BANK DHOFAR SAOG

FINANCIAL STATEMENTS

31 DECEMBER 2015

Registered and principal place of business:

Bank Dhofar SAOG
Central Business District
P.O. Box 1507
Ruwi 112
Sultanate of Oman

Building a better
working world

Ernst & Young LLC
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C.R. No. 1224013
PR No. HMH/15/2015; HMA/9/2015

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BANK DHOFAR SAOG

Report on the Financial Statements

We have audited the accompanying financial statements of Bank Dhofar SAOG (the "Bank"), which comprise the statement of financial position as at 31 December 2015, and the statement of comprehensive income, and statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board of Directors' Responsibility for the Financial Statements

The Board of Directors is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the relevant requirements of the Commercial Companies Law of 1974, as amended, and the Capital Market Authority, and for such internal control as the Board of Directors determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2015, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

In our opinion, the financial statements comply, in all material respects, with the relevant requirements of the Commercial Companies Law of 1974, as amended, and the Capital Market Authority.

Ernst & Young

28 February 2016
Muscat

ارنست ويونغ ش م م
س.ت: ١٢٢٤٠١٣
ص ب: ١٧٥٠ روي - ١١٢، سلطنة عمان
EY ERNST & YOUNG LLC
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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF
Bank Dhofar SAOG (the "Bank")

We have audited the accompanying statement of financial position of Maisarah Islamic Banking Services (the "Islamic Window") as of 31 December 2015, and the related statements of income, changes in owners' equity, sources and uses of charity fund and cash flows for the year then ended 31 December 2015, and a summary of significant accounting policies and other explanatory information. These financial statements and the Bank's undertaking to operate its Islamic Window in accordance with Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Islamic Window as of 31 December 2015, the results of its operations, changes in owner's equity, sources and uses of charity fund and cash flows for the year then ended 31 December 2015 in accordance with the Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Islamic Window and the Financial Accounting Standards issued by AAOIFI.

Ernst & Young LLC

28 February 2016
Muscat

إرنست ويونغ ش م م
س.ت: ١٢٢٤٠١٣
ص.ب: ١٧٥٠ روي – ١١٢ ، سلطنة عمان
EY ERNST & YOUNG LLC
C.R. No. 1224013
P.O. Box 1750 - P.C. 112, Sultanate of Oman

STATEMENT OF FINANCIAL POSITION
As at 31 December 2015

	Notes	2015 RO'000	2014 RO'000
Assets			
Cash and balances with Central Bank of Oman	5	**439,833**	584,370
Loans, advances and financing to banks	7	**138,036**	91,164
Loans, advances and financing to customers	8	**2,729,306**	2,254,705
Available-for-sale investments	9	**35,802**	26,886
Held-to-maturity investments	10	**169,391**	149,988
Intangible asset	11	**1,986**	2,383
Property and equipment	12	**8,795**	9,683
Other assets	13	**69,912**	74,948
Total assets		**3,593,061**	3,194,127
Liabilities			
Due to banks	14	**308,864**	175,013
Deposits from customers	15	**2,592,371**	2,482,179
Other liabilities	16	**111,422**	107,742
Subordinated loans	17	**103,875**	103,875
Total liabilities		**3,116,532**	2,868,809
Shareholder's equity			
Share capital	18 (a)	**154,473**	134,324
Share premium	19	**40,018**	40,018
Special reserve	20 (d)	**18,488**	18,488
Legal reserve	20 (a)	**40,214**	35,537
Subordinated loan reserve	20 (b)	**62,025**	41,250
Investment revaluation reserve	20 (c)	**327**	(46)
Retained earnings	21	**45,484**	55,747
Total equity attributable to the equity holders of the Bank		**361,029**	325,318
Perpetual Tier 1 Capital Securities	18 (b)	**115,500**	-
Total equity		**476,529**	325,318
Total liabilities and equity		**3,593,061**	3,194,127
Net assets per share (Rial Omani)	22	**0.234**	0.242
Contingent liabilities and commitments	32	**844,318**	716,075

The financial statements were authorised on _________ 2016 for issue in accordance with a resolution of the Board of Directors.

Eng. Abdul Hafidh Salim Rajab Al-Aujaili
Chairman

Abdul Hakeem Omar Al Ojaili
Acting Chief Executive Officer

The attached notes 1 to 38 form part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2015

	Notes	**2015 RO'000**	2014 RO'000
Interest income		**118,173**	106,782
Interest expense		**(33,695)**	(33,202)
Net interest income	*23*	**84,478**	73,580
Income from Islamic financing		**7,683**	3,625
Profit expenses		**(1,954)**	(417)
Net income from Islamic financing and investment activities		**5,729**	3,208
Fees and commission income		**17,019**	13,483
Fees and commission expense		**(1,729)**	(1,335)
Net fees and commission income		**15,290**	12,148
Other income	*24*	**9,729**	9,915
Operating income		**115,226**	98,851
Staff and administrative costs	*25*	**(47,862)**	(42,580)
Depreciation	12	**(3,337)**	(3,583)
Operating expenses		(**51,199)**	(46,163)
Profit from operations		**64,027**	52,688
Provision for loan impairment	*26*	**(14,305)**	(11,658)
Recoveries from allowance for loan impairment	*26*	**5,522**	4,724
Bad debts written-off		**(1)**	-
Impairment of available-for-sale investments	*20*	**(2,742)**	-
Profit from operations after provision		**52,501**	45,754
Income tax expense	*27*	**(5,736)**	(5,301)
Profit for the year		**46,765**	40,453
Profit for the year		**46,765**	40,453
Other comprehensive income:			
Items that are or may be reclassified to statement of income:			
Net changes in fair value of available-for-sale investments	*9*	**(2,238)**	(1,159)
Reclassification adjustment on sale of available-for-sale investments	*9*	**(131)**	(641)
Impairment of available-for-sale investments	20	**2,742**	-
Other comprehensive loss for the year, net of tax		**373**	(1,800)
Total comprehensive income for the year		**47,138**	38,653
Earnings per share basic and diluted (Rials Omani)	28	**0.027**	0.026

The attached notes 1 to 38 form part of these financial statements.

BANK DHOFAR SAOG

STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2015

		Attributable to equity holders of Bank									
	Notes	**Share capital**	**Share premium**	**Special reserve**	**Legal reserve**	**Subordinated loans reserve**	**Investment revaluation reserve**	**Retained earnings**	**Total**	**Perpetual Tier capital security**	**Total equity**
		RO'000	**RO'000**	**RO'000**	**RO'000**	**RO'000**	**RO'000**	**RO'000**	**RO'000**	**RO'000**	**RO'000**
Balances as at 1 January 2015		**134,324**	**40,018**	**18,488**	**35,537**	**41,250**	**(46)**	**55,747**	**325,318**		**325,318**
Total comprehensive income for the year											
Profit for the year		**-**	**-**	**-**	**-**	**-**	**-**	**46,765**	**46,765**	**-**	**46,765**
Other comprehensive income for the year											
Net change in fair value of available-for-sale investments		**-**	**-**	**-**	**-**	**-**	**(2,238)**	**-**	**(2,238)**	**-**	**(2,238)**
Transfer to statement of income on sale of available-for-sale investments		**-**	**-**	**-**	**-**	**-**	**(131)**	**-**	**(131)**	**-**	**(131)**
Impairment of available-for-sale investments		**-**	**-**	**-**	**-**	**-**	**2,742**	-	**2,742**	**-**	**2,742**
Total comprehensive income for the year		**-**	**-**	**-**	**-**	**-**	**373**	**46,765**	**47,138**	**-**	**47,138**
Transfer to legal reserve	*20*	**-**	**-**	**-**	**4,677**	**-**	**-**	**(4,677)**	**-**	**-**	-
Transfer to subordinated loan reserve	*20*	**-**	**-**	**-**	**-**	**20,775**	**-**	**(20,775)**	**-**	**-**	-
Proceeds from Perpetual Tier 1 capital securities		-	-	-	-	-	-	**-**	-	**115,500**	**115,500**
Perpetual Tier 1 issuance cost		-	-	-	-	-	-	**(755)**	**(755)**	**-**	**(755)**
Additional Tier 1 coupon		-	-	-	-	-	-	**(3,956)**	**(3,956)**	**-**	**(3,956)**
Transactions with owners recorded directly in equity											
Dividend paid for 2014	38	-	-	-	-	-	-	**(6,716)**	**(6,716)**	**-**	**(6,716)**
Bonus shares issued for 2014	*38*	**20,149**	**-**	**-**	**-**	**-**	**-**	**(20,149)**	**-**	**-**	-
Balances as at 31 December 2015		**154,473**	**40,018**	**18,488**	**40,214**	**62,025**	**327**	**45,484**	**361,029**	**115,500**	**476,529**

The attached notes 1 to 38 form part of these financial statements.

