Accounting Matters and Disclosure and Internal Control

Critical Accounting Estimates

The most significant assets and liabilities for which we must make estimates include: allowance for credit losses; financial instruments measured at fair value; pension and other employee future benefits; impairment of securities; provisions for income taxes and deferred tax assets; goodwill and intangible assets; purchased loans; insurance-related liabilities; and provisions, including legal reserves. We make judgments in assessing whether substantially all risks and rewards have been transferred in respect of transfers of financial assets and whether we control SEs. These judgments are discussed in Notes 6 and 7, respectively, on page 157 of the consolidated financial statements. Note 17 on page 174 of the consolidated financial statements discusses the judgments made in determining the fair value of financial instruments. If actual results were to differ from the estimates we make, the impact would be recorded in future periods. We have established detailed policies and control procedures that are intended to ensure the judgments we make in estimating these amounts are well controlled, independently reviewed and consistently applied from period to period. We believe that our estimates of the fair value of BMO's assets and liabilities are appropriate.

For a more detailed discussion of the use of estimates, please see Note 1 on page 144 of the consolidated financial statements.

Allowance for Credit Losses

The allowance for credit losses (ACL) consists of specific allowances that represent estimated losses related to impaired loans in the portfolio provided for but not yet written off, and collective allowances, which is our best estimate of impairment in the existing portfolio for loans that have not yet been individually identified as impaired. Establishing allowances requires significant judgment regarding key assumptions, including the probability of default, severity of loss, the timing of future cash flows and the valuation of collateral. One of our key performance measures is the provision for credit losses as a percentage of average net loans and acceptances. Over the 10 years prior to 2017, our average annual ratio has ranged from a high of 0.88% in 2009 to a low of 0.19% in 2015. The ratio varies with changes in the economy and credit conditions. To establish a range for the collective allowance, the high and low provision ratios of the past 10 years are applied to year-end net loans and acceptances in 2017. This range, when aggregated with the specific allowance, establishes a range of $1,139 million to $3,752 million. Our provision for credit losses in 2017 was $774 million and our allowance for credit losses at October 31, 2017 was $1,996 million. Additional information on the process and methodology for determining the allowance for credit losses can be found in the discussion of Credit and Counterparty Risk on page 86, as well as in Note 4 on page 152 of the consolidated financial statements.

Financial Instruments Measured at Fair Value

BMO records trading and available-for-sale securities, and derivatives, at their fair value, and certain assets and liabilities are designated under the fair value option. Fair value represents our estimate of the amount we would receive, or would be required to pay in the case of a liability, in a current transaction between willing parties. We employ a fair value hierarchy to categorize the inputs we use in valuation techniques to measure fair value. The extent of our use of quoted market prices (Level 1), internal models using observable market information (Level 2) and internal models without observable market information (Level 3) in the valuation of securities, derivative assets and liabilities, and liabilities recorded at fair value as at October 31, 2017, as well as a sensitivity analysis of our Level 3 financial instruments, is disclosed in Note 17 on page 174 of the consolidated financial statements.

Our valuation models use general assumptions and market data, and therefore do not reflect the specific risks and other factors that could affect a particular instrument's fair value. Valuation Product Control (VPC), a group within Market Risk Management independent of the trading lines of business, ensures that the fair values at which financial instruments are recorded are materially accurate by:

- developing and maintaining valuation policies and procedures in accordance with regulatory requirements and IFRS;
- establishing official rate sources for valuation of all portfolios; and
- providing independent review of portfolios where prices supplied by traders are used for valuation.

For instruments that are valued using models, VPC identifies situations in which valuation adjustments must be made to the model estimates to arrive at fair value. As a result, we incorporate certain adjustments when using internal models to establish fair values. These fair value adjustments take into account the estimated impact of credit risk, liquidity risk and other items, including closeout costs. For example, the credit risk valuation adjustment for derivative financial instruments incorporates credit risk into our determination of fair values by taking into account factors such as the counterparty's credit rating, the duration of the instrument and changes in credit spreads. We also incorporate an estimate of the implicit funding costs borne by BMO for over-the-counter derivative positions (the funding valuation adjustment).

The methodologies used for calculating these adjustments are reviewed on an ongoing basis to ensure that they remain appropriate. Significant changes in methodologies are made only when we believe that a change will result in better estimates of fair value.

The Valuation Steering Committee is BMO's senior management valuation committee. It meets at least monthly to address the more challenging material valuation issues related to BMO's portfolios, approves valuation adjustments and methodology changes, and acts as a key forum for discussing positions categorized as Level 3 for financial reporting purposes and their inherent uncertainty.

Valuation Adjustments

(Canadian $ in millions) As at October 31	**2017**	2016
Credit risk	**63**	92
Funding risk	**15**	60
Liquidity risk	**33**	43
Total	**111**	195

Valuation adjustments decreased in 2017, primarily due to higher interest rates and tighter corporate bond and CDS spreads.

Pension and Other Employee Future Benefits

Our pension and other employee future benefits expense is calculated by independent actuaries using assumptions determined by management. If actual experience were to differ from the assumptions used, the difference would be recognized in other comprehensive income.

