120	(204,486)

40. RISK MANAGEMENT (Contd.)

40.4 Market Risk (Contd.)

Foreign Currency Exchange Risk

The Bank defines the foreign currency exchange risk as potential loss due to adverse changes in currency exchange rates and their implied volatility. The Bank sets risk limits on the level of exposure by foreign currencies, which are monitored on a frequent basis against the approved risk appetite. Apart from using foreign exchange exposure mismatch, the Bank uses the Value-at-Risk ("VaR") approach to manage and measure foreign exchange risk.

The VaR approach

The VaR approach is an integral part of the Bank's risk management since March 2007. The VaR approach is designed to measure market risk in a normal market environment. It assumes that any changes occurring in the risk factors affecting the normal market environment will follow a normal distribution.

The Bank calculates the VaR losses using a 99% confidence level and a one day holding period. The calculation employs a Variance and Covariance technique and uses one year of historical market data as input variables. The one-day VaR losses are estimated at 99% confidence level, as follows:

	Variance/ Covariance MNT'000		Variance/ Covariance MNT'000
2017 – 31st December	22,623	2016 – 31st December	59,928
2017 - Average Daily	67,585	2016 - Average Daily	75,703
2017 – Highest	209,527	2016 - Highest	277,278
2017 – Lowest	11,205	2016 - Lowest	16,508

40. RISK MANAGEMENT (Contd.)

40.4 Market Risk (Contd.)

Currency Risk (Contd.)

The table below summarises the Bank's exposure to foreign exchange risk as 31 December, 2017. Included in the table are the Bank's financial assets and liabilities at carrying amounts, categorised by currencies.

Financial assets and financial liabilities	MNT MNT'000	USD MNT'000	Euro MNT'000	Other MNT'000	Total MNT'000
As at 31 December 2017					
Assets					
Cash and balances with BoM	262,081,700	71,152,132	6,924,928	125,604,937	465,763,697
Due from banks	10,542,763	292,007,372	4,566,513	6,257,185	313,373,833
Reverse repurchase agreements	64,974,429	-	-	-	64,974,429
Derivative financial instruments*	32,231,463	689,658,178	-	-	721,889,641
Financial investments					
-available-for-sale	47,366,617	-	-	-	47,366,617
-held-to-maturity	578,348,399	-	-	-	578,348,399
Loans and advances to customers	1,189,263,639	154,705,331	116,203	17,640	1,344,102,813
Other assets	8,967,464	838,957	14,809	8,130	9,829,360
	2,193,776,474	**1,208,361,970**	**11,622,453**	**131,887,892**	**3,545,648,789**
Liabilities					
Due to banks	107,403,362	8,855	1,472	122,901,852	230,315,541
Repurchase agreements	214,925,195	-	-	-	214,925,195
Due to customers	1,032,151,509	244,458,810	11,407,268	6,496,043	1,294,513,630
Derivative financial instruments*	612,562,613	32,073,067	-	-	644,635,680
Borrowed funds	153,570,210	803,462,428	-	-	957,032,638
Subordinated loans	-	110,262,405	-	-	110,262,405
Other liabilities	11,315,445	2,660,180	33,265	149,697	14,158,587
	2,131,928,334	**1,192,925,745**	**11,442,005**	**129,547,592**	**3,465,843,676**
Net position	**61,848,140**	**15,436,225**	**180,448**	**2,340,300**	**79,805,113**

** The figure is shown at gross amount to reflect the actual currency position*

40. RISK MANAGEMENT (Contd.)

40.4 Market Risk (Contd.)

Currency Risk (Contd.)

The table below summarizes the Bank's exposure to foreign exchange risk as 31 December, 2016. Included in the table are the Bank's financial assets and liabilities at carrying amounts, categorized by currencies (Contd.).