STATEMENT OF CHANGES IN EQUITY (continued)
For the year ended 31 December 2015

		Attributable to equity holders of Bank									
	Notes	Share capital RO'000	Share premium RO'000	Special reserve RO'000	Legal reserve RO'000	Subordinated loans reserve RO'000	Investment revaluation reserve RO'000	Retained earnings RO'000	Total RO'000	Perpetual Tier capital security RO'000	Total equity RO'000
Balances as at 1 January 2014		**121,013**	**40,018**	**18,488**	**31,492**	**26,250**	**1,754**	**64,592**	**303,607**		**303,607**
Total comprehensive income for the year											
Profit for the year		-	-	-	-	-	-	**40,453**	**40,453**	-	**40,453**
Other comprehensive income for the year											
Net change in fair value of available-for-sale investments		-	-	-	-	-	**(1,159)**	-	**(1,159)**	-	**(1,159)**
Transfer to statement of income on sale of available-for-sale investments		-	-	-	-	-	**(641)**	-	**(641)**	-	**(641)**
Total comprehensive income for the year		-	-	-	-	-	**(1,800)**	**40,453**	**38,653**	-	**38,653**
Transfer to legal reserve	*20*	-	-	-	**4,045**	-	-	**(4,045)**	-	-	-
Transfer to subordinated loan reserve	*20*	-	-	-	-	**15,000**	-	**(15,000)**	-	-	-
Transactions with owners recorded directly in equity											
Dividend paid for 2013	*38*	-	-	-	-	-	-	**(16,942)**	**(16,942)**	-	**(16,942)**
Bonus shares issued for 2013	*38*	**13,311**	-	-	-	-	-	**(13,311)**	-	-	-
Balances as at 31 December 2014		**134,324**	**40,018**	**18,488**	**35,537**	**41,250**	**(46)**	**55,747**	**325,318**	-	**325,318**

The attached notes 1 to 38 form part of these financial statements.

BANK DHOFAR SAOG

STATEMENT OF CASH FLOWS
For the year ended 31 December 2015

	2015	2014
	RO'000	RO'000
Cash flows from operating activities		
Interest, financing income, commission and other receipts	**145,569**	129,793
Interest payments, return on islamic banking deposits	**(36,171)**	(33,639)
Cash payments to suppliers and employees	**(39,817)**	(51,397)
	69,581	44,757
Decrease in operating assets		
Loans, advances and financing to customers	**(483,384)**	(359,729)
Loans, advances and financing to banks	**(4,688)**	(12,117)
Receipts from treasury bills and certificates of deposits (net)	**(154)**	(15,416)
	(488,226)	(387,262)
Increase in operating liabilities		
Deposits from customers	**110,192**	450,433
Due to banks	**132,960**	68,478
	243,152	518,911
Net cash from operating activities	**(175,493)**	176,406
Income tax paid	**(5,392)**	(7,580)
Net cash from operating activities	**(180,885)**	168,826
Cash flows from investing activities		
Investment income	**2,856**	1,960
Purchase of investments	**(9,976)**	(12,786)
Proceeds from sale of investments	**1,629**	8,827
Dividend received	**718**	757
Purchase of property and equipment	**(2,586)**	(2,410)
Proceeds from sale of property and equipment	**176**	186
Net cash used in investing activities	**(7183)**	(3,466)
Cash flow (used in) / from financing activities		
Subordinated loan	**-**	28,875
Proceeds from issue of perpetual tier 1 capital securities	**115,500**	-
Additional tier 1 coupon	**(3,956)**	-
Perpetual tier 1 capital securities issuance cost	**(755)**	-
Dividend paid	**(6,716)**	(16,942)
Net cash from financing activities	**104,073**	11,933
Net change in cash and cash equivalents	**(83,995)**	177,293
Cash and cash equivalents at the beginning of the year	**602,548**	425,255
Cash and cash equivalents at the end of the year	**518,553**	602,548
Cash and balances with Central Bank of Oman (Note 5)	**439,833**	584,370
Capital deposit with Central Bank of Oman	**(500)**	(500)
Loans, advances and financing to banks due within 90 days	**61,660**	19,476
Treasury bills within 90 days	**19,249**	-
Due to banks within 90 days	**(1,689)**	(798)
Cash and cash equivalents for the purpose of the cash flow statement	**518,553**	602,548

The attached notes 1 to 38 form part of these financial statements.

1 LEGAL STATUS AND PRINCIPAL ACTIVITIES

Bank Dhofar SAOG (the "Bank") is incorporated in the Sultanate of Oman as a public joint stock company and is principally engaged in corporate, retail and investment banking activities. The Bank's Islamic Banking Window, Maisarah Islamic Banking services has an allocated capital of RO 40 million from the core paid up capital of the shareholders. The Bank has a primary listing on the Muscat Securities Market ("MSM") and its principal place of business is the Head Office, Capital Business District ("CBD"), Muscat, Sultanate of Oman.

2 BASIS OF PREPARATION

The Bank prepares a separate set of financial statements for its Islamic Banking Window (IBW) in accordance with the requirements of Section 1.2 of Title 3 of the Islamic Banking Regulatory Framework ("IBRF") issued by CBO. The separate set of financial statements of its IBW are prepared in accordance with Financial Accounting Standards ("FAS") issued by Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"), the Sharia Rules and Principles as determined by the Sharia Supervisory Board of the Islamic Window (the "SSB") and other applicable requirements of CBO. The IBWs financial statements are then converted into International Financial Reporting Standards (IFRS) compliant financial statements and included in these financial statements. All inter branch balances and transactions have been eliminated.

2.1 Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by International Accounting Standards Board (IASB), the requirements of the Commercial Companies Law of 1974, as amended and disclosure requirements of the Capital Market Authority of the Sultanate of Oman and the applicable regulations of the Central Bank of Oman.

2.2 Basis of measurement

The financial statements have been prepared on the historical cost basis except for derivative financial instruments, financial instruments at fair value through profit and loss and available-for-sale financial assets which are measured at fair value. The carrying values of recognised assets and liabilities that are designated as hedged items in fair value hedges that would otherwise be carried at amortised cost are adjusted to record changes in the fair values attributable to the risks that are being hedged in effective hedge relationships.

2.3 Functional and presentation currency

Items included in the Bank's financial statements are measured using Rials Omani which is the currency of the primary economic environment in which the Bank operates, rounded off to the nearest thousand.

2.4 Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements estimates and assumptions that effect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in note 4.

2 BASIS OF PREPARATION (*continued*)

2.5 (a) New and amended standards and interpretations to IFRS relevant to the Bank

For the year ended 31 December 2015, the Bank has adopted all of the new and revised standards and interpretations issued by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for periods beginning on 1 January 2015.

The following new standards and amendments became effective as of 1 January 2015:

- Amendments to IAS 19 Defined Benefit Plans: Employee Contributions
- Annual Improvements 2010-2012 Cycle
  - IFRS 2 Share-based Payment
  - IFRS 3 Business Combinations
  - IFRS 8 Operating Segments
  - IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets
  - IAS 24 Related Party Disclosures
- Annual Improvements 2011-2013 Cycle
  - IFRS 3 Business Combinations
  - IFRS 13 Fair Value Measurement
  - IAS 40 Investment Property

The adoption of those standards and interpretations has not resulted in any major changes to the Bank's accounting policies and has not affected the amounts reported for the current and prior periods.

2.5 (b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank:

The following new standards and amendments have been issued by the International Accounting Standards Board (IASB) but are not yet mandatory for the year ended 31 December 2015:

- IFRS 15, Revenue from Contracts with Customers: effective for annual periods commencing 1 January 2018;
- IFRS 9, Financial Instruments - Hedge accounting: effective for annual periods commencing 1 January 2018;
- IFRS 16, Leases: effective for annual periods commencing 1 January 2019;
- IFRS 14 Regulatory Deferral Accounts
- Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisitions of Interests
- Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation
- Amendments to IAS 27: Equity Method in Separate Financial Statements
- Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture
- Annual Improvements 2012-2014 Cycle – Amendments to IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, IFRS 7 Financial Instruments: Disclosures, IAS 19 Employee Benefits and IAS 34 Interim Financial Reporting
- Amendments to IAS 1 Disclosure Initiative
- Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception

2 BASIS OF PREPARATION (*continued*)

2.5 (b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank: (continued)

IFRS 9 Financial Instruments
In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* that replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

The Bank plans to adopt the new standard on the required effective date. The Bank plans to perform a detailed assessment in the future to determine the impact of all three aspects of IFRS 9.

(a) Classification and measurement
The Bank does not expect a significant impact on its balance sheet or equity on applying the classification and measurement requirements of IFRS 9. It expects to continue measuring at fair value all financial assets currently held at fair value. Quoted equity shares currently held as available-for-sale with gains and losses recorded in other comprehensive income (OCI) will be measured at fair value through profit or loss instead, which will increase volatility in recorded profit or loss. The Available-for-sale (AFS) reserve currently in accumulated OCI will be reclassified to opening retained earnings. Debt securities are expected to be measured at fair value through OCI under IFRS 9 as the Bank expects not only to hold the assets to collect contractual cash flows but also to sell a significant amount on a relatively frequent basis.

The equity shares in non-listed companies are intended to be held for the foreseeable future. The Bank expects to apply the option to present fair value changes in OCI, and, therefore, believes the application of IFRS 9 would not have a significant impact. If the Bank were not to apply that option, the shares would be held at fair value through profit or loss, which would increase the volatility of recorded profit or loss.