Pension and other employee future benefits expense and the related obligations are sensitive to changes in discount rates. We determine discount rates at each year end for all our plans using high-quality corporate bonds with terms matching the plans' specific cash flows.

Additional information regarding our accounting for pension and other employee future benefits, including a sensitivity analysis for key assumptions, is included in Note 22 on page 184 of the consolidated financial statements.

Impairment of Securities

We have investments in securities issued or guaranteed by Canadian, U.S. and other governments, corporate debt and equity securities, mortgage-backed securities and collateralized mortgage obligations, which are classified as either available-for-sale securities, held-to-maturity securities or other securities. We review available-for-sale, held-to-maturity and other securities at each quarter-end reporting period in order to identify and evaluate investments that show indications of possible impairment. An investment is considered impaired if there is objective evidence that the estimated future cash flows will be reduced. We consider evidence such as delinquency or default, bankruptcy, restructuring or other evidence of deterioration in the creditworthiness of the issuer, or the absence of an active market. The decision to record a write-down, its amount and the period in which it is recorded could change if management's assessment of those factors were to differ. We do not record impairment write-downs on debt securities when impairment is due to changes in market rates, if future contractual cash flows associated with the debt security are still expected to be recovered.

At the end of 2017, total unrealized losses related to available-for-sale securities for which cost exceeded fair value and an impairment write-down had not been recorded were $480 million ($135 million in 2016). These unrealized losses resulted from changes in market interest rates and not from deterioration in the creditworthiness of the issuer.

Additional information regarding our accounting for available-for-sale securities, held-to-maturity securities and other securities and the determination of fair value is included in Note 3 on page 149 and Note 17 on page 174 of the consolidated financial statements.

Income Taxes and Deferred Tax Assets

Our approach to tax is governed by our tax risk management framework, which is implemented through internal controls and processes. We actively seek to identify, evaluate, monitor and manage any tax risks that may arise to ensure our financial exposure is well understood and is within a level consistent with our objectives for the management of tax risk, as set out in our tax risk management framework. We consider all applicable laws in connection with our commercial activities, and where tax laws change in our business or for our customers, we adapt and change. We are committed to maintaining productive relationships and cooperating with taxing authorities in all tax matters. We seek to resolve disputes in a collaborative manner; however, where our interpretation of tax law differs from that of taxing authorities, we are prepared to defend our position.

The provision for income taxes is calculated based on the expected tax treatment of transactions recorded in our Consolidated Statements of Income or Changes in Equity. In determining the provision for income taxes, we interpret tax legislation, case law and administrative positions in numerous jurisdictions, and, based on our judgment, record our estimate of the amount required to settle tax obligations. We also make assumptions about the expected timing of the reversal of deferred tax assets and liabilities. If our interpretations and assumptions differ from those of taxing authorities or if the timing of reversals is not as expected, our provision for income taxes could increase or decrease in future periods. The amount of any such increase or decrease cannot be reasonably estimated.

Deferred tax assets are recognized only when it is probable that sufficient taxable profit will be available in future periods against which deductible temporary differences may be utilized. We are required to assess whether it is probable that our deferred income tax asset will be realized prior to its expiration and, based on all available evidence, determine if any portion of our deferred income tax asset should not be recognized. The factors used to assess the probability of realization are our past experience of income and capital gains, our forecast of future net income before taxes, and the remaining expiration period of tax loss carryforwards. Changes in our assessment of these factors could increase or decrease our provision for income taxes in future periods.

If income tax rates increase or decrease in future periods in a jurisdiction, our provision for income taxes for future periods will increase or decrease accordingly. Furthermore, our deferred tax assets and liabilities will increase or decrease as income tax rates increase or decrease, respectively, and will result in an income tax impact. For example, under the proposals contained in the *Tax Cuts and Jobs Act*, a reduction in the U.S. federal rate from 35% to 20%, if effective January 1, 2018, would reduce our net deferred tax asset by approximately US$400 million, which would result in a one-time corresponding tax charge in our net income. Refer to the Capital Regulatory Developments section on page 71 for further discussion on the related impact to our CET1 Ratio. If the U.S. federal rate reduction is effective in a following year, the amount of the reduction in the deferred tax asset would reduce accordingly. In addition, a reduction in the U.S. federal rate to 20% is expected to increase our annual net income from what it would have otherwise been. The size of this annual net income increase and any impact on our deferred tax asset is uncertain at this point and will be dependent on many factors, including the tax rate enacted and its timing, phase-in provisions and details of the final legislation and its interpretation.

In fiscal 2017, we were reassessed by the Canada Revenue Agency (CRA) for additional income taxes and interest in an amount of approximately $116 million in respect of certain 2012 Canadian corporate dividends. Previously, in fiscal 2016, we were reassessed by the CRA for additional income taxes of approximately $76 million in respect of certain 2011 Canadian corporate dividends. In its reassessments, the CRA denied dividend deductions on the basis that the dividends were received as part of a "dividend rental arrangement." The tax rules dealing with dividend rental arrangements were revised in the 2015 Canadian Federal Budget, which introduced rules that applied as of May 1, 2017. In the future, it is possible that we may be reassessed for significant income tax for similar activities in 2013 and subsequent years. We remain of the view that our tax filing positions were appropriate and intend to challenge any reassessment. If our challenge is unsuccessful, the additional tax expense would negatively impact our net income.

