STATE BANK

2017
ANNUAL REPORT

www.statebank.mn

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INTRODUCTION

State Bank is a state-owned commercial bank, established pursuant to decree No.384 of the Government of Mongolia and resolution No.259 of the Minister of Finance dated 23 November 2009.

State Bank provides a comprehensive range of financial services to customers across Mongolia through its more than 500 branches, 280 ATMs and 2,500 point of sale (POS) merchants.

We work towards being a bank with the best service, excellent customer care, the least exposure to risk and most efficient operation by delivering prompt, comprehensive, internationally-accepted and state-of-the-art banking and financial services throughout the country, bolstering array of cooperation, and enabling stable business operation of our customers.

Last year, the total assets of the State Bank stood at MNT 2 trillion while the prudential ratios, such as the capital adequacy ratio and liquidity ratio, set forth by the Bank of Mongolia were fully maintained.

Within the framework of ensuring implementation of banking sector policies, State Bank has been taking series of measures intended to reduce risks. As a result, the Bank was chosen again as one of the TOP 3 banks in the industry to solidify its previous achievements.

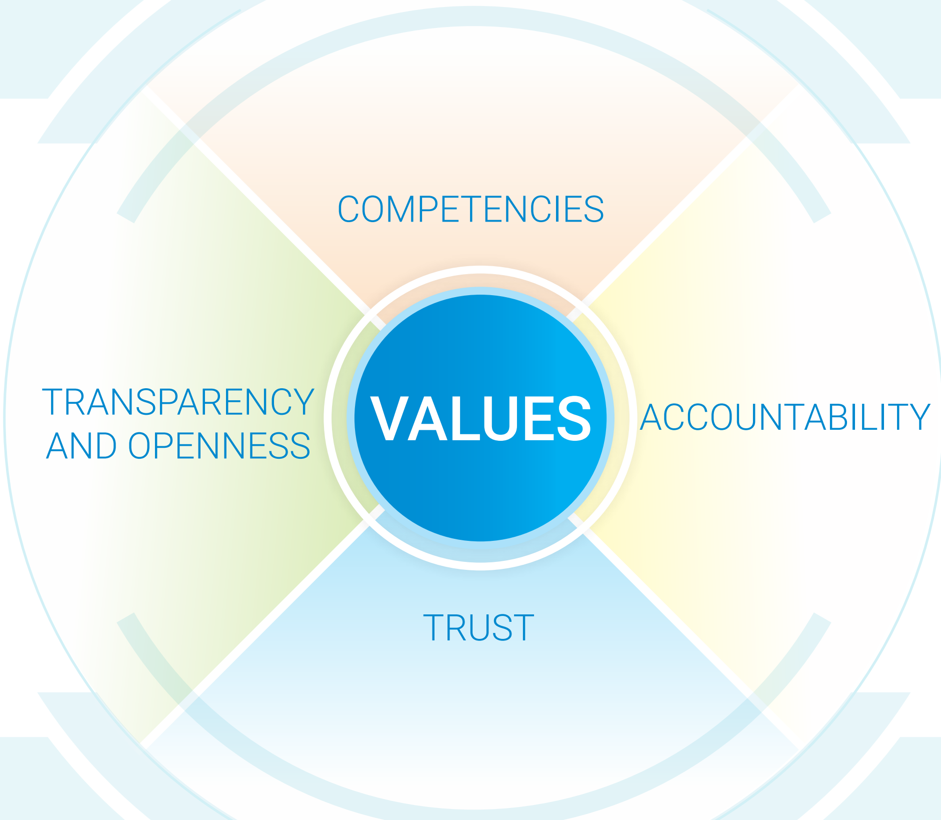
State Bank keeps pace with latest technology and software offered to international banking and finance field and ensures regular upgrading of its electronic banking solution, so that more than ten financial services are rendered online, enabling the customers to receive the banking services using their computers and phones without time and geographical limitations.

VISION

TO BE THE LEADING NATIONAL BANK WITH GLOBALLY ACCEPTED SERVICES AND VALUES.

MISSION

WE AIM TO BECOME A RISK-FREE BANK WITH THE BEST COMMUNICATION AND LEADING TECHNOLOGY WHILE DELIVERING COMPREHENSIVE FINANCIAL SERVICES THROUGHOUT THE COUNTRY IN A HIGHLY PROFESSIONAL MANNER, WHICH ULTIMATELY CONTRIBUTES TO THE DEVELOPMENT OF MONGOLIA.



MESSAGE FROM THE CHAIRMAN OF THE BOARD OF DIRECTORS

Sincerely yours,

J.GANBAT,

CHAIRMAN OF THE BOARD
OF DIRECTORS,
Head of the Fiscal Policy and Planning
Department of the Ministry of Finance

On behalf of the Board of Directors, I am delighted to present the 2017 Annual Report of the State Bank to our esteemed customers, partners and employees.

State Bank has been providing comprehensive banking and financial services in a timely and risk-free manner to 2.8 million customers through its extensive network of more than 500 branches, and energetic and skilled team of 3800 employees across Mongolia.

2017 was a year of overcoming the economic hurdles faced by the country to invigorate the economic growth and to enhance the risk management framework of banking and financial sector. Despite the these challenges , the State Bank has successfully overcame the year as it has continued to meet the expectations of the customers, deposit holders, and business partners and has fully maintained the prudential ratio requirements of the Bank of Mongolia, as a result, we have been selected as one of the TOP-3 banks in Mongolia. In addition to that, Fitch upgraded the Bank's credit rating outlook from "stable" to "positive" and gave the rating of "B-". This has been the demonstration of the Bank's ongoing achievements.

In 2017, five new branches were opened and comprehensive e-banking solution was introduced to 51 branches . Through successful introduction of wide range of innovative new products and services, the State Bank continues to put strong emphasis on the enhancement of our business model in order to stay current to the economic and business developments.

Our financial statements were reviewed and verified by KPMG Audit LLC – an internationally-recognized audit institution. It has been 7 years since the bank successfully transitioned into International Accounting Standards.

As a major national and state-owned bank that conducts significant portion of the country's payment and settlements alone, the State Bank aims to become the pillar of country's socio-economic development through introduction of innovative financial products that contribute to the social well-being of the country.

We sincerely believe that our achievements, which are a result of effective cooperation with our customers and business partners as well as the contribution of all employees of the Bank, will be further extended towards more success, contributing significantly to the development and sustainability of the banking and financial market in Mongolia.

I would like to take this opportunity to wish you further success and prosperity..

BOARD OF DIRECTORS

NARANTSOGT Sanjaa
Member of the Board,
State Secretary, Ministry of Finance

BATKHUU Idesh
Member of the Board,
Head of the Development Financing Department, Ministry of Finance

BYAMBASUREN Urgamal
Member of the Board,
Deputy Chief of the Cabinet Secretariat

SAINZORIG Purevjav
Member of the Board,
Head of the Legal Policy Department,
Ministry of Justice and Internal affairs

ENKHBOLD Zorigtbaatar
Member of the Board,
Head of the Procurement Policy Division,
Legal Department, Ministry of Finance

BATJARGAL Mishir
Independent Member of the Board

GANZORIG Ayush (Ph.D.)
Independent Member of the Board,
Professor of the Department of Economy,
National University of Mongolia

TSOGTBAYAR Tamjid
Independent Member of the Board

KHANGAI Enkhtsogt
Member of the Board,
Lawyer

ANUN Nyamsuren
Secretary of the Board,
Chief Audit Executive

MESSAGE FROM THE CHIEF EXECUTIVE OFFICER

Greetings to our valued customers and partners!

State Bank delivers array of banking and financial services to 2.8 million customers using our network of more than 500 branches across Mongolia.

In 2017, total assets of State Bank reached MNT 2.3 trillion while total deposits increased to MNT 1.8 trillion, a clear indicator of the customer trust in the Bank. Consequently, net profit for the year was MNT 12.4 billion. The Bank also maintained the prudential ratios established by the Bank of Mongolia.

State Bank pursues four key principles in its day-to-day operation, namely minimal risk, innovation, timely delivery of government services to customers, and corporate social responsibility.

Our achievements in line with the above principles can be summarized as follows:

- In order to achieve minimal risk, the Bank's financial statements were audited by KPMG Audit LLC – one of the four largest audit firms in the world. In addition, the bank's operational risk was assessed and confirmed by Moody's credit rating agency at "B3" rating with stable outlook.
- For innovation, Gyals Banking – a comprehensive e-banking platform – was developed. Further enhancements of the platform include updating of Gyals Banking App to allow fingerprint sign-in and execution of transactions worth up to MNT 5 million, addition of QPay menu for easy transactions using QR codes and introduction of self-service E-banking corners at 51 branches.
- The Bank enables easy payment arrangements for utility bills, social insurance premiums and traffic tickets while ensuring smooth disbursement of pensions and social welfare allowances within the scope of ensuring timely delivery of government services to customers.
- Within its corporate social responsibility measures, State Bank carries out number of campaigns each year including Eco-Education, Knowledge Support, Financial Education and Appreciation Campaigns. Joint projects and programmes were implemented with Mongolia Pupils' Union, Mongolian Chess Federation, Khureelen Project, Health and Social Insurance Departments and National Recreational Park as well as the public to promote positive attitude within the society.

On behalf of the State Bank, I wish every success and prosperity to our esteemed customers and business partners who have vested their trust in us to support the aforementioned endeavours.

Sincerely yours,

G.DULGUUN,

CHIEF EXECUTIVE
OFFICER, STATE BANK

MANAGEMENT TEAM

G.DULGUUN
Chief Executive Officer

D.BAYARSAIKHAN
General Director

D.GANBAATAR
First Deputy Director

A.GANBAATAR
Chief Risk Officer

D.SUGAR
Chief Business Officer

G.TOGTOKHBAATAR
Chief Financial Officer

G.ENKHTAMIR
Chief Information Technology Officer

O.BAASANSUREN
Chief Operations Officer

MANAGEMENT TEAM

Director, Product Development and Marketing Department
B.SODONBAATAR

Director, Treasury Department
L.CHINBAT

Director, Internal Audit Department
N.BATDORJ

Director, Human Resources Department
L.BOLORMAA

Director, Risk Management and Credit Policy Department
B.DELGERBAYAR

Director, Information Technology Department
B.ALTANGEREL

Director, Internal Supervision Department
A.BATMUNKH

Director, Branch Management Department
Z.TUYATSETSEG

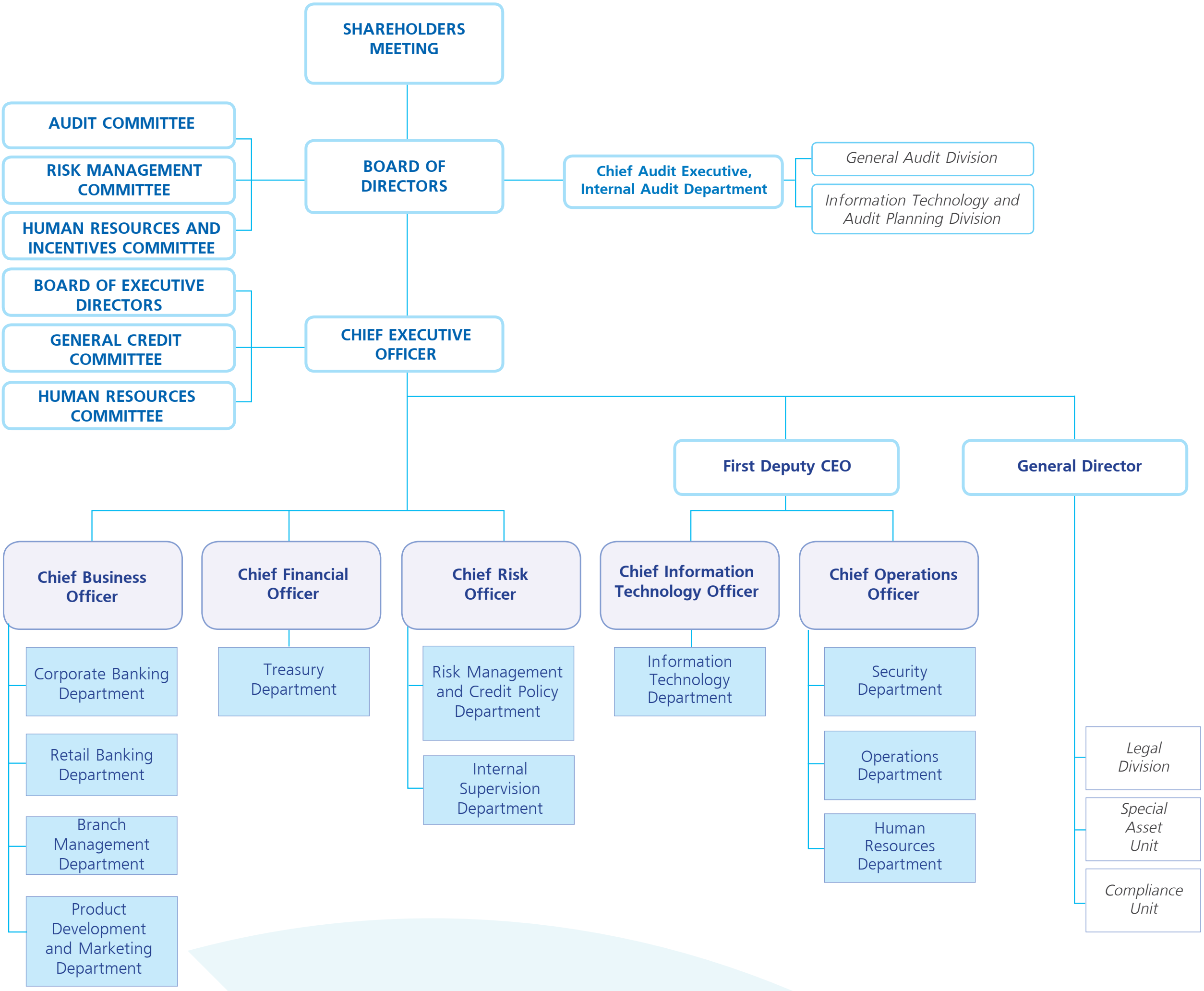
Director, Security Department
T.BATTULGA

Director, Corporate Banking Department
U.GANTUR

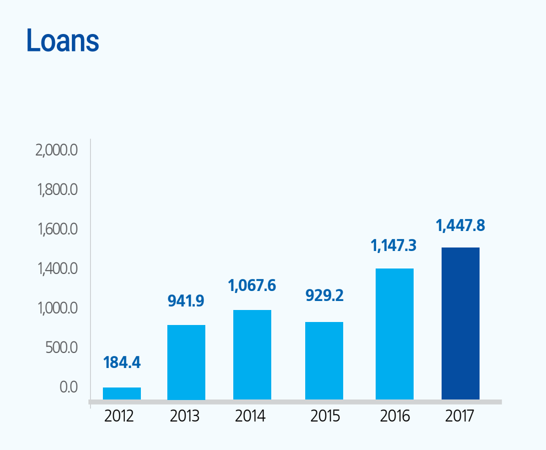
Director, Retail Banking Department
D.RINCHINDORJ

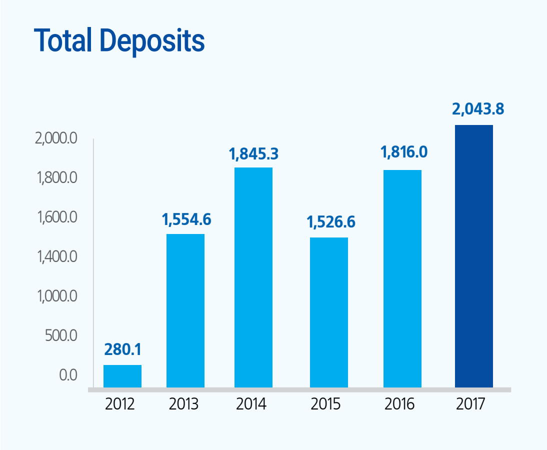
Director, Operations Department
L.GANGEREL

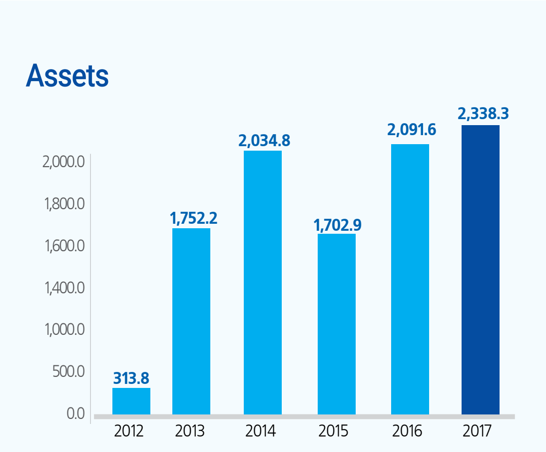
ORGANIZATIONAL STRUCTURE

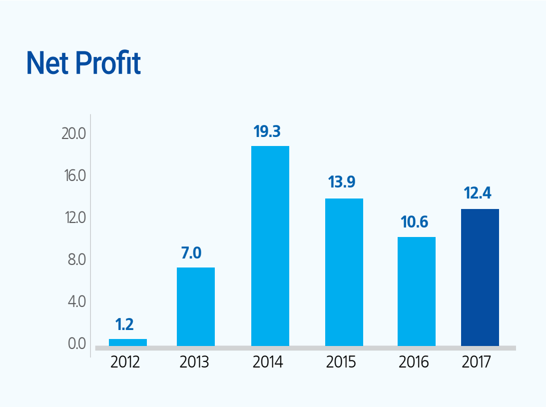


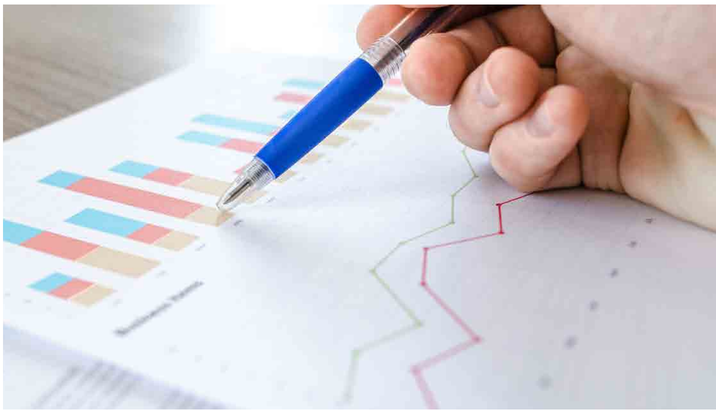
FINANCIAL HIGHLIGHTS /in MNT billion/











KEY MILESTONES AND EVENTS

KEY MILESTONES

The year 2017 brought range of achievements to the State Bank.

