ASIAN INFRASTRUCTURE INVESTMENT BANK

AUDITOR'S REPORT AND FINANCIAL STATEMENTS FOR THE PERIOD FROM 16 JANUARY 2016 (DATE OF COMMENCEMENT OF OPERATIONS) TO 31 DECEMBER 2016

羅兵咸永道

Independent Auditor's Report

To the Board of Governors of the Asian Infrastructure Investment Bank:

Opinion

What we have audited

The financial statements of Asian Infrastructure Investment Bank (the "Bank") set out on pages 1 to 42, which comprise:

- the statement of comprehensive income for the period from 16 January 2016 (date of commencement of operations) to 31 December 2016;
- the statement of financial position as at 31 December 2016;
- the statement of changes in equity for the period from 16 January 2016 to 31 December 2016;
- the statement of cash flows for the period from 16 January 2016 to 31 December 2016; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2016, and of its financial performance and its cash flows for the period from 16 January 2016 to 31 December 2016 in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISA"). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report.

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

Independence

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ("IESBA Code"), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

Responsibilities of Management and Board of Directors for the Financial Statements

Management is responsible for the preparation of the financial statements that give a true and fair view in accordance with IFRS, and for such internal control as management determine 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 intend to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

The Board of Directors is responsible for overseeing the Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. We report our opinion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISA 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 ISA, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by 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 auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

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

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

PricewaterhouseCoopers

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 21 March 2017

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FINANCIAL STATEMENTS

ASIAN INFRASTRUCTURE INVESTMENT BANK
Statement of Comprehensive Income
For the period from 16 January 2016 (Date of Commencement of Operations) to 31 December 2016

In thousands of US Dollars	**Note**	**For the period from 16 January 2016 to 31 December 2016**
Interest income	5.1	23,455
Interest expense	5.1	-
Net interest income		**23,455**
Net fee and commission expense	5.2	(70)
Unrealised gain on investment at fair value through profit or loss	5.5	14,873
Impairment provision	5.6	(277)
General and administrative expenses	5.3	(30,658)
Net foreign exchange loss		(26)
Operating profit for the period		**7,297**
Accretion of paid-in capital receivables	5.7	160,063
Net profit for the period		**167,360**
Other comprehensive income		-
Total comprehensive income		**167,360**
Attributable to:		
Equity holders of the Bank		**167,360**

The accompanying notes are an integral part of these financial statements.

ASIAN INFRASTRUCTURE INVESTMENT BANK
Statement of Financial Position
As at 31 December 2016

In thousands of US Dollars	**Note**	**31 December 2016**
Assets		
Cash and cash equivalents	5.4	1,281,992
Term deposits	5.4	2,292,141
Investment at fair value through profit or loss	5.5	3,179,873
Funds deposited for co-financing arrangements		23,623
Loan investments, at amortised cost	5.6	9,553
Paid-in capital receivables	5.7	11,007,227
Other assets	5.8	958
Total assets		**17,795,367**
Liabilities		
Other liabilities	5.9	5,538
Total liabilities		**5,538**
Members' equity		
Paid-in capital	5.10	18,065,400
Reserve for accretion of paid-in capital receivables	5.7	(282,868)
Retained earnings		7,297
Total members' equity		**17,789,829**
Total liabilities and members' equity		**17,795,367**

The accompanying notes are an integral part of these financial statements.

Mr. Jin Liqun
President

Mr. Thierry de Longuemar
Vice President
and Chief Financial Officer

ASIAN INFRASTRUCTURE INVESTMENT BANK
Statement of Changes in Equity
For the period from 16 January 2016 (Date of Commencement of Operations) to 31 December 2016

In thousands of US Dollars	**Note**	**Subscribed capital**	**Less: callable capital**	**Paid-in capital**	**Reserve for accretion of paid-in capital receivables**	**Retained earnings**	**Total equity**
16 January 2016		-	-	-	-	-	-
Capital subscription and contribution	5.10	90,327,000	(72,261,600)	18,065,400	-	-	18,065,400
Net profit for the period		-	-	-	-	167,360	167,360
Paid-in capital receivables - accretion effect	5.7	-	-	-	(442,931)	-	(442,931)
Transfer of accretion	5.12	-	-	-	160,063	(160,063)	-
31 December 2016		**90,327,000**	**(72,261,600)**	**18,065,400**	**(282,868)**	**7,297**	**17,789,829**

The accompanying notes are an integral part of these financial statements.

ASIAN INFRASTRUCTURE INVESTMENT BANK
Statement of Cash Flows
For the period from 16 January 2016 (Date of Commencement of Operations) to 31 December 2016

In thousands of US Dollars	**Note**	**For the period from 16 January 2016 to 31 December 2016**
Cash flows from operating activities		
Net profit for the period		167,360
Adjustments for:		
Interest income from term deposits		(17,141)
Accretion of paid-in capital receivables	5.7	(160,063)
Unrealised gain on investment at fair value through profit or loss	5.5	(14,873)
Impairment provision	5.6	277
Increase in loan disbursements	5.6	(9,830)
Funds deposited for co-financing arrangements		(23,623)
Increase in other assets	5.8	(958)
Increase in other liabilities	5.9	5,538
Net cash used in operating activities		(53,313)
Cash flows from investing activities		
Investment purchases	5.5	(3,165,000)
Increase in term deposits		(2,275,000)
Net cash used in investing activities		(5,440,000)
Cash flows from financing activities		
Capital contributions received	5.10	6,775,305
Net cash from financing activities		6,775,305
Net increase in cash and cash equivalents		1,281,992
Cash and cash equivalents at 16 January 2016		-
Cash and cash equivalents at 31 December 2016	**5.4**	**1,281,992**

The accompanying notes are an integral part of these financial statements.

1 GENERAL INFORMATION

Asian Infrastructure Investment Bank (the "Bank" or the "AIIB") is a multilateral development bank. In June 2015, representatives from 57 countries signed the Articles of Agreement (the "AOA"). The AOA entered into force on 25 December 2015. The Bank commenced operations on 16 January 2016. The principal office of the Bank is located in Beijing, the People's Republic of China (the "PRC").

The Bank seeks to invest in high quality projects that offer infrastructure solutions to improve the social and economic development of its member countries. It works in cooperation with sovereign governments, private financiers and other multilateral development banks to address the growing need for transportation networks, urban development, clean water supplies and low-carbon power within the region.

The legal status, privileges, and immunities for the operation and functioning of the Bank in the PRC are agreed in the AOA and further defined in the Headquarters Agreement between the government of the People's Republic of China (the "Government") and the Bank of 16 January 2016.

These financial statements were signed by the President and the Vice President and Chief Financial Officer on 21 March 2017.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

These financial statements for the Bank have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). According to By-Laws of the AIIB, the financial year of the Bank begins on January 1 and ends on December 31 of each year. For the year in which the Bank commences operations, the financial year begins on the date the Bank commences operations and ends on December 31 of that year. The financial statements for the period from date of commencing operations on 16 January 2016 to 31 December 2016 are the first annual financial statements of the Bank.