Additional information regarding our accounting for income taxes is included in Note 23 on page 189 of the consolidated financial statements.

Goodwill and Intangible Assets

Goodwill is assessed for impairment at least annually. This assessment includes a comparison of the carrying value and the recoverable amount of each cash-generating unit (CGU) in order to verify that the recoverable amount of the CGU is greater than its carrying value. If the carrying value were to exceed the recoverable amount of the CGU, an impairment calculation would be performed. The recoverable amount of a CGU is the higher of its fair value less costs to sell and its value in use.

Fair value less costs to sell was used to perform the impairment test in all periods. In determining fair value less costs to sell, we employ a discounted cash flow model, consistent with that used when we acquire businesses. This model is dependent on assumptions related to revenue growth, discount rates, synergies achieved on acquisition and the availability of comparable acquisition data. Changes in any of these assumptions would affect the determination of fair value for each of our CGUs in a different manner. Management must exercise judgment and make assumptions in determining fair value, and differences in judgments and assumptions could affect the determination of fair value and any resulting impairment write-down. At October 31, 2017, the estimated fair value of each of our CGUs was greater than its carrying value.

Intangible assets with definite lives are amortized to income on either a straight-line or an accelerated basis over a period not exceeding 15 years, depending on the nature of the asset. We test intangible assets with definite lives for impairment when circumstances indicate the carrying value may not be recoverable.

Intangible assets with indefinite lives are tested annually for impairment. If any intangible assets are determined to be impaired, we write them down to their recoverable amount, the higher of value in use and fair value less costs to sell, when this is less than the carrying value. Additional information regarding the composition of goodwill and intangible assets is included in Note 11 on page 167 of the consolidated financial statements.

Purchased Loans

Acquired loans are identified as either purchased performing loans or purchased credit impaired loans (PCI loans), both of which are recorded at fair value at the time of acquisition. The determination of fair value involves estimating the expected cash flows to be received from the acquired loan portfolio and determining the discount rate to be applied to those cash flows. In determining the discount rate, we consider various factors, including our cost to raise funds in the current market, the risk premium associated with the loans and the cost to service the portfolios.

PCI loans are those where the timely collection of principal and interest is no longer reasonably assured as at the date of acquisition. We regularly evaluate what we expect to collect on PCI loans. Changes in expected cash flows could result in the recognition of impairment or a recovery through the provision for credit losses. Estimating the timing and amount of expected cash flows requires significant management judgment regarding key assumptions, including the probability of default, severity of loss, timing of payment receipts and valuation of collateral. All of these factors are inherently subjective and can result in significant changes in estimates of expected cash flows over the term of a loan.

Purchased performing loans are subject to the same credit review processes we apply to loans we originate. We also assess the portfolio to ensure the remaining credit mark is adequate to cover probable credit losses in the portfolio. This requires judgment regarding assumptions, including the probability of default, severity of loss, timing of future cash flows, and valuation of collateral and estimated life of the loans.

Additional information regarding purchased loans is provided in Note 4 on page 152 of the consolidated financial statements.

Insurance-Related Liabilities

Insurance claims and policy benefit liabilities represent current claims and estimates of future insurance policy obligation liabilities. Liabilities for life insurance contracts are determined using the Canadian Asset Liability Method, which incorporates best-estimate assumptions for mortality, morbidity, policy lapses, surrenders, future investment yields, policy dividends, administration costs and margins for adverse deviation. These assumptions are reviewed at least annually and updated to reflect actual experience and market conditions. The most significant potential impact on the valuation of these liabilities would be the result of a change in the assumption for future investment yields. If the assumed yield were to increase by one percentage point, net income would increase by approximately $38 million. A reduction of one percentage point would lower net income by approximately $37 million. Additional information on insurance-related liabilities is provided in Note 14 on page 169 of the consolidated financial statements, and information on insurance risk is provided on page 99.

Provisions

BMO and its subsidiaries are involved in various legal actions in the ordinary course of business.

Provisions are recorded at the best estimate of the amount required to settle any obligation related to these legal actions as at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Factors considered in making the assessment include a case-by-case assessment of specific facts and circumstances, our past experience and the opinions of legal experts. Management and internal and external experts are involved in estimating any amounts that may be required. The actual costs of resolving these claims may be substantially higher or lower than the amount of the provisions.

Additional information regarding provisions is provided in Note 25 on page 192 of the consolidated financial statements.

Transfers of Financial Assets and Consolidation of Structured Entities

We sell Canadian mortgage loans to third-party Canadian securitization programs, including the Canadian Mortgage Bond program, and directly to third-party investors under the National Housing Act Mortgage-Backed Securities program. We assess whether substantially all of the risks and rewards of the loans have been transferred in order to determine if they qualify for derecognition. Since we continue to be exposed to substantially all of the prepayment, interest rate and/or credit risk associated with the securitized loans, they do not qualify for derecognition. We continue to recognize the loans and we recognize the related cash proceeds as secured financing in our Consolidated Balance Sheet. Additional information concerning the transfer of financial assets is included on page 76, as well as in Note 6 on page 157 of the consolidated financial statements.

