SIGNIFICANT DIFFERENCES BETWEEN MEXICAN BANKING GAAP AND U.S. GAAP

Mexican banks prepare their financial statements in accordance with Mexican Banking GAAP as prescribed by the CNBV. Mexican Banking GAAP encompasses general accounting rules for banks as issued by the CNBV and MFRS prescribed by the CINIF to the extent that the aforementioned accounting criteria do not address or supersede the accounting to be followed. Mexican Banking GAAP differs in certain significant respects from U.S. GAAP. Such differences might be material to the financial information contained in this offering memorandum. A summary of the significant differences that relate to balances or transactions maintained by Banorte is presented below. We have made no attempt to identify or quantify the impact of those differences. In making an investment decision, investors must rely upon their own examination of the Company, including the terms of this offering and the financial information contained in this offering memorandum. Potential investors should consult with their own professional advisors for an understanding of the differences between Mexican Banking GAAP and U.S. GAAP, and how those differences might affect the financial information herein.

This summary should not be taken as exhaustive of all differences between Mexican Banking GAAP and U.S. GAAP. No attempt has been made to identify all disclosure, presentation or classification differences that would affect the manner in which transactions or events are presented in financial statements, including the notes thereto. We have not included in this offering memorandum a reconciliation of our Mexican Banking GAAP financial statements to U.S. GAAP.

Loan Loss Reserve

On December 2, 2005, the General Rules Applicable to Mexican Banks became effective (amended through July 24, 2017) which include the accounting criteria applicable to banks. These accounting criteria also include the methodology for bank loan portfolio ratings. These provisions require the rating and creation of allowances for loan losses for each type of loan, providing for the assignment of a rating based on risk (*i.e.*, country, financial and industry), payment records and the value of guarantees for each borrower balance that exceeds 4,000,000 UDIS. The remainder is classified parametrically based on the number of months elapsed as of the first default. In its amendments effective June 1, 2017, the accounting criteria require that, when using the rating methodology for consumer and mortgage loan portfolios, financial institutions also consider payment records of the borrower with other financial institutions. This rating is used, among other things, to estimate a potential loan loss provision. However, the new provisions continue to allow the loan rating and creation of loan loss reserves based on internal methodologies previously authorized by the CNBV. Also, the CNBV allows the creation of additional reserves based on preventive criteria.

We assign an individual risk category to each commercial loan based on the borrower’s financial and operating risk level, its credit experience and the nature and value of the loans’ collateral. A loan loss reserve is determined for each loan based on a prescribed range of reserves associated to each risk category. In the case of the consumer and mortgage loan portfolio, the risk rating procedure and the establishment of loan reserves considers the accounting periods reporting past due, the probability of noncompliance, the severity of the loss based on its balance and the nature of any loan guarantees or collateral.

The outstanding balance of past-due loans is recorded as non-performing as follows:

- when there is evidence that the customer has declared bankruptcy;
- loans with a single payment of principal and interest at maturity are considered past due 30 calendar days after the date of maturity;

- loans with a single payment of principal at maturity and with scheduled interest payments are considered past due 30 calendar days after principal becomes past due and 90 calendar days after interest becomes past due;

- loans whose payment of principal and interest had been agreed to in scheduled payments are considered past due 90 days after the first installment is past due;

- in the case where a revolving line of credit is granted, loans are considered past due when payment has not been received for two normal billing periods or, when the billing period is not monthly, 60 calendar days following maturity; and

- customer bank accounts showing overdrafts are reported as non-performing loans at the time the overdraft occurs.

The U.S. GAAP methodology for recognition of loan losses is provided by the Financial Accounting Standards Board ("FASB") Accounting Standard Codification ("ASC") 450 *Contingencies* (previously Statement of Financial Accounting Standard ("SFAS") No. 5, "Accounting for Contingencies") and ASC 310 *Receivables* (previously SFAS No. 114, "Accounting by Creditors for Impairment of a Loan"), which establish that an estimated loss should be accrued when, based on information available prior to the issuance of the financial statements, it is probable that a loan has been impaired at the date of the financial statements and the amount of the loss can be reasonably estimated. For larger non-homogeneous loans, all individual loans should be assessed for impairment under ASC 310 (except for large groups of smaller-balance homogeneous loans which are collectively evaluated for impairment). Specific provisions are calculated when it is determined that it is probable that a bank will not recover the full contractual principal and interest on a loan (impaired loan), in accordance with the original contractual terms.