The Bank has adopted all of the IFRS standards and interpretations effective for annual periods beginning on 1 January 2016. In addition, the Bank has adopted IFRS 9 *Financial Instruments* (full version issued in July 2014 and mandatorily effective on 1 January 2018), IFRS 15 *Revenue from Contracts with Customers* (mandatorily effective on 1 January 2018), and IFRS 16 *Leases* (mandatorily effective on 1 January 2019) prior to their respective mandatory effective dates.

The financial statements have been prepared under the historical cost convention, except for those financial assets measured at fair value.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgement in its process of applying the Bank's polices. The areas involving a higher degree of judgement or complexity, or areas where judgements or estimates are significant to the financial statements are disclosed in Note 3. The financial statements have been prepared on a going concern basis.

2.2 New accounting pronouncements

Certain amendments to IFRS have been issued but are not mandatory for periods ending on 31 December 2016. The Bank does not expect the adoption of these amendments to have a material impact on the Bank and therefore has not early adopted those amendments. These amendments mainly include:

(i) IFRIC 22 Foreign currency transactions and advance consideration; and
(ii) IAS 7 Amendments disclosure initiative

2.3 Functional currency and foreign currency transactions

The functional currency of the Bank and the presentation currency of the Bank are both United States Dollar ("USD" or "US Dollar").

Foreign currency transactions are initially translated into USD using exchange rates prevailing at the dates of the related transactions. At the end of the reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are recognised in profit or loss during the period in which they arise.

2.4 Financial instruments

2.4.1 Financial assets

The Bank's financial assets are classified into three categories:

(a) Amortised cost,
(b) Fair value through other comprehensive income (FVOCI), or
(c) Fair value through profit or loss (FVPL).

The basis of classification depends on the relevant business model and the contractual cash flow characteristics of the underlying financial asset.

(a) Classification of financial assets at amortised cost

The Bank classifies its financial assets at amortised cost only if both of the following criteria are met:

(i) The financial asset is held within a business model having the objective of collecting the contractual cash flows; and
(ii) The contractual terms give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal outstanding.

The Bank applies the effective interest method to the amortised cost of a financial asset.

(b) Classification of financial assets at FVOCI

Financial assets at FVOCI comprise:

(i) Financial assets having contractual cash flows which reflect solely payments of principal and interest on outstanding principal, and for which the objective of the related business model is achieved both by collecting contractual cash flows and selling financial assets, and
(ii) Investments in equity instruments which are neither held for trading nor contingent consideration, and for which the Bank has made an irrevocable election at initial recognition to recognise changes in fair value through OCI rather than profit or loss.

For (i) above, interest is calculated using the effective interest method and recognised in profit or loss. Except for gains or losses from impairment and foreign exchange, the financial asset is measured at FVOCI. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified to profit or loss.

For (ii) above, investments in equity instruments are required to be measured at FVPL with the irrevocable option at inception to present changes in fair value in OCI, in which case the accumulated fair value changes in OCI will not be reclassified to profit or loss in the future. Dividends on such investments are recognised in profit or loss, unless the dividend clearly represents a recovery of part of the cost of the investment.

(c) Classification of financial assets at FVPL

The Bank classifies the following financial assets at FVPL:

(i) Financial assets that do not qualify for measurement at either amortised cost or FVOCI,
(ii) Financial assets that are designated at initial recognition at FVPL irrevocably, when such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise,
(iii) Investments in equity instruments that are held for trading, and
(iv) Investments in equity instruments for which the entity has not elected to recognise fair value gains and losses through OCI.

2.4.2 Financial liabilities

The Bank's financial liabilities are classified as either financial liabilities through FVPL or other financial liabilities, carried at amortised cost.

(a) Classification of financial liabilities at FVPL

Financial liabilities at FVPL have two subcategories, financial liabilities held for trading and those designated as FVPL on initial recognition. There were no financial liabilities classified as FVPL during the reporting period or as at 31 December 2016.

(b) Other financial liabilities

Other financial liabilities are measured at amortised cost, using the effective interest method. The related interest expenses are recognised in profit or loss.

2.4.3 Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of the Bank after deducting all of its liabilities.

A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. The puttable instrument that includes such an obligation is classified as an equity instrument when meeting all the generally required features being most subordinate class of shares with identical features and all have the same rights on liquidation.

2.4.4 Impairment of financial instruments

Financial assets of the Bank that are measured at amortised cost (Note 2.4.1(a)), FVOCI (Note 2.4.1 (b) (i)) and certain unrecognised financial instruments such as loan commitments are subject to credit loss estimated through an expected credit loss ("ECL") model, assessed on a forward looking basis.

At each reporting date, the Bank assesses whether the credit risk of a financial instrument has increased significantly since initial recognition. When making this assessment, the Bank considers the change in the risk of a default occurring over the expected life of the financial instrument. To make this assessment, the Bank compares the risk of a default occurring as at the reporting date with the risk of a default occurring as at the date of initial recognition, based on reasonable and supportable information that is available without undue cost or effort and is indicative of significant increases in credit risk since initial recognition.

At each reporting date, the Bank measures the loss allowance for a financial instrument at either:

(i) An amount equal to the lifetime ECL if the credit risk related to that financial instrument has increased significantly since initial recognition; or
(ii) An amount equal to a 12-month ECL if the credit risk related to that financial instrument has not increased significantly since initial recognition.

The Bank measures ECL related to a financial instrument in a way that reflects:

(i) An unbiased and probability-weighted amount determined by evaluating a range of possible outcomes;
(ii) The time value of money; and
(iii) Reasonable and supportable information that is available without undue cost or effort at the reporting date regarding relevant past events, current circumstances, and forecasts of future economic conditions.

The Bank identified financial assets as having credit impairment when one or more events that could have a detrimental impact on the estimated future cash flows of that financial asset have occurred.

The Bank recognises the loss allowance of loan commitments as a provision. However, if a financial instrument includes both a loan (i.e. financial asset) and an undrawn commitment (i.e. loan commitment) component and the Bank cannot separately identify the ECL on the loan commitment component from those on the financial asset component, the ECL on the loan commitment is recognised together with the loss allowance for the financial asset. To the extent that the combined ECL exceed the gross carrying amount of the financial asset, the ECL is recognised as a provision.

2.4.5 Determination of fair value

Fair value 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.

For financial instruments traded in active markets, the determination of fair values of financial assets and financial liabilities is based on quoted market prices.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, pricing service, or regulatory agency; and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive.

For financial instruments not traded in active markets, fair value is determined using appropriate valuation techniques. Valuation techniques include the use of recent transaction prices, discounted cash flow analysis, option pricing models and others commonly used by market participants. These valuation techniques include the use of observable and/or unobservable inputs.

2.4.6 Recognition and derecognition

The Bank recognises a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument.

At initial recognition, the Bank measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Before evaluating whether, and to what extent, derecognition is appropriate, the Bank determines whether the derecognition analysis should be applied to a part of a financial asset or a financial asset in its entirely. The Bank derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and has not retained control of the transferred asset, the Bank derecognises the financial asset and recognises separately as assets or liabilities any rights and obligations created or retained in the transfer.