Loans as well as trade receivables are held to collect contractual cash flows and are expected to give rise to cash flows representing solely payments of principal and interest. Thus, the Bank expects that these will continue to be measured at amortised cost under IFRS 9. However, the Bank will analyse the contractual cash flow characteristics of those instruments in more detail before concluding whether all those instruments meet the criteria for amortised cost measurement under IFRS 9.

(b) Impairment
IFRS 9 requires the Bank to record expected credit losses on all of its debt securities, loans and trade receivables, either on a 12-month or lifetime basis. The Bank expects to apply the simplified approach and record lifetime expected losses on all trade receivables. The Bank expects an impact on its equity due to unsecured nature of its loans and receivables, but it will need to perform a detailed analysis which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact.

2 BASIS OF PREPARATION (*continued*)

2.5 (b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank: (continued)

IFRS 9 Financial Instruments (continued)

(c) Hedge accounting
The Bank believes that all existing hedge relationships that are currently designated in effective hedging relationships will still qualify for hedge accounting under IFRS 9. As IFRS 9 does not change the general principles of how an entity accounts for effective hedges, the Bank does not expect a significant impact as a result of applying IFRS 9. The Bank will assess possible changes related to the accounting for the time value of options, forward points or the currency basis spread in more detail in the future.

IFRS 15 Revenue from Contracts with Customers
IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognising revenue. The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2018 with early adoption permitted. The Bank is currently assessing the impact of IFRS 15 and plan to adopt the new standard on the required effective date. The Bank is considering the clarifications issued by the IASB in an exposure draft in July 2015 and will monitor any further developments.

IFRS 16 Leases
The IASB issued IFRS 16 Leases (IFRS 16), which requires lessees to recognise assets and liabilities for most leases. For lessors, there is little change to the existing accounting in IAS 17 Leases. The Bank will perform a detailed assessment in the future to determine the extent. The new standard will be effective for annual periods beginning on or after 1 January 2019. Early application is permitted, provided the new revenue standard, IFRS 15 Revenue from Contracts with Customers, has been applied, or is applied at the same date as IFRS 16.

Other IASB Standards and Interpretations that have been issued but are not yet mandatory, and have not been early adopted by the Bank, are not expected to have a material impact on the Bank's financial statements.

3 SIGNIFICANT ACCOUNTING POLICIES

3.1 Foreign currency translations

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of income. Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, other than those held at cost, such as equities classified as available-for-sale financial assets, are included in the investment revaluation reserve in equity.

3.2 Financial assets and liabilities

3.2.1 Classification

The Bank classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, held to maturity and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(a) Financial assets at fair value through profit or loss

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

i) The designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis.

ii) The assets and liabilities are part of a group of financial assets, financial liabilities or both, which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy.

iii) The financial instrument contains one or more embedded derivatives, which significantly modify the cash flows that would otherwise be required by the contract.

Financial assets and financial liabilities at fair value through profit or loss are recorded in the statement of financial position at fair value. Changes in fair value are recorded in other operating income. Interest earned or incurred is accrued in interest income or interest expense, respectively, using the Effective Interest Rate ("EIR"), while dividend income is recorded in other operating income when the right to the payment has been established.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

When the Bank is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of an asset to the lessee, the arrangement is presented within loans and advances.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Financial assets and liabilities (continued)

3.2.1 Classification (continued)

(b) Loans and receivables (continued)

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest rate method. Interest on loans is included in the statement of comprehensive income and is reported as ‘interest income’. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the loan and recognised in the consolidated statement of comprehensive income as ‘Impairment for credit losses’.

(c) Held to maturity

Held to maturity financial assets are non-derivative assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity and which are not designated at fair value through profit or loss or available-for-sale.

These are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method.

Interest on held to maturity investments is included in the consolidated statement of comprehensive income and reported as ‘interest income’. In the case of impairment, the impairment loss is been reported as a deduction from the carrying value of the investment and recognised in the consolidated statement of comprehensive income as ‘impairment for investments’. Held to maturity investments are corporate bonds and treasury bills.

(d) Available-for-sale financial assets

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

The Bank has not designated any loans or receivables as available-for-sale.

After initial measurement, available-for-sale financial investments are subsequently measured at fair value.

Unrealised gains and losses are recognised directly in equity (other comprehensive income) in the change in fair value of investments available-for-sale. When the investment is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the profit or loss in other operating income. Interest earned whilst holding available-for-sale financial investments is reported as interest income using the EIR. Dividends earned whilst holding available-for-sale financial investments are recognised in the profit or loss as other operating income when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the profit or loss in impairment for investments and removed from the change in fair value of investments available-for-sale.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Financial assets and liabilities (continued)

3.2.2 Derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Bank designates certain derivatives as either:

(i) hedges of the fair value of recognised assets or liabilities or a firm commitment (fair value hedge);

(ii) hedges of a particular risk associated with a recognised asset or liability or a highly probable forecast transaction (cash flow hedge); or

(iii) hedges of a net investment in a foreign operation (net investment hedge).

The Bank makes use of derivative instruments to manage exposures to interest rate, foreign currency and credit risks, including exposures arising from highly probable forecast transactions and firm commitments. In order to manage particular risks, the Bank applies hedge accounting for transactions which meet specified criteria. Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any such derivative instruments are recognised immediately in the statement of comprehensive income within ‘Other income’.

At inception of the hedge relationship, the Bank formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the risk management objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship at inception and ongoing basis.

At each hedge effectiveness assessment date, a hedge relationship must be expected to be highly effective on a prospective basis and demonstrate that it was effective (retrospective effectiveness) for the designated period in order to qualify for hedge accounting. A formal assessment is undertaken by comparing the hedging instrument’s effectiveness in offsetting the changes in fair value or cash flows attributable to the hedged risk in the hedged item, both at inception and at each quarter end on an ongoing basis. A hedge is expected to be highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated were offset by the hedging instrument in a range of 80% to 125% and were expected to achieve such offset in future periods. Hedge ineffectiveness is recognised in the profit or loss in ‘other income’. For situations where the hedged item is a forecast transaction, the Bank also assesses whether the transaction is highly probable and an exposure to variations in cash flows that could ultimately affect the profit or loss.

(i) Fair value hedges
For designated and qualifying fair value hedges, the cumulative change in the fair value of a hedging derivative is recognised in the profit or loss in other operating income. Meanwhile, the cumulative change in the fair value of the hedged item attributable to the risk hedged is recorded as part of the carrying value of the hedged item in the consolidated statement of financial position and is also recognised in the profit or loss in other income. If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is discontinued prospectively. For hedged items recorded at amortised cost, the difference between the carrying value of the hedged item on termination and the face value is amortised over the remaining term of the original hedge using the recalculated EIR method. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the profit or loss.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Financial assets and liabilities (continued)

3.2.2 Derivative financial instruments and hedging activities

(ii) Cash flow hedges
For designated and qualifying cash flow hedges, the effective portion of the cumulative gain or loss on the hedging instrument is initially recognised directly in equity in the Cash flow hedge reserve. The ineffective portion of the gain or loss on the hedging instrument is recognised immediately in other income in the profit or loss.

When the hedged cash flow affects the profit or loss, the gain or loss on the hedging instrument is recorded in the corresponding income or expense line of the profit or loss. When the forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously recognised in the other comprehensive income are removed from the reserve and included in the initial cost of the asset or liability.

When a hedging instrument expires, or is sold, terminated, exercised, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss that has been recognised in other comprehensive income at that time remains in other comprehensive income and is recognised when the hedged forecast transaction is ultimately recognised in the profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to the profit or loss.

3.2.3 Recognition

The Bank initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date that they are originated. All other financial assets and liabilities are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

3.2.4 Derecognition

(i) Financial assets
A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- The rights to receive cash flows from the asset have expired
- The Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a ‘pass–through’ arrangement; and either:
  - The Bank has transferred substantially all the risks and rewards of the asset; or
  - The Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass–through arrangement, and has neither transferred nor retained substantially all of the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank’s continuing involvement in the asset. In that case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Financial assets and liabilities (continued)

3.2.4 Derecognition (continued)

(ii) Financial liabilities
A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss.

3.2.5 Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and the Bank intends to either settle on a net basis or to realise the asset and settle the liability simultaneously. Income and expenses are presented on a net basis only when permitted by the accounting standards or for gains and losses arising from a Bank of similar transactions.

3.2.6 Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the EIR of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

3.2.7 Fair value measurement

A number of the Bank's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on a number of accounting policies and methods. Where applicable, information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability. Details are set out in note 34.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible to the Bank.

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

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

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

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Financial assets and liabilities (continued)

3.2.7 Fair value measurement (continued)

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

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

At each reporting date, the Bank analyses the movements in the values of assets and liabilities which are required to be re-measured or re-assessed as per the Bank's accounting policies. For this analysis, the Bank verifies the major inputs applied in the latest valuation by agreeing the information in the Valuation computation to contracts and other relevant documents.

The Bank also compares each the changes in the fair value of each asset and liability with relevant external sources to determine whether the change is reasonable.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

3.2.8 Investment in equity and debt securities

For investments traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market prices at the close of business on the reporting date.

The fair value of interest-bearing items is estimated based on discounted cash flows using interest rates for items with similar terms and risk characteristics.

For unquoted equity investments fair value is determined by reference to the market value of a similar investment or is based on the expected discounted cash flows.