In the normal course of business, BMO enters into arrangements with SEs. We are required to consolidate SEs if we determine that we control the SEs. We control an SE when we have power over the entity, exposure or rights to variable returns from our investment and the ability to exercise power to affect the amount of our returns. Additional information concerning BMO's interests in SEs is included on page 77, as well as in Note 7 on page 157 of the consolidated financial statements.

Caution

This Critical Accounting Estimates section contains forward-looking statements. Please see the Caution Regarding Forward-Looking Statements.

Changes in Accounting Policies in 2017

There were no changes in our accounting policies in 2017.

Future Changes in Accounting Policies

BMO monitors the potential changes to IFRS proposed by the International Accounting Standards Board (IASB) and analyzes the effects that any such changes to the standards may have on BMO's financial reporting and accounting policies. New standards and amendments to existing standards that will be effective for BMO in future reporting periods are described in Note 1 on page 144 of the consolidated financial statements.

Adoption of IFRS 9 Financial Instruments

In July 2014, the IASB issued IFRS 9 *Financial Instruments* (IFRS 9), which addresses impairment, classification, measurement and hedge accounting. At the direction of our regulator, OSFI, IFRS 9 is effective for the bank for the fiscal year beginning November 1, 2017. Additional guidance relating to the adoption of IFRS 9 has been provided by OSFI in its Guideline – IFRS 9 *Financial Instruments and Disclosures* (OSFI Guideline). These guidelines are considered in our determination of the allowance for credit losses. Based on October 31, 2017 data and current implementation status, we estimate the adoption of IFRS 9 will lead to an increase in shareholders' equity of approximately $100 million before tax ($65 million after tax) driven by the impairment requirements of IFRS 9. We continue to refine and monitor certain aspects of our impairment process which may change the actual impact on adoption.

The bank has a centrally managed IFRS 9 program that brings together subject matter experts on methodology, data, modelling, information technology processing, risk and reporting. The bank has performed an assessment of the population of financial instruments impacted by the classification and measurement requirements of IFRS 9 and developed an impairment methodology to support the calculation of the expected credit loss allowance. Specifically, during 2017 the bank developed its approach for assessing a significant increase in credit risk and incorporating forward-looking information including macroeconomic factors, and developed and validated the required models. Information technology systems and process architecture were designed using our existing governance framework, while existing internal controls were refined and new controls over key processes and significant areas of judgment were developed and tested within parallel runs of the systems and processes.

Impairment of Financial Assets

IFRS 9 introduces a new expected credit loss (ECL) impairment framework for all financial assets and certain off-balance sheet loan commitments and guarantees. The new ECL framework will result in an allowance for expected credit losses being recorded on financial assets regardless of whether there has been an actual loss event. This differs from the current approach where the allowance recorded on performing loans is designed to capture only losses that have been incurred, whether or not they have been specifically identified.

The bank will recognize a loss allowance at an amount equal to 12-month expected credit losses, if the credit risk at the reporting date has not increased significantly since initial recognition (Stage 1). IFRS 9 requires the recognition of expected credit losses over the remaining life of the financial assets which are considered to have experienced a significant increase in credit risk (Stage 2). An impaired loan requires the recognition of lifetime losses, which is the same as our current specific allowance.

The determination of a significant increase in credit risk takes into account many different factors and will vary by product and risk segment. The main factors considered in making this determination are relative changes in probability-weighted probability of default since origination and certain criteria such as 30-day past due and watch-list status. The assessment of a significant increase in credit risk will require experienced credit judgment.

Key Impairment Modelling Concepts

ECL is a function of the probability of default (PD), exposure at default (EAD) and loss given default (LGD), with the timing of the loss also considered, and is estimated by incorporating forward-looking economic information and through the use of experienced credit judgment to reflect factors not captured in models.

The PD represents the likelihood that a loan will not be repaid and will go into default in either a 12-month horizon for Stage 1 or lifetime horizon for Stage 2. The PD for each individual instrument is modelled based on historic data and is estimated based on current market conditions and reasonable and supportable information about future economic conditions.

EAD is modelled on historic data and represents an estimate of the outstanding amount of credit exposure at the time a default may occur. For off-balance sheet and undrawn amounts, EAD includes an estimate of any further amounts to be drawn at the time of default.

LGD is the amount that may not be recovered in the event of default and is modelled based on historic data and reasonable and supportable information about future economic conditions, where appropriate. LGD takes into consideration the amount and quality of any collateral held.

For the purposes of IFRS 9, the allowance for credit losses is affected by a variety of key characteristics, such as, but not limited to, the probability of default, loss given default, the expected balance at default, as well as the expected life of the financial asset. As a consequence, the allowance for credit losses for Stage 2 financial assets will increase with the expected lifetime or the expected EAD. Incorporating forecasts of future economic conditions into the measurement of expected credit losses will also impact the allowance for credit losses for each stage.