Under U.S. GAAP, estimated losses on impaired loans that are individually assessed are required to be measured at the present value of expected future cash flows discounted at the loan's effective rate, the loan's observable market price or at the fair value of the collateral if the loan is collateral dependent. To calculate the allowance required for smaller-balance impaired loans and unimpaired loans, historical loss ratios are determined by analyzing historical loss trends. These ratios are determined by loan type to obtain loss estimates for homogeneous groups of clients. Such historical loss ratios are updated to incorporate the most recent data reflective of current economic conditions, in conjunction with industry performance trends, geographic or obligor concentrations within each portfolio segment, and any other pertinent information. These updated ratios serve as the basis for estimating the allowance for loan losses for such smaller-balance impaired loans and non-impaired loans.

Under Mexican Banking GAAP, loans may be written-off when collection efforts have been exhausted or when they have been fully provisioned. On the other hand, for U.S. GAAP, loans (or portions of particular loans) should be written-off in the period that they are deemed uncollectible.

Non-Accrual Loans

Under Mexican Banking GAAP, the recognition of interest income is suspended when loans become past due based on the number of past due periods as established by the CNBV.

Under U.S. GAAP, the accrual of interest is generally discontinued when, in the opinion of management, it is expected that the borrower will not be able to fully pay its principal and interest. Generally this occurs when loans are 90 days or more past due. Any accrued but uncollected interest is reversed against interest income at that time.

Foreclosed Assets

Under Mexican Banking GAAP, there are two categories of foreclosed assets: (1) those received as payment in-kind and (2) those that are repossessed by judicial order. For both categories, foreclosed assets are recorded at the lesser of cost or estimated net realizable value.

On date of foreclosure, if the book value (contractual value) of the loan to be foreclosed is higher than net realizable value of the foreclosed asset the difference will be charged to the loan loss allowance. If the book value (contractual value) of the loan to be foreclosed is lower than the net realizable value of the repossessed asset, the carrying amount of the foreclosed asset is the book value of the loan. Foreclosed assets are subsequently adjusted by standard provisions as issued by the CNBV. The provisions depend on the nature of the foreclosed asset and the number of months outstanding.

Under U.S. GAAP, as required by ASC 470 *Debt* (previously SFAS No. 15, “Accounting by Debtors and Creditors for Troubled Debt Restructurings”), foreclosed assets received in full satisfaction of a receivable are reported at the time of foreclosure or physical possession at their estimated fair value less estimated costs of sale. If the foreclosed asset qualifies as an asset held for a long lived asset to be disposed by sale in accordance with ASC 360 *Property, Plant and Equipment* (previously SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”), such asset is thereafter carried at the lower of its carrying amount or fair value less estimated sale costs. Those assets not eligible for being considered as assets to be disposed of by sale are considered assets to be held and used and are depreciated based on their useful lives and are subject to impairment tests under ASC 360.

Investment Valuation

Under Mexican Banking GAAP, investments are divided into the following categories:

- Trading securities are defined as those in which management invests to obtain gains from short-term price fluctuations. The unrealized gains or losses resulting from the mark-to-market of these investments are recognized in the statement of income for the period.

- For-sale securities are those in which management invests to obtain medium-term earnings. The unrealized gains or losses resulting from the mark-to-market of equity securities, net of deferred taxes, is recognized in stockholders’ equity.

- Held-to-maturity investments are those instruments in which management invests with the intention of holding them until maturity and are recorded at amortized cost. Furthermore, on November 9, 2009, the CNBV issued a ruling to amend the General Rules Applicable to Mexican Banks, which allows securities to be reclassified to the category of securities held to maturity or from the category of trading securities to that of securities available for sale, albeit with the prior express authorization of the CNBV.

Under Mexican Banking GAAP, the fair value amounts are determined by independent third party price quotes or in certain cases based on internal valuation methods. The fair value adjustment for for-sale equity securities is reflected in equity and includes the related deferred income tax effects and loss from monetary position (if determined). All amounts are reversed into earnings upon sale or maturity of the securities.

Under Mexican Banking GAAP, provisions must be made for permanent impairment of for-sale or held-to-maturity securities. If the conditions that led to the provision being established improve sufficiently, then the provision can be reversed.

For U.S. GAAP, under ASC 320 *Investments—Debt and Equity Securities* (previously SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities"):

- Debt securities must be classified, according to management's intent and ability to hold the security, within one of the following categories: held-to-maturity, trading, or available-for-sale. Marketable equity securities must be classified as either trading securities or available-for-sale securities.

- Trading securities are those actively bought and sold. Such securities are recorded at fair value, with resulting unrealized gains and losses recognized in the statement of income.

- Securities which management has the intent and ability to hold to maturity are classified as held-to-maturity, a classification allowed only for debt securities, except for preferred stock with required redemption dates. Held-to-maturity securities are carried at amortized cost.