3.2.9 Fair value measurement of derivatives

The fair value of forward contracts is estimated based on observable market inputs for such contracts as on the reporting date.

The fair value of interest rate swaps is arrived at by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3 Identification and measurement of impairment of financial assets

(a) Assets carried at amortised cost

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and an impairment loss is incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention about the following loss events as well as considering the guidelines issued by the Central Bank of Oman:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including adverse changes in the payment status of borrowers in the group, or national or local economic conditions that correlate with defaults on the assets in the group.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a Bank of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of comprehensive income. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

Future cash flows of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Bank and historical loss experience for assets with credit risk characteristics similar to those in the Bank.

The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3 Identification and measurement of impairment of financial assets (continued)

(a) Assets carried at amortised cost (continued)

When a loan is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.

If in a subsequent period, the amount of impairment loss decreases and decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the statement of comprehensive income. Also refer to notes 3.2.1 (b) loans and receivables and 3.2.1 (c) held to maturity investments.

(b)Assets classified as available-for-sale

The Bank assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. For debt securities, the Bank uses the criteria referred to at (a) above. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is also evidence that the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss - is removed from equity and recognised in the profit or loss. Impairment losses on equity instruments recognised in the profit or loss are not reversed through profit or loss; increases in their fair value after impairment are recognised in other comprehensive income. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the profit or loss.

(c)Renegotiated loans

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

3.4 Cash and cash equivalents

Cash and cash equivalents consist of cash in hand, balances with Bank, treasury bills and money market placements and deposits maturing within three months of the date of acquisition. Cash and cash equivalents are carried at amortised cost in the statement of financial position. Treasury bills and certificates of deposit issued for a term longer than three months are classified as available-for-sale or held-to-maturity at the date of acquisition.

3.5 Due from banks

These are stated at cost, less any amounts written off and provisions for impairment. Due from banks include Nostro balances, placements and loans to banks.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.6 Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and impairment loss. Cost includes expenditures that are directly attributable to the acquisition of the asset.

When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

	Years
Buildings	7 - 25
Furniture and fixtures	3 - 7
Motor vehicles	3 - 5
Computer equipment	4
Core banking system	10

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within 'Other income' in the statement of comprehensive income.

Repairs and renewals are charged to the statement of comprehensive income when the expense is incurred. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditure is recognised in the statement of comprehensive income as an expense as incurred.

3.7 Collateral pending sale

The Bank occasionally acquires real estate in settlement of certain loans and advances. Real estate is stated at the lower of the net realisable value of the related loans and advances and the current fair value of such assets. Gains or losses on disposal and unrealised losses on revaluation are recognised in the statement of comprehensive income.

3.8 Intangible assets

Goodwill represents the excess of the cost of an acquisition over the fair value of the net identifiable assets acquired at the date of acquisition. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.

3.9 Deposits

Deposits from banks and customers, debt securities and subordinated liabilities are the Bank's sources of funding. These are initially measured at fair value plus transaction costs and subsequently measured at their amortised cost using the EIR.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.10 Income tax

Income tax expense comprises current and deferred tax. Taxation is provided in accordance with Omani fiscal regulations.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date and any adjustments to tax payable in respect of previous years.

Income tax is recognised in the profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Deferred tax assets/liabilities are calculated using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the reporting date.

The carrying amount of deferred income tax assets/liabilities is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

3.11 Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Bank in the statement of financial position.

3.12 Acceptances

Acceptances are disclosed on the statement of financial position under other assets with corresponding liability disclosed under other liabilities. Therefore, there is no off-balance sheet commitment for acceptances.

3.13 Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in amounts due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to other banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.14 Trade and settlement date accounting

All “regular way” purchases and sales of financial assets are recognised on the trade date, i.e. that date the Bank commits to purchase the assets. Regular way purchase or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

3.15 Leases

Finance leases, which transfer to the Bank substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the statement of comprehensive income on a straight-line basis over the lease term.

3.16 Employee benefits

End of service benefits are accrued in accordance with the terms of employment of the Bank’s employees at the reporting date, having regard to the requirements of the Oman Labour Law. Employee entitlements to annual leave and leave passage are recognised when they accrue to employees and an accrual is made for the estimated liability arising as a result of services rendered by employees up to the reporting date.

Contributions to a defined contribution retirement plan and occupational hazard insurance for Omani employees in accordance with the Omani Social Insurances Law of 1991 and its subsequent amendments are recognised as an expense in the statement of comprehensive income as incurred.

3.17 Financial guarantees contracts

Financial guarantees are contracts that require the issuer to make specified payments to reimburse the beneficiary for a loss incurred because the debtor fails to make payments when due, in accordance with the terms of the debt. Such guarantees are given to Banks, financial institutions or other entities on behalf of the customers.

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was issued. Subsequent to initial recognition, the Bank’s liabilities under such guarantees are measured at the higher of initial measurement, less amortisation calculated to recognise in the statement of comprehensive income the fee income earned on the straight line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the reporting date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgment of management. Any increase in the liability relating to guarantees is taken to the statement of comprehensive income.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.18 Borrowings

Borrowings are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the statement of income over the period of the borrowings using the effective interest method.

Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw-down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalised as a pre-payment for liquidity services and amortised over the period of the facility to which it relates.

3.19 Dividend on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the shareholders. Interim dividends are deducted from equity when they are paid.

Dividends for the year that are approved after the reporting date are dealt with as an event after the balance sheet date.

3.20 Directors' remuneration

The board of directors' remuneration is accrued within the limits specified by the Capital Market Authority and the requirements of the Commercial Companies Law of the Sultanate of Oman.

3.21 Revenue and expense recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

3.21.1 Interest income and expense

For all financial instruments measured at amortised cost, interest bearing financial assets classified as available-for-sale and financial instruments designated at fair value through profit or loss, interest income or expense is recorded using the effective interest rate (EIR). EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses.

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

Interest income, which is doubtful of recovery is included in loan impairment and excluded from income, until it is received in cash.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.21 Revenue and expense recognition (continued)

3.21.2 Fees and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank retained no part of the loan package for itself or retained a part at the same effective interest rate for the other participants. Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party – such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportionment basis. Asset management fees related to investment funds are recognised rateably over the period the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time.

3.21.3 Dividends

Dividend income is recognised in the consolidated statement of comprehensive income in 'Other income, when the Bank's right to receive income is established.

3.21.4 Provisions

A provision is recognised if, as a result of past event, the Bank has a present legal or constructive obligation that can be estimated reliably and it is probable that an outflow of economic benefits will be required to settle the obligations. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the liability.

3.22 Segment reporting

A segment is a distinguishable component of the Bank that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. The Bank currently operates only in the Sultanate of Oman. The Bank's primary format for reporting segmental information is business segments, based upon management and internal reporting structure. The Bank's main business segments are corporate and retail banking. Segmental information pertaining to Islamic Banking Window is also disclosed in note 37.

3.23 Earnings per share

The Bank presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprises convertible notes.

4 CRITICAL ACCOUNTING JUDGMENT AND KEY SOURCES OF ESTIMATION UNCERTAINTY

The preparation of financial statements requires the management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. The resulting accounting estimates will, by definition, seldom equal the related actual results. Specific fair value estimates are disclosed in note 34.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods. The Bank's significant accounting estimates were on:

(a) Classification of investments

Management decides on acquisition of an investment whether it should be classified as fair value through profit or loss, available-for-sale or held-to-maturity investments.

Available-for-sale investments

Management follows the guidance set out in International Accounting Standard (IAS) 39 Financial Instruments: Recognition and Measurement on classifying non-derivative financial assets as available-for-sale. This classification requires management's judgement based on its intentions to hold such investments.

Held-to-maturity investments

Management follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgements. In making this judgement, the Management evaluates its intention and ability to hold such investments to maturity. If the Management fails to keep these investments to maturity other than for the specific circumstances-for example, selling an insignificant amount close to maturity – it will be required to classify the entire class as available-for-sale. The investments would, therefore, be measured at fair value.

(b) Fair value estimation

Fair value is based on quoted market prices at reporting date without any deduction for transaction costs. If a quoted market price is not available, fair value is estimated based on discounted cash flow and other valuation techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market-related rate for a similar instrument at the reporting date.

4 CRITICAL ACCOUNTING JUDGMENT AND KEY SOURCES OF ESTIMATION UNCERTAINTY *(continued)*

(c) Impairment

Impairment losses on loans and advances

The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the consolidated statement of comprehensive income, the Bank makes judgements as to whether there is any observable data indicating an impairment followed by measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified within that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers and or national or local economic conditions that correlate with defaults on assets in the Bank. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed periodically to reduce any difference between loss estimates and actual loss experience. For individually significant loans and advances which are impaired, the necessary impairment loss is considered based on the future cash flow estimates. Individually significant loans and advances which are not impaired and all individually insignificant loans and advances are then assessed collectively considering historical experience and observable data on a portfolio basis, in groups of assets with similar risk characteristics to determine whether collective impairment loss to be made. In determining collective impairment loss, the Bank takes into account several factors including credit quality, concentration risk, levels of past due, sector performance, available collateral and macro-economic conditions.