Upon derecognition of a financial asset in its entirety, the difference between the carrying amount of the asset and the sum of the consideration received and receivable and, where applicable, the cumulative gain or loss that had been recognised in other comprehensive income is reclassified to profit or loss, except for those investments in equity instruments designated as FVOCI.

Financial liabilities are derecognised when the related obligation is discharged, is cancelled or expires. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in the profit or loss.

2.5 Property improvements

Property improvements are stated at cost less accumulated depreciation. Depreciation is calculated on a straight line basis to write down the cost of each asset to its residual value over its estimated useful economic life. Property improvements are depreciated over a useful economic life of 3 years.

2.6 Cash and cash equivalents

Cash and cash equivalents are items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Deposits with a maturity of three months or less are classified as cash and cash equivalents.

2.7 Revenue

2.7.1 Interest income

Interest income is calculated using the effective interest method. In this regard, the effective interest rate is applied to the gross carrying amount of a financial asset except for:

(i) financial assets purchased or originated with credit impairment, for which the credit adjusted effective interest rate is applied to the amortised cost of the financial asset from initial recognition; and
(ii) financial assets with credit impairment that has been recognised subsequent to initial recognition, for which the original effective interest rate is applied to the net carrying value in subsequent reporting periods.

With respect to (ii) above, in subsequent reporting periods, interest income is calculated by applying the effective interest rate to the gross carrying amount if the credit risk of the financial asset improves so that it is no longer credit impaired and the improvement can be related objectively to an event.

2.7.2 Front-end and commitment fees

Front-end fees received by the Bank relating to the origination or acquisition of a financial asset are an integral part of generating an involvement with the resulting financial instrument and, accordingly, are an integral part of the effective interest rate of that financial instrument.

Commitment fees received by the Bank to originate a loan when the loan commitment is not measured at FVPL are treated as follows:

(i) if it is probable that the Bank will enter into a specific lending arrangement and is an integral part of the effective interest rate of a financial instrument, and the commitment expires without the Bank making the loan, the fee is recognised as revenue at expiration of the commitment.
(ii) if it is likely that a specific lending arrangement will not be entered into, and is not an integral part of the effective interest rate of the financial instrument, the fee is accounted for as revenue over the commitment period.

2.7.3 Administration fees

Administration fees are recognised as revenue throughout the period that the services are rendered.

2.8 Employee benefits

Employee benefits represent consideration given, and are expenditures incurred by the Bank, in exchange for services rendered by employees or for termination of employment contracts. These benefits include short-term employee benefits and contributions to defined contribution plans.

Short-term employee benefits

During the reporting period in which an employee has rendered services, the Bank recognises the short-term employee benefits payable for those services as a liability with a corresponding increase in the related expense. Short-term employee benefits include salaries, pre-retirement medical insurance, life insurance, accidental death and disability provision, death grant, sick leave, travel accident coverage, long-term disability, multipurpose loans to staff as well as a special allowance for staff recruited globally.

Defined contribution plans

A defined contribution plan is a pension plan under which the Bank pays fixed contributions into a separate entity. The Bank has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay any employees the benefits relating to employee service earned in any current and prior period. When an employee has rendered service to the Bank during a period, it recognises a contribution payable to a defined contribution plan in exchange for that service, along with the related expense. Defined contribution plans include defined contribution pension plans and post-retirement medical benefit plans.

2.9 Leases

A lease contract is one which conveys the right to control the use of an asset for a specified period of time. The lease liability is measured as the present value of the payments that are not paid at the date of recognition discounted at the leases' implicit interest rate. The right of use asset is measured at cost, consisting of the lease liability plus any payments made before the commencement of lease and less any lease incentives.

2.10 Dividend

Dividend distributions to the Bank's shareholders are recognised as a liability in the period in which the dividends are approved by the Board of Governors.

2.11 Current and non-current presentation

The Bank presents its assets and liabilities in the order of liquidity as this provides more relevant information.

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions that affect the amounts recognised in the financial statements, and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

3.1 Impairment losses on financial instruments

The measurement of the ECL allowance for financial assets measured at amortised cost requires extensive financial modelling and significant assumptions about future economic conditions and credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses).

A number of significant judgements are also required in measuring ECL, which include:

- Determining criteria for significant increase in credit risk and definition of default;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and probability of forward-looking scenarios for each type of product; and
- Assigning exposures through an internal credit grading process.

Details of the inputs, assumptions, and estimation techniques used in measuring ECL are further disclosed in Note 5.13(c), which also presents sensitivities of the ECL.

3.2 Measurement of fair value

Paid-in capital receivables are initially measured at fair value. The Bank is required to use valuation techniques to determine the fair value as at the reporting date. The Bank made judgements about the expected timing of future cash flows and the appropriate discount rate to apply. If the interest rate were changed +/-1 basic point ("bps"), the fair value of the capital receivables would have decreased/increased by approximately USD 3 million.

3.3 Structured entity consolidation

The Bank manages the AIIB's Project Preparation Special Fund (the "Special Fund"), and has made a judgement on whether or not, for accounting purposes, it is the principal or an agent, to assess whether the Bank controls the Special Fund and should consolidate it. The Bank identified the Special Fund's assets as a "silo" when conducting its consolidation assessment. When performing this assessment, the Bank considered several factors including, among other things, the scope of its decision-making authority over the structured entity, the rights held by other parties, the remuneration to which it is entitled in accordance with the related agreements for the asset management services, the Bank's exposure to variability of returns from other interests that it holds in the structured entity. The Bank is not exposed to any significant variability in its returns and as such was deemed to not control the Special Fund. The Bank performs re-assessment periodically.

Detailed information about the unconsolidated structured entity is set out in Note 5.15.

4 TAXATION

In accordance with Article 51 of the AOA, within the scope of its official activities, the Bank, its assets, property, income, and its operations and transactions, shall be exempt from all taxation and from all custom duties in its member countries. Article 51 also exempts the Bank from any obligation for the payment, withholding, or collection of any tax or duty.

(All amounts in thousands of US Dollars unless otherwise stated)

5 NOTES TO THE FINANCIAL STATEMENTS

5.1 Interest income and expense

For the period from 16 January 2016 to 31 December 2016, interest income and expense are as follows:

Interest income	
Loan investments (1)	6
Cash and deposits	23,449
Total interest income	**23,455**
Interest expense	-
Total interest expense	-
Net interest income	**23,455**

(1) Interest income for loan investments includes amortisation of front-end fees, commitment fees and other incremental and directly related costs in relation to loan origination that are an integral part of the effective interest rate of those loans.

5.2 Net fee and commission expense

For the period from 16 January 2016 to 31 December 2016, net fee and commission expense is comprised of:

Administration fee (Note 5.15)	100
Total fee and commission income	**100**
Co-financing service fee accrued for the period	(170)
Total fee and commission expense	**(170)**
Net fee and commission expense	**(70)**

(All amounts in thousands of US Dollars unless otherwise stated)

5.3 General and administrative expenses

For the period from 16 January 2016 to 31 December 2016, general and administrative expenses are as follows:

Staff costs (1)	12,226
Professional service expenses	6,729
Facilities and administration expenses	4,553
IT equipment and services	3,170
Travelling expenses	2,102
Auditor's remuneration	455
Others	1,423
Total general and administrative expenses	**30,658**

(1) Staff costs

Staff costs for the period from 16 January 2016 to 31 December 2016 include the following:

Short-term employee benefits	10,826
Defined contribution pension plans	1,391
Others	9
Total	**12,226**

Refer to Note 5.16 for details of key management remuneration.