State Bank ranked 11th in TOP-100 companies selected jointly by the Government of Mongolia and the Mongolian National Chamber of Commerce and Industry (MNCCI) for tangible contributions to socio-economic development of the country. The Bank stood third among the banking industry peers.

State Bank received a prestigious Golden Award for Quality and Business Prestige from the Global Trade Leaders' Club–an international association of leading businesses.

The Bank's 2017 financial statements were audited by KPMG Audit LLC – one of the four largest audit firms in the world. In addition, the bank's operational risk was assessed and confirmed by Moody's at"B3" rating with stable outlook.

State Bank became the top premium participant at National Tourism Expo-"Ulaanbaatar-2017".

A comprehensive e-banking platform – Gyals Banking – with easiest access and timely service was developed. Further enhancements of the platform include updating of Gyals Banking App to allow fingerprint sign-in and execution of transactions worth up to MNT 5 million, addition of QPay menu for easy transactions using QR codes and introduction of self-service E-banking corners at 51 branches.

Using certified mail services of Mongol Post JSC, cards ordered by our customers can reach not only parts of the country but also any corners in the world in reliably manner.

KEY EVENTS

"COMPLIANCE FORUM 2017" SUCCESSFULLY HELD.

Compliance Forum has been held annually by banks to serve as the platform for banking professionals to exchange information, foster discussions and share views on the issues faced by the industry. This year's forum was jointly organized by State Bank and Mongolian Bankers' Association, and drew participants from wide networks of agencies and industries such as international and domestic banks and financial institutions, and police department.

STATE BANK RECOGNIZED THE BEST POS MERCHANTS.

State Bank accommodates settlements of 3.8 million payment cards used throughout Mongolia using its network of more than 2800 POS merchants. The Bank held "Appreciation Day" in November 2017 at Bayangol Hotel for representatives of the best merchants. The event recognized 200 POS merchants with exceptional performances in 2017.

NEW BRANCH

State Bank continues to seek delivery of services tailored to the needs and comforts of our customers. In 2017, two sub- branches –15 Khoroolol and Bayangol –moved into their new premises in Ulaanbaatar while two new sub-branches – Khoimor and Uliastai– started their new operation.

SOFT LOANS TO SMALL AND MEDIUM ENTERPRISES IN NEED OF FUNDING.

State Bank signed an on-lending agreement with "Supporting the Credit Guarantee Fund of Mongolia for economic diversification and employment" project. Under this scheme, long-term soft loans with guarantees will be disbursed to small and medium enterprises with lack of collateral.

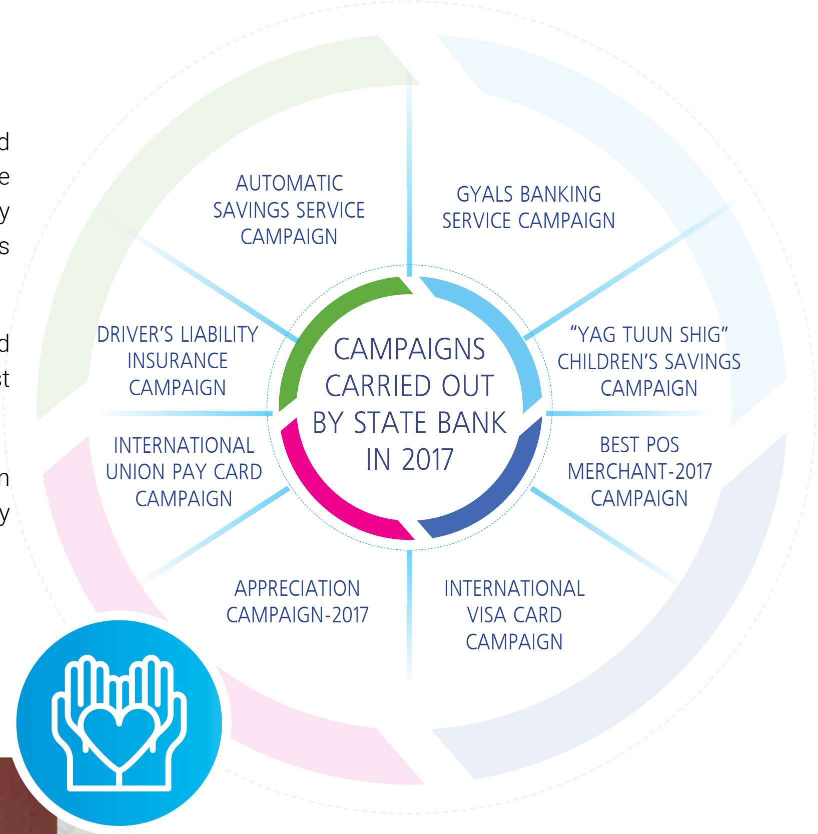
WON "BANKER-2017" CUP FOR INTERBANK BASKETBALL AND FOOTBALL MATCHES

"Banker-2017" basketball and football matches were organized by State Bank to commemorate 93rd year anniversary of the banking system in Mongolia. State Bank won both matches on consecutive years, so that the cups will remain with the Bank.

ACTIVITIES FOR CUSTOMERS

ACTIVITIES FOR CUSTOMERS

- Several promotional campaigns were organized among the customers in 2017. These include Automatic Savings, Gyals Banking, Union Pay Card, Appreciation and "Yag Tuun Shig" Children's Savings Campaigns.
- More than 3800 employees of State Bank raised MNT 10 million to help the efforts to fight forest and steppe fire.
- Employees initiated book and stationary donation programme for "Unur Bul" Child and Family Development Centre.



SPORTS

- D.Munkhzul, an athlete of State Bank became the World Junior Chess Champion, repeating the previous year's achievement.
- State Bank has been supporting its employees who achieved success in major sports tournaments. Kh.Ariunbat, an employee of the Bank, won the first ever bronze medal for Mongolia in an international paragliding event – "Terenggau International Paragliding Completion TIPCO-2017" – held in Malaysia. E.Dulguun, another employee, won FIBA 3x3 Asia Cup held in Mongolia as part of the national team and became the Most Valuable Player.

RETAIL BANKING

In 2017, State Bank focused on enhancement of key products and services as well as introduction of new services and technology. The following are some of the highlights:

CARD

State Bank adheres to international security standards for payment cards by introducing latest technology and control systems. Our Bank offers services of 14 different cards including domestic and international VISA, JCB and Union Pay.

DEPOSIT-TAKING ATM

In addition to our 280 ATMs throughout the country, more than 20 ATMs with deposit-taking function were installed in Ulaanbaatar to streamline the banking services. In the subsequent years, this type of ATMs will be introduced to rural areas.

SAVINGS AND DEPOSIT

State Bank offers variety of savings and deposit services with flexible terms and high interest yields. These include Compounding interest savings, which enable monthly calculation of interest rates, and Automatic savings service, which automatically rounds up card purchases as well as bill and loan payments, and transfers the discrepancies into savings accounts.

LOAN SERVICES

In 2017, the loan portfolio of State Bank increased by 24.4% while interest income rose by 28.8% compared to the previous year. Loans with highest yields are agricultural, herder and consumer loans. Majority of the interest income in 2017 was generated from salary, business and pension loan portfolios.

E-MONEY SERVICE

Customers can withdraw cash from State Bank ATMs using their mobile phones in the absence of the cards. The withdrawal can be made within 1 hour using a transaction code received via internet and mobile phone.

DEPOSIT-SECURED ONLINE LOAN

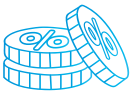
This service enables disbursement of online loans within 5 minutes using one's savings account denominated both in local and international currencies.

Loan Activities

Branch Management Department facilitates the timely delivery of loan products through Ulaanbaatar and rural branches. During the reporting year, MNT 1,507.0 billion loans were disbursed to 865,426 borrowers for their financial needs.

We aim to have national outreach for our loan products and prioritize in issuance of agricultural, herder and consumer loans. Consumer loan terms and conditions were adjusted for longer tenure and lesser requirements to accommodate the ongoing collaboration with customers.

The Bank started disbursing subsidized Pension loan and Student development loan, implemented by the Government of Mongolia.



New loan product with gold collateral was introduced.

Insurance intermediary service

State Bank provides comprehensive BANCASSURANCE service through its network of 500 plus branches. Under this framework, more than 20 insurance products tailored to the needs of customers are offered. The following activities were carried out in 2017 to boost the insurance intermediary service efficiency:

- The first-ever forum on "Roles of Banks in the Development of Insurance Industry" was jointly organized by the State Bank and the Mongolian Bankers' Association. The forum discussed the future outlook of Banc assurance and enhancement of legal environment.
- The sales period for index-based livestock insurance product was extended by 2 months and resulted 220% increase in sales comparing to the year before.
- "Insurance Campaign" was held for 2 weeks in 6 districts of Ulaanbaatar and 21 provinces upon commemoration of 83rd anniversary of insurance industry in Mongolia.
- State Bank entered into cooperation agreements with 12 insurance companies in Mongolia, so that their assured policies are sold to individual-customers. Doing so made the Bank as implementer of adequate insurance in one hand and Bank-Assurance or Bank-Insurance market developer on the other hand. As of the end of 2017, 98,315 insurance agreements were intermediated.

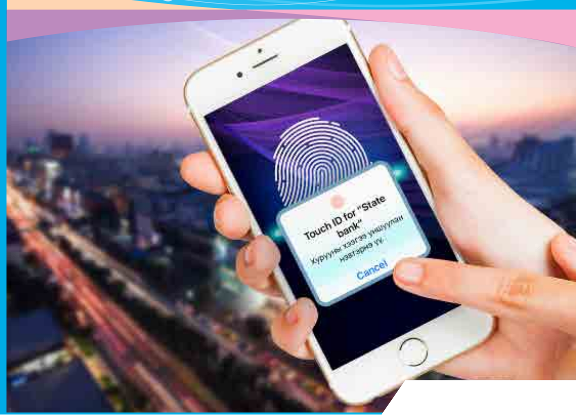
Brand Products

GYALS BANKING SERVICE

This banking service allows customers to access their bank accounts to conduct transactions and receive other banking services using channels such as web applications and cell phone menu installed at information technology and communication devices (mobile phone, computer and other e-equipment) without going in person to service halls of the bank.

State Bank added the following services to Gyals Banking for improved customer satisfaction and increased product competitiveness:

- Design was updated for improved simplicity and convenience.
- Payment by QR code using QPay menu was enabled on smart application of the service.
- Customers can now register for the automatic savings service through the web channel.
- Sign-in and transaction processing using fingerprint technology was introduced to the smart application.
- When Gyals Banking Service is suspended, customers can make renewal through web and application channels without in-person request.



PERSONAL NUMBER SERVICE

We offer free personal number service, which allow customers to choose 4-8 digits that represent account number for making the transaction.. For example, those numbers can be the birth date, license plate number, or mobile phone number etc.

Income transactions made using the personal number will be notified to customers by message sent to their mobile phones within one minute, and there will be no additional charge for the message.

BILLING SERVICE

For many years, with the participation of billers, State Bank has been running an e-billing service to settle payments of Homeowners Association, public utility, electricity, internet, cable, IPTV and insurance companies. Last year the number of the billers increased by 15% and income earned from premiums went up by 4%.

Customers can make their payments using variety of options such as State Bank website, smart application, mobile phone menu installed on sim cards or ATMs.

Receipts of payments are sent to customer emails.

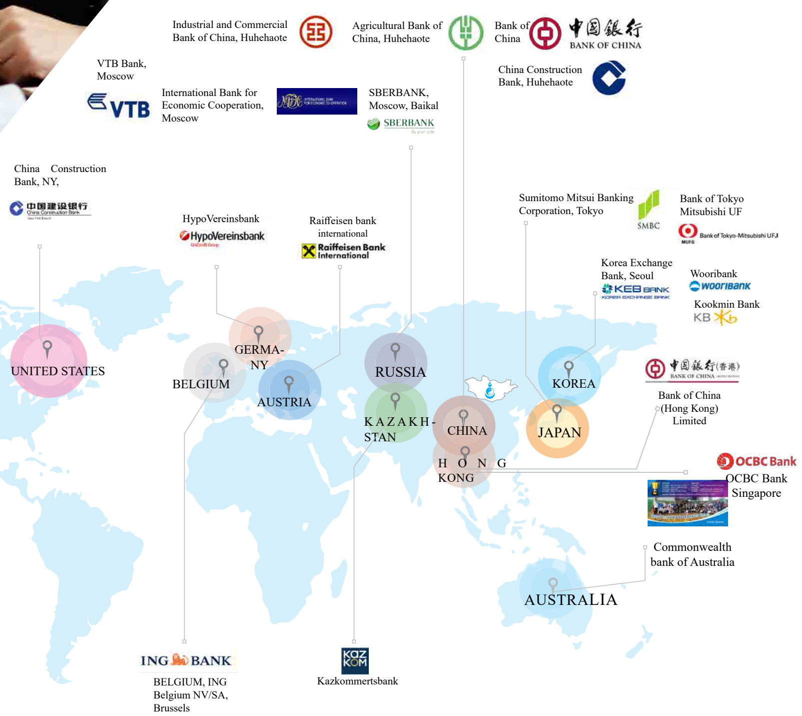
AUTOMATIC SAVINGS SERVICE

Automatic savings service rounds up transaction carried out on MNT accounts to nearest 1000 and transfers the discrepancies into savings accounts. This service rounds up all types of transactions such as card purchases, billings and loan payments.

CORPORATE BANKING

INTERNATIONAL FX TRADE

INTERNATIONAL MONEY TRANSFER



CORPORATE BANKING

Corporate Banking Department aims to establish effective relationships with ministries, agencies, development centres, major state-owned and private entities, international and domestic organizations with strategic significance in order to draw deposits, create quality loan portfolio, improve monitoring on loan repayment and attain minimal risk.

Trade finance products are offered to entities that make regular purchases from overseas. Moreover, low-interest trade finance loans are intermediated from international correspondent banks, so that trade risks borne by the customers are reduced while financial needs are accommodated.

Thanks to efforts designed to increase the non-interest incomes, such as promotion of FX activities, cash and income collection services, standing orders, sales of mobile phone cards, collection of telephone bills, letters of credits, guarantees and collection of service fees from billers, the financial target established by the Board of Directors was exceeded by 39%.

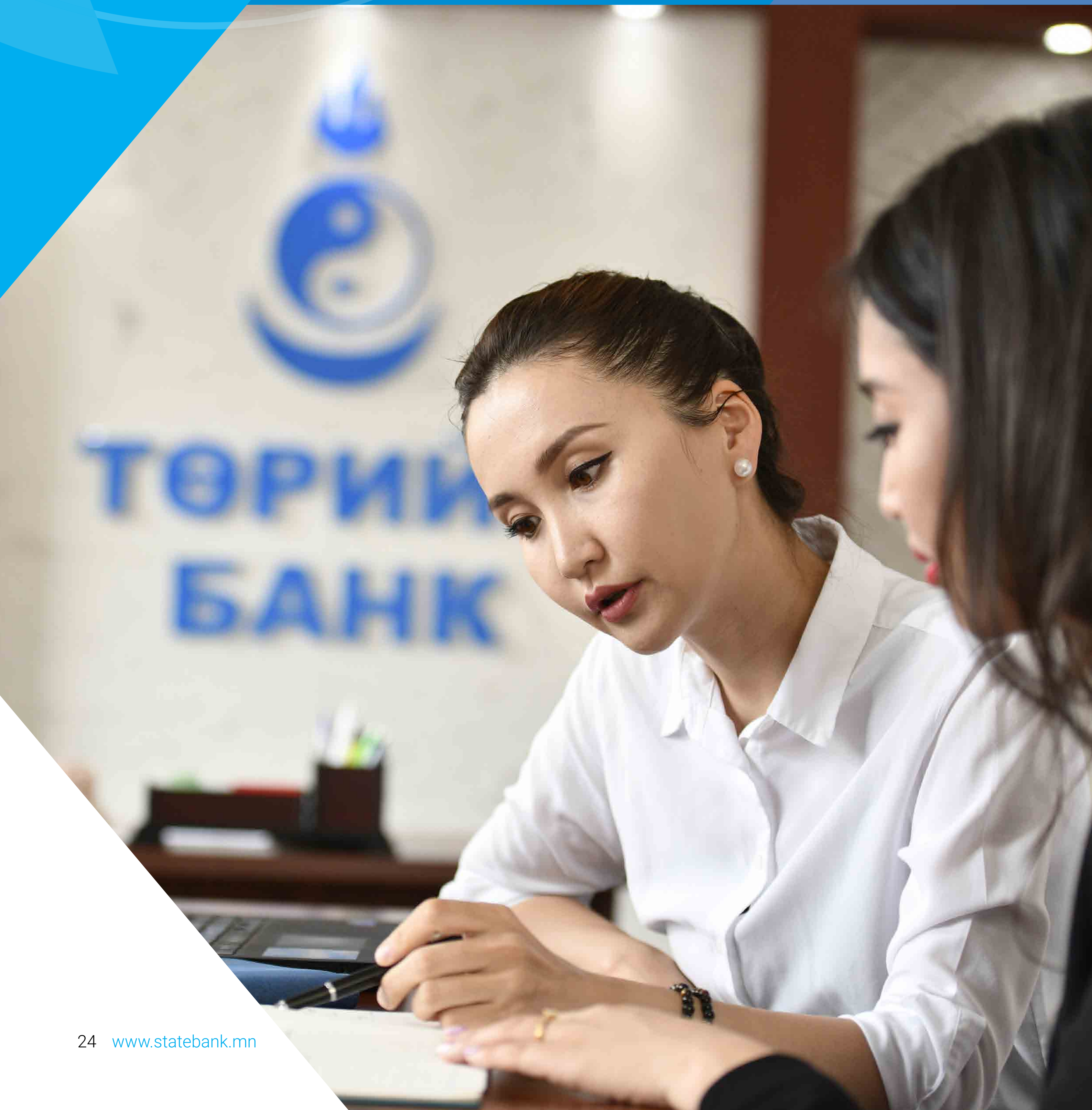
Loan activities:

Within the framework of projects and programmes implemented by the government, low-interest loans were disbursed to all sectors of the economy through on-lending programmes that accommodate the financial needs of entities.