Impairment on due from banks

The Bank reviews its portfolio of due from banks on a quarterly basis to assess impairment. In determining whether an impairment loss should be recorded in the consolidated statement of comprehensive income, the Bank makes judgements as to whether there is any observable data indicating an impairment. For individually impaired placements, the Bank considers the necessary impairment loss based on the expected cash flows and borrower's financial position. In addition, the Bank assesses the portfolio on a collective basis and estimates the collective impairment loss if any. The judgements and estimates used for impairment assessment depend on a number of parameters which include the borrower's financial condition, local and international economic conditions and economic outlook

Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Bank to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value.

Impairment of available-for-sale equity investment

Management determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, management evaluates among other factors, the normal volatility in equity price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology and operational and financing cash flows.

4 CRITICAL ACCOUNTING JUDGMENT AND KEY SOURCES OF ESTIMATION UNCERTAINTY *(continued)*

(d) Useful life of property and equipment

Depreciation is charged so as to write off the cost of assets over their estimated useful lives. The calculation of useful lives is based on management's assessment of various factors such as the operating cycles, the maintenance programs, and normal wear and tear using its best estimates.

(e) Deferred tax asset

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits together with future tax planning strategies

5 Cash and balances with Central Bank of Oman

	2015 **RO'000**	2014 RO'000
Cash in hand	**31,979**	36,121
Balances with the Central Bank of Oman	**237,684**	238,249
Placements with Central Bank of Oman	**170,170**	-
Certificate of deposits with original maturity of 90 days or less	**-**	310,000
	439,833	584,370

At 31 December 2015, cash and balances with Central Bank of Oman included balances with the Central Bank of Oman amounting to RO 500,000 (2014: RO 500,000) as minimum reserve requirements. These funds are not available for the Bank's daily business.

6 Recovery from a legal case (RO 26.1 million)

In relation to Oman International Bank "OIB" (currently HSBC Oman) case filed against the Bank, Ali Redha and his group companies, the Bank on 25 March 2013 received a cheque of RO 26.1 million from the Primary Court in Muscat. This amount being the amount transferred in September 2011 from Bank Dhofar to the Primary Court under the above mentioned case proceedings. By receiving the amount of RO 26.1 million, the case has been closed in the Bank's favour in 2013.

7. Loans and advances to banks

	2015 **RO'000**	2014 RO'000
Syndicated loans to other banks	**80,841**	73,920
Less: impairment allowance (collective)	**(409)**	(439)
Net syndicated loans to other banks	**80,432**	73,481
Placements with other banks	**48,090**	4,821
Current clearing accounts	**9,514**	12,862
	138,036	91,164

At 31 December 2015, there are no concentrations with any banks representing 20% or more of the Bank's placements (2014: no concentration).

Movement of the impairment allowance as below:

	2015 **RO'000**	2014 RO'000
Opening balance as on 1 January	**439**	367
Add: Additions during the year	**-**	256
Less: Reversal during the year	**(30)**	(184)
Closing balance as on 31 December	**409**	439

8 Loans, advances and financing to customers

	2015	2014
	RO'000	RO'000
Overdrafts	**149,261**	130,591
Loans	**2,299,290**	1,953,070
Loans against trust receipts	**111,700**	79,484
Bills discounted	**6,867**	10,445
Advance against credit cards	**7,684**	7,705
Others	**43,207**	27,980
Islamic Banking Window financing	**209,915**	133,034
Gross loans, advances and financing	**2,827,924**	2,342,309
Less: Impairment allowance	**(98,618)**	(87,604)
Net loans, advances and financing	**2,729,306**	2,254,705

The movement in the impairment allowance is analysed below:

(a) Allowance for loan impairment

	2015	2014
1 January	**56,887**	50,809
Allowance during the year	**14,335**	11,586
Released to the statement of income during the year	**(5,522)**	(4,724)
Written off during the year	**(890)**	(784)
31 December	**64,810**	56,887

(b) Reserved interest

	2015	2014
1 January	**30,717**	29,810
Reserved during the year	**6,042**	5,682
Released to the statement of income during the year	**(763)**	(944)
Written off during the year	**(2,188)**	(3,831)
31 December	**33,808**	30,717
Total impairment allowance	**98,618**	87,604

As a matter of policy, the Bank considers waiver / write-off or settlement only in such cases where the Bank is satisfied that the recovery of the full outstanding liabilities from the borrower is not possible in the normal course of business or out of the securities realisation or through enforcement of the guarantee (wherever available) and that legal action will not yield higher recoveries after considering the time and costs involved.

Proposals for waivers /write off are not formula driven and are decided on case by case basis after weighing all pros and cons. The rationale is invariably documented. In all cases, the Bank aims to recover the maximum value through enforcement of collaterals/guarantees etc.

In 2015, the Bank has written off RO 2.42 million (2014: RO 2.66 million) as technical write off.

8 Loans, advances and financing to customers *(continued)*

Interest is reserved by the Bank against loans and advances which are impaired.

Out of the total provisions of RO 98,618,000 (2014: RO 87,604,000) a collective provision was made on portfolio basis amounting to RO 37,792,000 (2014: RO 32,349,000). Collective provision includes RO 2,430,000 against financing of Islamic window (2014: RO 1,494,000)

At 31 December 2015, impaired loans and advances on which interest has been reserved amount to RO 64,932,694 (2014: RO 58,680,172) and loans and advances on which interest is not being accrued amount to RO 973,000 (2014: RO 1,251,000).

Loans advances and financing are summarised as follows:

	2015		2014	
	Loans, advances and financing to customers RO'000	**Loans, advances and financing to banks RO'000**	Loans, advances and financing to customers RO'000	Loans, advances and financing to banks RO'000
Neither past due nor impaired	**2,728,369**	**138,445**	2,265,922	91,603
Past due but not impaired	**34,624**	**-**	16,625	-
Impaired	**64,931**	**-**	59,762	-
Gross loans and advances	**2,827,924**	**138,445**	2,342,309	91,603
Less: Impairment allowance	**(98,618)**	**(409)**	(87,604)	(439)
Total	**2,729,306**	**138,036**	2,254,705	91,164

Loans, advances and financing neither past due nor impaired

The credit quality of the portfolio of loans, advances and financing that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by the Bank.

Loans and advances past due but not impaired

	2015 RO'000	2014 RO'000
Past due up to 30 days	**19,867**	11,019
Past due 30 – 60 days	**10,996**	4,082
Past due 60 – 89 days	**3,761**	1,524
Total	**34,624**	16,625

8 Loans, advances and financing to customers *(continued)*

Impaired

	2015	2014
	RO'000	RO'000
Substandard	**3,069**	2,999
Doubtful	**5,257**	3,608
Loss	**56,605**	53,155
Total	**64,931**	59,762

Fair value of collaterals

Upon initial recognition of loans, advances and financing, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In subsequent periods, the fair value is updated by reference to market price or indexes of similar assets.

Loans, advances and financing renegotiated

Restructuring activities include extended payment arrangements, approved external management plans, modification and deferral of payments. Restructuring policies and practices are based on indicators or criteria which, in the judgment of management, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to term loans, in particular customer finance loans. Renegotiated loans that are classified as standard amounted to RO 14,369,000 at 31 December 2015 (2014: RO 44,908,000).

9 Available-for-sale investments

a) Equity investments

		Fair value	
	Cost	**2015**	2014
	RO'000	**RO'000**	RO'000
Quoted on the Muscat Securities Market			
Banking and investments	**3,723**	**3,684**	1,211
Services	**5,063**	**5,041**	5,257
Industrial	**8,948**	**8,584**	7,737
	17,734	**17,309**	14,205
Unquoted			
Omani companies	**1,377**	**1,900**	2,483
	1,377	**1,900**	2,483
	19,111	**19,209**	16,688
b) Sukuk			
Unquoted			
Omani company/Govt.	**16,364**	**16,593**	10,198
	16,364	**16,593**	10,198
	35,475	**35,802**	26,886

At 31 December 2015, the market value of the Sukuk approximates to the carrying value.

10 Held-to-maturity investments

	2015	2014
	RO'000	RO'000
Treasury bills	**39,236**	61,121
Government Development Bonds	**120,155**	88,867
	159,391	149,988
Local un – listed sukuk	**10,000**	-
	169,391	149,988

Outstanding treasury bills were issued by central banks outside Sultanate of Oman for a term less than 3 carry interest rates ranging from 0.11% per annum (2014 from: 0.30%) per annum.

Outstanding Government Development Bonds carry interest ranging from 1.85% to 4.3% per annum and mature from Dec 2016 to Feb 2025. (2014: 3.25% to 5.50%) per annum and mature from 2015 to 2022.)

11 Intangible asset

	2015	2014
	RO'000	RO'000
1 January	**2,383**	2,780
Impaired during the year	**(397)**	(397)
31 December	**1,986**	2,383

Intangible asset represents goodwill which resulted from the acquisition of branches of the Commercial Bank of Oman in the year 2001 and merger with Majan International Bank in the year 2003. Goodwill is tested for impairment each year. An assessment has been made to establish projected future cash flows associated with the cash generating unit (CGU) by using discount rate equivalent to cost of funds of the Bank. An impairment change of RO 397,000 (2014: 397,000) was recognised during the year.