(All amounts in thousands of US Dollars unless otherwise stated)

5.4 Cash and deposits with banks

	31 December 2016
Cash	-
Deposits with banks	
- Demand deposits	4,488
- Term deposits	3,569,645
Total Cash and deposits with banks	**3,574,133**
Less: term deposits with maturity more than 3 months (1)	(2,292,141)
Total Cash and cash equivalents	**1,281,992**

(1) Term deposits with maturity more than 3 months have maturities ranging from 3 months to 24 months.

5.5 Investment at fair value through profit or loss

The Bank places funds with an external counterparty in a trust fund account (the "Trust Fund"), which, in accordance with the related Administrative Agreement between the Bank and the counterparty, reinvests the funds in a larger collective pool of investments (the "Pool") in accordance with the investment mandate for the entire Pool. Notional allocations within the Pool are made, subject to the Investment Framework agreement between the Bank and the counterparty, to create a model portfolio exposure, as the basis for determining the fair value of the Trust Fund. The Bank classifies this investment as a single unit of account measured at fair value through profit and loss. Fees charged for the administration of the Trust Fund are comprised of a flat fee based upon average assets under management and full-cost recovery of the counterparty's staff costs, related benefits and allocated overhead related to administering the Pool.

The counterparty does not guarantee any investment return or the principal amount deposited. The Trust Fund reports its notional allocation in the Pool as one class of financial assets.

The initial investment as at 31 December 2016 was USD 3,165 million. The fair value gain on this investment during the period from 16 January 2016 to 31 December 2016 was USD 14.87 million.

5.6 Loan investments, loan commitments and related ECL allowance

	31 December 2016		
	Gross carrying amount	Less: ECL allowance	Net carrying amount
Sovereign loans	9,830	(277)	9,553

The ECL allowance is calculated on the basis of committed and disbursed loan amounts as at 31 December 2016. Total loan commitments as at 31 December 2016 were USD 334 million. Additional information about the loan investments, loan commitments and the related ECL is included in Note 5.13 on financial risk management.

(All amounts in thousands of US Dollars unless otherwise stated)

5.7 Paid-in capital receivables

According to the AOA, payments for paid-in capital (refer to Note 5.10) are due in five instalments, with the exception of members designated as less developed countries, who may pay in ten instalments. Paid-in capital receivables represent amounts due from members in respect of paid-in capital. These amounts are initially recognised at fair value and subsequently measured at amortised costs. The fair value discount is accreted through income using the effective interest rate method. In the period from 16 January 2016 to 31 December 2016, a total discount of USD 443 million was debited into reserve, among which USD 160 million has been accreted through income in the current period. As at 31 December 2016, paid-in capital receivables, at amortised cost, are listed as follows:

Members	**Paid-in capital receivables at amortised cost as at 31 December 2016**
Australia	430,896
Austria	58,488
Azerbaijan	39,999
Bangladesh	98,609
Brunei Darussalam	6,129
Cambodia	9,359
China	3,479,854
Denmark	44,043
Egypt	102,081
Finland	48,753
France	395,954
Georgia	6,310
Germany	523,473
Iceland	2,052
India	979,699
Indonesia	394,036
Israel	58,368
Italy	301,572
Jordan	13,892
Kazakhstan	114,798
Korea	436,442
Kyrgyz Republic	4,153
Lao PDR	6,424
Luxembourg	8,106
Maldives	1,031
Malta	1,580
Mongolia	4,791
Myanmar	38,995
Nepal	12,063
Netherlands	120,420
New Zealand	53,876
Norway	86,287
Oman	30,320
Pakistan	162,072

(All amounts in thousands of US Dollars unless otherwise stated)

Members	**Paid-in capital receivables at amortised cost as at 31 December 2016**
Philippines	192,537
Poland	97,622
Qatar	71,024
Russia	763,574
Saudi Arabia	299,384
Singapore	29,186
Sri Lanka	42,232
Sweden	98,908
Switzerland	110,959
Tajikistan	5,251
Thailand	167,149
Turkey	306,373
United Arab Emirates	139,159
United Kingdom	478,770
Uzbekistan	25,714
Vietnam	104,460
Total paid-in capital receivables	**11,007,227**

As at 31 December 2016, the contractual undiscounted paid-in capital receivables overdue amounted to USD 433.80 million (Note 5.10), because of an administrative delay but not considered as impaired. Of this amount, USD 433.18 million was collected by the date of the approval of the financial statements (Note 5.17).

As at 31 December 2016, USD 3,856 million of the above balance is due within 12 months from the reporting date.

5.8 Other Assets

	31 December 2016
Prepaid co-financing service fee	175
Property improvements	168
Others	615
Total other assets	**958**

5.9 Other liabilities

	31 December 2016
Staff costs payable	436
Accrued expenses	5,102
Total other liabilities	**5,538**

(All amounts in thousands of US Dollars unless otherwise stated)

5.10 Share capital

	31 December 2016
Authorized capital	100,000,000
– Allocated	
- Subscribed	90,327,000
- Unsubscribed	7,824,400
– Unallocated	1,848,600
Total authorized capital	100,000,000
Subscribed capital	90,327,000
Less: callable capital	(72,261,600)
Paid-in capital	18,065,400
Paid-in capital comprises:	
– amounts received	6,775,305
– amounts due but not yet received	433,795
– amounts not yet due	10,856,300
Total paid-in capital	**18,065,400**

In accordance with Articles 4 and 5 of the AOA, the initial authorized capital stock of the Bank is USD 100 billion, divided into 1,000,000 shares, which shall be available for subscription only by members.

The original authorized capital stock is divided into paid-in shares and callable shares, with paid-in shares having an aggregate par value of USD 20 billion and callable shares having an aggregate par value of USD 80 billion.

Payment of the amount subscribed to the callable capital stock of the Bank shall be subject to call only as and when required by the Bank to meet its liabilities. Calls on unpaid subscriptions shall be uniform in percentage on all callable shares.

In accordance with Article 37 of the AOA, any member may withdraw from the Bank at any time by delivering a notice in writing to the Bank at its principal office. A withdrawing member remains liable for all direct and contingent obligations to the Bank to which it was subject at the date of delivery of the withdrawal notice. At the time a country ceases to be a member, the Bank shall arrange for the repurchase of such country's shares by the Bank as a part of the settlement of accounts with such country. For this purpose, the repurchase price of the shares shall be the value shown on the books of the Bank on the date the country ceases to be a member.