In order to facilitate loans with funding from the Government of Mongolia, the Bank of Mongolia, and foreign banks, State Bank has been collaborating with variety of stakeholders including the Bank of Mongolia, Ministry of Finance, Ministry of Mining and Heavy Industry, Ministry of Labour and Social Welfare, Japan International Cooperation Agency (JICA) Project Unit, Taiwan EXIM Bank, Urban Development Sector Project by Asian Development Bank (ADB) and Market and Pasture Management Development Project and Loan Guarantee Fund.

The loans introduced in 2017 are business loans with funding from the bank, JICA project loan and guaranteed project loans.

RISK MANAGEMENT



RISK MANAGEMENT

State Bank created an effective risk management framework to mitigate potential risks to the Bank by identification, assessment, prevention, and monitoring of risks within scope of its risk management policy.

Relevant policies and procedures are reviewed and updated regularly to ensure compliance with international risk management standards and best practices.

The Bank fully conformed to the prudential ratio requirements set by the Bank of Mongolia as part of its liquidity risk management measures. FX and interest risks are managed accordingly as part of the market risk measures.

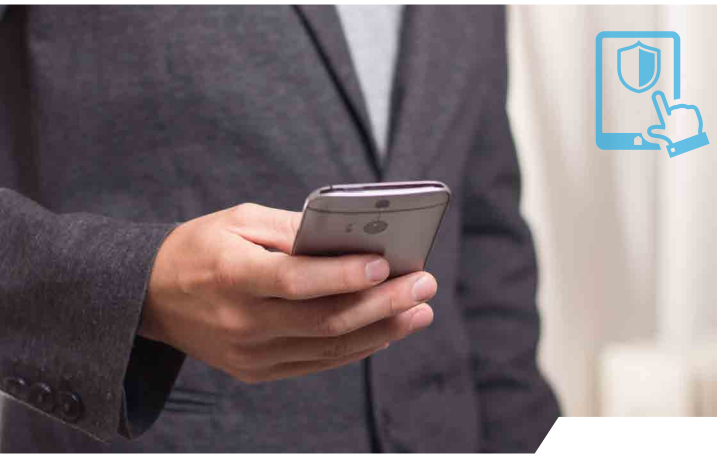
Under the scope of operational risk management, TOP-5 risks are identified on a monthly basis using the risk database while operational risk trend report is prepared on quarterly basis. In relation to those reports, risk mitigation plans are developed and implemented at branch and unit level. In order to expand the risk database and identify the risks properly, the risk logging software was enhanced, so that the risks are classified and categorized in accordance with Basel III requirements.

Bankwide emergency mitigation drill was organized to ensure preparedness and disaster mitigation skills of employees and to comply with relevant laws and regulation. This event enhanced the knowledge, awareness and responsibilities of employees to respond emergency situations.

As of the end of 2017, the amount of non-performing loans in the overall banking system reached MNT 1,967.9 billion or 8.50% of the total loan portfolio. If the loans of liquidated banks are taken out, the amount of non-performing loans stood at MNT 967.9 billion or 7.17% of total loan portfolio. As for State Bank, the percentage of non-performing loans was 4.80% of total loan portfolio, which was 3.70 notches lower than the system average, as of the end of 2017. This demonstrates the quality of the Bank assets and the effectiveness of the Bank's goal to be "free of risks".

INFORMATION TECHNOLOGY

Information technology



The capacities of servers were doubled to accommodate the ever increasing flow of data and to ensure reliable and safe delivery of banking services to customers.

The electronic banking services were enhanced with new products and state-of-the-art technology.

The core banking system was updated while latest technology was introduced to in-house software development.

Information Security

New technologies have been introduced to safeguard the IT infrastructure of banking system and customer information security. As a result, international standard requirements were fully met. Some of the measures include:

- Cutting-edge security devices were installed to protect the web programmes of the bank from outside attacks. Any security incidents were detected and mitigated in a timely manner.
- New system was introduced to detect and destroy malicious codes posing threats of virus or data theft.
- Network security device was installed to enhance infrastructure for internal and external networks of the Bank. This enabled the prevention, detection and response measures taken against any security threats.
- Safety requirements for SWIFT international remittance network were fully accommodated.
- Requirements for Version 3.2 of Payment Card Industry Data Security Standard (PCI DSS), a proprietary information security standard, were fully met and relevant certification was received.
- Practical guidelines for customers are delivered through available channels in association with the network security amidst the increased emphasis on information security issues.

Electronic Banking

- The following activities were carried out in 2017 to promote businesses and ensure business continuity and reliability:
- 600 POS devices and 20 ATMs were installed while card embossing and issuance process was streamlined.
- Testing for dual currency cards was conducted successfully, so that preparatory works for market introduction were completed.
- EMV card acceptance project was completed succeffully.
- Promotional activities were carried out among merchant outlets, so that the number of transactions through merchant outlets was increased by 16%.


ТӨРИЙН БАНК

HUMAN RESOURCES

REMUNERATION AND SOCIAL WELFARE:

- In order to improve the remuneration system, mimimum and maximum salary caps were raised for tellers, VIP tellers, supervising tellers, specialist tellers and relationship managers at Ulaanbaatar and rural branches.
- Assistance and support were given to 377 employees as part of the social welfare measures.
- 16.1% of the overall employees were rewarded with various recognitions from government and other agencies. Those recognitions serve as tools to motivate and reward employees on their performance.
- Reception was held among the retired employees in relation to the Lunar New Year celebration. This is one of the corporate social responsibility measures of the Bank.
- A drawing competition was held among children of employees during the International Children's Day. The theme of the competition was 'Happiness'.

TRAINING AND DEVELOPMENT:

- In 2017, total of 8,653 employees (duplicated number) attended 207 trainings organized in-house and in conjunction with domestic and international training institutions as part of continuing education, capacity building and development objectives. The total training hours reached 84,950 man/hours.
- Professional skills contest – "BEST TELLER-2017" –was successfully held among 1100 tellers throughout the Bank to further the knowledge and skills of front office employees.
- "New Idea-New Innovation" public speaking contest and "Million Flowers" campaign were held among employees to boost productivity, satisfaction and teamwork.


Бид инновацийг дэмждэг
Би ажлаараа бахархдаг
Манай баг ШИЛДЭГ НЬ
Бид Нийгмийн хариуцлагыг хэрэгжүүлэгч


Бид шинийг санаачлагч
Бид харилцагчаа хүндэтгэдэг
Бид БАНКИР
Бид чадварлаг хамт олон

AUDITED FINANCIAL STATEMENTS

STATE BANK LLC
(INCORPORATED IN MONGOLIA)

FOR THE YEAR ENDED 31 DECEMBER 2017

STATE BANK LLC
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017

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GENERAL INFORMATION

BOARD OF DIRECTORS:	Mr. Ganbat Jigjid Mr. Narantsogt Sanjaa Mr. Dorjsembed Batsengee Mr. Byambasuren Urgamal Mr. Sainzorig Purevjav Mr. Bilguun Purevbatbaatar Ms. Batjargal Mishir Mr. Ganzorig Ayush Mr. Tsogtbayar Tamjid
COMPANY SECRETARY:	Ms. Anun Nyamsuren
REGISTERED OFFICE:	State Bank Building Baga Toiruu - 7/1, 1st Khoroo, Chingeltei District, Ulaanbaatar - 210644, Mongolia
AUDITORS:	KPMG Audit LLC #602, Blue Sky Tower, Peace Avenue 17, 1st khoroo, Sukhbaatar District, Ulaanbaatar 14240. Mongolia

STATE BANK LLC

STATEMENT BY THE CHAIRMAN AND EXECUTIVES

We, Ganbat Jigjid, being the Chairman of State Bank LLC (the "Bank"), Bayarsaikhan Dashdondov, being the General Director, Dulguun Ganbyamba, being the Chief Executive Officer, and Togtokhbaatar Ganzorig, being the 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 38 to 99 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.

We have responsibility for ensuring that the Bank keeps proper accounting records which disclose with reasonable accuracy the financial position of the Bank and which enable them to ensure that the financial statements comply with the requirements set out in note 2 thereto.

We also have a general responsibility for taking such steps as are reasonably open to us to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

We consider that, in preparing the financial statements including explanatory notes, the Bank has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgment and estimates, and that all applicable accounting standards have been followed.

GANBAT
JIGJID

Chairman

BAYARSAIKHAN
DASHDONDOV

General Director

УЛААНБААТАР ХОТ
ТӨРИЙН БАНК ХХК
УХН11373 5341469

DULGUUN
GANBYAMBA

Chief Executive Officer

TOGTOKHBAATAR
GANZORIG

Chief Financial Officer

Ulaanbaatar, Mongolia
14 March 2018

KPMG Audit LLC
#602, Blue Sky Tower, Peace Avenue,
1st Khoroo, Sukhbaatar District,
Ulaanbaatar 14240, Mongolia

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OPINION

We have audited the accompanying financial statements of State Bank LLC ("the Bank"), which comprise the statement of financial position as of 31 December 2017, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

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

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 Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Bank in accordance with International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants ("IESBA Code") together with the ethical requirements that are relevant to our audit of the financial statements in Mongolia and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

We draw attention to Note 29 to the financial statements, which describes that in May 2017, the Executive Board of the International Monetary Fund (IMF) approved a three-year extended arrangement under the Extended Fund Facility for Mongolia to support the country's economic reform program. As part of the program, the Bank of Mongolia commissioned Diagnostic Studies on Commercial Banks in Mongolia including an Asset Quality Review (AQR). The AQR was performed predominantly based on version 2 of the European Central Bank's AQR Manual, as localised by the Bank of Mongolia in several areas. Preliminary summary results were informed to each commercial bank in January 2018. As at the date of approval of these financial statements, final results of the AQR and stress test are pending, and the full implications of the assessment on the Mongolian financial sector and for the Bank specifically are as yet unclear. This creates a significant uncertainty in market, regulatory, credit and other risks including related implications for capital adequacy, and in the Bank's future exposure to such risks, the implications of which will only be realised with time. The financial impact resulting from this AQR and stress test on the Bank's financial statements cannot be reasonably estimated at this time, therefore no adjustments for this matter have been recorded to the Bank's financial statements. Our opinion is not qualified in respect of this matter.

Other Matter

The financial statements of the Bank as of and for the year ended 31 December 2016 were audited by Ernst & Young Mongolia Audit LLC who expressed an unqualified opinion on those financial statements on 15 March 2017.

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

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

INDEPENDENT AUDITORS' REPORT

TO: THE SHAREHOLDERS OF STATE BANK LLC

Auditors' 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 auditors' report that includes our opinion. 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 skepticism 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 management.

- Conclude on the appropriateness of management's 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 auditors' 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 auditors' 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.

КЭЙ ПИ ЭМ ЖИ АУДИТ ХХК

KPMG Audit LLC

LLC

KPMG Audit LLC
Ulaanbaatar, Mongolia
15 March 2018

УЛААНБААТАР ХОТ
ТТ33977 д. 5543495

This report is effective as of 14 March 2018 the audit report date. Certain subsequent events or circumstances, which may occur between the audit report date and the time of reading this report, could have a material impact on the accompanying financial statements and notes thereto. Accordingly, the readers of the audit report should understand that the above audit report has not been updated to reflect the impact of such subsequent events or circumstances, if any. Furthermore, this report is intended solely for the use of the Board of Directors and current Shareholders of the Bank. To the fullest extent permitted by law, we do not assume responsibility towards or accept liability to any other party than the Bank in relation to the contents of this report.

STATE BANK LLC

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 MNT'000	2016 MNT'000
Interest and similar income	3	281,130,697	223,356,438
Interest and similar expenses	4	(178,820,410)	(151,448,925)
Net interest income		**102,310,287**	**71,907,513**
Fee and commission income	5	23,224,764	23,077,825
Fee and commission expenses	5	(3,199,456)	(2,472,159)
Net fee and commission income		**20,025,308**	**20,605,666**
Net trading income	6	6,911,753	2,264,230
Other operating income	7	1,256,305	7,929,822
Total operating income		**130,503,653**	**102,707,231**
Credit loss expense	8	(41,962,043)	(15,131,685)
Net operating income		**88,541,610**	**87,575,546**
Operating expenses	9	(76,211,320)	(76,303,621)
Profit before tax		**12,330,290**	**11,271,925**
Income tax income/(expense)	10	62,549	(679,734)
Profit for the year		**12,392,839**	**10,592,191**
Other comprehensive income			
Items that are or may be reclassified to profit or loss in subsequent periods:			
Fair value reserve: *Net change in fair value*		(1,217,386)	501,641
Related tax	19	121,678	(50,164)
Other comprehensive (loss) / income for the year, net of tax	25	**(1,095,708)**	**451,477**
Total comprehensive income for the year		**11,297,131**	**11,043,668**

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

STATE BANK LLC

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2017

	Notes	2017 MNT'000	2016 MNT'000
ASSETS			
Cash and balances with Bank of Mongolia	**11**	269,922,019	288,418,179
Due from banks and other financial institutions	**12**	49,304,129	142,206,967
Reverse repurchase agreements	**21**	–	2,998,768
Derivative financial instruments	**13**	282,957	–
Loans and advances to customers	**14**	1,399,758,870	1,128,995,688
Financial investments – available-for-sale	**15**	520,526,783	427,619,291
Financial investments – available-for-sale as collateral in repurchase agreements	**15**	7,760,816	7,760,816
Other assets	**16**	6,522,293	12,778,559
Property and equipment	**17**	82,858,961	78,914,811
Intangible assets	**18**	1,402,091	1,962,475
TOTAL ASSETS		**2,338,338,919**	**2,091,655,554**
LIABILITIES			
Due to banks and other financial institutions	**20**	193,282,383	127,139,398
Repurchase agreements	**21**	7,722,342	7,722,342
Derivative financial instruments	**13**	–	6,997
Due to customers	**22**	1,573,467,532	1,351,618,088
Borrowed funds	**23**	298,626,501	351,859,125
Other liabilities	**24**	8,008,511	7,190,858
Deferred tax liabilities	**19**	377,632	561,859
TOTAL LIABILITIES		**2,081,484,901**	**1,846,098,667**
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK			
Ordinary shares	**25**	113,000,000	113,000,000
Other reserves	**25**	15,243,886	16,691,594
Subordinated loan	**26**	65,000,000	65,000,000
Retained earnings		63,610,132	50,865,293
TOTAL EQUITY		**256,854,018**	**245,556,887**
TOTAL LIABILITIES AND EQUITY		**2,338,338,919**	**2,091,655,554**

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

STATE BANK LLC

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

	Ordinary shares	Other reserves	Retained earnings	Subordinated loan	Total equity
	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
	(Note 25)	(Note 25)		(Note 26)	
At 1 January 2016	**113,000,000**	**16,702,043**	**39,811,176**	**–**	**169,513,219**
Profit for the year	–	–	10,592,191	–	10,592,191
Other comprehensive income	–	451,477	–	–	451,477
Total comprehensive income	**–**	**451,477**	**10,592,191**	–	**11,043,668**
Transfers	–	(461,926)	461,926	–	–
Subordinated loan	–	–	–	65,000,000	**65,000,000**
At 31 December 2016	**113,000,000**	**16,691,594**	**50,865,293**	**65,000,000**	**245,556,887**
Profit for the year	–	–	12,392,839	–	12,392,839
Other comprehensive loss	–	(1,095,708)	–	–	(1,095,708)
Total comprehensive income	–	**(1,095,708)**	**12,392,839**	–	**11,297,131**
Transfers	–	(352,000)	352,000	–	–
At 31 December 2017	**113,000,000**	**15,243,886**	**63,610,132**	**65,000,000**	**256,854,018**

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

STATE BANK LLC

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 MNT'000	2016 MNT'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		12,330,290	11,271,925
Adjustments for:			
Changes in fair value of financial derivatives		(289,954)	410,430
Credit loss on loans and advances to customers	**8**	34,980,713	15,157,986
Credit loss/(recovery) on other assets	**8**	6,981,330	(26,301)
Net gain on sales of available-for-sale securities	**6**	(3,732,057)	(685,307)
Depreciation of property and equipment	**9**	5,975,535	5,798,366
Amortisation of intangible assets	**9**	1,178,191	1,086,826
Property and equipment written-off	**9**	365,382	62,414
Intangible assets written-off	**9**	13,146	1,915
Operating profit before working capital changes		**57,802,576**	**33,078,254**
Changes in operating assets:			
Statutory deposits with BoM		(44,586,813)	(35,473,539)
Due from banks and financial institutions		70,867,845	(70,012,570)
Loans and advances to customers		(305,743,895)	(156,976,600)
Reverse repurchase agreement		2,998,768	–
Other assets		(725,064)	(42,313)
Changes in operating liabilities:			
Due to banks and financial institutions		66,142,985	(57,302,302)
Repurchase agreements		–	(3,037,242)
Due to customers		221,849,444	202,121,663
Other liabilities		817,653	372,592
Cash from/(used in) operations		**69,423,499**	**(87,272,057)**
Income tax paid		–	(101,933)
Net cash flows from/(used in) operating activities		**69,423,499**	**(87,373,990)**

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

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 MNT'000	2016 MNT'000
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of financial investments		(141,190,206)	(58,604,285)
Proceeds from disposal of financial investments		341,980,586	3,100,350
Purchase of property and equipment	**17**	(10,285,067)	(5,533,355)
Purchase of intangible assets	**18**	(630,953)	(933,309)
Net cash flows from/(used in) investing activities		**189,874,360**	**(61,970,599)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of borrowed funds		(118,721,300)	(89,123,620)
Drawdown of borrowed funds		65,488,676	248,313,638
Net cash flows generated (used in)/from financing activities		**(53,232,624)**	**159,190,018**
Net increase in cash and cash equivalents		206,065,235	9,845,429
Cash and cash equivalents brought forward		**284,141,311**	**274,295,882**
Cash and cash equivalents carried forward	**27**	**490,206,546**	**284,141,311**

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

STATE BANK LLC

NOTES TO THE FINANCIAL STATEMENTS – 31 DECEMBER 2017

1. CORPORATE INFORMATION

State Bank LLC ("the Bank") is engaged in the business of providing banking and financial services pursuant to License No. 26 issued by the Bank of Mongolia ("BoM"). There were no significant changes in the nature of the Bank's activities during 2017.