- All other debt securities and marketable equity securities that are not classified as debt securities or held-to-maturity securities are classified as available-for-sale securities. Available-for-sale securities are recorded at fair value with the resulting unrealized gains and losses recorded net of applicable deferred taxes as other comprehensive income ("OCI"), a separate component of shareholders' equity until realized, at which time the realized gain or loss is recorded in the income statement. Non-marketable equity securities are valued at cost, less a provision for other-than temporary impairment in value.

U.S. GAAP has specific criteria limiting reclassifications of securities within the held-to-maturity classification. If any sales are made from the held-to-maturity portfolio other than in certain specific circumstances, then all held-to-maturity securities are deemed to be tainted and are consequently classified as available-for-sale.

U.S. GAAP does not contemplate the monetary position effect which is presently recognized under Mexican Banking GAAP. Nevertheless, under U.S. GAAP, if there is a decline in carrying amount of an available-for-sale or held-to-maturity security below its fair value, it is judged to be other-than-temporary, the cost basis of the individual security is written down to its fair value and the amount of the write-down is recorded as charged to income. The new written down value of the security forms the new cost basis of the security. An impairment loss cannot be reversed if conditions improve.

For Mexican Banking GAAP purposes, any foreign currency effects on available-for-sale debt securities are reported in earnings. However, under U.S. GAAP and per ASC 310-10-35 (*Fair Value Changes of Foreign-Currency-Denominated Available-for-Sale Debt Securities* paragraphs 36-37) (formerly EITF 96-15 "Accounting for the Effects of Changes in Foreign Currency Exchange Rates on Foreign-Currency-Denominated Available-for-Sale Debt Securities"), the entire change in the fair value of foreign-currency-denominated available-for-sale debt securities should be reported in stockholders' equity. This fair value serves as the basis under which other-than temporary impairment is considered.

Fair Value of Financial Instruments

Mexican Banking GAAP defines fair value as the amount an interested and informed market participant would be willing to exchange for the purchase or sale of an asset or to assume or settle a liability in a free market. This definition can consider either an entry or an exit price.

U.S. GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This definition only considers an exit price. Consideration must be given to the principal and most advantageous market and the highest and best use of the asset.

Furthermore, U.S. GAAP establishes a three-level hierarchy to be used when measuring and disclosing fair value in a company's financial statements. Categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation. The following is a description of the three hierarchy levels:

- Level 1—Listed prices for identical instruments in active markets.
- Level 2—Listed prices for similar instruments in active markets; listed prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.
- Level 3—Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

Repurchase Agreements

Under Mexican Banking GAAP, at the contracting date of the repurchase transaction, when the financial institution is the reselling party, the entry of cash or a debit settlement account, and an account payable at fair value, initially at the agreed-upon price, is recorded and represents the obligation to restitute cash to the repurchasing party. Subsequently, during the term of the repurchase transaction, the account payable is valued at fair value by recognizing the interest on the repurchase agreement using the effective interest method in results of the year. In relation to the collateral granted, the credit institution will reclassify the financial assets in its balance sheet as restricted, which will be valued based on the criteria described above in this note until the maturity of the repurchase transaction.

When an entity acts as repurchasing party, the withdrawal of funds available is recognized on the contracting date of the repurchase transaction or a credit settlement account, with an account receivable recorded at fair value, initially at the agreed-upon price, which represents the right to recover the cash paid. The account receivable will be valued subsequently during the term of the repurchase agreement at fair value through the recognition of interest on the repurchase agreement based on the effective interest method in the results of the year. Similarly, if the repurchasing party becomes a reselling party based on the performance of another repurchase transaction with the collateral received in guarantee for the initial transaction, the interest generated by the second repurchase transaction must be recognized in the results of the year when accrued, according to the effective interest method, and also affects the valued account payable according to the applied cost.

Under U.S. GAAP, repurchase agreements are transfer transactions subject to specific provisions and conditions that must be met in order for a transaction to qualify as a sale rather than a secured borrowing. In most cases, banks in the U.S. enter into repurchase transactions that qualify as secured borrowings. Accordingly, our assets subject to a repurchase agreement would not be derecognized.

Derivatives

Under Mexican Banking GAAP, the assets and/or liabilities arising from transactions with derivative financial instruments are recognized or cancelled in the financial statements on the date the transaction is carried out, regardless of the date of settlement or delivery of the asset. Financial institutions initially recognize all derivatives as assets or liabilities in the balance sheet at fair value, taking into consideration the execution price. Any transaction costs that are directly attributable to the acquisition of the derivative are directly recognized in results. All derivatives are valued at fair value without deducting any estimated sale costs or other types of disposal. The period net valuation effects are recognized in the results of the period as trading gain/loss.