(All amounts in thousands of US Dollars unless otherwise stated)

	Total shares	Subscribed capital	Callable capital	Paid-in capital	Paid-in capital received	Paid-in capital not yet received
Members						
Australia	36,912	3,691,200	2,953,000	738,200	295,280	442,920
Austria	5,008	500,800	400,600	100,200	40,080	60,120
Azerbaijan	2,541	254,100	203,300	50,800	10,164	40,636
Bangladesh	6,605	660,500	528,400	132,100	26,420	105,680
Brunei Darussalam	524	52,400	41,900	10,500	4,200	6,300
Cambodia	623	62,300	49,800	12,500	2,500	10,000
China	297,804	29,780,400	23,824,300	5,956,100	2,382,440	3,573,660
Denmark	3,695	369,500	295,600	73,900	28,890	45,010
Egypt	6,505	650,500	520,400	130,100	26,020	104,080
Finland	3,103	310,300	248,200	62,100	12,420	49,680
France	33,756	3,375,600	2,700,500	675,100	270,040	405,060
Georgia	539	53,900	43,100	10,800	4,320	6,480
Germany	44,842	4,484,200	3,587,400	896,800	358,720	538,080
Iceland	176	17,600	14,100	3,500	1,400	2,100
India	83,673	8,367,300	6,693,800	1,673,500	669,400	1,004,100
Indonesia	33,607	3,360,700	2,688,600	672,100	268,840	403,260
Israel	7,499	749,900	599,900	150,000	90,000	60,000
Italy	25,718	2,571,800	2,057,400	514,400	205,760	308,640
Jordan	1,192	119,200	95,400	23,800	9,520	14,280
Kazakhstan	7,293	729,300	583,400	145,900	29,180	116,720
Korea	37,387	3,738,700	2,991,000	747,700	299,080	448,620
Kyrgyz Republic	268	26,800	21,400	5,400	991	4,409
Lao PDR	430	43,000	34,400	8,600	1,720	6,880
Luxembourg	697	69,700	55,800	13,900	5,560	8,340
Maldives	72	7,200	5,800	1,400	280	1,120
Malta	136	13,600	10,900	2,700	1,080	1,620
Mongolia	411	41,100	32,900	8,200	3,280	4,920
Myanmar	2,645	264,500	211,600	52,900	10,580	42,320
Nepal	809	80,900	64,700	16,200	3,240	12,960
Netherlands	10,313	1,031,300	825,000	206,300	82,520	123,780
New Zealand	4,615	461,500	369,200	92,300	36,920	55,380
Norway	5,506	550,600	440,500	110,100	22,020	88,080
Oman	2,592	259,200	207,400	51,800	20,720	31,080
Pakistan	10,341	1,034,100	827,300	206,800	41,360	165,440
Philippines	9,791	979,100	783,300	195,800	-	195,800
Poland	8,318	831,800	665,400	166,400	66,560	99,840
Qatar	6,044	604,400	483,500	120,900	48,360	72,540
Russia	65,362	6,536,200	5,229,000	1,307,200	522,880	784,320
Saudi Arabia	25,446	2,544,600	2,035,700	508,900	203,560	305,340
Singapore	2,500	250,000	200,000	50,000	20,000	30,000
Sri Lanka	2,690	269,000	215,200	53,800	10,760	43,040

(All amounts in thousands of US Dollars unless otherwise stated)

Members	Total shares	Subscribed capital	Callable capital	Paid-in capital	Paid-in capital received	Paid-in capital not yet received
Sweden	6,300	630,000	504,000	126,000	25,200	100,800
Switzerland	7,064	706,400	565,100	141,300	28,260	113,040
Tajikistan	309	30,900	24,700	6,200	620	5,580
Thailand	14,275	1,427,500	1,142,000	285,500	114,200	171,300
Turkey	26,099	2,609,900	2,087,900	522,000	208,800	313,200
United Arab Emirates	11,857	1,185,700	948,600	237,100	94,840	142,260
United Kingdom	30,547	3,054,700	2,443,800	610,900	122,180	488,720
Uzbekistan	2,198	219,800	175,800	44,000	17,600	26,400
Vietnam	6,633	663,300	530,600	132,700	26,540	106,160
Total	**903,270**	**90,327,000**	**72,261,600**	**18,065,400**	**6,775,305**	**11,290,095**

5.11 Reserves

Based on Article 18.1 of the AOA, the Board of Governors shall determine at least annually what part of the net income of the Bank shall be allocated, after making provision for reserves, to retained earnings or other purposes and what part, if any, shall be distributed to the members.

5.12 Distribution

Distributable retained earnings as at 31 December 2016 were USD 7.3 million. As at 31 December 2016, USD 160 million of retained earnings has been transferred to reserve for accretion of the paid-in capital receivables.

No dividends were declared during the reporting period.

5.13 Financial risk management

(a) Overview

The Bank adopts a proactive and comprehensive approach to risk management that is instrumental to the Bank's financial viability and success in achieving its mandate. The ability to identify, mitigate, and manage risk begins with the Bank's policies established with a strong risk culture. In addition to establishing appropriate risk parameters, a thorough robust project review and monitoring process, the risk management function provides independent oversight of credit, market, liquidity, operational, and associated reputational risk in the Bank's activities. It is also designed to integrate asset and liability management.

(b) Financial risk management framework

The Bank has established its risk appetite, risk management objectives and strategies in its Risk Limits Policy, and its Risk Management Framework (the "RMF"). Within this RMF, the Risk Management Department is responsible for monitoring financial risks with the oversight of the Risk Committee.

The Risk Committee is responsible for establishing the overall risk appetite of the Bank and reviewing and approving the risk management objectives and strategies. The Risk Committee monitors the integrated risk processes, on a cross-sector and cross-category basis for the Bank. The Board approves key risk policies as recommended by the President and the Executive Committee.

The Risk Management Department has overall responsibility for managing all aspects of risks, including implementing risk management strategies, initiatives and credit policies, and approving internal policies, measures and procedures related to risk management.

(b) Financial risk management framework

(i) Investment operations portfolio

At the project level, the Bank employs experienced employees with project finance skills and credit risk training in order to identify, invest in, and monitor commercially sound projects with positive economic impacts.

An investment committee of senior managers review the credit quality and merits of proposed individual projects in line with the Bank's policies and procedures. In order to make its recommendations, such committee is provided by the relevant departments with assessments specific to their area, including risk, legal, finance, strategy, environmental and social aspects, and procurement.

Accountabilities at different stages of the credit risk/project approval process are delineated and regularly updated by the Bank's management.

(ii) Treasury portfolio

The treasury portfolio includes deposits with banks and the investments in the Trust Fund.

According to the Bank's General Investment Authority, the Bank can make investments in the assets specified in a list of eligible assets, including deposits and certain money market funds that invest in high credit quality securities.

With respect to the Trust Fund described in Note 5.5, the Trust Fund's assets consist of its notionally allocated share of cash and investments in the Pool. The Pool is actively managed and invested in accordance with the investment strategy established for all such kind of Trust Funds administered by the counterparty. The objectives of the investment strategy is foremost to maintaining adequate liquidity to meet foreseeable cash flow needs and preserve capital and then, to maximize investment returns. The Pool is exposed to credit, market and liquidity risks.

(c) Credit risk

Credit risk management

The Bank takes on exposure to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of the Bank's lending and other transactions with counterparties giving rise to financial assets and loan commitments.