Financial assets and financial liabilities	MNT MNT'000	USD MNT'000	Euro MNT'000	Other MNT'000	Total MNT'000
As at 31 December 2016					
Assets					
Cash and balances with BoM	115,994,154	203,471,420	1,365,545	5,948,757	326,779,876
Due from banks	322	149,141,742	4,255,730	5,229,274	158,627,068
Reverse repurchase agreements	-	-	-	-	-
Derivative financial instruments*	89,928,202	648,790,510	-	-	738,718,712
Financial investments					
-available-for-sale	28,117,332	-	-	-	28,117,332
-held-to-maturity	266,524,798	88,595,126	-	-	355,119,924
Loans and advances to customers	1,043,416,847	113,606,499	173,862	4,375	1,157,201,583
Other assets	4,490,555	954,782	3,721	12,974	5,462,032
	1,548,472,210	**1,204,560,079**	**5,798,858**	**11,195,380**	**2,770,026,527**
Liabilities					
Due to banks	46,631	703,232	550	-	750,413
Due to customers	754,487,277	217,573,493	5,818,633	7,624,284	985,503,687
Derivative financial instruments*	524,918,380	89,709,704	-	-	614,628,084
Borrowed funds	192,318,659	743,775,336	-	-	936,093,995
Subordinated loans	-	123,443,085	-	-	123,443,085
Other liabilities	10,227,480	11,847,991	404	57,033	22,132,908
	1,481,998,427	1,187,052,841	5,819,587	7,681,317	2,682,552,172
Net position	**66,473,783**	**17,507,238**	**(20,729)**	**3,514,063**	**87,474,355**

** The figure is shown as gross amount to reflect the actual currency position*

40. RISK MANAGEMENT (Contd.)

40.4 Market Risk (Contd.)

Prepayment Effect

Prepayment effect is the financial effect which will be caused by the customers and counterparties that repay or request repayment earlier than expected.

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

If 20% of repayable financial instruments were prepaid at the beginning of the year, with all other variables held constant, the profit before tax for the year would be reduced by MNT 10,647 million (2016: MNT 9,239 million).

Operational Risk

The Bank defines the operational risk as potential loss resulting from inadequate or failed internal processes, people and systems or from the impact of external events, including legal risks. The Bank's operational risk function guides process owners on the definition and implementation of effective controls aimed at prevention, detection, and mitigation of operational risks. Process reviews and controls readings define operational risk ratings which guide the operational risk acceptance and management.

41. CAPITAL ADEQUACY

The Bank actively manages its capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by BoM. During the past year, the Bank complied in full with all its externally imposed capital requirements.

Capital management

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

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

Regulatory capital

BoM requires commercial banks to maintain a minimum core capital adequacy ratio of 9% (2016: 9%) and risk weighted capital ratio of at least 14% (2016: 14%) 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:

	2017	2016
Core capital ratio	11.19%	12.73%
Risk weighted capital ratio	16.86%	19.19%

	2017 MNT'000	2016 MNT'000
Tier I capital		
Ordinary shares	55,342,753	55,342,753
Other reserves	10,531,368	10,531,368
Retained profits	123,483,759	103,760,094
Total Tier I Capital	189,357,880	169,634,215
Tier II capital		
Subordinated loans	94,678,940	84,817,108
Other	1,470,750	1,255,916
Total capital /capital base	**285,507,570**	**255,707,239**

41. CAPITAL ADEQUACY (Contd.)

Regulatory capital (Contd.)

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

	2017		2016	
	Risk		Risk	
	Assets	Weighted	Assets	Weighted
%	MNT'000	MNT'000	MNT'000	MNT'000
0	1,191,014,742	-	784,237,755	-
20	144,285,015	28,857,003	79,018,911	15,803,782
50	290,551,406	145,275,703	211,441,179	105,720,590
70	305,848,188	214,093,732	294,049,642	205,834,749
100	1,208,053,821	1,208,053,821	907,340,470	907,340,470
120	57,503,707	69,004,448	57,969,019	69,562,823
150	-	-	-	-
Adjustments:				
Operational risk ratio		20,867,155		23,881,130
Foreign exchange risk ratio		6,804,386		4,448,672
Total	**3,197,256,879**	**1,692,956,248**	**2,334,056,976**	**1,332,592,216**

42. MONGOLIAN TRANSLATION

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

43. EVENTS AFTER THE REPORTING PERIOD

There have been no significant events after the reporting period requiring disclosure in the financial statements.