12 Property and equipment

	Freehold land RO'000	Buildings RO'000	Furniture and fixtures RO'000	Motor Vehicles RO'000	Computer equipment RO'000	Capital work-in-progress RO'000	Total RO'000
Cost							
1 January 2015	140	1,573	13,138	1,341	18,901	357	35,450
Additions	-	-	761	187	1,473	165	2,586
Disposals	-	-	(1,240)	(172)	(142)	(42)	(1,596)
31 December 2015	**140**	**1,573**	**12,659**	**1,356**	**20,232**	**480**	**36,440**
Depreciation							
1 January 2015	-	1,056	9,729	1,171	13,811	-	25,767
Charge for the year	-	58	1,304	151	1,824	-	3,337
Disposals	-	-	(1,176)	(153)	(130)	-	(1,459)
31 December 2015	**-**	**1,114**	**9,857**	**1,169**	**15,505**	**-**	**27,645**
Carrying value							
31 December 2015	**140**	**459**	**2,802**	**187**	**4,727**	**480**	**8,795**
31 December 2014	140	517	3,409	170	5,090	357	9,683

12 Property and equipment (continued)

	Freehold Land RO'000	Buildings RO'000	Furniture and fixtures RO'000	Motor Vehicles RO'000	Computer equipment RO'000	Capital work-in-progress RO'000	Total RO'000
Cost							
1 January 2014	140	1,573	12,251	1,666	17,683	251	33,564
Additions	-	-	942	52	1,290	126	2,410
Disposals	-	-	(55)	(377)	(72)	(20)	(524)
31 December 2014	**140**	**1,573**	**13,138**	**1,341**	**18,901**	**357**	**35,450**
Depreciation							
1 January 2014	-	997	8,415	1,346	11,903	-	22,661
Charge for the year	-	59	1,344	201	1,979	-	3,583
Disposals	-	-	(30)	(376)	(71)	-	(477)
31 December 2014	**-**	**1,056**	**9,729**	**1,171**	**13,811**	**-**	**25,767**
Carrying value							
31 December 2014	**140**	**517**	**3,409**	**170**	**5,090**	**357**	**9,683**
31 December 2013	140	576	3,836	320	5,780	251	10,903

13 Other assets

	2015 RO'000	2014 RO'000
Acceptances	**59,713**	65,113
Interest receivable	**5,842**	4,149
Prepaid expenses	**1,584**	1,680
Positive fair value of derivatives (note 33)	**-**	1,320
Deferred tax assets (note 27)	**62**	-
Other receivables	**2,711**	2,686
	69,912	74,948

14 Due to banks

	2015 RO'000	2014 RO'000
Syndicated Inter bank borrowings	**96,250**	38,500
Inter bank borrowings	**210,925**	135,715
Payable on demand	**1,689**	798
	308,864	175,013

In 2015 the bank successfully raised 3 years USD 250 million term loan at LIBOR linked rates (in 2014 the bank successfully raised 2 years USD 100 million term loan at LIBOR link rates)

At 31 December 2015, Inter bank borrowings includes Islamic Window's inter bank borrowings with other bank of RO 52,325,000. (2014 RO 23,100,000)

At 31 December 2015 no borrowings with any banks represented 20% or more of the Bank's borrowings (2014: one bank). The Bank has not had any defaults of principal, interest or other breaches during the year on its borrowed funds.

15 Deposits from customers

	2015 RO'000	2014 RO'000
Current accounts	**715,302**	686,095
Savings accounts	**435,759**	402,433
Time deposits	**1,227,648**	1,274,542
Margin accounts	**21,504**	22,101
Islamic Banking Window deposits	**192,158**	97,008
	2,592,371	2,482,179

Current accounts and time deposits include deposits from the Government of the Sultanate of Oman and its entities amounting to RO 1,097,497,000 as at 31 December 2015 (2014: RO 1,076,168,000).

At 31 December 2015, deposits from customers include Islamic Window's current deposits, saving deposits and time deposits of RO 192,158,000 (2014 RO 97,008,000).

16 Other liabilities

	2015 RO'000	2014 RO'000
Acceptances	**59,713**	65,113
Interest payable	**3,661**	4,183
Creditors and accruals	**39,951**	29,795
Income tax provision	**6,688**	5,805
Deferred tax liability (note 27)	**-**	473
Negative fair value of derivatives (note 33)	**130**	1,320
Employee terminal benefits	**1,279**	1,053
	111,422	107,742

Employee terminal benefits

The Bank's net liability and the movement in the employee terminal benefits during the year are as follows:

	2015 RO'000	2014 RO'000
1 January	**1,053**	871
Expense recognised in the statement of income	**241**	255
Paid to employees	**(15)**	(73)
	1,279	1,053

17 Subordinated loans

	2015 RO'000	2014 RO'000
Subordinated loan - US Dollar	**28,875**	28,875
Subordinated loan - RO	**75,000**	75,000
	103,875	103,875

In September 2014, the Bank availed USD 75 million (RO 28.875 million) unsecured subordinated loan for a tenor of 66 months. This facility carries a fixed rate of interest payable half yearly, with principal being repaid on maturity.

In December 2012, the Bank availed RO 25 million unsecured subordinated loan from the major shareholders for a tenor of 5 years and one month. This facility carries a fixed rate of interest payable half yearly with principle being repaid on maturity.

In November 2011, the Bank availed RO 50 million unsecured subordinated loan from the major shareholders for a tenor of 5 years and one month. This facility carries a fixed rate of interest payable half yearly, with principal being repaid on maturity.

18 (a) Share capital

The authorised share capital consists of RO 2,200,000,000 ordinary shares of RO 0.100 each (2014: 2,200,000,000 ordinary shares of RO 0.100 each).

At 31 December 2015, the issued and paid up share capital comprise 1,544,728,546 ordinary shares of RO 0.100 each (2014: 1,343,242,214 ordinary shares of RO 0.100 each).

Shareholders

The following shareholders of the Bank own 10% or more of the Bank's share capital:

	2015 No. of shares	**%**	2014 No. of shares	%
Dhofar International Development and Investment Company SAOG	**432,523,991**	**28.0%**	373,625,997	27.8%
Eng. Abdul Hafidh Salim Rajab Al Aujaili and his related Companies	**321,901,224**	**20.8%**	279,914,110	20.8%
Civil Service Employees' Pension Fund	**157,714,879**	**10.2%**	137,232,341	10.2%
Total	**912,140,094**	**59.0%**	790,772,448	58.9%
Others	**632,588,452**	**41.0%**	552,469,766	41.1%
	1,544,728,546	**100%**	1,343,242,214	100%

The Bank's Islamic Banking Window, "Maisarah" Islamic Banking Services has an allocated capital of RO 40,000,000 million in respect of Islamic Banking Window from the core paid up capital of the Bank as of 31 December 2015.

On 26 June 2014, the Board of Directors proposed the increase of Islamic Banking Window's allocated capital from RO 12,500,000 to RO 25,000,000 from the core paid up capital of the shareholders. A resolution to approve the increase in share capital has presented to the shareholders in the annual general meeting on 29 March 2015 and thereafter on 18 June 2015 Maisarah's paid-up capital was increased from OMR 25 million to OMR 40 Million from its shareholders core capital.

Bank Dhofar SAOG, as part of strengthening its capital base and to fund planned growth in the coming years, the extraordinary general meeting (EGM) held on 24 December 2014 has resolved to:

1. Raise its Capital by issuing Tier 1 (including Additional Tier 1) type Capital Instruments in 2015 up to OMR 115.50 million (USD 300 million), subject to Central Bank of Oman and other Regulatory Approvals;
2. Increase Bank's regulatory capital by issue of convertible bonds to raise up to OMR 100 Million (USD 259.75 Million) with a coupon to be determined at the time of issue based on market conditions, subject to regulatory approvals
3. Issue senior non-capital debt instruments up to USD 500 million in the next four years, subject to necessary Central Bank of Oman and Regulatory Approvals;

On 27 May 2015, the Bank issued Perpetual Tier 1 Capital Securities (the "Tier 1 Securities"), amounting to USD 300,000,000 (Please refer Note 18 b). The other capital fund raising program have not yet been finalised.

The shareholders of the Bank in the annual general meeting held during March 2015 approved the issuance of 15% bonus shares comprising 201,486,332 shares of par value RO 0.100 each (2014: 133,114,093 shares of par value RO 0.100 each) and 5% (2014 – 14%) as cash dividend of the paid share capital of the Bank amounting to RO 6,716,000 for the year ended 31 December 2014 (2014 – RO 16,942,000 for the year ended 31 December 2013).

18 (b) Perpetual Tier 1 Capital Securities

On 27 May 2015, the Bank issued Perpetual Tier 1 Capital Securities (the "Tier 1 Securities"), amounting to USD 300,000,000.

The Tier 1 Securities constitute direct, unconditional, subordinated and unsecured obligations of the Bank and are classified as equity in accordance with IAS 32: Financial Instruments – Classification. The Tier 1 Securities do not have a fixed or final maturity date. They are redeemable by the Bank its discretion on 27 May 2020 (the "First Call Date") or on any interest payment date thereafter subject to at the prior consent of the regulatory authority.

The Tier 1 Securities bear interest on their nominal amount from the issue date to the First Call Date at a fixed annual rate of 6.85%. Thereafter the interest rate will be reset at five year intervals. Interest will be payable semi-annually in arrears and treated as deduction from equity.