The Bank is a limited liability company incorporated and domiciled in Mongolia. Its registered office is at State Bank Building, Baga Toiruu - 7/1, 1st Khoroo, Chingeltei District, Ulaanbaatar -210644, Mongolia.

The Bank is 24.779% owned by the Ministry of Finance of Mongolia and 75.221% owned by the Deposit Insurance Corporation ("DIC"), an entity controlled by the Government of Mongolia. DIC does not hold any voting rights.

The financial statements for the year ended 31 December 2017 were authorised for issue in accordance with a resolution of the Board of Directors on 13 March 2018.

2. ACCOUNTING POLICIES

2.1 BASIS OF PREPARATION

These financial statements have been prepared on a historical cost basis, except for available-for-sale financial investments, derivative financial instruments and properties that have been measured at fair value. The financial statements are presented in Mongolian Togrog (MNT), which is the functional currency of the Bank 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 (IFRSs) as promulgated by the International Accounting Standards Board (IASB).

Certain corresponding figures have been reclassified to conform to the current year's presentation.

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 reporting date (current) and more than 12 months after the reporting date (non-current) is presented in Note 32.

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts without being contingent on a future event and there is an intention to settle on a net basis in all of the following circumstances:

- The normal course of business;
- The event of default;
- The event of insolvency or bankruptcy of the Bank and/or the counterparties.

Positions recognized on a net basis primarily include balances with exchanges, repurchase agreements, clearing houses and brokers. Derivative assets and liabilities with master netting arrangements are only presented net when they satisfy the eligibility of netting for all of the above criteria and not just in the event of default.

2.2 SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the Bank's financial statements requires management to make judgments, estimates and assumptions that affect the reported amount of revenues, expenses, assets and liabilities and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

The key assumptions concerning the future and other key sources of estimating uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are described below. The Bank based its assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances beyond the control of the Bank. Such changes are reflected in the assumptions when they occur.

Going concern

The Bank's management has made an assessment of its ability to continue as a going concern and is satisfied that it 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.

Fair value of financial instruments

The fair value of financial instruments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e., an exit price) regardless of whether that price is directly observable or estimated using another valuation technique. When the fair values of financial assets and financial liabilities recorded in 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 if this is not available, judgment is required to establish the fair values. Judgments and estimates include considerations of liquidity and model inputs related to items such as credit risk (both own and counterparty), funding value adjustments, correlation and volatility. For further details about determination of fair value please see Note 30.

Effective Interest Rate (EIR) method

The Bank's EIR methodology recognises interest income using a rate of return that represents the best estimate of a constant rate of return over the expected behavioural life of loans and deposits and recognizes the effect of potentially different interest rates charged at various stages and other characteristics of the product life cycle (including prepayments and penalty interest and charges). This estimation, by nature, requires an element of judgement regarding the expected behaviour and life-cycle of the instruments, as well as expected changes to BoM policy rate and other fee income/expense that are integral parts of the instrument.

Impairment losses on loans and advances

The Bank reviews its individually significant loans and advances at each reporting date to assess whether an impairment loss should be recorded in the income statement.

The Bank's impairment methodology for assets carried at amortised cost results in the recording provisions for:

- Specific impairment losses on individually significant or specifically identified exposures;
- Collective impairment losses on individually not significant or not specifically identified exposures;

All categories include an element of management's judgement, in particular for the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses. These estimates are driven by a number of factors, the changing of which can result in different levels of allowances.

Additionally, judgements around the inputs and calibration of the collective include the criteria for the identification of smaller homogeneous portfolios, the effect of concentrations of risks and economic data (including repayment trends, collateral values such as real estate prices indices for residential mortgages, country risk and the performance of different individual groups, and bankruptcy trends), and for determination of the emergence period. The methodology and assumptions are reviewed regularly in the context of actual loss experience.

The impairment methodology and its application is disclosed in more detail in Notes 8 and 14, and further described in Note 29.

STATE BANK LLC

NOTES TO THE FINANCIAL STATEMENTS – 31 DECEMBER 2017

Impairment of available-for-sale investments

The Bank reviews its debt securities classified as available-for-sale investments at each reporting date to assess whether they are impaired as explained in Note 29.

This assessment, including estimated future cash flows and other inputs in to the discounted cash flow model and in the case of equity instruments, the interpretation of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the Bank evaluates, among other factors, historical share price movements, and the duration and extent to which the fair value of an investment is less than its cost.

Revaluation of properties

The Bank measures its land and buildings at revalued amounts with changes in fair value being recognised in other comprehensive income (OCI). In 2013, the Bank engaged an independent valuation specialist to assess fair value of the buildings. Buildings were valued by reference to market-based evidence, using comparable prices adjusted for specific market factors such as nature, location and condition of the buildings. As at 31 December 2017, management has assessed that the fair values of buildings has not changed significantly from the carrying amounts. This assessment requires exercise of judgment from management based on their experience of those properties as well as other assumptions described in Note 30.

Deferred tax assets

Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Judgement 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.

Provisions and other contingent liabilities

The Bank operates in a regulatory and legal environment that, by nature, has a heightened element of litigation risk inherent to its operations. As a result, it may involve in litigations, arbitrations and regulatory investigations and proceedings in Mongolia arising in the ordinary course of the Bank's business.

When the Bank can reliably measure the outflow of economic benefits in relation to a specific case and considers such outflows to be probable, the Bank records a provision against the case. Where the probability of outflow is considered to be remote, or probable, but a reliable estimate cannot be made, a contingent liability is disclosed.

However, when the Bank is of the opinion that disclosing these estimates on a case-by-case basis would prejudice their outcome, then the Bank does not include detailed, case-specific disclosures in its financial statements.

Given the subjectivity and uncertainty of determining the probability and amount of losses, the Bank takes into account a number of factors including legal advice, the stage of the matter and historical evidence from similar incidents. Significant judgement is required to conclude on these estimates. For further details on provisions and other contingencies see Note 28.

2.3 NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

The following new standards, interpretations and amendments to existing standards have been published and are effective for subsequent annual periods, and the Bank has not early adopted them.

(i) IFRS 9 Financial Instruments (IFRS 9)

IFRS 9, published in July 2014, replaces the existing guidance in IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, a new expected credit loss model for calculating impairment of financial assets, and new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IFRS 9. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted.

In 2017, the Bank of Mongolia announced that the adoption of IFRS 9 for commercial banks in Mongolia should be deferred until 2020. The Bank is currently assessing the potential impact on its financial statements resulting from this delay in the adoption of IFRS 9, including considering the impact on its accounting reporting framework and its compliance with IFRS. As a result, the Bank has not yet assessed the full impact of adopting IFRS 9.

(ii) IFRS 15 Revenue from Contracts with Customers (IFRS 15)

IFRS 15, published in January 2016, establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18, Revenue, IAS 11, Construction Contracts and IFRIC 13, Customer Loyalty Programmes. IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted.

IFRS 15 is not expected to have a significant impact on the Bank's financial statements.

(iii) IFRS 16 Leases (IFRS 16)

IFRS 16, published in January 2016, supersedes IAS 17. IFRS 16 eliminates the classification of leases as either operating or finance leases for a lessee. Instead, all leases are treated in a similar way to finance leases under IAS 17. For those leases previously classified as operating leases, the most significant effect of the new requirements will be an increase in lease assets and financial liabilities and a change to the nature of expenses. IFRS 16 does not require a lessee to recognise assets and liabilities for short-term leases and leases of low-value assets. IFRS 16 is effective for annual periods beginning on or after 1 January 2019, with early adoption permitted.

The Bank is assessing the potential impact on its financial statements resulting from the application of IFRS 16.

(iv) IFRS 17 Insurance Contracts (IFRS 17)

IFRS 17, published in May 2017, is a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 Insurance Contracts (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features.

A few scope exceptions will apply. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in IFRS 4, which are largely based on grandfathering previous local accounting policies, IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of IFRS 17 is the general model, supplemented by:

- A specific adaptation for contracts with direct participation features (the variable fee approach)
- A simplified approach (the premium allocation approach) mainly for short-duration contracts.

IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2021. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17.

IFRS 17 is not expected to have a significant impact on the Bank's financial statements.

2.4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) Foreign currency translation

The functional currency of the Bank is the Mongolian Togrog. Transactions in foreign currencies are initially recorded in the functional currency at the spot rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated into the functional currency at the spot rate of exchange at the reporting date. All differences arising on non–trading activities are taken to other operating income/expense in the statement of profit and loss.

STATE BANK LLC

NOTES TO THE FINANCIAL STATEMENTS – 31 DECEMBER 2017

Non–monetary items that are measured at historical cost in a foreign currency are translated using the spot exchange rates as at the date of recognition.

MNT/USD exchange rates as at 31 December 2017 and 31 December 2016 were 2,427.13 and 2,489.53, respectively.

(2) Financial instruments - initial recognition and subsequent measurement

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

(i) Date of recognition

Financial assets and liabilities, with the exception of loans and advances to customers and balances due to customers, 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. Loans and advances to customers are recognised when funds are transferred to the customers' account. The Bank recognises due to customer balances when funds reach the Bank.

(ii) Initial measurement of financial instruments

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

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

A derivative is a financial instrument or other contract with all three of the following characteristics:

a) Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

b) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

c) It is settled at a future date.

The Bank enters into derivative transactions with various counterparties. These include interest rate swaps, cross currency swaps and forward foreign exchange contracts on interest rates and foreign currencies. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Changes in the fair value of derivatives are included in net trading income unless hedge accounting is applied.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if they meet the definition of a derivative (as defined above), 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 FVPL. The embedded derivatives separated from the host are carried at fair value in the trading portfolio with changes in fair value recognised in profit or loss.

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

The Bank classifies financial assets or financial liabilities as held for trading when they have been purchased or issued primarily for short term profit making through trading activities or form part of a portfolio of financial instruments that are managed together for which there is evidence of a recent pattern of short-term profit taking. Held for trading assets and liabilities are recorded and measured in the statement of financial position at fair value. Changes in fair value are recognised in net trading income. Interest and dividend income or expense is recorded in net trading income according to the terms of the contract, or when the right to payment has been established. Included in this classification are debt securities, equities, short positions and customer loans that have been acquired principally for the purpose of selling or repurchasing in the near term.

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

Financial assets and financial liabilities classified in this category are those that have been designated by management on initial recognition.

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

(vi) Available-for-sale financial investments

Available-for-sale investments include equity and debt securities. Equity investments classified as available-for-sale are those which are neither classified as held for trading nor designated at FVPL. Debt securities in this category are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity or in response to changes in market conditions. The Bank has not designated any loans or receivables as available-for-sale. After initial measurement, available-for-sale financial investments are subsequently measured at fair value.

Unrealised gains and losses are recognised directly in OCI in the available-for-sale reserve. When the investment is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the income statement, in other operating income. Where the Bank holds more than one investment in the same security, they are deemed to be disposed of on a first—in first—out basis. Interest earned whilst holding available-for-sale financial investments is reported as interest income using the EIR which takes into account any discount/premium and qualifying transaction costs that are an integral part of the instrument's yield. Dividends earned whilst holding available-for-sale financial investments are recognised in the income statement as other operating income when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the income statement in 'impairment losses on financial investments' and removed from the available-for-sale reserve. Further details on impairment of available-for-sale investments is provided in Note 29.

(vii) 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 any impairment loss. 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 profit or loss. The losses arising from impairment of such investments are recognised in the 'Credit loss expense'.

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

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

This account 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;
- Those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration.

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After initial measurement, amounts due from banks and loans and advances to customers are subsequently measured at amortised cost using EIR, less any 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 EIR. The amortisation is included in 'Interest and similar income' in profit or loss. The losses arising from impairment are recognised in profit or loss under 'Credit loss expense'.

The Bank may enter into certain lending commitment 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 it is an onerous contract that is likely to give rise to a loss.

(ix) Debt issued and other borrowed funds

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

After initial measurement, borrowed funds are subsequently measured at amortised cost using the EIR. The amortised cost of borrowed funds is calculated using EIR by taking into account any transaction costs related to the transaction. An analysis of the Bank's 'Borrowed funds' is disclosed in Note 23.

Financial instruments issued by the Bank that are not held for trading or designated at FVPL, are classified as liabilities under Debt issued and other borrowed funds, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

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

A compound financial instrument which contains both a liability and an equity component is separated at the issue date.

When establishing the accounting treatment of these non-derivative instruments the Bank first establishes whether the instrument is a compound instrument and classifies such instruments or components separately as financial liabilities, financial assets, or equity instruments in accordance with IAS 32. The Bank separately recognises the components of a financial instrument that: (a) creates a financial liability for the Bank; and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. When allocating the initial carrying amount of a compound financial instrument to its equity and liability components, the equity component is assigned the residual amount after deducting from the entire fair value of the instrument, the amount separately determined for the liability component. The value of any derivative features (such as a call options) embedded in the compound financial instrument, other than the equity component (such as an equity conversion options) is included in the liability component. Once the Bank has determined the split between equity and liability, it further evaluates if the liability component has embedded derivatives which would require separation. The Bank only separates the embedded derivatives from the host contract and accounts for them as a derivative when:

- The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;
- A separate instrument with the same terms of the embedded derivatives would meet the definition of a derivative;
- The hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in profit or loss (i.e., a derivative that is embedded in a financial asset or financial liability at FVPL is not separated).

Borrowed fund convertible into shares is disclosed under subordinated loan under equity (Note 26).

(x) Due to customers

This includes current, savings, time deposits and bank guarantee fund from customers (Note 22).

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

(xi) 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 20). The Bank recognises due to customer balances when funds reach the Bank.

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

(xii) 'Day 1' profit or loss

When the transaction price is different to 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 recognizes the difference between the transaction price and fair value (a 'Day 1' profit or loss) in profit or loss. 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 profit or loss when the inputs become observable or when the instrument is derecognized.

(xiii) 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 profit or loss.

In rare circumstances, the Bank may reclassify a non-derivative trading asset out of the held-for-trading financial investments category and into the loans and advances category if it meets the definition of loans and advances 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.

(3) Derecognition of financial assets and financial liabilities

(i) Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when the rights to receive cash flows from the asset have expired. Bank also derecognises the assets if it has both transferred the asset, and the transfer qualifies for derecognition.

The Bank has transferred the asset if, and only if, either:

- The Bank has transferred its contractual rights to receive cash flows from the asset; or
- It retains the rights to the cash flows, but has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass—through' arrangement

Pass-through arrangements are transactions when Bank retains the contractual rights to receive the cash flows of a financial asset (the 'original asset'), but assumes a contractual obligation to pay those cash flows to one or more entities (the 'eventual recipients'), when all of the following three conditions are met:

- Bank has no obligation to pay amounts to the eventual recipients unless it has collected equivalent amounts from the original asset, excluding short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates.
- Bank cannot sell or pledge the original asset other than as security to the eventual recipients for the obligation to pay them cash flows
- Bank has to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the Bank is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients

Transfer only qualifies for derecognition if 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 of the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. In that case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

(ii) Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or has 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 profit or loss.

(4) Repurchase and reverse repurchase agreements

Securities sold under agreements to repurchase at a specified future date are not derecognised from the statement of financial position as the Bank retains substantially all of 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. When the counterparty has the right to sell or re-pledge the securities, the Bank reclassifies those securities in its statement of financial position to financial assets held for trading pledged as collateral or to financial investments available-for-sale pledged as collateral, as appropriate.

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'.

(5) Determination of fair value

In order to show how fair values have been derived, financial instruments are classified based on a hierarchy of valuation techniques, as summarised below:

- **Level 1 financial instruments** -Those where the inputs used in the valuation are unadjusted quoted prices from active markets for identical assets or liabilities that the Bank has access to at the measurement date. The Bank considers markets as active only if there are sufficient trading activities with regards to the volume and liquidity of the identical assets or liabilities and when there are binding and exercisable price quotes available on the balance sheet date.
- **Level 2 financial instruments** - Those where the inputs that are used for valuation and are significant, are derived from directly or indirectly observable market data available over the entire period of the instrument's life. Such inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical instruments in inactive markets and observable inputs other than quoted prices such as interest rates and yield curves, implied volatilities, and credit spreads. In addition, adjustments may be required for the condition or location of the asset or the extent to which it relates to items that are comparable to the valued instrument. However, if such adjustments are based on unobservable inputs which are significant to the entire measurement, the Bank will classify the instruments as Level 3.
- **Level 3 financial instruments –** Those that include one or more unobservable input that is significant to the measurement as whole.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

For assets and liabilities that are recognized in the financial statements on a recurring basis, the Bank determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

External appraisers are involved for valuation of properties. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained.