The IFRS 9 terms used above in arriving at expected credit losses differ from those used in calculating our regulatory capital as follows:

	Regulatory Capital	IFRS 9
PD	• Through the cycle 12-month loss view • The definition of default is generally 90 days past due except for credit cards, which uses 180 days past due	• Point-in-time 12-month or lifetime horizon according to the applicable stage based on past experience, current conditions and reasonable supportable forward-looking information • Default definition consistent with regulatory capital
EAD	• Includes expected draws prior to default and cannot be lower than current outstanding	• Represents the expected exposure across a 12-month or lifetime horizon according to the applicable stage and can be lower than the current outstanding
LGD	• Downturn LGD based on a severe economic downturn • Certain regulatory floors apply • Includes direct and indirect costs associated with collection	• Expected LGD based on 12-month or lifetime horizon according to the applicable stage adjusted for reasonable supportable forward-looking information where appropriate • No regulatory floors • Only direct costs included
Other		• Lifetime losses are discounted back to the balance sheet date

IFRS 9 requires the consideration of past events, current market conditions and reasonable forward-looking supportable information about future economic conditions in determining whether there has been a significant increase in credit risk, and in calculating the amount of expected losses. In assessing information about possible future economic conditions, we utilized multiple economic scenarios representing our base case, benign and adverse forecasts, all of which are developed by our Economics group. Key economic variables used in the determination of the allowance for credit losses include GDP, the unemployment rate and housing prices, among others. We use regional economic variables in our models to reflect the geographic diversity of our portfolios, where appropriate.

In considering the lifetime of a loan, IFRS 9 generally requires the use of the contractual period of the loan, including prepayment, extension and other options. For revolving instruments, such as credit cards, which may not have a defined contractual period, the lifetime is based on historical behaviour.

The bank's ECL methodology also requires the use of experienced credit judgment to incorporate the estimated impact of factors that are not captured in the modelled ECL results.

As a result of the forward-looking nature of the standard, we anticipate that the provision for credit losses recorded in the income statement will become more responsive to expected changes in the economic environment and be recorded earlier in the credit cycle than under the current accounting standard.

Classification and Measurement of Financial Assets and Liabilities

The new standard requires that we classify debt instruments based on our business model for managing the assets and the contractual cash flow characteristics of those assets. The business model test determines the classification based on the business purpose for holding the asset. Debt instruments will be measured at fair value through profit and loss unless certain conditions are met that permit measurement at fair value through other comprehensive income (FVOCI) or amortized cost. Debt instruments that have contractual cash flows representing only payments of principal and interest will be eligible for classification as FVOCI or amortized cost. Gains and losses recorded in other comprehensive income for debt instruments will be recognized in profit or loss only on disposal.

Equity instruments would be measured at fair value through profit or loss unless we elect to measure them at FVOCI. Future unrealized gains and losses on fair value through profit or loss equity instruments will be recorded in income. Currently, the unrealized gains and losses are recognized in other comprehensive income for available-for-sale equity instruments. For equity instruments we elect to record at FVOCI, gains and losses would never be recognized in income.

Upon adoption we expect to reclassify $2.1 billion of debt and equity securities previously recorded as available for sale securities to fair value through profit or loss. Upon adoption we expect to reclassify $2.1 billion of loan balances previously recorded at amortized cost to fair value through profit or loss.

We reviewed items currently elected at fair value through profit or loss. Under IFRS 9, certain instruments managed on a fair value basis are now mandatorily accounted for as fair value through profit or loss as a result of our business model. As a result, we expect no change in the accounting for these instruments. Our remaining existing fair value designations are expected to continue under IFRS 9.

As permitted by IFRS 9, in fiscal 2015, we early adopted the provisions relating to the recognition of changes in own credit risk for financial liabilities designated at fair value through profit or loss. Additional information regarding changes in own credit risk is included in Notes 13 and 14 on pages 168 and 169, respectively, of the consolidated financial statements.

Hedge Accounting

IFRS 9 introduces a new hedge accounting model that expands the scope of hedged items and risks eligible for hedge accounting and aligns hedge accounting more closely with risk management. The new model no longer specifies quantitative measures for effectiveness testing and does not permit hedge de-designation. IFRS 9 includes a policy choice that would allow us to continue to apply the existing hedge accounting rules. We did not adopt the hedge accounting provisions of IFRS 9; however, as required by the standard, we will adopt the new hedge accounting disclosures.

Impacts on Governance and Controls

The bank has applied its existing governance framework to ensure that appropriate controls and validations are in place over key processes and judgments to determine the ECL. As part of the implementation, we are in the process of refining existing internal controls and implementing new controls where required in areas that are impacted by IFRS 9, including controls over the development and probability weighting of macroeconomic scenarios, credit risk data and systems, the determination of a significant increase in credit risk and the classification of loans and securities.
In addition to the existing risk management framework, we established a committee to review, challenge and approve key inputs and assess appropriateness of the allowance.