Under Mexican Banking GAAP, a financial institution should consider the following the CNBV requirements for the purposes of classifying a derivative financial instrument:

- Hedging of an open risk position - Consists of the purchase or sale of derivative financial instruments to reduce the risk of a transaction or group of transactions. If they are fair value hedges, the primary position covered is valued at market and the net effect of the derivative hedge instrument is recorded in results of the period. If they are cash flow hedges, the hedge derivative instrument is valued at market and the valuation for the effective portion of the hedge is recorded within OCI account in stockholders' equity. Any ineffective portion is recorded in results.

- Trading positions - Consist of the positions assumed by the financial institution as market participant for purposes other than hedging risk positions. In forward and futures contracts, the balances represent the difference between the fair value of the contract and the contracted forward price. If the difference is positive, it is considered as surplus value and presented under assets; however, if negative, it is considered as a shortfall and presented under liabilities. In options, their balance represents the fair value of the premium and they are valued at fair value, recognizing the valuation effects in the results for the year. In swaps, the balance represents the difference between the fair value of the swap asset and liability.

Under U.S. GAAP, ASC 815 *Derivatives and Hedging* (previously SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities") provides that:

- Derivative financial instruments, although considered to be an effective hedge from an economic perspective that have not been designated as a hedge for accounting purposes are recognized in the balance sheet at fair value with changes in the fair value recognized in earnings concurrently with the change in fair value of the underlying assets and liabilities.

- For all derivative instruments that qualify as fair value hedges for accounting purposes, of existing assets, liabilities or firm commitments, the change in fair value of the derivative should be accounted for in the statement of income, and be fully or partially offset in the statement of income by the change in fair value of the underlying hedged item.

- For all derivative contracts that qualify as hedges of cash flows for accounting purposes, the change in the fair value of the derivative should be initially recorded in OCI in stockholders' equity. Once the effects of the underlying hedged transaction are recognized in earnings, the corresponding amount in OCI is reclassified to the statement of income to offset the effect of the hedged transaction.

- All derivative instruments that qualify as hedges are subject to periodic effectiveness testing. Effectiveness is the derivative instrument's ability to generate offsetting changes in the fair value or cash flows of the underlying hedged item. The ineffective portion of the change in fair value for a hedged derivative is immediately recognized in earnings, regardless of whether the hedged derivative is designated as a cash flow or fair value hedge.

Under Mexican Banking GAAP, the designation of a derivative instrument as a hedge of a net position ("macro hedging") is allowed. However, macro hedging is not permitted under U.S. GAAP.

However under U.S. GAAP, certain implicit or explicit terms included in host contracts that affect some or all of the cash flows or the value of other exchanges required by the contract in a manner similar to a derivative instrument, must be separated from the host contract and accounted for at fair value. Under Mexican Banking GAAP, the recognition of embedded derivative instruments is required beginning in 2009.

Securitized Transactions and the Consolidation of Special-Purpose Entities

Under Mexican Banking GAAP, as of January 1, 2009, securitized transactions must fulfill the requirements established in accounting criterion C-1 "Recognition and derecognition of financial assets" in order to be considered a sale and transfer of assets. If this is not the case, these assets must remain on the balance sheet, together with the respective debt issuances and the effects on results based on this criterion. Furthermore, a company must consolidate a special-purpose entity (SPE) when the economic basis of the relationship between both entities shows that the SPE is controlled by the former. Also, all securitized transactions made before the effective date of criterion C-1, are not consolidated since this criterion was issued considering a prospective implementation.

Under U.S. GAAP, ASC 860 *Transfers and Servicing* (previously SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement 125") provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. The guidance focuses on control. Under that approach, after a transfer of financial assets (*e.g.* a securitization), an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. This Statement provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings.

A transfer of financial assets in which the transferor surrenders control over those assets is accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The transferor has surrendered control over transferred assets if and only if all of the following conditions are met:

- The transferred assets have been isolated from the transferor (beyond the reach of the transferor and its creditors), even in bankruptcy;

- Each transferee (or, if the transferee is a qualifying special-purpose entity ("QSPE") (for more information on control that eliminates the QSPE exemption under U.S. GAAP beginning in 2016, see "—Consolidation"), each holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) it received, and no condition both constrains the transferee (or holder) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor; and

- The transferor does not maintain effective control over the transferred assets through either (1) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity, (2) the ability to unilaterally cause the holder to return specific assets, other than through a cleanup call, or (3) an agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them.