An analysis of fair values of financial instruments and further details as to how they are measured are provided in Note 30.

(6) Impairment of financial assets

The Bank assesses at each reporting 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 have 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 reorganization, 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, 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 assets' 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 profit or loss. 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. Recoveries of written-off loans from previous years are recorded as 'other operating income' in the period it was recovered.

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 financial assets to loans and advances, the discount rate for measuring any impairment loss is the new EIR determined at the reclassification date. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped based on the credit risk characteristics of the loans and advances such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

The Bank adopted the basic approach where the impairment allowances are computed on weighted average of historical loss experience of each risk grouping over the outstanding balance. 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.

See Note 8 for details of impairment losses on financial assets carried at amortised cost and Note 14 for an analysis of the impairment allowance on loans and advances by class.

(ii) Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each reporting 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 such as:

Observable data regarding a decline in estimated future cash-flows and or a decline in underlying collateral (in the case of asset backed securities when the Bank expects to recover the outstanding from the sale of the underlying assets) impacting the Bank's ability to recover all cash flows. 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 income statement. 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 income statement, the impairment loss is reversed through the income statement.

In the case of equity investments classified as available-for-sale, objective evidence includes:

- A 'significant' or 'prolonged' decline in the fair value of the investment below its cost and/or
- Other information about the issuer that may negatively affect an equity issuer's performance.

The Bank treats 'significant' generally as 20% and 'prolonged' generally as greater than six months.

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 income statement, is removed from equity and recognised in impairment losses on financial investments in the income statement. 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.

See Note 29 for details of impairment losses on financial investments – available-for-sale.

(iii) Renegotiated loans

The loan may be restructured in a number of ways. 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.

(iv) Collateral repossessed

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 statement of financial position. Subsequently, repossessed assets are measured at the lower of cost and fair value less costs to sell and are included in 'Other assets'.

(7) Leasing

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

Bank as a lessee

Leases that 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 on a straight-line basis over the lease term. Contingent rental payable is recognised as an expense in the period in which they are incurred.

Bank as a lessor

Leases where the Bank do 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. Contingent rents are recognised as revenue in the period in which they are earned.

(8) Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank

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and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

(i) Interest and similar income and expense

For all financial instruments measured at amortised cost, interest bearing financial assets classified as available-for-sale and financial instruments designated at fair value through profit or loss, interest income or expense is recorded using EIR which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. 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. Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(ii) Fee and commission income

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

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.

Fee income forming an integral part of the corresponding financial instrument

Fees that the Bank considers to be an integral part of the corresponding financial instruments include: loan origination fees, loan commitment fees for loans that are likely to be drawn down and other credit related fees. The recognition of these fees (together with any incremental costs) form an integral part of the corresponding financial instruments and are recognised as interest income through an adjustment to the EIR. The exception is, when it is unlikely that a loan will be draw down, the loan commitment fees are recognised as revenue on expiry. Loan commitments that are within the scope of IAS 39 (i.e., are designated as FVPL, or are at a below market rate of interest, or are settled net) are accounted for as derivatives and measured at fair value through profit or loss.

(iii) Net trading income

Results arising from trading activities include all gains and losses from changes in fair value of financial assets and financial liabilities 'held-for-trading' including derivatives.

(9) Cash and cash equivalents

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

(10) Property and equipment

Property and equipment are initially stated at cost excluding the costs of day-to-day servicing. Depreciation is calculated using the straight-line method to write down the cost of property and equipment to their residual values over their estimated useful lives. Changes in the expected useful life are accounted for by changing the depreciation period or method, as appropriate, and treated as changes in accounting estimates. Land is not depreciated. The estimated useful lives of the assets are as follows:

Buildings	40 years
Computer hardware	3 years
Office furniture and equipment	10 years
Motor vehicles	10 years

Property and equipment transferred from customers is initially measured at fair value at the date on which control is obtained.

Land and buildings are subsequently measured at fair value less accumulated depreciation and impairment losses recognized at the date of revaluation. Valuations are performed with sufficient frequency to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

The frequency of revaluations depends upon the changes in fair values of the items of land and buildings being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required. Some items of land and buildings may experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of land and buildings with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.

A revaluation surplus is credited to the asset revaluation reserve in equity. However, to the extent that it reverses a revaluation deficit of the same asset previously recognised in profit or loss, the increase is recognised in profit and loss. A revaluation deficit is recognised in profit or loss, except to the extent that it offsets an existing surplus on the same asset recognised in the asset revaluation reserve.

An item of property and equipment is de-recognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in profit or loss.

The residual values, useful lives and methods of depreciation of property and equipment are reviewed at each financial year end and adjusted prospectively, if appropriate.

(11) Intangible assets

The Bank's intangible assets include the value of computer software and licenses.

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. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. 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 yearend. 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 they are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is presented as part of 'other operating expense' in profit or loss.

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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
Software licenses	1-3 years

(12) Impairment of non-financial assets

The Bank assesses at each statement of financial position 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 CGU's 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 peer companies or other available fair value indicators.

For assets excluding goodwill, an assessment is made at each statement of financial position 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 recognized 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 profit or loss.

Impairment losses relating to goodwill are not reversed in future periods. The Bank did not need to record impairment for its non-financial assets over the reported periods.

(13) 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 cumulative amortisation, 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 profit or loss.

(14) 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.

(15) 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 reporting 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.

The carrying amount of deferred tax assets is reviewed at each reporting 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 reporting date.

Current and deferred taxes are recognised as income tax benefits or expenses in the income statement except for tax related to the fair value remeasurement of available-for-sale assets, which is charged or credited to OCI. These exceptions are subsequently reclassified from OCI to the income statement together with the respective deferred loss or gain. The Bank also recognises the tax consequences of payments and issuing costs, related to financial instruments that are classified as equity, directly in equity.

The Bank only off-sets its deferred tax assets against liabilities when there is both a legal right to offset and it is the Bank's intention to settle on a net basis.

(16) Equity

Ordinary shares are classified as equity. The transaction costs of an equity transaction are accounted for as a deduction from the equity, net of tax. Equity transaction costs comprise only those incremental external costs directly attributable to the equity transaction which would otherwise have been avoided.

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

(17) Other reserves

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

Asset revaluation reserve

The revaluation surplus reserve is used to record the surplus arising from the revaluation of the Bank's land and buildings.

Reserves

The Bank maintains reserves in order to hedge itself against unforeseen risks. At the discretion of the management, a portion of undistributed retained earnings is transferred to these reserves.

Available for sale reserve

The reserves recorded in other comprehensive income on the Bank's statement of profit or loss and other comprehensive income includes 'Available–for–sale' reserve which comprises changes in fair value of available–for–sale investments.

Social development fund

At the discretion of the management, a portion of retained earnings is contributed to the fund which is used to address the Bank employees' social and economic needs

STATE BANK LLC

NOTES TO THE FINANCIAL STATEMENTS – 31 DECEMBER 2017

3. INTEREST AND SIMILAR INCOME

	2017 MNT'000	2016 MNT'000
Cash and balances with BoM	9,549,262	8,008,402
Reverse repurchase agreements	367,088	294,923
Due from banks and financial institutions	6,442,240	7,522,733
Loans and advances to customers	216,999,823	167,554,470
Financial investments – available-for-sale	47,772,284	22,669,827
Financial investments – held-to-maturity	–	17,004,256
	281,130,697	**223,054,611**
Interest income on swaps	–	301,827
	281,130,697	**223,356,438**

Interest and similar income from financial investments – available-for-sale and held-to-maturity includes interest income from government bonds amounting to MNT 32,872,343 thousand (2016: MNT 32,154,458 thousand).

4. INTEREST AND SIMILAR EXPENSES

	2017 MNT'000	2016 MNT'000
Due to banks and financial institutions	9,070,381	12,004,514
Repurchase agreements	810,639	1,074,953
Due to customers	155,843,034	128,683,087
Borrowed funds	13,096,356	9,581,534
	178,820,410	**151,344,088**
Interest expense on swaps	–	104,837
	178,820,410	**151,448,925**

5. NET FEES AND COMMISION INCOME

	2017 MNT'000	2016 MNT'000
Fees and commission income		
Credit related fees and commissions	6,690,895	5,140,222
Remittance and other service fees	2,204,770	2,248,146
Card related fees and commissions	5,302,231	4,576,166
Account service fees and commissions	9,026,818	7,742,553
Other fees and commissions	50	3,370,738
	23,224,764	**23,077,825**
Fees and commission expenses		
Bank service charges	1,193,820	991,129
Card transaction charges	1,769,467	1,481,030
Others	236,169	–
	3,199,456	**2,472,159**
Net fees and commission income	**20,025,308**	**20,605,666**

6. NET TRADING INCOME

	2017 MNT'000	2016 MNT'000
Foreign exchange	3,182,567	1,578,923
Debt securities	3,732,057	685,307
Precious metals	(2,871)	–
	6,911,753	**2,264,230**

Foreign exchange income includes net gains and losses from trading in spot and forward contracts and other currency derivatives. Debt securities income includes the results of selling and buying of debt securities available for sale and related interest income and expense.

7. OTHER OPERATING INCOME

	2017 MNT'000	2016 MNT'000
Non-trading foreign exchange gain, net	721,159	7,305,558
Others	535,146	624,264
	1,256,305	**7,929,822**

8. CREDIT LOSS EXPENSE

	2017 MNT'000	2016 MNT'000
Charge/(reversal) of provision for loan impairment		
Loans and advances to customers (Note 14)	34,980,713	15,157,986
Other assets (Note 16)	6,981,330	(26,301)
	41,962,043	**15,131,685**

9. OTHER OPERATING EXPENSES

	2017 MNT'000	2016 MNT'000
Salaries, wages and bonuses	39,472,711	40,905,060
Depreciation (Note 17)	5,975,535	5,798,366
Rental charges under operating leases	4,434,823	4,922,175
Contribution to social and health fund	4,353,308	4,532,720
Insurance expense	4,026,147	3,495,827
IT and Communication expense	2,974,457	2,925,884
Safety	1,539,360	1,433,223
Advertising and Marketing expense	1,533,449	1,727,854
Stationery expense	1,520,137	1,401,035
Utilities	1,519,459	1,421,097
Amortisation expense (Note 18)	1,178,191	1,086,805
Business trip	837,333	786,376
Transportation expense	654,916	656,965
Audit and Professional service fee	603,429	921,663
Property and equipment written off	365,382	62,414
Loss on disposal of intangible assets	13,146	1,915
Other	5,209,537	4,224,242
	76,211,320	**76,303,621**

STATE BANK LLC
NOTES TO THE FINANCIAL STATEMENTS – 31 DECEMBER 2017

10. 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	–	120,281
Deferred tax:		
Relating to temporary differences	–	15,418
Write off of deferred tax assets (Note 19)	(62,549)	544,035
	(62,549)	**679,734**

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

The Government of Mongolia continues to reform the business and commercial infrastructure in its transition to a market economy. As a result the laws and regulations affecting businesses continue to change rapidly.

These changes are sometimes characterized by poor drafting, varying interpretations and inconsistent application by the tax authorities. In particular, taxes are subject to review and investigation by a number of authorities who are enabled by law to impose fines and penalties. While the Bank believes it has provided adequately for all tax liabilities based on its understanding of the tax legislation and status at the period-end, the above facts may create tax risks for the Bank which are not possible to quantify at this stage.

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 tax	12,330,290	11,271,925
Tax at statutory tax rates of 10% and 25% (2016: 10% and 25%)	2,632,573	2,367,981
Tax effect of:		
Tax-exempt income	(8,458,692)	(8,054,982)
Income taxable on special tax rate	(22,018)	(11,076)
Non-deductible expenses	945,537	503,103
Current-year losses for which no deferred tax asset is recognised	4,430,582	4,934,309
Effect of movements of unrecognised deferred tax assets	409,469	940,399
Tax expense for the year	**(62,549)**	**679,734**

The tax loss for the year ended 31 December 2017 is MNT 17,722,328 thousand (2016: MNT 19,737,235 thousand) and deferred tax assets arising from tax loss were not recognized as at 31 December 2017 and 2016 as the Bank is uncertain whether there would be sufficient taxable profit in the next two years available against which the tax losses carried forward can be utilised.

11. CASH AND BALANCES WITH BoM

	2017 MNT'000	2016 MNT'000
Cash on hand	52,324,613	67,709,412
Current accounts with BoM	217,597,406	220,708,767
	269,922,019	**288,418,179**

Current accounts with BoM are maintained in accordance with BoM regulations. The balances maintained with BoM are determined at not less than 12.0% of customer deposits based on average balance of two (2) weeks. As at 31 December 2017, the average reserves required by BoM for that period of 2 weeks were MNT 195,263 million (2016: MNT 149,429 million) for local currency and MNT 23,357 million (2016: MNT 24,604 million) for foreign currency maintained on current accounts with BoM.

12. DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	2017 MNT'000	2016 MNT'000
Placement with foreign banks and financial institutions	9,058,410	43,631,902
Placement with local banks and financial institutions	40,245,719	98,575,065
	49,304,129	**142,206,967**

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

13. DERIVATIVE FINANCIAL INSTRUMENTS

The table below shows the fair values 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.

		Fair Value			Fair Value	
	Notional Amount	Assets	Liabilities	Notional Amount	Assets	Liabilities
	2017 MNT'000	2017 MNT'000	2017 MNT'000	2016 MNT'000	2016 MNT'000	2016 MNT'000
Swaps	24,396,400	282,957	–	174,500	–	6,997
	24,396,400	**282,957**	**–**	**174,500**	**–**	**6,997**

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

The Bank's exposure under derivative contracts is closely monitored as part of the overall management of its market risk (see also Note 29.4).

STATE BANK LLC
NOTES TO THE FINANCIAL STATEMENTS – 31 DECEMBER 2017

14. LOANS AND ADVANCES TO CUSTOMERS

	2017	2016
	MNT'000	MNT'000
Business loans	368,420,799	331,688,628
Mortgage loans	227,340,295	260,014,922
Consumer loans	716,729,704	507,166,312
Agricultural loans	129,475,684	44,285,779
Other	-	3,275,852
	1,441,966,482	**1,146,431,493**
Accrued interest receivable	26,276,110	16,219,415
Gross loans and advances to customers	**1,468,242,592**	**1,162,650,908**
Allowance for impairment losses	(68,483,722)	(33,655,220)
Net loans and advances to customers	**1,399,758,870**	**1,128,995,688**

Transferred financial assets that are not derecognised in their entirety

Every year starting from October 2012, the Bank sells rights to the cash flows arising on a portfolio of fixed rate mortgage loans to Mongolian Mortgage Corporation LLC ("MIK") and provides guarantees over the performance of the loans. The Bank has determined that substantially all the risks and rewards of the portfolio are retained and, consequently, the loans were not derecognised. The Bank accounts for the transaction as a collateralised borrowing and records the cash received as financial liability. The carrying amount of the remaining transferred loan portfolio as at 31 December 2017 was MNT 5,188 million (2016: MNT 2,326 million) and that of the liability was MNT 5,188 million (2016: MNT 2,326 million).

Transferred financial assets that are derecognised in their entirety

Every year the Bank sells rights to the cash flows arising on portfolios of fixed rate mortgage loans to wholly own special purpose companies of MIK Holding JSC in exchange for Residential Mortgage Backed Securities ("RMBS"). The Bank derecognizes the loan portfolios and recognizes the Senior RMBS and Junior RMBS received as financial assets. The carrying amounts of the transferred loan portfolios were MNT 59,068 million (2016: MNT 22,705 million) in total. The Senior and Junior RMBS recognized as financial assets amounted to MNT 53,162 million and MNT 5,906 million respectively (2016: MNT 20,434 million and MNT 2,270 million). During the year ended 31 December 2017, Senior RMBS amounting to MNT 53,162 million (2016: MNT 20,434 million) were transferred to BoM to settle loans owing to BoM.

Impairment allowance for loans and advances to customers

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

	Business MNT'000	Consumer MNT'000	Mortgage MNT'000	Agricultural MNT'000	Total MNT'000
At 31 December 2017					
At 1 January 2017	26,332,172	1,807,359	5,434,451	81,238	33,655,220
Charge for the year	28,229,969	6,630,434	2,638,618	1,349,606	38,848,627
Reversal	(2,764,181)	(495,692)	(520,533)	(87,508)	(3,867,914)
Effect of foreign currency movements	(108,777)	(19,507)	(20,484)	(3,443)	(152,211)
At 31 December 2017	**51,689,183**	**7,922,594**	**7,532,052**	**1,339,893**	**68,483,722**
Individual impairment	31,512,422	–	43,118	–	31,555,540
Collective impairment	20,176,761	7,922,594	7,488,934	1,339,893	36,928,182
	51,689,183	**7,922,594**	**7,532,052**	**1,339,893**	**68,483,722**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**68,558,095**	**–**	**938,200**	**–**	**69,496,295**
At 31 December 2016					
At 1 January 2016	16,365,594	1,339,427	1,394,932	37,722	19,137,675
Charge for the year	15,317,915	4,003,096	4,448,624	176,131	23,945,766
Reversal	(4,808,517)	(3,437,543)	(409,105)	(132,615)	(8,787,780)
Write off	(542,820)	(97,621)	–	–	(640,441)
At 31 December 2016	**26,332,172**	**1,807,359**	**5,434,451**	**81,238**	**33,655,220**
Individual impairment	15,673,816	39,081	1,269,614	–	16,982,511
Collective impairment	10,658,356	1,768,278	4,164,837	81,238	16,672,709
	26,332,172	**1,807,359**	**5,434,451**	**81,238**	**33,655,220**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**55,612,022**	**184,063**	**2,870,523**	**–**	**58,666,608**

The fair value of the collateral that the Bank holds relating to loans individually determined to be impaired as at 31 December 2017 amounts to MNT 39,694 million (2016: MNT 66,997 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 29.2.