(c) Credit risk

The Bank is primarily exposed to credit risk in both its loan granting of bank activities and deposit placing of the treasury activities. The counterparties could default on their contractual obligations or the value of the Bank's investments could become impaired. The Bank's maximum exposure to credit risk from financial instruments before taking into account any collateral held or other credit enhancements is their carrying amount presented on the statement of financial position. The maximum exposure to credit risk from the undrawn loan commitments is USD 334 million. As at 31 December 2016, no collateral or other credit enhancements are held for the financial assets and loan commitments.

(i) Credit risk in the investment operations portfolio

- Sovereign-backed infrastructure loans

Sovereign-backed infrastructure loans are the obligation of a member country as borrower or guarantor. The Bank's credit decisions are based on assessments of the borrower's or guarantor's capacity to service the loan. These assessments are undertaken in accordance with the relevant operational policies. Specifically, the Bank performs its own sovereign credit analysis and assigns its own internal sovereign credit rating. When making these assessments, the Bank gives particular consideration to the International Monetary Fund/World Bank debt sustainability analyses and will utilize, where appropriate, country and macroeconomic reporting by multilateral development banks ("MDBs"), commercial banks, and "think tanks". The appraisal of sovereign-backed loans takes into account, as appropriate, a full assessment of the project's benefits and risks. The Bank's internal rating has 12 notches, with rating 1-4 for investment grade.

As an international financial institution, the Bank does not participate in country debt rescheduling or debt reduction exercises of sovereign-backed loans or guarantees.

When a borrower fails to make payment on any principal, interest, or other charge due to the Bank, the Bank may suspend disbursements immediately on all loans to that borrower. The conditions for suspension of sovereign loans are presented in more detail in the Bank's operational policies. Under its operational policies, the Bank would cease making new sovereign-backed loans to the borrower once any loans are overdue by more than 30 days and suspend all disbursements to or guaranteed by the member concerned once any loans are overdue by more than 60 days.

(c) Credit risk

- Non-sovereign-backed infrastructure loans

The Bank provides private enterprises and state-owned or state-controlled enterprises with loans that do not have a full member guarantee. However, the Bank retains the right, when it deems it advisable, to require a full or partial sovereign guarantee.

The Bank assigns an internal credit rating taking into account specific project, sector, macro, and country credit risks.

As at 31 December 2016, all the loans and loan commitments originated by the Bank are sovereign-backed infrastructure loans.

(ii) Credit risk in the treasury portfolio

Treasury activities and risk appetite are monitored by the Risk Committee and Board of Directors. The Bank has a limits policy which determines the maximum exposure to eligible counterparties and instruments. Eligible counterparties must have a single A credit rating or higher. All individual counterparty and investment credit lines are monitored and reviewed by Risk Management periodically.

As at 31 December 2016, the treasury portfolio includes term deposits with banks and investment in Trust Fund described in Note 5.5. As the Trust Fund is not subject to significant credit risk, the credit risk of the treasury portfolio is mainly from the term deposits. Given the high credit quality and its immaterial ECL, no loss provisions are assigned for the investments in the treasury portfolio for the period ended 31 December 2016.

(All amounts in thousands of US Dollars unless otherwise stated)

(c) Credit risk

Credit quality analysis

Except for loan investments, other financial assets at amortised cost are paid-in capital receivables and deposits with banks, for which credit risk is not significant.

The following table sets out information about the credit quality of loan investments and loan commitments issued as at 31 December 2016.

Loan investments at amortised cost and undrawn portion of the same loan contracts	**31 December 2016**
Gross carrying amount of loan investments	9,830
Credit exposure for loan commitments of the undrawn portion	334,305
12 month ECL	(277)
Carrying amount	**343,858**

Included above, the credit exposure from both loan investments and loan commitments of USD 216 million are rated as investment grade according to the Bank's internal rating methodology.

As at 31 December 2016, all the loan investments and loan commitments are issued to borrowers in Asia.

Loss allowance reconciliation

	Gross carrying amount	12 month ECL
As at the 16 January 2016	-	-
Loan investments originated	9,830	(32)
Loan commitments originated	334,305	(245)
As at 31 December 2016	**344,135**	**(277)**

(c) Credit risk

ECL measurement

The Bank adopts an ECL 'three-stage' model for applicable financial instruments. A 'three-stage' model for impairment is based on changes in credit quality since initial recognition:

- A financial instrument that is not credit-impaired on origination is classified in 'Stage 1', and has its credit risk continuously monitored by the Bank;
- If a significant increase in credit risk ("SICR") since initial recognition is defined, the financial instrument is moved to 'Stage 2', but is not yet deemed to be credit-impaired;
- If the financial instrument is deemed to be in credit-impaired, the financial instrument is then moved to 'Stage 3'.

The Bank's main credit risk exposure is from loan investments and loan commitments, and the credit risk of other financial assets is not significant.

The following reflects the Bank's ECL measurement focus on loan investments and loan commitments. Given the nature of AIIB's business (large infrastructure loans), all the instruments are assessed on an individual basis.

The key judgements and assumptions adopted by the Bank are discussed below:

(i) Significant increase in credit risk

The Bank considers a financial instrument to have experienced SICR when one or more of the following quantitative, qualitative or backstop criteria have been met:

- Quantitative criteria:

Deterioration in credit rating is used as the quantitative criteria of SICR:

- For Investment grade loans, rating downgrade by 2 notches compared with rating at origination
- For Non-investment grade loans, rating downgrade by 1 notch compared with rating at origination

All loan investments and loan commitments included in the Bank's banking book initially are rated at origination using internal rating methodology. The methodology used to rate the level of credit risk of these individual loans depends on the type of loan. For sovereign loans, a sovereign loan creditworthiness assessment methodology is used, with the Rating provided by Economist Investigation Unit (the "EIU") and Standard & Poor's (the "S&P") with adjustments based on historical data from peer banks. For non-sovereign loans, the loan may be rated using the Project Finance Rating tool provided by S&P for project finance type loans. These initial ratings are used to estimate the Stage 1 - 12-month ECL at each reporting date to determine the SICR since origination.

(c) Credit risk

- Qualitative criteria:

In addition to the quantitative criteria, the following qualitative elements will also contribute to a determination that the loan should migrate to Stage 2:

- Adverse changes in business, financial or economic conditions;
- Expected breach of contract that may lead to covenant waivers or amendments;
- Transfer to watchlist/monitoring;
- Change in payment behaviour.

- Backstop:

  - 30 days past due.

(ii) Definition of credit-impaired assets

Credit-impaired assets, which migrate to Stage 3, are those with respect to which one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired include observable data about the following events:

- significant financial difficulty of the issuer or the borrower;
- a breach of contract, such as a default or past due event;
- the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

It may not be possible to identify a single discrete event—instead, the combined effect of several events may have caused financial assets to become credit-impaired.