Business Combinations

Through December 31, 2004, under Mexican Banking GAAP, the excess of the purchase price over the adjusted book value of net assets acquired was recorded as goodwill and amortized over 20 years (negative goodwill if book value exceeded the purchase price was recognized over a period not exceeding five years). Upon the adoption of NIF B-7, "Business Acquisitions," which is similar to the required accounting practices established by U.S. GAAP, requires the purchase price to be ascribed to the fair value of separately identifiable assets and liabilities acquired and that the difference between the purchase price and the fair value of identifiable assets and liabilities be allocated to goodwill or negative goodwill, as applicable.

Under U.S. GAAP, prior to January 1, 2009, SFAS No. 141, “Business Combinations” required the purchase price over the book value of assets and liabilities acquired to be allocated to the fair value of separately identifiable assets and liabilities acquired.

Under U.S. GAAP, beginning in January 1, 2009, ASC 805-10 (SFAS No. 141(R), “Business Combinations – a replacement of FASB No. 141”), now requires an acquirer in a business combination to (a) recognize assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree at fair value as of the acquisition date, and (b) expense all acquisition-related costs. ASC 805-10 (SFAS No. 141(R)), also amends ASC 740-10 (SFAS No. 109, “Accounting for Income Taxes”) to require that any reductions to an acquired entity’s valuation allowances on deferred taxes and acquired tax contingencies that occur after the measurement period be recorded as a component of income tax expense.

Employee Retirement Obligations

Mexican Banking GAAP requires the recognition of a severance indemnity liability calculated based on actuarial computations. Similar recognition criteria under U.S. GAAP are established in ASC 712 *Compensation—Nonretirement Postemployment Benefits* (previously SFAS No. 112, “Employers’ Accounting for Post-employment Benefits”), which requires that a liability for certain termination benefits provided under an ongoing benefit arrangement such as these statutorily mandated severance indemnities, be recognized when the likelihood of future settlement is probable and the liability can be reasonably estimated.

Under Mexican Banking GAAP, pension and seniority premium obligations are determined in accordance with NIF D-3. Under U.S. GAAP, such costs are accounted for in accordance with ASC 715 *Compensation—Retirement Benefits* (previously SFAS No. 87, “Employers’ Accounting for Pensions”), whereby the liability is measured, similar to Mexican Banking GAAP, using the projected unit credit method at either corporate or government bonds based discount rates. The U.S. GAAP standard became effective on January 1, 1989 whereas NIF D-3 became effective on January 1, 1993. Therefore, a difference between Mexican Banking GAAP and U.S. GAAP exists due to the accounting for the transition obligation at different implementation dates.

Post-retirement benefits are accounted for under U.S. GAAP in accordance with ASC 715 (previously SFAS No. 106, “Employers’ Accounting for Postretirement Benefits Other Than Pensions”), which applies to all post-retirement benefits, such as life insurance provided outside a pension plan or other postretirement health care and welfare benefits expected to be provided by an employer to current and former employees. The cost of postretirement benefits is recognized over the employees’ service periods and actuarial assumptions are used to project the cost of health care benefits and the present value of those benefits. For Mexican Banking GAAP purposes, as required by NIF D-3, we account for such benefits in a manner similar to U.S. GAAP. SFAS No. 106 became effective on January 1, 2003 whereas NIF D-3 became effective on January 1, 1993.

In addition, under U.S. GAAP, the accounting for defined benefit postretirement plans, which include seniority premiums within Mexico, was amended in 2006 such that an employer is required to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position, recognizing changes in that funded status in the year in which the changes occur through OCI. Accordingly, unrecognized items may exist in Mexican FRS which are included as part of the employee benefit liability under U.S. GAAP.

Starting January 1, 2016, amendments to NIF D-3 became effective, in which unrecognized actuarial items, should be treated as follows:

a) the whole balance of the modifications to the plan (past service) not yet recorded, should be recorded affecting the retained earnings of the oldest period presented;

b) the accumulated unrecorded Profit or Losses of the Plan (GPP) (for entities that used the projected unit credit method), should be recorded affecting the initial balance of OCI for remedies of the oldest period presented.

Therefore, a difference arises since U.S. GAAP has not amended the recognition of actuarial remeasurements.

Guarantees

For Mexican Banking GAAP purposes, guarantees are recorded at cost at inception and disclosed in memorandum accounts unless payments in connection with the guarantee are probable, where the amounts expected to be paid are recorded.

For U.S. GAAP purposes, guarantees are accounted for under ASC 460 *Guarantees* (previously FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others—an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB interpretation No. 34"), which requires that an entity recognizes, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing such guarantee.

For Mexican Banking GAAP purposes, guarantees are recorded at cost at inception and disclosed in memorandum accounts unless payments in connection with the guarantee are probable, where the amounts expected to be paid are recorded.

Equity Method Investees

Under Mexican Banking GAAP, investments in associated companies in which we have more than a 10% ownership, are accounted for by the equity method.