STATE BANK LLC

NOTES TO THE FINANCIAL STATEMENTS – 31 DECEMBER 2017

15. FINANCIAL INVESTMENTS

	2017	2016
	мян.төг	**мян.төг**
Available-for-sale:		
Equity investments		
Quoted equities at fair value	5,253,299	6,374,165
Unquoted equities at cost	12,461	11,205
	5,265,760	**6,385,370**
Fixed income investments		
Junior RMBS, at fair value	41,530,133	19,397,613
Quoted bonds at fair value	–	26,852,994
Unquoted government bonds	50,814,053	76,888,050
Quoted government treasury bills	43,181,807	161,140,480
Unquoted BoM treasury bills	379,735,030	53,949,013
Unquoted promissory notes	–	83,005,771
	515,261,023	**421,233,921**
	520,526,783	**427,619,291**
Available-for-sale as collateral in repurchase agreements:		
Unquoted bonds*	**7,760,816**	**7,760,816**

*Unquoted bonds

As at 31 December 2017, the bond was held as collateral against the Bank's repurchase agreement.

Quoted equity represents investment in equity quoted on the Mongolia Stock Exchange.

Unquoted equities represent investments made in unquoted companies. Investments in unquoted equities are recorded at cost as management determined 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.

Junior "RMBS" are interest bearing long term securities issued by MIK Holding JSC (see Note 14) which per the Securities Law of Mongolia, are required to be held by commercial banks for at least 3 years.

BoM treasury bills ("BoM bills") are short term investments acquired at a discount. Government treasury bills are short term bills acquired either at a discount or premium. Government bonds are interest bearing long term bonds acquired either at a discount or premium.

Promissory notes are securities issued by Ministry of Finance as per resolution of Parliament #07 and Government #282.

16. OTHER ASSETS

	2017 MNT'000	2016 MNT'000
Promissory note	7,436,601	7,302,836
Consumables and other office supplies	1,825,553	1,806,976
Prepaid expenses	1,760,378	973,328
Income tax receivable	194,380	159,336
Other	3,584,329	3,847,604
	14,801,241	**14,090,080**
Less: Impairment allowance on other receivables	(8,278,948)	(1,311,521)
	6,522,293	**12,778,559**

	2017 MNT'000	2016 MNT'000
Impairment allowance on other receivables		
At 1 January	1,311,521	1,239,112
Charge for the year (Note 8)	7,242,912	–
Reversal (Note 8)	(282,691)	(26,301)
Foreign exchange difference	(13,903)	98,710
At 31 December	**8,257,839**	**1,311,521**
Impairment allowance on foreclosed properties		
At 1 January	–	–
Charge for the year (Note 8)	21,109	–
At 31 December	**21,109**	–

17. PROPERTY AND EQUIPMENT

	Land and buildings	Computer hardware	Office furniture and equipment	Motor vehicles	Construction-in-progress	Total
	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
At 31 December 2017						
At cost/valuation						
At 1 January 2017	72,156,656	15,403,665	19,076,727	5,742,878	1,933,094	114,313,020
Additions	–	2,938,528	3,595,752	637,380	3,113,407	10,285,067
Disposals	(97,697)	(867,404)	(515,383)	(251,053)	(133,232)	(1,864,769)
Reclassification	2,538,600	–	–	–	(2,538,600)	–
At 31 December 2017	74,597,559	17,474,789	22,157,096	6,129,205	2,374,669	122,733,318
Accumulated depreciation						
At 1 January 2017	10,222,731	12,819,609	9,327,875	3,027,994	–	35,398,209
Charge for the year (Note 9)	1,908,940	1,710,228	1,810,495	545,872	–	5,975,535
Disposals	(22,065)	(865,773)	(417,427)	(194,122)	–	(1,499,387)
At 31 December 2017	12,109,606	13,664,064	10,720,943	3,379,744	–	39,874,357
Net carrying amount	**62,487,953**	**3,810,725**	**11,436,153**	**2,749,461**	**2,374,669**	**82,858,961**

17. PROPERTY AND EQUIPMENT

At 31 December 2016	Land and buildings MNT'000	Computer hardware MNT'000	Office furniture and equipment MNT'000	Motor vehicles MNT'000	Construction-in-progress MNT'000	Total MNT'000
At cost/valuation						
At 1 January 2016	69,885,229	14,785,232	18,789,086	5,757,998	23,270	109,241,285
Additions	630,041	872,298	547,140	22,880	3,460,996	5,533,355
Write-offs	–	(283,851)	(134,826)	(38,000)	(4,943)	(461,620)
Reclassification	1,641,386	29,986	(124,673)	–	(1,546,699)	–
At 31 December 2016	72,156,656	15,403,665	19,076,727	5,742,878	1,933,094	114,313,020
Accumulated depreciation						
At 1 January 2016	8,217,752	11,493,775	7,803,938	2,483,584	–	29,999,049
Charge for the year (Note 9)	1,986,025	1,542,230	1,707,810	562,301	–	5,798,366
Write-offs	–	(282,866)	(98,449)	(17,891)	–	(399,206)
Reclassification	18,954	66,470	(85,424)	–	–	–
At 31 December 2016	10,222,731	12,819,609	9,327,875	3,027,994	–	35,398,209
Net carrying amount	**61,933,925**	**2,584,056**	**9,748,852**	**2,714,884**	**1,933,094**	**78,914,811**

Land and buildings are carried at fair value. Had these buildings been recognised under the cost model as at 31 December 2017, the carrying amount of the land and buildings would have been MNT 52,293 million (2016: MNT 51,387 million). As at 31 December 2017 the Bank had contractual commitments to acquire property and equipment of MNT 2,013 million (2016: MNT 1,834 million) (see Note 28).

STATE BANK LLC
NOTES TO THE FINANCIAL STATEMENTS – 31 DECEMBER 2017

18. INTANGIBLE ASSETS

	Computer software MNT'000	Software licenses MNT'000	Total MNT'000
At 31 December 2017			
At cost			
At 1 January 2017	2,763,231	2,420,295	5,183,526
Additions	–	630,953	630,953
Disposals	(21,208)	(1,876)	(23,084)
At 31 December 2017	2,742,023	3,049,372	5,791,395
Amortisation			
At 1 January 2017	1,846,130	1,374,921	3,221,051
Charge for the year (Note 9)	288,699	889,492	1,178,191
Disposals	(9,693)	(245)	(9,938)
At 31 December 2017	2,125,136	2,264,168	4,389,304
Net carrying amount	**616,887**	**785,204**	**1,402,091**
At 31 December 2016			
At cost			
At 1 January 2016	3,682,947	1,668,492	5,351,439
Charge for the year (Note 9)	162,006	771,303	933,309
Write-offs	(501,722)	(599,500)	(1,101,222)
Reclassification	(580,000)	580,000	–
At 31 December 2016	2,763,231	2,420,295	5,183,526
Net carrying amount			
At 1 January 2016	2,472,293	761,239	3,233,532
Charge for the year (Note 9)	374,603	712,223	1,086,826
Write-offs	(499,808)	(599,499)	(1,099,307)
Reclassification	(500,958)	500,958	–
At 31 December 2016	1,846,130	1,374,921	3,221,051
Net carrying amount	**917,101**	**1,045,374**	**1,962,475**

19. DEFERRED TAX

	2017	2016
	MNT'000	MNT'000
Deferred tax (liabilities)/assets		
At 1 January	(561,859)	47,849
Recognised in statement of other comprehensive income	121,678	(50,164)
Reversal of deferred tax liability	–	40,343
Temporary difference on depreciation of intangible assets (Note 10)	62,549	(55,852)
Recognised in profit or loss (Note 10)	–	(544,035)
At 31 December	**(377,632)**	**(561,859)**

	Deferred tax liability	Deferred tax asset	Net deferred tax liability
	MNT'000	MNT'000	MNT'000
As at 31 December 2017			
Revaluation of financial investments – available-for-sale	(377,632)	–	(377,632)
	(377,632)	**–**	**(377,632)**
As at 31 December 2016			
Revaluation of financial investments – available-for-sale	(499,310)	–	(499,310)
Relating to temporary differences on depreciation of intangible assets	(62,549)	–	(62,549)
	(561,859)	**–**	**(561,859)**

20. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	2017 MNT'000	2016 MNT'000
Current accounts from banks and financial institutions	22,253,652	34,331,608
Time deposits from banks and financial institutions	171,028,731	92,807,790
	193,282,383	**127,139,398**

At 31 December 2017 and 2016, due to banks included current accounts and time deposits with local and foreign banks. At 31 December 2017, time deposits relate to deposits from local and foreign banks with interest rates between 1.2% and 17.8% (2016: 2.9% to 14.75%) per annum and original maturity from 8 to 267 days (2016: 4 to 176 days).

21. REPURCHASE AGREEMENTS

During its normal course of business, the Bank borrows and lends securities and may also sell securities under agreements to repurchase (repos) and purchase securities under agreements to resell (reverse repos).

The following table summarises the consideration paid, including accrued interest, recorded in the statement of financial position, within reverse repurchase agreements, reflecting the transaction's economic substance as a loan provided by the Bank:

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	2017 MNT'000	2016 MNT'000
Reverse repurchase agreements	–	2,998,786

The following table summarises the liability arising from the consideration received, including accrued interest within repurchase agreements, reflecting the transaction's economic substance as a loan to the Bank:

	2017 MNT'000	2016 MNT'000
Repurchase agreements	**7,722,342**	7,722,342

22. DUE TO CUSTOMERS

	2017 MNT'000	2016 MNT'000
Government deposits		
- Current accounts	161,275,997	145,095,213
- Time deposits	33,778,177	97,923,561
- Bank guarantee fund	50,077	224,089
Private sector deposits		
- Current accounts	103,641,665	83,513,783
- Demand deposits	633	86,801
- Time deposits	55,208,142	45,422,423
- Bank guarantee fund	6,222,148	4,555,718
Individual deposits		
- Current accounts	80,219,300	73,127,726
- Demand deposits	193,802,030	174,755,609
- Time deposits	939,269,281	726,913,079
- Bank guarantee fund	82	86
	1,573,467,532	**1,351,618,088**

23. BORROWED FUNDS

	2017 MNT'000	2016 MNT'000
Borrowed funds from organisations		
Bank of Mongolia	91,452,174	113,309,814
Ministry of Finance	85,111,859	75,266,658
Ministry of Finance - Asian Development Bank	2,670,595	2,803,336
Development Bank	73,458,152	84,074,498
Labor Service Center/Center for Employment Service	4,000,000	21,000,000
SME Development Fund	8,983,672	13,876,103
Ministry of Finance/Japan Bank for International Cooperation	26,543,872	17,258,894
Mongolian Mortgage Corporation LLC	5,210,214	7,275,984
Promissory notes	-	14,993,838
Other	1,195,963	2,000,000
Total borrowed funds	**298,626,501**	**351,859,125**

Borrowings are all unsecured.

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

- capital related ratios (such as risk weighted capital adequacy ratio, ratio between tier 1 capital and total capital);
- financial risks related ratios (such as aggregate foreign currency open position, single currency foreign exchange risk ratio, liquidity ratio);
- credit related ratios (such as single largest borrowers to the equity ratio, related party lending ratio and aggregate large exposures ratio);
- other ratios (non-current assets to total assets, non-performing loans to total loan ratio, etc.).

In case of non-compliance with covenants e.g., if the Bank defaults, the borrowing becomes immediately payable on demand. For this reason, the Bank monitors its compliance with BoM prudential ratios and other debt covenants on a monthly basis through the Planning and Analysis Division. The Financial Department compares the Bank's performance results against ratio requirements and presents the result to the Asset and Liability Committee ("ALCO").

As of 31 December 2017 and 2016, the Bank has complied with all covenants.

24. OTHER LIABILITIES

	2017 MNT'000	2016 MNT'000
Payables and accrued expenses	2,049,877	2,372,877
Delay on clearing settlement	5,087,005	3,951,833
Other	871,629	866,148
	8,008,511	**7,190,858**

25. SHARE CAPITAL AND OTHER RESERVES

Share Capital

	Number of shares authorized, issued and fully paid of MNT 1,000,000 each		Amount	
	2017	2016	2017 MNT'000	2016 MNT'000
At 31 December	113,000	113,000	113,000,000	113,000,000

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Other reserves

	Social development fund	Other reserves	Available-for-sale reserve	Asset revaluation reserve	Total other reserves
	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
At 31 December 2017					
At January 1	956,832	693,669	4,493,791	10,547,302	16,691,594
Transfers to retained earnings	–	–	–	(352,000)	(352,000)
Net change in fair value of available-for-sale investments	–	–	(1,095,708)	–	(1,095,708)
At 31 December 2017	**956,832**	**693,669**	**3,398,083**	**10,195,302**	**15,243,886**
At 31 December 2016					
At 1 January					
Transfers to retained earnings	956,832	693,669	4,042,314	11,009,228	16,702,043
Net change in fair value of available-for-sale investments	–	–	–	(461,926)	(461,926)
At 31 December 2016	–	–	451,477	–	451,477
2016 оны 12-р сарын 31	**956,832**	**693,669**	**4,493,791**	**10,547,302**	**16,691,594**

Dividends

The Bank has not declared any dividend in 2017 and 2016.

26. SUBORDINATED LOAN

On 22 February 2016, the Government of Mongolia transferred a mortgage loan portfolio amounting to MNT 65 billion to the Bank relating to the "Good herdsmen" loan program initiated by the Government. The consideration for the loan portfolio is a MNT 65 billion interest free convertible loan which must be converted into 65,000 shares of the Bank with nominal value of MNT 1 million each at maturity in 5 years. On 24 June 2016 the Bank of Mongolia gave permission to account for this subordinated loan as equity.

27. ADDITIONAL CASH FLOW INFORMATION

	2017 MNT'000	2016 MNT'000
Cash and balances with BoM (Note 11)	269,922,019	288,418,179
Due from banks and other financial institutions (Note 12)	49,304,129	142,206,967
Unquoted BoM treasury bills (Note 15)	379,735,030	53,949,013
Quoted Government treasury bills (Note 15)	43,181,807	161,140,480
Unquoted Government bonds (Note 15)	58,574,869	84,648,866
	800,717,854	**730,363,505**
Less: Minimum reserve with Bank of Mongolia not available to finance the Bank's day to day operations (see Note 11)	(218,620,220)	(174,033,407)
Less: Placement with other banks with original maturities of more than three months	(300,000)	(71,167,845)
Less: Government treasury bills with original maturities of more than three months	(33,016,219)	(116,372,076)
Less: Government bonds with original maturities of more than three months	(58,574,869)	(84,648,866)
Total cash and cash equivalents	**490,206,546**	**284,141,311**

28. 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 (see Note 29.2).

	2017 MNT'000	2016 MNT'000
Contingent liabilities		
Performance guarantees not covered by collateral	2,713,158	1,068,215
Letters of credit	102,558	–
	2,815,716	**1,068,215**
Commitments		
Undrawn commitments to lend	3,481,175	1,495,988
Property and equipment	2,013,321	1,833,863
	5,494,496	**3,329,851**
Total	**8,310,212**	**4,398,066**

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Contingent liabilities

Guarantees commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to tender and bid auction. They generally 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.

Commitments

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

Legal claims

Litigation is a common occurrence in the Banking industry due to the nature of the business undertaken. The Bank has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of loss can be reasonably estimated, the Bank makes adjustments to account for any adverse effects which the claims may have on its financial statements. At 31 December 2017, the Bank had one material outstanding legal claim.

On 28 November 2013, the Bank filed a criminal complaint to the State Police Investigation Office against E. Suren regarding the validity of a guarantee alleged to have been entered into between Savings Bank and Just Group LLC. Prior to the criminal complaint, a civil case favouring E. Suren to request payment amounting to USD 32.85 million by the Bank to Just Group was decided by the Court on the grounds that the duties of Savings Bank were transferred to the Bank as indicated in Article 2.3 of the "Agreement to Transfer Assets and Liabilities" (the "Transfer Agreement") executed by the Bank and Savings Bank receivership.

The Bank disagrees with the court ruling arguing that the Bank was not the respondent to the case on the following grounds: 1) according to the decision of BoM, the assets and liabilities as well as the branch offices of the Savings Bank transferred to the Bank are limited to the list of assets and liabilities stated in the Appendix of the "Agreement to Transfer Assets and Liabilities", which excludes the guarantee allegedly entered into by Savings Bank and Just Group LLC; and 2) State Bank sent an official letter to Sukhbaatar district court on 14 February 2017 to reconsider the case on the basis that the guarantee agreement should not be considered valid due to newly identified circumstances and evidence. The case has been under hearings at various courts in 2017, and as of the end of February 2018 it was in Bayanzurkh district court.

Management is of the opinion that the ultimate resolution of the case will be favourable to the Bank. Hence the Bank did not recognise any liability as at 31 December 2017 and 2016.

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.

Asset Quality Review (AQR)

In 2017 the Bank of Mongolia commissioned Diagnostic Studies on the commercial banks in Mongolia. Preliminary summary results of these studies were informed to the banks in January 2018.

Following the AQR, the Bank of Mongolia plans to perform stress tests under varying macro-economic scenarios and assumptions, as well as to perform follow up supervisory inspections of each bank during which recent developments in the banks' financial status will be assessed as a follow up to the preliminary AQR results.

As at the date of approval of these financial statements, final results of the AQR and stress test are pending, and the full implications of the assessment on the Mongolian financial sector and for the Bank specifically are as yet unclear. For further details, refer to Note 29.4 Market risk.