Impacts on Capital Planning

IFRS 9 will impact our reported capital as a result of the adjustment recorded in shareholders' equity on adoption of the standard; this impact is not expected to be significant. During 2017, the BCBS released its standard on *Regulatory treatment of accounting provisions – interim approach and transitional arrangements*. The BCBS clarified it will retain its current treatment of provisions under both Standardized Approach and Advanced Internal Ratings Based frameworks at this time. Further, the BCBS allows local jurisdictions the option to choose whether to apply a transitional arrangement for the impact of IFRS 9 on regulatory capital. The bank's regulator, OSFI, has not established a transitional arrangement for regulatory capital purposes.

Other Future Accounting Changes

For details on other future accounting policy changes, see Note 1 on page 144 of the consolidated financial statements.

Transactions with Related Parties

In the ordinary course of business, we provide banking services to our key management personnel on the same terms that we offer these services to our preferred customers. Key management personnel are defined as those persons having authority and responsibility for planning, directing and/or controlling the activities of an entity, being the directors and the most senior executives of the bank. We provide banking services to our joint ventures and equity-accounted investees on the same terms offered to our customers for these services. We also offer employees a subsidy on annual credit card fees.

Details of our investments in joint arrangements and associates and the compensation of key management personnel are disclosed in Note 28 on page 198 of the consolidated financial statements.

Shareholders' Auditors' Services and Fees

Review of Shareholders' Auditors

The Audit and Conduct Review Committee (ACRC) is responsible for the appointment, compensation and oversight of the shareholders' auditors and conducts an annual assessment of the performance and effectiveness of the shareholders' auditors, considering factors such as: (i) the quality of the services provided by the shareholders' auditors' engagement team during the audit period; (ii) the relevant qualifications, experience and geographical reach to serve BMO Financial Group; (iii) the quality of communications received from the shareholders' auditors; and (iv) the independence, objectivity and professional skepticism of the shareholders' auditors.

The ACRC believes that it has robust review processes in place to monitor audit quality and oversee the work of the shareholders' auditors, including the lead audit partner, which include:

- annually reviewing the audit plan in two separate meetings, including a consideration of the impact of business risks on the audit plan and an assessment of the reasonableness of the audit fee;
- reviewing qualifications of the senior engagement team members;
- monitoring the execution of the audit plan of the shareholders' auditors, with emphasis on the more complex and risky areas of the audit;
- reviewing and evaluating the audit findings, including in camera sessions;
- evaluating audit quality and performance, including recent Canadian Public Accountability Board (CPAB) and Public Company Accounting Oversight Board (PCAOB) inspection reports on the shareholders' auditors and their peer firms;
- at a minimum, holding quarterly meetings with the ACRC Chair and the lead audit partner to discuss audit-related issues independently of management; and
- performing a comprehensive review of the shareholders' auditors every five years, and performing an annual review between these comprehensive reviews, following the guidelines set out by the Chartered Professional Accountants of Canada (CPA of Canada) and the CPAB.

In 2017, an annual review of the shareholders' auditors was completed. Input was sought from ACRC members and management on areas such as communication effectiveness, industry insights and audit performance. In 2015, the ACRC completed a periodic comprehensive review of the shareholders' auditors. The comprehensive review was based on the recommendations of the CPA of Canada and the CPAB. These reviews focused on: (i) the independence, objectivity and professional skepticism of the shareholders' auditors; (ii) the quality of the engagement team; and (iii) the quality of communications and interactions with the shareholders' auditors. As a result of these reviews, the ACRC was satisfied with the performance of the shareholders' auditors.

Independence of the shareholders' auditors is overseen by the ACRC in accordance with our Auditor Independence Standard. The ACRC also ensures that the lead audit partner rotates out of that role after five consecutive years and does not return to that role for a further five years.

Pre-Approval Policies and Procedures

As part of BMO Financial Group's corporate governance practices, the ACRC oversees the application of our policy limiting the services provided by the shareholders' auditors that are not related to their role as auditors. The ACRC pre-approves the types of services (permitted services) that can be provided by the shareholders' auditors, as well as the annual audit plan, which includes fees for specific types of services. For permitted services that are not included in the pre-approved annual audit plan, approval to proceed with the engagement is obtained and the services to be provided are presented to the ACRC for ratification at its next meeting. All services must comply with our Auditor Independence Standard, as well as professional standards and securities regulations governing auditor independence.

Shareholders' Auditors' Fees

Aggregate fees paid to the shareholders' auditors during the fiscal years ended October 31, 2017 and 2016 were as follows:

(Canadian $ in millions) Fees (1)	**2017**	2016
Audit fees	**19.1**	17.6
Audit-related fees (2)	**2.5**	2.5
All other fees (3)	**2.1**	2.7
Total	**23.7**	22.8

(1) The classification of fees is based on applicable Canadian securities laws and U.S. Securities and Exchange Commission definitions.

(2) Audit-related fees for 2017 and 2016 relate to fees paid for accounting advice, specified procedures on our Proxy Circular and other specified procedures.

(3) All other fees for 2017 and 2016 relate primarily to fees paid for reviews of compliance with regulatory requirements for financial information and reports on internal controls over services provided by various BMO Financial Group businesses. They also include the costs of translation services.