For U.S. GAAP purposes, investments in associated companies in which we have a 20 to 50% ownership over which we can exert significant influence on the company, but do not have a controlling interest, are accounted for by the equity method. Investments in which we have less than a 20% ownership are generally accounted for under the cost method.

Retained Earnings Adjustments

Where specific approval is given by the CNBV, certain adjustments and provisions which are created during the year may be charged to retained earnings and not to the statement of income for the period.

Under U.S. GAAP, when adjustments which relate to correction of errors in the prior year occur, the prior period financial statements are required to be restated. Under U.S. GAAP, loss provisions or other operating and non-operating expenses are recognized as a charge to income.

Deferred Income Tax

Mexican Banking GAAP is similar to U.S. GAAP with respect to accounting for deferred income taxes in that an asset and liability approach is required. Under Mexican Banking GAAP, deferred tax assets must be reduced by a valuation allowance if it is "highly probable" that all or a portion of the deferred tax assets will not be realized. The determination of the need for a valuation allowance must consider future taxable income and the reversal of temporary taxable differences. Net deferred income tax assets or liabilities are presented within long-term assets or liabilities.

Under U.S. GAAP, deferred income taxes are also accounted for using the asset and liability approach. However, under U.S. GAAP, a valuation allowance is recognized if, based on the weight of all positive and negative available evidence, it is “more likely than not” that all or a portion of the deferred tax asset will not be realized. In order to make this determination, entities must consider future reversals of taxable temporary differences, future taxable income, taxable income in prior carryback years and tax planning strategies. Additionally, if the company has experienced recurring losses, little weight, if any, may be placed on future taxable income as objective evidence to support the recoverability of a deferred income tax asset.

Consolidation

Under Mexican Banking GAAP, an entity is required to consolidate subsidiaries over which it is has established control, despite not holding a majority of the voting common stock of the subsidiary. Determining whether an entity has control is based on an analysis of corporate governance and economic risk and benefits.

Under U.S. GAAP, when a company has a controlling financial interest (either through a majority voting interest or through the existence of other control factors) in an entity, such entity’s financial statements should be consolidated, irrespective of whether the activities of the subsidiary are non-homogeneous with those of the parent. In addition to the traditional concept of consolidation, on January 17, 2003, the FASB issued FASB Interpretation No. 46, “Consolidation of Variable Interest Entities- an Interpretation of ARB No. 51,” replaced in December 2003, by Interpretation ASC 810 Consolidation (previously No. 46(R) “Consolidation of Variable Interest Entities- an interpretation of APB 51” (“FIN 46R”)), which contained certain clarifications to address accounting for variable interest entities. The primary purpose of ASC 810 is to provide guidance on the identification of, and financial reporting for, entities over which control is achieved through means other than voting rights; such entities are known as variable-interest entities (“VIEs”). Generally, VIEs are to be consolidated by the primary beneficiary which represents the enterprise that will absorb the majority of the VIEs’ expected losses if they occur, receive a majority of the VIEs’ residual returns if they occur, or both. Through 2009, QSPEs and certain other entities are exempt for the consolidation provisions of FIN 46R. As described in ASC 840-40 Transfers to Qualifying Special Purpose Entities (previously SFAS No. 140, par. 35), a QSPE is a trust or other legal vehicle that meets certain conditions. Under U.S. GAAP, a QSPE is not consolidated in the financial statements of a transferor or its affiliates.

Effective beginning January 1, 2019, Accounting Standards Update No. 2009-16, seeks to improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting

Effects of Inflation

Through December 31, 2007, Mexican Banking GAAP required that the effects of inflation be recorded in financial information and that financial statements be restated to constant Pesos as of the latest balance sheet date presented. Beginning January 1, 2008, Mexican Banking GAAP modified the accounting for the recognition of the effects of inflation and defines two economic environments: (i) an “inflationary environment,” in which the cumulative inflation of the three preceding years is 26% or more, in which case the effects of inflation should be recognized using the comprehensive method; and (ii) a “non-inflationary environment’, in which the cumulative inflation of the three preceding years is less than 26%, in which case, no inflationary effects should be recognized in the financial statements. Additionally, beginning January 1, 2018 amendments to NIF B-10 require that, in a non-inflationary environment, entities disclose the accumulated inflation rate for the last three years, and that it served as basis to classify the economic environment in which they operated in the current year as non-inflationary; the accumulated inflation rate of the last two years, and the inflation rate for the reporting period.