29. RISK MANAGEMENT

29.1 Introduction

The main risks inherent in the Bank's operations are credit risk, liquidity risk, interest rate risk, foreign exchange risk and operational risk, all of which are controlled by the Bank's Risk Management Department, an independent unit reporting directly to the Chief Executive Officer. The primary goal of risk management is to allocate capital to business segments commensurate with their risk/reward profiles and to maximize the Bank's risk-adjusted return on capital through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

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

(i) Individuals who manage the risks clearly understand the requirement and measurement system;

(ii) The Bank's risk exposure is within the limits established by the Board of Directors ("BOD");

(iii) The risk measured is in line with the business strategy as approved by BOD;

(iv) The capital allocation is consistent with the risk of exposures; and

(v) The Bank's performance objectives are aligned with the risk appetite and tolerance.

Risk management structure

The Board of Directors is responsible for the overall risk management approach and for approving the risk policy and credit policy which specify risk appetite and tolerances.

Board Risk Management Committee ("BRMC")

The Board Risk Management Committee assists the Board of Directors in monitoring and controlling the risk exposures of the Bank. BRMC sets the comprehensive risk management approach and approves the risk strategies and principles that establish the objectives guiding all the Bank's activities and implement the necessary policies and procedures.

Risk Management Committee ("RMC")

RMC is responsible for anticipating and managing new and ongoing financial risk across business departments and maintaining appropriate limits on risk taking, adequate systems and standards for measuring operational risk, credit risk and performance, comprehensive risk reporting and management review process. Two levels of risk management committees operate at the bank: the central RMC and the branch level RMC.

Internal Audit

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

Asset and Liability Committee ("ALCO")

ALCO has the overall responsibility for the development of the risk strategy, making recommendation to BOD and BRMC. Once approved, ALCO implements the principles, frameworks, policies and limits relating to interest rate, liquidity and market risks.

Credit Committees

It is the credit decision making body of the Bank and operates within clearly defined parameters authorised by an internal policy. The committees have the following main functions:

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- Review of the quality, composition and risk profile of the entire credit portfolio on an ongoing basis;
- Approval of limits of credit exposures to each sectors and geographical regions;
- Approval of credit procedures;
- Approval of credit classification and provisioning;
- Approval of credit applications.

Risk Management Department

The Risk Management Department is responsible for ensuring the management and implementation of the Bank's risk policy in all level through its three divisions with specific responsibilities defined below:

Operational Risk Management Division

The operational risk management division is responsible for implementing and maintaining risk related policies and procedures to ensure an independent control processes.

The division is responsible for monitoring compliance with operational risk principles, identifying, measuring operational risk exposures and ensuring that contingent commitments are within risk management and reporting system.

Special Assets Division:

Main function of the Special Asset Division is to compensate the bank's non-performing assets and save Bank's capital.

Credit Risk Management Division:

The main responsibilities of the Credit Risk Management Division are as follows:

(i) To conduct credit risk analysis and research;
(ii) To perform independent risk assessments for credit applications to determine the degree of credit risk involved;
(iii) To monitor loan portfolio and make recommendations to diversify loan portfolio by sectors and geographical regions;
(iv) To mitigate risk exposures of the Bank's loan portfolio using various tools.

Risk measurement and reporting system

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment.

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

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to BOD, ALCO, Risk Management and Credit Committees, and the head of each business departments. The reports include the aggregate credit exposure, credit metric forecasts, VaR, liquidity ratios and risk profile changes.

Both ALCO and Risk Management Committee receive a comprehensive risk report every quarter which is designed to provide all the necessary information to assess and conclude on the risk exposure of the Bank. Bi-weekly briefing is presented to ALCO on the utilisation of market limits, analysis of Value-at-Risk ("VaR") and liquidity, and any other risk developments.

Risk mitigation

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

The Bank actively utilizes collaterals and personal guarantees to reduce its credit risks.

Excessive Risk Concentration

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

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

At the individual basis, BoM sets the standards of limitation as follows:

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

The Bank's policy requires it to maintain sufficient liquidity corresponding to the level of deposit concentration.

29.2 Credit risk

Credit risk is the risk that the Bank could incur a loss because its customers, clients or counterparties fail to fulfill their contractual obligations. The Bank manages and controls credit risk by carefully screening credit applications, setting interest rate adjusted for risk level, and setting limits on credit exposures for individual counterparties, geographical area, and industry, and monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. The credit quality review process allows the Bank to identify potential losses and take early corrective actions.

The Bank regularly examines and improves credit policies and procedures to keep its lending activities in line with the best practice.

Credit-related Commitments Risks

The Bank makes available to its customers, guarantees and standby letters of credit, which may require the Bank to make payments on their behalf. Such payments, if made, are collected from customers based on the terms of the particular letters of guarantee. These commitments expose the Bank to similar risks as loans; therefore the related risks are managed by the same procedures and policies.

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.

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	Gross maximum exposure 2017 MNT'000	**Gross maximum exposure 2016 MNT'000**
Cash and balances with BoM		
(excluding cash on hand) – Note 11	217,597,406	220,708,767
Due from banks and other financial institutions (Note 12)	49,304,129	142,206,967
Reverse repurchase agreement (Note 21)	–	2,998,768
Derivative financial instruments (Note 13)	282,957	–
Loans and advances to customers (Note 14)	1,468,242,592	1,162,650,908
Financial investments – available-for-sale (Note 15)	515,261,023	421,233,921
Financial investments – available-for-sale as collateral in repurchase agreements (Note 15)	7,760,816	7,760,816
Other assets (Note 16)	11,020,930	11,150,440
Total	**2,269,469,853**	**1,968,710,587**
Contingent liabilities (Note 28)	2,815,716	1,068,215
Undrawn commitments to lend (Note 28)	3,481,175	1,495,988
Total	**6,296,891**	**2,564,203**
Total credit risk exposure	**2,275,766,744**	**1,971,274,790**

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.

Analysis of risk concentration

The table below shows the analysis per industry sector of the Bank's loans and advances to customers (Note 14) in gross amounts, before taking into account the fair value of the loan collateral held or other credit enhancements.

	2017 Gross maximum exposure MNT'000	%	2016 Gross maximum exposure MNT'000	%
Consumers	962,604,606	66%	778,887,672	67%
Agriculture	190,950,057	13%	167,511,609	14%
Construction	87,940,105	6%	61,859,503	5%
Manufacturing	83,374,981	6%	48,588,023	4%
Wholesale and retail	31,097,847	2%	29,934,133	3%
Hotel and restaurants	28,051,770	2%	–	0%
Mining and exploration	13,785,379	1%	5,995,018	1%
Transportation and communications	7,371,058	1%	5,370,335	0%
Real estate	6,118,126	0%	6,633,455	1%
Healthcare	4,050,026	0%	2,851,597	0%
Tourism	3,957,470	0%	2,541,432	0%
Financial services	1,789,585	0%	2,789,452	0%
Education	1,583,615	0%	3,222,678	0%
Electricity and oil	1,545,843	0%	1,610,723	0%
Maintenance	203,367	0%	–	0%
Public service	2,141	0%	39,261	0%
Other	43,816,316	3%	44,816,017	4%
	1,468,242,592	**100%**	**1,162,650,908**	**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 main types of collateral obtained are as follows:

(i) corporate lending: charges over real-estate properties, inventories, plants and equipment, machineries and vehicles;

(ii) small business lending: charges over real estate properties and inventories;

(iii) consumer lending: charges over automobiles and assignment of income; and charges over real estate properties;

(iv) residential mortgages: mortgages over residential properties.

The Bank also obtains guarantees from parent companies for loans to their subsidiaries and personal guarantees from the main shareholders for the limited liability entities but the potential benefits are not included in the above.

The Bank regularly monitors the market value of collateral and requests additional collateral when necessary in accordance with the underlying agreement.

It is the Bank's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. The Bank does not occupy repossessed properties for business use.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank using internal credit ratings.

The following table shows the description of credit risk grading system of the Bank:

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

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

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

		2017						
		Neither Past Due nor Impaired					Past due or individually impaired	
	Notes	Excellent	Good	Satisfactory	Substandard	Not rated		Total
		MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
Cash and balances with BoM	**11**	217,597,406	–	–	–	–	–	217,597,406
Due from banks and other financial institutions	**12**	41,281,068	–	8,023,061	–	–	–	49,304,129
Financial investments –	**15**							
Available-for-sale		473,730,890	–	–	–	41,530,133	–	515,261,023
Available-for-sale as collateral in repurchase agreements		7,760,816	–	–	–	–	–	7,760,816
Loans and advances to customers	**14**							
Business loans		220,589,447	36,520,491	287,538	23,004	–	118,446,395	375,866,875
Consumer loans		721,729,991	869,766	106,928	594,355	–	5,481,678	728,782,718
Mortgage loans		220,233,001	1,152,172	275,456	2,294,584	–	4,345,357	228,300,570
Agriculture loans		134,907,654	46,648	556	–	–	337,571	135,292,429
Other assets	**16**	2,724,951	–	–	–	–	8,295,979	11,020,930
Total		**2,040,555,224**	**38,589,077**	**8,693,539**	**2,911,943**	**41,530,133**	**136,906,980**	**2,269,186,896**

		2016						
		Neither Past Due nor Impaired					Past due or individually impaired	
	Notes	Excellent	Good	Satisfactory	Substandard	Not rated		Total
		MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
Cash and balances with BoM	**11**	220,708,767	–	–	–	–	–	220,708,767
Due from banks and other financial institutions	**12**	40,778,921	1,587,736	99,840,310	–	–	–	142,206,967
Reverse repurchase agreement	**21**	–	–	2,998,768	–	–	–	2,998,768
Financial investments –	**15**							
Available-for-sale		401,836,308	–	–	–	19,397,613	–	421,233,921
Available-for-sale as collateral in repurchase agreements		7,760,816	–	–	–	–	–	7,760,816
Loans and advances to customers	**14**							
Business loans		263,869,305	4,730,283	99,641	140,026	–	67,753,579	336,592,834
Consumer loans		506,986,067	2,108,677	151,811	781,249	–	5,822,852	515,850,656
Mortgage loans		254,287,973	2,284,416	6,568	231,067	–	4,313,760	261,123,784
Agriculture loans		45,264,153	62,045	1,021	–	–	480,563	45,807,782
Others		–	3,275,852	–	–	–	–	3,275,852
Other assets	**16**	1,228,402	–	–	–	–	9,922,038	11,150,440
Total		**1,742,720,712**	**14,049,009**	**103,098,119**	**1,152,342**	**19,397,613**	**88,292,792**	**1,968,710,587**

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An analysis of past due but not individually impaired loans, by age, is provided below.

31 December 2017	Less than 30 days MNT'000	More than 31 to 60 days MNT'000	61 to 90 days MNT'000	More than 91 days MNT'000	Total MNT'000
Business loans	13,062,520	–	6,163,192	8,635,299	27,861,011
Total	**13,062,520**	**–**	**6,163,192**	**8,635,299**	**27,861,011**

31 December 2016	Less than 30 days MNT'000	More than 31 to 60 days MNT'000	61 to 90 days MNT'000	More than 91 days MNT'000	Total MNT'000
Business loans	1,558,710	6,052,171	1,470,621	2,707,085	11,788,587
Mortgage loans	122,986	35,971	300,470	1,318,538	1,777,965
Consumer loans	552,279	587,246	449,055	4,067,929	5,656,509
Agricultural loans	6,898	9,021	34,459	430,707	481,085
Total	**2,240,873**	**6,684,409**	**2,254,605**	**8,524,259**	**19,704,146**

Of the total aggregate amount of gross past due but not individually impaired loans and advances to customers, the value of collateral that the Bank held as at 31 December 2017 was MNT 41,458 million (2016: MNT 28,297 million). Please refer to Note 14 for additional information with respect to allowance for impairment losses on loans and advances to customers.

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

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

	2017 MNT'000	2016 MNT'000
Loans and advances to customers:		
Project loans	20,164,338	21,157,628
Business loans	38,325,011	33,130,483
Mortgage loans	5,122,252	5,304,785
Special condition loans	4,351,647	5,483,601
Agricultural loans	809,156	539,339
Consumer loans	250,336	367,922
	69,022,740	**65,983,758**

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

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

Collectively assessed allowances

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

Financial guarantees and letters of credit are assessed and provisions are made in a similar manner as for loans and advances.

29.3 Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stressed circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank always holds sufficient amount of liquid assets which is much higher than the level required by the BoM. In addition, the Bank complies with the reserve requirement of 12 percent of customer deposits based on average period of two weeks.

Analysis of financial liabilities by remaining contractual maturities

The table below summarizes the maturity profile of the Bank's financial assets and liabilities at 31 December 2017 and 31 December 2016 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.

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31 December 2017	On demand	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total undiscounted financial liabilities
	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
Cash and balances with BoM	269,922,019	–	–	–	–	–	269,922,019
Due from banks and other financial institutions	15,024,299	34,440,642	325,260	–	–	–	49,790,201
Derivative financial instruments	–	283,810	–	–	–	–	283,810
Financial investments – - Available-for-sale	5,265,760	392,226,197	39,082,040	–	61,638,418	108,228,991	606,441,406
- Available-for-sale as collateral in repurchase agreements	–	–	–	–	8,641,787	–	8,641,787
Loans and advances to customers	38,389,347	47,345,178	116,093,481	175,236,191	1,259,396,662	537,239,632	2,173,700,491
	328,601,425	**474,295,827**	**155,500,781**	**175,236,191**	**1,329,676,866**	**645,468,623**	**3,108,779,714**
Due to banks and other financial institutions	12,860,314	115,090,072	62,447,433	3,806,836	–	–	194,204,655
Due to customers	538,939,627	319,000,437	286,668,881	334,481,216	88,902,802	118,949,272	1,686,942,235
Borrowed funds	4,063,527	2,398,689	60,742,366	4,811,375	150,417,192	134,655,140	357,088,289
Repurchase agreements	–	7,722,342	–	–	–	–	7,722,342
Other liabilities	8,008,511	–	–	–	–	–	8,008,511
	563,871,979	**444,211,540**	**409,858,680**	**343,099,427**	**239,319,994**	**253,604,412**	**2,253,966,032**
Net position	**(235,270,554)**	**30,084,287**	**(254,357,899)**	**(167,863,236)**	**1,090,356,872**	**391,864,211**	**854,813,682**

31 December 2016	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
Cash and balances with BoM	288,418,179	–	–	–	–	–	288,418,179
Due from banks and other financial institutions	44,634,331	76,943,545	–	24,895,300	–	–	146,473,176
Reverse repurchase agreements	–	2,998,912	–	–	–	–	2,998,912
Financial investments Available-for-sale	4,304,841	320,651,032	31,950,177	–	50,390,368	88,478,888	495,775,306
Available-for-sale as collateral in repurchase agreements	–	–	–	–	8,641,787	–	8,641,787
Loans and advances to customers	38,923,775	35,508,884	87,070,111	131,427,143	944,547,497	402,929,724	1,640,407,134
Other assets	2,536,083	–	–	–	–	–	2,536,083
	378,817,209	**436,102,373**	**119,020,288**	**156,322,443**	**1,003,579,652**	**491,408,612**	**2,585,250,577**
Due to banks and other financial institutions	28,796,300	12,074,190	66,243,489	25,756,823	–	–	132,870,802
Derivative financial instruments	–	174,500	–	–	–	–	174,500
Due to customers	488,227,058	288,037,041	247,447,263	234,044,863	69,412,319	82,784,080	1,409,952,624
Borrowed funds	18,301,325	63,621,833	1,702,723	63,872,068	107,647,218	168,317,463	423,462,630
Repurchase agreements	–	–	–	–	7,728,684	–	7,728,684
Other liabilities	7,190,858	–	–	–	–	–	7,190,858
	542,515,541	**363,907,564**	**315,393,475**	**323,673,754**	**184,788,221**	**251,101,543**	**1,981,380,098**
Net position	**(163,698,332)**	**72,194,809**	**(196,373,187)**	**(167,351,311)**	**818,791,431**	**240,307,069**	**603,870,479**

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29.4 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates or foreign exchange rates. The Bank manages and monitors this risk element using VaR and sensitivity analyses. The market risk for the trading portfolio is managed and monitored based on a VaR methodology that reflects the interdependency between risk variables. Non–trading positions are managed and monitored using other sensitivity analyses.

Asset Quality Review (AQR)

On 24 May 2017, the Executive Board of the International Monetary Fund (IMF) approved a three-year extended arrangement under the Extended Fund Facility for Mongolia to support the country's economic reform program. The total financing package amounts to approximately $5.5 billion, including support from the Asian Development Bank, the World Bank, Japan, Korea and China. One of the pillars of the program is a comprehensive effort to rehabilitate the banking system and strengthen the Bank of Mongolia. As part of the program, the Bank of Mongolia commissioned Diagnostic Studies on Commercial Banks in Mongolia including an Asset Quality Review (AQR). The AQR was performed predominantly based on version 2 of the European Central Bank's AQR Manual, as localised by the Bank of Mongolia in several areas. Preliminary summary results were informed to each commercial bank in January 2018.

Following the AQR, the Bank of Mongolia plans to perform stress tests under varying macro-economic scenarios and assumptions, as well as to perform follow up supervisory inspections of each bank during which recent developments in the banks' financial status will be assessed as a follow up to the preliminary AQR results. The stress tests and AQR are planned to be completed by 31 March 2018, following which the results and related implications on the banks' capital are expected to be informed to the commercial banks.