(c) Credit risk

(iii) Measurement of the 12-month and lifetime ECL

- Estimation of 12-month ECL:

  - Point-in-time Probability of Default (PIT PD) is converted from Through-The-Cycle (TTC) PD using the Vasicek Merton formula, based on calculation of cycle factor/state of economy for 3 scenarios (Base, Good, Bad) and mapped to AIIB ratings.
  - Loss Given Default (LGD) at present is 30% for sovereign and 70% for non-sovereign, based on management's estimates established on the analysis of market data statistics and related judgement.
  - Exposure at Default (EAD) is calculated as Current exposure + projected disbursement in the next 1 year.
  - 12-month ECL = PIT PD * LGD * EAD
  - The above calculation is performed for each of the three scenarios and then probability weighted. The weight of the 3 scenarios are 50%:25%:25% (Base, Good and Bad). The estimation is based on the best representative management judgement without undue cost or effort that, going forward the current path of macroeconomic projections with equal chance of being significantly worse (Bad scenario) or better (Good scenario), considering the projections of macroeconomics of those countries that the Bank has credit exposure.

(c) Credit risk

- Estimation of lifetime ECL

  - PIT PD
    - Unconditioned PD term structure is based on the S&P or EIU default rate data by year end rating grade and then mapped to AIIB ratings.
    - Conditioned PD term structure is based on PIT PD calculation based on the Vasicek Merton formula for the first 3 years (as in 12-month ECL calculation) and the Through-the-Cycle PD (TTC PD) for the remaining years. Management considers this estimate is in line with the concept of reversing to mean on average (through the cycle).
  - LGD is the same as 12-month ECL calculation.
  - EAD for any given year is based on Current exposure + net projected disbursement in the next 1 year, as by the disbursement schedule for each year. If the above is not available, use linear amortization.
  - Lifetime is equal to contractual lifetime.
  - Lifetime ECL = NPV (PIT PD * LGD * EAD for each year) across the life time of the loan.
  - Discount rate is equal to effective interest rate.
  - In the same way as the 12-month ECL calculation, the above calculation is done for each of the three scenarios and then probability weighted, and the weighting of the 3 scenarios are the same as 12-month ECL calculation.

(c) Credit risk

(iv) Forward-looking information incorporated in ECL

Forward-looking information has been incorporated taking into account the following steps:

- Macro Scenario development
  - 3 Macro Scenarios – Base, Good, Bad. Each scenario is forecasted for 3 years.
  - Choice of macro scenarios and probability weighting of each scenario is approved by the Risk Committee.

- Establishment of TTC PD
  - TTC PD is calculated based on each customer's internal AIIB rating.

- Determining "state of economy"/"Cycle Factor" (CF)
  - State of economy/CF are determined based on a regression based macro model.
  - Regression is calculated based on historic observations of CF and macro-economic factors. Relationships obtained from regression is used to calculate CF given a set of macro-economic scenarios.

- Calculation of PIT PD

  The Bank uses the Vasicek-Merton formula to convert current customer rating (TTC) to PIT PD for a given state of economy/CF.

(c) Credit risk

Sensitivity analysis

The output of the Bank's impairment provisioning model is most sensitive to management's assessment of the credit risk of the sovereign-backed infrastructure loans and loan commitments as expressed by assigning an internal credit rating. Had each exposure been downgraded one notch on the Bank's internal credit rating scale, the impairment provision as at 31 December 2016 would have been approximately USD 1.45 million. Had each exposure been upgraded one notch the impairment provision as at 31 December 2016 would have been approximately USD 0.19 million.

(v) Definition of default

For the ECL measurement, "default" occurs when an obligor meets one or more of the following conditions:

- Failure to make a payment ("payment default") –180 days past due for sovereign-backed infrastructure loans and 90 days past due for non-sovereign-backed infrastructure loans. 180 days past due for sovereign-backed infrastructure loans is based on the consideration for slower administrative, processing and collection periods that are not driven by credit deterioration.
- Breach of specific covenants that trigger a default clause.
- Default under a guarantee or collateral or other support agreements.
- Failure to pay a final judgement or court order.
- Bankruptcy, liquidation, or the appointment of a receiver or any similar official.

(vi) Write off policy

The Bank reduces the gross carrying amount of a financial asset when the Bank has no reasonable expectations of recovering the contractual cash flows on a financial asset in its entirety or a portion thereof.

(All amounts in thousands of US Dollars unless otherwise stated)

(d) Market risk

The Bank is exposed to two major market risks in its investment, lending and other activities: currency risk and interest rate risk. The risks are that movements in exchange rates and interest rates may affect the financial positions taken by the Bank and, as a result, impact the Bank's net profit and equity.

In its asset and liability management process, the Bank pursues three goals: (a) reducing risks that might arise from the mismatch of assets and liabilities in terms of currency, interest rate sensitivity, or maturity; (b) monitoring the evolving risks to the Bank's income over time and establishing a framework that reduces the potential volatility of the Bank's income over the medium term; and (c) assigning clear responsibility for all market risks to which the Bank is exposed.

Currency risk

The Bank currently only offers loans in US Dollars. This will continue to be the case until the Bank is prepared to hedge non-dollar lending through swaps or other hedging mechanisms. As at 31 December 2016, the currency risk is not material for the Bank. Currency table for the main monetary items is listed as below:

	USD	Other currencies USD equivalent	Total
Financial assets			
Cash and cash equivalents	1,281,832	160	1,281,992
Term deposits	2,292,141	-	2,292,141
Investment at fair value through profit or loss	3,179,873	-	3,179,873
Funds deposited for co-financing arrangements	23,623	-	23,623
Loan investments, at amortised cost	9,553	-	9,553
Paid-in capital receivables	11,007,227	-	11,007,227
	17,794,249	**160**	**17,794,409**

(d) Market risk

Interest rate risk

The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes, but may reduce or create losses in the event that unexpected movements arise.

Sensitivity analysis

As the Bank has no material financial liabilities at 31 December 2016, the following table illustrates the potential impact for the current period, of a parallel upward or downward shift of 50 basis points in relevant interest rate curves on the Bank's interest income from the floating rate loan investments measured at amortised cost, based on the Bank's loan investments at the end of the reporting period. This analysis assumes that interest rates of all maturities move by the same amount, and does not reflect the potential impact of unparalleled yield curve movements.

The sensitivity analysis on net interest income is based on reasonably possible changes in interest rates over the next twelve months from the reporting date with the assumption that the structure of financial assets held at the period end remains unchanged.

	Interest income
+50 basis points	3
-50 basis points	(3)

(e) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. As at 31 December 2016, the Bank does not have any significant financial liabilities.

(f) Operational risk

Consistent with guidance issued by the Basel Committee on Banking Supervision, operational risk is defined as risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Effective management and mitigation of operational risk relies on a system of internal controls aimed at identifying various risks, and establishing acceptable risk parameters and monitoring procedures.

The Bank adopts the Basic Indicator Approach (as recommended by Basel II) for capital allocation for operational risks, which is set at 15% of the average gross income over the past three years, ignoring those years where income was not positive. For initial years, the Bank allocates capital for operational risk at 1% of its paid-in capital, reserves and retained earnings.