Under U.S. GAAP, historical costs must be maintained in the basic financial statements. Business enterprises are encouraged to disclose certain supplemental information concerning changing prices on selected statement of income and balance sheets items. Typically, however, no gain or loss on monetary position is recognized in the financial statements. However, specific rules and regulations established by the SEC allow for the presentation of inflation in a company's reconciliation from local GAAP to U.S. GAAP for companies registering securities with the SEC for sale in the United States, when, for local purposes, such company prepares comprehensive price-level adjusted financial statements, as required or permitted by their home-country GAAP.

The recording of appraisals of fixed assets is prohibited, with the objective of maintaining historical cost in the balance sheet. Although the effects of inflation are not recognized in the financial statements under U.S. GAAP, the SEC recognizes that presentation indicating the effects of inflation is more meaningful than historical cost-based financial reporting for Mexican entities because it represents a comprehensive measure of the effects of price level changes in the inflationary Mexican economy. For this reason, the effects of inflation accounting are generally not eliminated from the financial statements of Mexican companies making offerings in the United States securities markets in situations when Mexican MFRS or Mexican Banking GAAP are reconciled to U.S. GAAP.

In addition, under MFRS, NIF B-15, "Foreign Currency Transactions and Translation of Financial Statements of Foreign Operations" allows the restatement of information for prior periods in order to compare such information to information of the most current period presented, based on a weighted average restatement factor that reflects the relative inflation and currency exchange movements of the countries in which we operate. The restatement provisions of NIF B-15 do not meet the SEC's Regulation S-X requirement that the financial statements be stated in the same currency for all periods, because changes in foreign currency exchange rates are included in the restatement factor. Under U.S. GAAP, the primary financial statements should be presented in the same constant reporting currency for all periods.

Recent Mexican Banking GAAP Accounting Standards

As part of its efforts to converge Mexican standards with international standards, CINIF issued the following Mexican Financial Reporting Standards (NIF), Interpretations to Financial Information Standards (INIF) and improvements to NIF applicable to profitable entities which became effective for fiscal years that begin on January 1, 2017(1) and 2018(2):

The improvements consist in specifying the scope and definitions of these NIF to indicate more clearly their application and accounting treatment.

- NIF B-7, Business acquisitions - A modification was made to the prospective adoption of the improvements to NIF 2016, which establishes that acquisitions under common control should not form part of the scope of such NIF. (1)

- NIF B-13, Events after the reporting period - If an agreement is reached as of the authorization date for the issuance of the financial statements to maintain the contractual long-term payments of a debt instrument that is in default, such liability may be classified as a long-term item at the date of the financial statements; early application of this guidance as of January 1, 2016 is permitted. (1)

- NIF C-11, Stockholders' equity - Establishes that the costs incurred to list shares in a stock market which at the date of such listing were already owned by investors, and for which the issuing entity had already received the respective proceeds, should be recognized in net income or loss at the time of their accrual, because it is considered that there was no equity transaction. It also clarifies that any expense incurred in the re-issuance of repurchased shares should be recognized as a reduction of the capital issued and placed. (1)

- NIF D-3, Employee benefits - Is modified to establish, as a basic principle, that the discount rate to be used in the determination of the present value of the long-term defined benefit obligation should be a free market rate with a very low credit risk, which represents the value of money over time. Consequently, either the government bond market rate or the market rate for high-quality corporate bonds in absolute terms in a deep market, could be used, indistinctly, provided that the latter complies with the requirements established in Appendix B– Application guidance, B1– Guidance for the identification of issues of high-quality corporate bonds in absolute terms in a deep market. Early application is allowed.(1)

- NIF C-14, Transfer and disposals of financial assets – States that the recognition of the change to this NIF, effective from January 2018, should be made retrospectively for all financial statements presented in comparative periods. The change establishes that an entity should recognize a transferred asset as long as it has a continuous involvement, and that subsequent recognition for such asset should be based on the applicable NIF, according to the class of asset and its classification as determined by the entity. These requirements are consistent to those set out in ASC 860 for the transfer and disposal of financial assets. (2)

Furthermore, in January 2017, the CNBV published an amendment to Mexican Banking GAAP with respect to the methodology for

Additionally, CINIF issued the following Mexican Financial Reporting Standards (NIF), Interpretations to Financial Information Standards (INIF) and improvements to NIF applicable to credit institutions, which become effective for fiscal years that begin on January 1, 2019:

- NIF B-17 “Fair value measurement”.
- NIF C-2 “Investments in financial instruments”.
- NIF C-3 “Accounts receivable”.
- NIF C-9 “Provisions, contingencies, and commitments”.
- NIF C-10 “Derivative financial instruments and hedging activities”.
- NIF C-16 “Impairment of receivable financial instruments”.
- NIF C-19 “Payable financial instruments”.
- NIF C-20 “Receivable financial instruments, principal and interests”.
- NIF D-1 “Revenues from contracts with customers”.
- NIF D-2 “Costs from contracts with customers”.