As at the date of approval of these financial statements, final results of the AQR and stress test are pending, and the full implications of the assessment on the Mongolian financial sector and for the Bank specifically are as yet unclear. This creates a significant uncertainty in market, regulatory, credit and other risks including related implications for capital adequacy, and in the Bank's future exposure to such risks, the implications of which will only be realised with time. The financial impact resulting from this AQR and stress test on the Bank's financial statements cannot be reasonably estimated at this time, therefore no adjustments for this matter have been recorded to the Bank's financial statements.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect bank's profitability, future cash flows or the fair values of financial instruments. 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. Management has established limits on the interest rate gaps for stipulated periods. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained with the established limits.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's profit or loss. The sensitivity of the profit or loss 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	
		2017 MNT'000	2016 MNT'000
EUR	+/-120	15,694	14,005
USD	+/-120	68,406	708,394
MNT	+/-120	515,784	668,208

Currency risk

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

Objectives and limitations of the VaR Methodology

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

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

VaR limits have been established for all foreign currency open positions and exposures are reviewed daily against the limits by management. The estimated potential one-day losses on its foreign currency denominated financial instruments, as calculated in the VAR models are the following:

	Historical Simulation	Monte Carlo Simulation
	MNT'000	MNT'000
2017 – 31 December	(347,492)	(350,272)
2017 – Average Daily	(295,356)	(293,975)
2017 – Highest	(703,454)	(702,047)
2017 – Lowest	(162,576)	(155,098)
2016 – 31 December	1,080,338	1,046,202
2016 – Average Daily	623,083	613,683
2016 – Highest	1,342,172	1,295,735
2016 – Lowest	294,829	285,290

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The table below summarizes the Bank's exposure to foreign exchange risk as at 31 December 2017 and 31 December 2016. Included in the table are the Bank's financial assets and liabilities at carrying amounts, categorized by currencies.

Financial assets and financial liabilities by currency as at 31 December 2017	MNT	USD	Euro	Others	Total
	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
Assets					
Cash and balances with BoM (Note 11)	204,093,339	47,285,190	2,799,060	15,744,430	269,922,019
Due from banks and other financial institutions (Note 12)	300,890	42,685,903	2,014,445	4,302,891	49,304,129
Derivative financial instruments (Note 13)	282,957	–	–	–	282,957
Loans and advances to customers (Note 14)	1,387,641,936	12,115,477	–	1,457	1,399,758,870
Financial investments					
- available-for-sale (Note 15)	484,042,538	36,471,784	12,461	–	520,526,783
- available-for-sale as collateral in repurchase agreements (Note 15)	7,760,816	–	–	–	7,760,816
Other assets	2,494,100	228,273	1,449	18,160	2,741,982
	2,086,616,576	**138,786,627**	**4,827,415**	**20,066,938**	**2,250,297,556**
Liabilities					
Due to banks and other financial institutions (Note 20)	170,026,580	21,930,559	184,324	1,140,920	193,282,383
Repurchase agreements (Note 21)	7,722,342	–	–	–	7,722,342
Due to customers (Note 22)	1,435,619,492	125,975,687	4,615,347	7,257,006	1,573,467,532
Borrowed funds (Note 23)	297,262,947	1,363,554	–	–	298,626,501
Other liabilities (Note 24)	7,754,952	231,791	4,467	17,301	8,008,511
	1,918,386,313	**149,501,591**	**4,804,138**	**8,415,227**	**2,081,107,269**
Net position	**168,230,263**	**(10,714,964)**	**23,277**	**11,651,711**	**169,190,287**

Financial assets and financial liabilities by currency	MNT MNT'000	USD MNT'000	Euro MNT'000	Others MNT'000	Total MNT'000
as at 31 December 2016					
Assets					
Cash and balances with BoM (Note 11)	168,659,289	88,752,625	1,129,452	29,876,813	288,418,179
Due from banks and other financial institutions (Note 12)	82,616,952	46,947,884	3,878,799	8,763,332	142,206,967
Reverse repurchase agreement (Note 21)	2,998,768	–	–	–	2,998,768
Loans and advances to customers (Note 14)	1,125,472,110	3,487,038	14,746	21,794	1,128,995,688
Financial investments					
- available-for-sale (Note 15)	312,901,235	114,718,056	–	–	427,619,291
- available-for-sale as collateral in repurchase agreements (Note 15)	7,760,816	–	–	–	7,760,816
Other assets	2,303,993	7,517,144	1,303	16,479	9,838,919
	1,702,713,163	**261,422,747**	**5,024,300**	**38,678,418**	**2,007,838,628**
Liabilities					
Due to banks and other financial institutions (Note 20)	47,153,275	78,625,473	319,275	1,041,375	127,139,398
Repurchase agreements (Note 21)	7,722,342	-	-	-	7,722,342
Derivative financial instruments (Note 13)	6,997	-	-	-	6,997
Due to customers (Note 22)	1,175,865,962	139,680,449	4,434,756	31,636,921	1,351,618,088
Borrowed funds (Note 23)	350,122,625	1,736,500	-	-	351,859,125
Other liabilities (Note 24)	6,377,850	517,368	231,899	63,741	7,190,858
	1,587,249,051	**220,559,790**	**4,985,930**	**32,742,037**	**1,845,536,808**
Net position	**115,464,112**	**40,862,957**	**38,370**	**5,936,381**	**162,301,820**

Operational risk

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

30. FAIR VALUE DISCLOSURES

Determination of fair value and fair value hierarchy

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, and is best evidenced by an active quoted market price. Where quoted market prices are not available, the Bank used valuation techniques.

The following table shows an analysis of financial instruments and other assets 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				
Financial investments - available-for-sale (Note 15)	5,253,299	515,261,023	–	520,514,322
Revalued properties (Note 17)	–	–	62,487,953	62,487,953
Derivative financial instruments (Note 13)	–	282,957	–	282,957
Total	**5,253,299**	**515,543,980**	**62,487,953**	**583,285,232**
Financial liability				
Derivative financial instruments	–	–	–	–
Total	**–**	**–**	**–**	**–**

	Level 1 MNT'000	Level 2 MNT'000	Level 3 MNT'000	Total MNT'000
At 31 December 2016				
Financial assets				
Financial investments - available-for-sale (Note 15)	6,374,165	421,233,921	–	427,608,086
Revalued properties (Note 17)	–	–	61,933,925	61,933,925
Total	**6,374,165**	**421,233,921**	**61,933,925**	**489,542,011**
Санхүүгийн өр төлбөр				
Derivative financial instruments (Note 13)	–	6,997	–	6,997
Total	**–**	**6,997**	**–**	**6,997**

Transfers between level 1, 2 and 3

There were no transfers between level 1, 2 and 3 of the fair value hierarchy for the assets and liabilities which are recorded at fair value.

Movements in fair value measurements within Level 3 during the year are as follows:

Available for sale investments

	2017 MNT'000	2016 MNT'000
At 1 January	11,205	5,326
Purchases	5,390	5,879
Sales	(4,134)	–
At 31 December	**12,461**	**11,205**

Revalued properties

	2017 MNT'000	2016 MNT'000
At 1 January	61,933,925	61,667,477
Additions (Note 17)	2,538,600	2,252,473
Depreciation charged in statement of profit or loss and other comprehensive income (Note 17)	(1,908,940)	(1,986,025)
Disposals (Note 17)	(75,632)	–
At 31 December	**62,487,953**	**61,933,925**

Unquoted available-for-sale investments

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

Revaluation of properties

The fair value of the land and buildings were determined in the last revaluation by using market value approach. This means that valuations performed by the valuer are based on the estimated selling price of similar buildings in the market. The properties' fair values are based on valuations performed by an accredited independent valuer.

If the market price increased/decreased by 2%, the fair value of the properties would be increased/ decreased by MNT 1,249,759 thousand (2016: MNT 1,238,678 thousand).

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:

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

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As at 31 December 2017	Carrying amount MNT'000	Fair value MNT'000
Financial assets		
Loans and advances to customers (Note 14)	1,399,758,870	1,399,758,870
	1,399,758,870	**1,399,758,870**
Financial liabilities		
Borrowed funds (Note 23)	298,626,501	298,626,501
	298,626,501	**298,626,501**
As at 31 December 2016		
Financial assets		
Loans and advances to customers (Note 14)	1,128,995,688	1,128,995,688
	1,128,995,688	**1,128,995,688**
Financial liabilities		
Borrowed funds (Note 23)	336,865,287	336,865,287
	336,865,287	**336,865,287**

31. RELATED PARTY DISCLOSURES

Transactions with key management personnel of the Bank

The aggregate remuneration of directors and members of the Board of Directors during the year, paid by the Bank, was as follows:

	2017 MNT'000	2016 MNT'000
Short-term benefits:		
Salaries and other allowances	1,446,833	1,580,275
Contribution to social and health fund	14,000	46,066
Bonuses and other benefits	194,628	623,634
	1,655,461	**2,249,975**

Transactions with directors and key management

	2017 MNT'000	2016 MNT'000
Loans and advances to key management	482,142	517,788
Deposits from key management	304,638	124,950

Key management have banking relationships with the Bank which are entered into in the normal course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with other persons of a similar standing or, where applicable, with other employees. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

The loans and advances to key management were secured, bore interest rates from 5% to 36% (2016: 6% to 22.8%) per annum and are repayable within 1 to 30 years. The interest income received from such loans during the financial year amounted to MNT 49.66 million (2016: MNT 30.9 million).

The deposits from the key management bore interest rates from 0.6% to 17.8% (2016: 2.0% to 15.6%) per annum. The interest expense paid on the deposits from key management during the financial year amounted to MNT 5.1 million (2016: MNT 2.1 million).

Balances with shareholders

The balances as at 31 December were as follows:

	2017 MNT'000	2016 MNT'000
Borrowed funds (Note 23)	(87,782,454)	(78,069,994)
Subordinated loan (Note 26)	(65,000,000)	(65,000,000)
Deposits and current accounts	(44,969,680)	(65,444,952)
Unquoted government bonds (Note 15)	50,814,053	76,888,050
Quoted government treasury bills (Note 15)	43,181,807	161,140,480
Promissory notes (Note 15)	–	83,005,771

Transactions with shareholders

The principal transactions during the year were as follows:

		2017 MNT'000	2016 MNT'000
Borrowed funds	Proceeds	15,010,091	393,936
	Repayments	5,164,890	4,537,822
Deposits and current accounts	Deposited	1,163,827,008	450,334,887
	Withdrawal	1,184,302,280	393,955,757

The deposits and current accounts bore interest rates from 1.0% to 17.0% per annum. The interest expense recognised during the financial year amounted to MNT 1,194 million (2016: MNT 2,288 million).

The borrowed funds bore interest rates from 2.0% to 8.9% per annum. The interest expense recognised during the financial year amounted to MNT 2,472 million (2016: MNT 3,731 million).

The subordinated loan is interest free, and convertible into 65,000 shares of State Bank at the end of maturity. (See Note 26)

Balances with Bank of Mongolia

The balances as at 31 December were as follows:

	2017 MNT'000	2016 MNT'000
Current accounts with BoM (Note 11)	217,597,406	220,708,767
BoM treasury bills (Note 15)	379,735,030	53,949,013
Repurchase agreements (Note 21)	(7,722,342)	(7,722,342)
Borrowed funds (Note 23)	(91,452,174)	(113,309,917)

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Transactions with Bank of Mongolia

The principal transactions during the year were as follows:

		2017 MNT'000	2016 MNT'000
Current accounts with BoM	Deposited	10,835,529,519	8,849,518,696
	Withdrawal	10,838,640,879	8,874,988,385
Borrowed funds	Proceeds	175,044	109,383,473
	Repayments	22,032,786	51,048,960

The interest income and expense recognized in the transactions with Bank of Mongolia during the financial year amounted to MNT 20,495 million and MNT 4,539 million, respectively (2016: MNT 8,008 million and MNT 3,390 million).

Balances with Other Government Entities

The balances as at 31 December were as follows:

	2017 MNT'000	2016 MNT'000
Due to customers	(199,416,100)	(167,358,930)
Borrowed funds	(82,441,355)	(97,950,601)
Due from banks and other financial institutions	34,404,800	87,433,435
Unquoted bonds available-for-sale as collateral in repurchase agreements	7,760,816	7,760,816
Other assets: Receivables	7,436,601	7,436,601

The Bank recognised an impairment allowance of MNT 7,436,601 thousand on other receivables from related parties as at 31 December 2017 (2016: nil).

Transactions with Other Government Entities

The principal transactions during the year were as follows:

		2017 MNT'000	2016 MNT'000
Due to: Deposit and Current accounts	Deposited	2,528,759,516	4,175,011,351
	Withdrawal	2,496,702,346	4,259,860,336
Due from: Deposit and Current accounts	Deposited	114,203,336	56,079,433
	Withdrawal	167,231,971	146,438,622
Borrowed funds	Proceeds	476,987	85,644,836
	Repayments	15,986,233	10,275,832

The interest income and expense recognized in the transactions with other government entities during the financial year amounted to MNT 3,836 million and MNT 20,924 million, respectively (2016: MNT 19,880 million and MNT 4,141 million).

Terms and conditions of transactions with related parties

The above mentioned outstanding balances arose from the ordinary course of business. 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 provision for doubtful debts relating to amounts owed by related parties.

The Bank utilised the amendment in IAS 24 on 'partial exemption from the disclosure requirement for government-related entities'. Thus, individually immaterial transactions with government-related entities are not disclosed in these financial statements.

32. 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 29.3 'Liquidity risk and funding management' for the Bank's 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 (Note 11)	269,922,019	–	269,922,019
Due from banks and other financial institutions (Note 12)	49,304,129	–	49,304,129
Derivative financial instruments (Note 13)	282,957	–	282,957
Loans and advances to customers (Note 14)	443,509,912	956,248,958	1,399,758,870
Financial investments –			
- available-for-sale (Note 15)	422,929,298	97,597,485	520,526,783
- available-for-sale as collateral in repurchase agreements (Note 15)	7,760,816	–	7,760,816
Other assets (Note 16)	2,741,982	–	2,741,982
	1,196,451,113	**1,053,846,443**	**2,250,297,556**
Non-financial assets			
Other assets (Note 16)	3,780,311	–	3,780,311
Property and equipment (Note 17)	–	82,858,961	82,858,961
Intangible assets (Note 18)	–	1,402,091	1,402,091
	3,780,311	84,261,052	88,041,363
Total	**1,200,231,424**	**1,138,107,495**	**2,338,338,919**
Financial liabilities			
Due to banks and other financial institutions (Note 12)	193,282,383	–	193,282,383
Repurchase agreement (Note 21)	–	7,722,342	7,722,342
Due to customers (Note 22)	1,426,909,310	146,558,222	1,573,467,532
Borrowed funds (Note 23)	61,259,720	237,366,781	298,626,501
Other liabilities (Note 24)	8,008,511	–	8,008,511
Deferred tax liabilities (Note 19)	377,632	–	377,632
	1,689,837,556	**391,647,345**	**2,081,484,901**
Net*	**(489,606,132)**	**746,460,150**	**256,854,018**

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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 (Note 11)	288,418,179	–	288,418,179
Due from banks and other financial institutions (Note 12	141,056,957	1,150,010	142,206,967
Reverse repurchase agreements (Note 21)	2,998,768	–	2,998,768
Loans and advances to customers (Note 14)	384,986,038	744,009,650	1,128,995,688
Financial investments –			
- available-for-sale (Note 15)	207,328,677	220,290,614	427,619,291
- available-for-sale as collateral in repurchase agreements (Note 15)	7,760,816	–	7,760,816
Other assets (Note 16)	2,536,083	7,302,836	9,838,919
	1,035,085,518	**972,753,110**	**2,007,838,628**
Non-financial assets			
Other assets (Note 16)	2,939,640	–	2,939,640
Property and equipment (Note 17)	–	78,914,811	78,914,811
Intangible assets (Note 18)	–	1,962,475	1,962,475
	2,939,640	80,877,286	83,816,926
Total	**1,038,025,158**	**1,053,630,396**	**2,091,655,554**
Financial liabilities			
Due to banks and other financial institutions (Note 12)	127,139,398	–	127,139,398
Repurchase agreement (Note 21)	–	7,722,342	7,722,342
Derivative financial instruments (Note 13)	6,997	–	6,997
Due to customers (Note 22)	1,209,855,527	141,762,561	1,351,618,088
Borrowed funds (Note 23)	146,176,842	205,682,283	351,859,125
Other liabilities (Note 24)	7,190,858	–	7,190,858
Deferred tax liabilities (Note 19)	–	561,859	561,859
	1,490,369,622	**355,729,045**	**1,846,098,667**
Net*	**(452,344,464)**	**697,901,351**	**245,556,887**

* Certain classification of financial assets and liabilities were based on contractual obligations. However, the Bank does 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.

33. CAPITAL ADEQUACY

The adequacy of the Bank's capital is monitored using the rules and ratios established by BoM. During the past year, the Bank complied in full with the capital requirements set by the regulatory body.

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 healthy capital ratios to be able to absorb negative shocks.

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.

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 31 December were as follows:

	2017	**2016**
Core capital adequacy ratio	12.84%	13.50%
Risk-weighted capital ratio	18.61%	20.14%

	2017 MNT'000	**2016 MNT'000**
Tier I capital		
Ordinary shares	113,000,000	113,000,000
Other reserves	693,669	693,669
Retained earnings	63,610,132	50,865,293
Total Tier I Capital	177,303,801	164,558,962
Tier II capital		
Revaluation surplus	10,195,302	10,547,302
Social development fund	956,832	956,832
Available-for-sale reserve	3,398,083	4,493,791
Subordinated loan	65,000,000	65,000,000
Total Tier II Capital	79,550,217	80,997,925
Total capital /capital base	**256,854,018**	**245,556,887**

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

	2017		**2016**	
	Risk		**Risk**	
	Assets	**Weighted**	**Assets**	**Weighted**
%	**MNT'000**	**MNT'000**	**MNT'000**	**MNT'000**
0	813,481,960	–	661,376,123	–
20	6,573,008	1,314,602	45,061,370	9,012,274
50	308,419,217	154,209,608	310,157,997	155,078,999
70	161,435,593	113,004,915	121,730,889	85,211,622
100	1,106,000,089	1,106,000,089	966,823,491	967,348,491
120	4,859,174	5,831,009	1,689,065	2,026,878
150	–	–	244,606	366,909
Total	**2,400,769,041**	**1,380,360,223**	**2,107,083,541**	**1,219,045,173**

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34. EVENTS AFTER THE REPORTING DATE

Management is not aware of other significant events that occurred after the end of the reporting period, which would require adjustment to, or disclosure in, these financial statements.

35. MONGOLIAN TRANSLATION

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

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