Management's Annual Report on Disclosure Controls and Procedures and Internal Control over Financial Reporting

Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), on a timely basis so that appropriate decisions can be made regarding public disclosure.

As at October 31, 2017, under the supervision of the CEO and the CFO, Bank of Montreal's management evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Canada by *National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings*, and in the United States by Rule 13a-15(e) under the *Securities Exchange Act of 1934* (the Exchange Act). Based on this evaluation, the CEO and the CFO have concluded that our disclosure controls and procedures were effective, as at October 31, 2017.

Internal Control over Financial Reporting

Internal control over financial reporting is a process designed under the supervision of the bank's CEO and CFO, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements in accordance with IFRS and the requirements of the Securities and Exchange Commission (SEC) in the United States, as applicable. Management is responsible for establishing and maintaining adequate internal control over financial reporting for Bank of Montreal.

Bank of Montreal's internal control over financial reporting includes policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Bank of Montreal;

(ii) are designed to provide reasonable assurance that transactions are recorded as necessary to permit preparation of the consolidated financial statements in accordance with IFRS and the requirements of the SEC in the United States, as applicable, and that receipts and expenditures of Bank of Montreal are being made only in accordance with authorizations by management and directors of Bank of Montreal; and

(iii) are designed to provide reasonable assurance that any unauthorized acquisition, use or disposition of Bank of Montreal's assets which could have a material effect on the consolidated financial statements is prevented or detected in a timely manner.

Because of its inherent limitations, internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the related policies and procedures may deteriorate.

Bank of Montreal's management, under the supervision of the CEO and the CFO, has evaluated the effectiveness of internal control over financial reporting using the framework and criteria established in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission in May 2013 (2013 COSO Framework). Based on this evaluation, management has concluded that internal control over financial reporting was effective as at October 31, 2017.

At the request of Bank of Montreal's Audit and Conduct Review Committee, KPMG LLP (shareholders' auditors), an independent registered public accounting firm, has conducted an audit of the effectiveness of our internal control over financial reporting. The audit report states in its conclusion that, in KPMG's opinion, Bank of Montreal maintained, in all material respects, effective internal control over financial reporting as at October 31, 2017, in accordance with the criteria established in the 2013 COSO Framework. This audit report appears on page 137.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting in fiscal 2017 that have materially affected, or are reasonably likely to materially affect, the adequacy and effectiveness of our internal control over financial reporting.

Enhanced Disclosure Task Force

On October 29, 2012, the Enhanced Disclosure Task Force (EDTF) of the Financial Stability Board published its first report, Enhancing the Risk Disclosures of Banks. We support the recommendations issued by the EDTF for the provision of high-quality, transparent risk disclosures.

Disclosures related to the EDTF recommendations are detailed below.

General

1 Present all risk-related information in the Annual Report, Supplementary Financial Information and Supplementary Regulatory Capital Disclosure, and provide an index for easy navigation.

Annual Report: Risk-related information is presented in the Enterprise-Wide Risk Management section on pages 78 to 112.

An index for the MD&A is provided on page 26. An index for the notes to the consolidated financial statements is provided on page 144.

Supplementary Financial Information: An index is provided in our Supplementary Financial Information.

2 Define the bank's risk terminology and risk measures and present key parameters used.

Annual Report: Specific risk definitions and key parameters underpinning BMO's risk reporting are provided on pages 86 to 112.

A glossary of financial terms (including risk terminology) can be found on pages 202 to 203.

3 Discuss top and emerging risks for the bank.

Annual Report: BMO's top and emerging risks are discussed on pages 79 to 81.

4 Outline plans to meet new key regulatory ratios once the applicable rules are finalized.

Annual Report: BMO's plans to meet new regulatory ratios are outlined on pages 71 and 105.

Risk Governance

5 Summarize the bank's risk management organization, processes, and key functions.

Annual Report: BMO's risk management organization, processes and key functions are summarized on pages 81 to 86.

6 Describe the bank's risk culture.

Annual Report: BMO's risk culture is described on page 83.

7 Describe key risks that arise from the bank's business model and activities.

Annual Report: A diagram of BMO's risk exposure by operating segment is provided on page 74.

8 Describe the use of stress testing within the bank's risk governance and capital frameworks.

Annual Report: BMO's stress testing process is described on pages 85 to 86.

Capital Adequacy and Risk-Weighted Assets (RWA)

9 Provide minimum Pillar 1 capital requirements.

Annual Report: Pillar 1 capital requirements are described on pages 69 to 72.

Supplementary Financial Information: Regulatory capital is disclosed on page 35.

10 Summarize information contained in the composition of capital templates adopted by the Basel Committee.

Annual Report: An abridged version of the regulatory capital template is provided on page 72.

Supplementary Financial Information: Pillar 3 disclosure is provided on pages 35 to 37 and 39. A Main Features template can be found on BMO's website at www.bmo.com under Investor Relations and Regulatory Filings.

11 Present a flow statement of movements in regulatory capital, including changes in Common Equity Tier 1, Additional Tier 1, and Tier 2 capital.

Supplementary Financial Information: Regulatory capital flow statement is provided on page 40.