At the date of this report, the Institution’s management is in the process of assessing the effects of adopting these new standards on its financial information, which will be informed once the CNBV has officially published the A-2 Criterion, “Applicability of Particular Standards”, which might include specifics about the adoption of the abovementioned standards for financial institutions.

Recent U.S. GAAP Accounting Standards

In January 2016, the FASB issued ASU 2016-06. The ASU amends ASC 820, Fair Value Measurements and Disclosures (SFAS No. 157) to add new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. This ASU amends guidance on employers’ disclosures about postretirement benefit plan assets under ASC 715, Compensation – Retirement Benefits, to require that disclosures be provided by classes of assets instead of by major categories of assets. The guidance in the ASU is effective for the first reporting period (including interim periods) beginning after December 15, 2009, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2016, and for interim periods within those fiscal years. In the period of initial adoption, entities will not be required to provide the amended disclosures for any previous periods presented for comparative purposes. However, those disclosures are required for periods ending after initial adoption. Early adoption is permitted.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this ASU require all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The amendments in this ASU also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition the amendments in this ASU eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities and the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet for public business entities. This ASU is effective for annual reporting periods beginning after December 15, 2018.

In February 2016, the FASB issued ASU 2016-02, Leases, which introduces a lessee model that brings most leases on the balance sheet. The new standard also aligns many of the underlying principles of the new lessor model with those of ASC 606, the FASB's new revenue recognition standard (e.g., those related to evaluating when profit can be recognized). Furthermore, the ASU addresses other concerns related to the current leases model. For example, the ASU eliminates the requirement in current U.S. GAAP for an entity to use bright-line tests in determining lease classification. The ASU also requires lessors to increase the transparency of their exposure to changes in value of their residual assets and how they manage that exposure. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2019 with early application permitted.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in this ASU are effective for annual periods beginning after December 15, 2017 with early adoption permitted.

In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments, which amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. The ASU eliminates the probable initial recognition threshold in current guidance and, instead, requires an entity to reflect its current estimate of all expected credit losses. This ASU affects entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. The amendments affect loans, debt securities, trade receivables, net investments in leases, off balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The amendments in this ASU are effective for annual periods beginning after December 15, 2020.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments – a consensus of the FASB Emerging Issues Task Force, which addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The ASU is effective for annual periods beginning after December 15, 2018 with early adoption permitted.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) Intra-Entity Transfers of Assets Other Than Inventory, which requires that entities recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The amendments in this Update do not change US GAAP for the pre-tax effects of an intra-entity asset transfer under Topic 810, Consolidation, or for an intra-entity transfer of inventory. This ASU is effective for annual periods beginning after December 15, 2018 with early adoption permitted.

In November 2016, the FASB issued ASU 2016-18, Restricted Cash – a consensus of the FASB Emerging Issues Task Force, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this Update apply to all entities that have restricted cash or restricted cash equivalents and are required to present a statement of cash flows. This ASU is effective for annual periods beginning after December 15, 2018 with early adoption permitted.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which provides a screen to determine when an integrated set of assets and activities (referred to collectively as a “set”) is not a business. If the screen is not met, it (1) requires that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) removes the evaluation of whether a market participant could replace the missing elements. This ASU is effective for annual periods beginning after December 15, 2018.

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. ASU Topic 350, Intangibles—Goodwill and Other (Topic 350), currently requires an entity that has not elected the private company alternative for goodwill to perform a two-step test to determine the amount, if any, of goodwill impairment. In Step 1, an entity compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the entity performs Step 2 and compares the implied fair value of goodwill with the carrying amount of that goodwill for that reporting unit. An impairment charge equal to the amount by which the carrying amount of goodwill for the reporting unit exceeds the implied fair value of that goodwill is recorded, limited to the amount of goodwill allocated to that reporting unit. The amendments in this ASU remove the second step of the test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. This ASU is effective for annual periods beginning after December 15, 2021 with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017.

In March 2017, the FASB issued ASU 2017-07, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Postretirement Benefit Cost. The amendments in this ASU require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. It also requires the other components of net periodic pension cost and net periodic postretirement benefit cost as defined in paragraphs 715-30-35-4 and 715-60-35-9 to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. Additionally, only the service cost component is eligible for capitalization, when applicable. This ASU is effective for fiscal years beginning after December 15, 2018 with early adoption permitted.

In May 2017, the FASB issued ASU 2017-09 Scope of Modification Accounting for Share - Based Payment Arrangements. The ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. For all entities, the ASU is effective for annual reporting periods beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period.

These updates and amendments are not significantly different to the accounting principles established by NIF, and therefore, they would not create material differences in the financial information of the Company once they are applied.