The Bank at its sole discretion may elect not to distribute interest and this is not considered an event of default. If the Bank does not pay interest on the Tier 1 Securities, on a scheduled interest payment date (for whatever reason), then the Bank must not make any other distribution or payment on or with respect to its ordinary shares or any of its Other Common Equity Tier 1 Instruments or securities, ranking junior to or pari passu with the Tier 1 Securities unless and until it has paid one interest payment in full on the Tier 1 Securities. The Tier 1 Securities also allow the Bank to write-down (in whole or in part) any amounts due to the holders of the Securities in certain circumstances.

19 Share premium

In the year 2008, the Bank issued 176,921,306 shares by way of rights issue at a premium of RO 0.300 resulting in an increase in share premium by RO 53,076,392.

On 19 March 2013, the Shareholders of the Bank in the annual general meeting approved the issuance of 15% bonus shares amounting to RO 13,311,409 (133,114,993 shares of par value RO 0.100 each) from the share premium account.

20 Reserves

(a) Legal reserve

	2015	2014
	RO'000	RO'000
1 January	**35,537**	31,492
Appropriation for the year	**4,677**	4,045
31 December	**40,214**	35,537

In accordance with Article 106 of the Commercial Companies Law of 1974, annual appropriations of 10% of profit are made to the legal reserve until the accumulated balance of the reserve is equal to one-third of the Bank's paid up share capital. This reserve is not available for distribution.

b) Subordinated loans reserves

	2015	2014
	RO'000	RO'000
1 January	**41,250**	26,250
Appropriation for the year:		
Subordinated loan reserve	**20,775**	15,000
31 December	**62,025**	41,250

20 Reserves (continued)

b) Subordinated loans reserves (continued)

Consistent with the Bank for International Settlement ("BIS") Guidelines on capital adequacy, the Bank transfers an amount equivalent to 20% of the value of the subordinated loan each year to the subordinated loan reserve until the maturity of the loan. The amount of the reserve will be transferred to retained earnings through the statement of changes in equity upon settlement of the subordinated loan.

c) Investment revaluation reserve

The movements in the investments revaluation reserve is analysed below:

	2015 RO'000	2014 RO'000
1 January	**(46)**	1,754
(Decrease)/ Increase in fair value	**(2,238)**	(1,159)
Net transfer to statement of income on sale of available-for-sale investments	**(131)**	(641)
Impairment of available for sale investment	**2,742**	-
31 December	**327**	(46)

d) Special reserve

During the year 2013, the Bank recognised in the statement of income, recovery from a legal case of RO 26.1 million, out of which, the Bank allocated RO 18.49 million (equivalent amount that was used from share premium account for issuance of bonus shares, which was approved by the Shareholders in the annual general meeting held on 28 March 2012) to a special reserve to strengthen capital and requires prior approval of CBO for any distribution from this 'special reserve account' (refer note 6).

21 Retained earnings

Retained earnings represent the undistributed profits generated by the Bank since incorporation.

22 Net assets per share

Net assets per share are calculated by dividing the net assets attributable to equity holders of the Bank at the year-end by the number of shares outstanding at 31 December as follows:

	2015	2014
Net assets (RO)	**361,029,000**	325,318,000
Number of shares outstanding at 31 December (Nos.)	**1,544,728,546**	1,343,242,214
Net assets per share (RO)	**0.234**	0.242

23 Net interest income

	2015 RO'000	2014 RO'000
Loans and advances to customers	**115,913**	104,535
Debt investments	**337**	410
Money market placements	**1,908**	1,827
Others	**15**	10
Total interest income	**118,173**	106,782
Deposits from customers	**(32,680)**	(32,364)
Money market deposits	**(1,015)**	(838)
Total interest expense	**(33,695)**	(33,202)
Net interest income	**84,478**	73,580

Included in interest income from debt investments is an amount of RO 337,374,000 (2014: RO 396,528,000) being interest income from held-to-maturity investments.

Included in interest expenses from customers is interest on subordinated loan against related parties of RO 5,422,000 (2014: RO 4,439,000).

24 Other income

	2015 RO'000	2014 RO'000
Foreign exchange	**1,903**	1,398
Investment income (see below)	**4,396**	3,874
Miscellaneous income	**3,430**	4,643
	9,729	9,915
Investment income		
Dividend income- available-for-sale investments	**718**	757
Gain on disposal of available-for-sale investments	**180**	647
Income on Sukuk	**600**	507
Interest income on Government Development Bonds/Other bonds	**2,898**	1,963
	4,396	3,874

25 Staff and administrative costs

(a) Staff costs

	2015 RO'000	2014 RO'000
Salaries and allowances	**27,382**	23,365
Other personnel costs	**4,906**	3,586
Scheme costs	**670**	1,377
Non-Omani employees terminal benefit	**242**	255
	33,200	28,583

At 31 December 2015, the Bank had 1,371 employees (2014: 1,340 employees).

(b) Administrative costs

	2015 RO'000	2014 RO'000
Occupancy costs	**3,632**	3,486
Operating and administration cost	**9,676**	9,279
Impairment of goodwill	**397**	397
Others	**957**	835
	14,662	13,997
	47,862	42,580

26 Impairment of financial assets

	2015 RO'000	2014 RO'000
Provision for loan impairment (note 7 and 8)	**14,305**	11,658
Loans written-off	**1**	-
	14,306	11,658
Recoveries from provision for loan impairment (note 8)	**(5,522)**	(4,724)
Net impairment charge for financial assets	**8,784**	6,934

27 Income tax

	2015 RO'000	2014 RO'000
(a) Income tax expense:		
Current tax		
Current year	**6,271**	5,416
Prior years	**-**	-
	6,271	5,416
Deferred tax		
Current year	**(130)**	(55)
Prior years	**(405)**	(60)
	(535)	(115)
Tax expense for the year	**5,736**	5,301

27 Income tax (continued)

(b) Reconciliation:

The Bank is liable to income tax for the year 2015 in accordance with the income tax laws of the Sultanate of Oman at the rate of 12% on taxable profits in excess of RO 30,000. The following is a reconciliation of income taxes calculated at the applicable tax rate with the income tax expense:

	2015	2014
	RO'000	RO'000
	52,501	45,754
Tax liability at the rates mentioned above	**6,297**	5,487
Tax exempt revenue	**(107)**	(167)
Interest on Additional Tier 1 securities	**(475)**	-
Non-deductible expenses	**151**	36
Deferred tax – prior years	**(130)**	(55)
Tax expense for the year	**5,736**	5,301

(c) Temporary differences which give rise to deferred tax liability are as follows:

Particulars	2014	Recognised in	2015
	RO '000	income	RO '000
Property, plant and equipment	(266)	43	(223)
Intangible asset	(286)	48	(238)
Provisions (others)	24	468	523
Provision – loan loss	55	(24)	-
Net deferred tax assets/(liability)	(473)	535	62

***(d)* Status of previous year returns:**

The tax returns of the Bank for the years 2012 to 2014 have not yet been agreed with the Secretariat General for Taxation at the Ministry of Finance.

Management are of the opinion that additional taxes, if any, related to the open tax years would not be significant to the Bank's financial position as at 31 December 2015.

28 Earnings per share (basic and diluted)

The calculation of basic and diluted earnings per share is based on profit for the year attributable to ordinary shareholders as follows:

	2015	2014
Profit for the year (RO)	**46,765,000**	40,453,000
Less : Additional Tier 1 Coupon	**(3,956,000)**	-
Less : Perpetual Tier 1 issuance cost	**(755,000)**	-
Profit for the period attributable to equity holders of the bank after coupon and issuance cost on Tier 1 capital securities	**42,054,000**	40,453,000
Weighted average number of shares outstanding during the year	**1,544,728,546**	1,544,728,546
Earnings per share basic and diluted (RO)	**0.027**	0.026

Earnings per share (basic and diluted) have been derived by dividing the profit for the year attributable to the shareholders by the weighted average number of shares outstanding. As there are no dilutive potential shares, the diluted earnings per share is identical to the basic earnings per share.

For the purpose of earning per share calculation, the Bank has restated the previous year weighted average number of shares outstanding to include the 15% bonus shares of 201,486,332 shares issued in the first quarter of 2015.

29 Related parties transactions

In the ordinary course of business, the Bank conducts certain transactions with its Directors, shareholders and companies over which they are able to exert significant influence. The aggregate amounts of balances with such related parties are as follows:

	2015 RO'000	2014 RO'000
Loans and advances		
Directors and shareholders holding 10% or more interest in the Bank	**34,559**	21,162
Other related parties	**11,943**	9,803
	46,502	30,965
Subordinated loans		
Directors and shareholders holding 10% or more interest in the Bank	**48,663**	54,438
Other related parties	**40,775**	40,775
	89,438	95,213
Deposits and other accounts		
Directors and shareholders holding 10% or more interest in the Bank	**257,649**	325,022
Other related parties	**82,517**	87,515
	340,166	412,537

29 Related parties transactions (continued)

	2015 RO'000	2014 RO'000
Contingent liabilities and commitments		
Directors and shareholders holding 10% or more interest in the Bank	**142**	174
Other related parties	**1,618**	1,816
	1,760	1,990
Remuneration paid to Directors		
Chairman		
– remuneration proposed	**16**	17
– sitting fees paid	**10**	10
Other Directors		
– remuneration proposed	**103**	116
– sitting fees paid	**71**	57
	200	200
Other transactions		
Rental payment to related parties	**468**	380
Other transactions	**79**	70
Remuneration and fees proposed to Sharia' Board of Islamic Banking Window	**32**	32
Key management compensation		
– salaries and other benefits	**1,235**	956

30 Fiduciary assets

At 31 December 2015 and 2014, there were no funds under management with the Bank.