12 Discuss capital planning within a more general discussion of management's strategic planning.

Annual Report: BMO's capital planning process is discussed under Capital Management Framework on page 69.

13 Provide granular information to explain how RWA relate to business activities.

Annual Report: A diagram of BMO's risk exposure, including RWA by operating group, is provided on page 74.

14 Present a table showing the capital requirements for each method used for calculating RWA.

Annual Report: Regulatory capital requirement, as a percentage of RWA, is outlined on page 70.

Information about significant models used to determine RWA is provided on pages 88 to 89.

Supplementary Financial Information: A table showing RWA by model approach and risk type is provided on page 39.

15 Tabulate credit risk in the banking book for Basel asset classes.

Supplementary Financial Information: Wholesale and retail credit exposures by internal rating grades are provided on pages 46 to 47.

16 Present a flow statement that reconciles movements in RWA by credit risk and market risk.

Supplementary Financial Information: RWA flow statements are provided on page 40, with a reconciliation on page 38.

17 Describe the bank's Basel validation and back-testing process.

Annual Report: BMO's Basel validation and back-testing process for credit and market risk is described on pages 108 to 109.

Supplementary Financial Information: A table showing Exposure at Default and RWA by model approach and asset class is provided on page 39. A table showing estimated and actual loss parameters is provided on page 49.

Liquidity

18 Describe how the bank manages its potential liquidity needs and the liquidity reserve held to meet those needs.

Annual Report: BMO's potential liquidity needs and the liquidity reserve held to meet those needs are described on pages 99 to 101.

Funding

19 Summarize encumbered and unencumbered assets in a table by balance sheet category.

Annual Report: An Asset Encumbrance table is provided on page 102.

Additional collateral requirements in the event of downgrades by rating agencies are disclosed in Note 8 on page 162 of the consolidated financial statements.

Supplementary Financial Information: An Asset Encumbrance table by currency is provided on page 34.

20 Tabulate consolidated total assets, liabilities and off-balance sheet commitments by remaining contractual maturity.

Annual Report: A Contractual Maturity table is presented in Note 29 on pages 199 to 201 of the consolidated financial statements.

21 Discuss the bank's sources of funding and describe the bank's funding strategy.

Annual Report: BMO's sources of funding and funding strategy are described on pages 103 to 104.

A table showing the composition and maturity of wholesale funding is provided on page 104.

Market Risk

22 Provide a breakdown of balance sheet positions into trading and non-trading market risk measures.

Annual Report: A table linking balance sheet items to market risk measures is provided on page 98.

23 Provide qualitative and quantitative breakdowns of significant trading and non-trading market risk measures.

Annual Report: Trading market risk exposures are described and quantified on pages 94 to 96.

Structural (non-trading) market risk exposures are described and quantified on pages 97 to 98.

24 Describe significant market risk measurement model validation procedures and back-testing and how these are used to enhance the parameters of the model.

Annual Report: Market risk measurement model validation procedures and back-testing for trading market risk and structural (non-trading) market risk are described on pages 107 to 109.

25 Describe the primary risk management techniques employed by the bank to measure and assess the risk of loss beyond reported risk measures.

Annual Report: The use of stress testing, scenario analysis and Stressed Value at Risk for market risk management is described on pages 94 to 96.

Credit Risk

26 Provide information about the bank's credit risk profile.

Annual Report: Information about BMO's credit risk profile is provided on pages 88 to 91 and in Notes 4 and 5 on pages 153 to 156 of the consolidated financial statements.

Supplementary Financial Information: Tables detailing credit risk information are provided on pages 19 to 29 and 42 to 50.

27 Describe the bank's policies related to impaired loans and renegotiated loans.

Annual Report: Impaired and renegotiated loan policies are described in Note 4 on pages 153 and 155, respectively, of the consolidated financial statements.

28 Provide reconciliations of impaired loans and the allowance for credit losses.

Annual Report: Continuity schedules for gross impaired loans and allowance for credit losses are provided on page 91 and in Note 4 on page 154 of the consolidated financial statements.

29 Provide a quantitative and qualitative analysis of the bank's counterparty credit risk that arises from its derivative transactions.

Annual Report: Quantitative disclosures on collateralization agreements for over-the-counter (OTC) derivatives are provided on page 93 and qualitative disclosures are provided on pages 86 to 87.

Supplementary Financial Information: Quantitative disclosures for OTC derivatives are provided on page 33.

30 Provide a discussion of credit risk mitigation.

Annual Report: A discussion of BMO's credit and counterparty risk management is provided on page 87. Collateral management discussions are provided on page 87 and in Note 8 on pages 162 to 165 and in Note 25 on page 193 of the consolidated financial statements.

Supplementary Financial Information: The Exposures Covered by Credit Risk Mitigation table is provided on page 43.

Other Risks

31 Describe other risks and discuss how each is identified, governed, measured and managed.

Annual Report: A diagram illustrating the risk governance process that supports BMO's risk culture is provided on page 81.

Other risks are discussed on pages 105 to 112.

32 Discuss publicly known risk events related to other risks, where material or potentially material loss events have occurred.

Annual Report: Other risks are discussed on pages 105 to 112.