(g) Capital management

The Bank collectively manages the paid-in capital plus reserves and retained earnings as capital. To ensure that the Bank has the highest possible credit on a stand-alone basis at all times, two relevant limits are relevant to be always observed. The first, as required by Article 12.1 of the AIIB's AOA, the Bank's total unimpaired subscribed capital, reserves, and retained earnings have to be always greater than the total exposure from its investment operations (i.e. loans, equity investments, guarantees and other types of financing). This limit may be increased up to 250% of the Bank's unimpaired subscribed capital, reserves, and retained earnings with the approval of the Board of Governors. The second, using an economic capital framework, the Bank's available capital must be greater than the required economic capital given the composition of its investment assets by credit risk rating plus a certain amount of buffer. The amount of buffer will be based on the outcome of the stress testing exercise on AIIB's portfolio based on scenarios chosen by the Risk Committee and benchmark comparison of additional buffer to MDBs and private sector banks, which typically ranges between 25% and 75% of the economic capital requirement calculated based on the level of risk and composition of investment asset portfolios. This requirement is evaluated against the requirement for capital as of the then current date as well as for the next three years.

5.14 Fair value disclosures

The majority of the Bank's assets and liabilities in the statement of financial position are financial assets and financial liabilities. Fair value measurement of non-financial assets and non-financial liabilities do not have a material impact on the Bank's financial position and operations, taken as a whole.

The Bank does not have any financial assets or financial liabilities subject to non-recurring fair value measurements for the period ended 31 December 2016.

The fair value of the Bank's financial assets and financial liabilities are determined as follows:

- If traded in active markets, fair values of financial assets and financial liabilities with standard terms and conditions are determined with reference to quoted market bid prices and ask prices, respectively.
- If not traded in active markets, fair values of financial assets and financial liabilities are determined in accordance with generally accepted pricing models or discounted cash flow analysis using prices from observable current market transactions for similar instruments.

Fair value hierarchy

The Bank classifies financial assets and financial liabilities into the following three levels based on the extent to which inputs to valuation techniques used to measure fair value of the financial assets and financial liabilities are observable:

Level 1: fair value measurements are those derived from quoted prices (unadjusted) in an active market for identical assets or liabilities;

Level 2: fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices); and

Level 3: fair value measurements are based on models, and the unobservable inputs are significant to the entire measurement.

(All amounts in thousands of US Dollars unless otherwise stated)

Financial assets and financial liabilities not measured at fair value on the statement of financial position

The tables below summarises the carrying amounts and fair values of those financial assets and financial liabilities not measured in the statement of financial position at their fair value as at 31 December 2016:

	Carrying amount	Fair value
Financial assets		
Cash and cash equivalents	1,281,992	1,281,992
Term deposits	2,292,141	2,291,991
Funds deposited for co-financing arrangements	23,623	23,623
Loan investments, at amortised cost	9,553	9,553
Paid-in capital receivables	11,007,227	10,522,553
Financial liabilities		
Other liabilities	5,538	5,538

As at 31 December 2016, the Bank's balances of those financial assets and liabilities not measured at fair value but with short-term maturity approximate their fair values.

Loan investments and paid-in capital receivables measured at amortised cost were calculated using Level 3 inputs by discounting the cash flows at a current interest rate applicable to each loan and paid-in capital receivables.

Financial assets and financial liabilities measured at fair value on the statement of financial position

The table below summarises the fair values of the financial assets and financial liabilities measured in the statement of financial position at their fair value:

	Level 1	Level 2	Level 3	Total
Investment at fair value through profit or loss	-	3,179,873	-	3,179,873

Investment at fair value through profit or loss are amounts invested in the Trust Fund. Refer to Note 5.5.

The Trust Fund's notionally allocated share in the Pool is not traded in any market. The fair value of the Trust Fund is derived from that of the notionally allocated assets.

There have been no significant transfers among Level 1, Level 2 and Level 3 during the period.

5.15 Unconsolidated structured entity

The Special Fund established and administered by the Bank based on Article 17.1 of the AOA is an unconsolidated structured entity for accounting purposes. The objective of the Special Fund is to support and facilitate the preparation of projects for the benefit of one or more members of the Bank that, at the time when the decision to extend the grant is made by the Bank, are classified as recipients of financing from the International Development Association, including Blend countries; however, the projects that benefit other members may also be eligible for such assistance in exceptional circumstances, such as innovative and complex projects and regional or cross-border projects with significant regional impacts. Consistent with Article 10 of the Bank's AOA, the resources of the Special Fund shall at all times and in all respects be held, used, committed, invested or otherwise disposed of entirely separately from the Bank's ordinary resources.

The resources of the Special Fund consist of: (a) amounts accepted from any member of the Bank, any of its political or administrative sub-divisions, or any entity under the control of the member or such sub-divisions or any other country, entity or person approved by the President may become a contributor to the Special Fund; (b) income derived from investment of the resources of the Special Fund; and (c) funds reimbursed to the Special Fund, if any.

The full cost of administering the Special Fund is charged to that Special Fund. The Bank charges an administration fee equal to 1% of any contribution, and the Special Fund bears all expenses appertaining directly to operations financed from the resources of the Special Fund.

As at 31 December 2016, the Special Fund had aggregate contributions amounting to USD 10 million. The Bank, acting as manager of the Special Fund, receives administration fees and cost recovery fees. For the period from 16 January 2016 to 31 December 2016, total fees amounted to USD 0.1 million.

Administration of the Special Fund does not expose the Bank to any loss. The Bank is not obliged to provide financial support to the Special Fund.

(All amounts in thousands of US Dollars unless otherwise stated)

5.16 Related party transactions

Parties are generally considered to be related if the parties are under common control, or one party has the ability to control the other party or can exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely to the legal form.

As at 31 December 2016, the outstanding balances with related parties were as follows:

	Key management personnel	Other related parties
Assets – loan granted	23	-
Liabilities	-	-

The income and expense items affected by transactions with related parties for the period from 16 January 2016 to 31 December 2016, were as follows:

	Key management personnel	Other related parties
Income	-	100
Expense	-	-

Income from other related parties relates to the Special Fund administration fee (Note 5.15).

Key management personnel

Key management personnel are those persons who have the authority and responsibility to plan, direct, and control the activities of the Bank. Key management personnel of the Bank is defined as the members of the Bank's Executive Committee, that is, in accordance with the Terms of Reference of the Executive Committee, the President, the Vice Presidents and the General Counsel.

During the period from 16 January 2016 to 31 December 2016, other than the loan granted to key management personnel as disclosed above, the Bank had no other material transactions with key management personnel.

The compensation of key management personnel during the period comprises short-term employee benefits of USD 2.12 million and defined contribution pension plans of USD 0.3 million.

Use of office building

In accordance with Article 5 of the Headquarters Agreement, the Government provides a permanent office building and the temporary office accommodation to the Bank, free of charge.

Short-term advance from the Ministry of Finance of the PRC

A non-interest bearing start-up budget loan facility of RMB 53.95 million (USD 8.3 million) to fund the Bank's initial organizational activities was provided by the Ministry of Finance of the PRC. All amounts owed were repaid on 1 April 2016.

5.17 Events after the end of the reporting period

Subsequent to 31 December 2016, USD 433.18 million of paid-in capital receivables that were overdue have been received by the Bank from members.