31 Single borrower and senior members

	2015 RO'000	2014 RO'000
(a) Single borrower		
Total direct exposure	**124,960**	189,145
Number of Members	**2**	3
(b) Senior members		
Total exposure:		
Direct	**50,310**	33,907
Indirect	**1,760**	1,990
	52,070	35,897
Number of Members	**27**	16

32 Contingent liabilities and commitments

(a) Credit related contingent items

Letters of credit, guarantees and other commitments for which there are corresponding customer liabilities:

	2015 RO'000	2014 RO'000
Letters of credit	**133,358**	87,680
Guarantees and performance bonds	**710,960**	628,395
	844,318	716,075

At 31 December 2015, letters of credit, guarantees and other commitments amounting to RO 110,893,000 (2014: RO 136,610,000) are counter guaranteed by other banks.

(b) Capital and investment commitments

	2015 RO'000	2014 RO'000
Contractual commitments for property and equipment	**933**	1,152

33 Derivative financial instruments

The Bank uses the following derivative instruments for both hedging and non-hedging purposes:

Currency forwards represent commitments to purchase foreign and domestic currency, including undelivered spot transactions. Currency swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies. No exchange of principal takes place, except for certain currency swaps. The Bank's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligation. This risk is monitored on an ongoing basis with reference to the current fair value, a proportion of the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Bank assesses counterparties using the same techniques as for its lending activities.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the statement of financial position but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Bank's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities shown within other assets and other liabilities, can fluctuate significantly from time to time. The fair values of derivative instruments held are set out below:

At 31 December 2015		**Fair value increase / decrease**	
	Contract / notional amount RO'000	**Assets RO'000**	**Liabilities RO'000**
Foreign exchange derivatives			
Currency forward - purchase contracts	**316,370**	**165**	**-**
Currency forward - sales contracts	**314,799**	**-**	**295**

At 31 December 2014		Fair value increase / decrease	
	Contract / notional amount RO'000	Assets RO'000	Liabilities RO'000
Foreign exchange derivatives			
Currency forward - purchase contracts	227,273	1,442	-
Currency forward - sales contracts	225,927	-	122

The following table indicates the year in which the cash flows associated with derivatives that are expected to impact statement of income.

	Assets		**Liabilities**	
	2015 RO'000	2014 RO'000	**2015 RO'000**	2014 RO'000
Expected cash flow less than 6 months	**-**	1,320	**130**	**-**

34 Fair value information

Based on the valuation methodology outlined below, the fair values of all financial instruments at 31 December 2015 are considered by the Management not to be materially different to their book values.

Estimation of fair values

The following summarises the major methods and assumptions used in estimating the fair values of assets and liabilities:

Loans and advances

Fair value is calculated based on discounted expected future principal and interest cash flows. Loan repayments are assumed to occur at contractual repayment dates, where applicable. For loans that do not have fixed repayment dates or that are subject to prepayment risk, repayments are estimated based on experience in previous periods when interest rates were at levels similar to current levels, adjusted for any differences in interest rate outlook. Expected future cash flows are estimated considering credit risk and any indication of impairment. Expected future cash flows for homogeneous categories of loans are estimated on a portfolio basis and discounted at current rates offered for similar loans to new borrowers with similar credit profiles. The estimated fair values of loans reflect changes in credit status since the loans were made and changes in interest rates in the case of fixed rate loans.

Investments

Fair value is based on quoted market prices at the reporting date without any deduction for transaction costs. If a quoted market price is not available, fair value is estimated based on discounted cash flow and other valuation techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market-related rate for a similar instrument at the reporting date.

Current account balances due to and due from banks

The carrying amount of current account balances due to and from banks was considered to be a reasonable estimate of fair value due to their short term nature.

Bank and customer deposits

For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the reporting date. The estimated fair value of fixed-maturity deposits, including certificates of deposit, is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. The value of long-term relationships with depositors is not taken into account in estimating fair values.

Other financial instruments

No fair value adjustment is made with respect to credit-related off-balance sheet financial instruments, which include commitments to extend credit, standby letters of credit and guarantees, as the related future income streams materially reflect contractual fees and commissions actually charged at the reporting date for agreements of similar credit standing and maturity.

Foreign exchange contracts are valued based on market prices. The market value adjustments in respect of foreign exchange contracts are included in other assets and other liabilities.

34 Fair value information *(continued)*

Fair value versus carrying amounts

The fair value of the financial assets and liabilities approximates their carrying value as stated in the statement of financial position.

Fair value measurements recognised in the statement of financial position

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

At 31 December 2015	**Level 1 RO'000**	**Level 2 RO'000**	**Level 3 RO'000**	**Cost RO'000**	**Total RO'000**
Available-for-sale investments					
Equity instruments	**16,882**	-	**2,327**	**-**	**19,209**
Sukuk	**6,395**	**10,198**	**-**	**-**	**16,593**
At 31 December 2014					
Available-for-sale investments					
Equity instruments	14,205	-	2,483	-	16,688
Sukuk	-	10,198	-	-	10,198

Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which market observable prices exist and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index process and expected price volatilities and correlations.

Observable prices or model inputs are usually available in the market for listed debt and equity securities, exchange-traded derivatives and simple over-the-counter derivatives such as interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgment and estimation and also reduces the uncertainty associated with determining fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

35 Financial risk management

The important types of financial risks to which the Bank is exposed are credit risk, liquidity risk and market risk. The risk management division of the Bank is an independent and dedicated unit reporting directly to the Risk Management Committee (“RMC”) of the Board. The division’s primary responsibility is to assess, monitor and recommend strategies for control of credit, market and operational risk. The absence of any direct or indirect reporting lines and permanent membership in all the Bank’s committees are among the factors which reflect the independence of the Risk Management Divisions working and the key role it plays within the Bank.

The risk management framework is pivoted on a host of committees involving the executive management and the Board of Directors (“the Board”) for approval and reporting purposes. The Board has the overall authority for approval of strategies and policies, which it exercises through it’s various sub-committees. The Risk Management Committee of the Board is responsible for reviewing and recommending to the full Board for approval all risk policies and procedures. RMC also reviews the risk profile of the Bank as presented to it by the RMD and appraises the full Board in its periodic meetings.

Credit risk

The most important risk to which the Bank is exposed, is credit risk. To manage the level of credit risk, the Bank deals with counter-parties of good credit.

Board Credit Committee is the final credit approving authority of the Bank which is mainly responsible for approving all credit proposals beyond the authority level of the management and also for reviewing and approving credit policies. This committee is also the final authority for approving investments beyond the authority of the management. The Management Credit Committee (“MCC”) is the management decision making body which is empowered to consider all credit related issues upto certain limits.

Credit risk is managed by the RMD through a system of independent risk assessment in credit proposals beyond a threshold limit of RO 100,000 before they are considered by the appropriate approving authorities. The Bank has in place a risk grading system for analyzing the risk associated with credit. This facilitates the approving authorities in making their credit decision. In addition, RMD assists/ reviews grading of obligors, conducts regular macro analysis of the credit portfolio, and monitors credit concentration limits. Maximum counterparty/group exposures are limited to 15% of the Bank’s capital base as stipulated by CBO and where a higher limit is required for projects of national importance prior CBO approval is obtained. Individual country limits using external leading rating agencies have also been set up to ensure portfolio diversification in terms of sovereign risk ratings and geographical exposure. These limits are approved by the Board. Retail lending is strictly in accordance with the CBO guidelines. The analysis of credit is given below:

35 Financial risk management *(continued)*

Credit risk *(continued)*

(a) Geographical concentrations

	Assets			Liabilities		
	Gross loans advances and financing to banks	**Gross Loans Advances and financing**	**Investment securities**	**Deposits from customers**	**Due to banks**	**Contingent liabilities**
	RO'000	**RO'000**	**RO'000**	**RO'000**	**RO'000**	**RO'000**
31 December 2015						
Sultanate of Oman	**43,270**	**2,819,983**	**185,944**	**2,589,322**	**63,017**	**708,184**
Other GCC countries	**26,577**	**7,941**		**2,276**	**197,722**	**39,897**
Europe and North America	**27,718**	**-**	**19,249**	**5**	**21,175**	**47,280**
Africa and Asia	**40,880**	**-**	**-**	**768**	**26,950**	**48,957**
	138,445	**2,827,924**	**205,193**	**2,592,371**	**308,864**	**844,318**
31 December 2014						
Sultanate of Oman	-	2,336,759	115,753	2,478,557	59,454	549,060
Other GCC countries	14,443	5,550	61,121	3,179	67,539	54,026
Europe and North America	45,189	-	-	4	25,028	68,025
Sultanate of Oman	31,971	-	-	439	22,992	44,964
	91,603	2,342,309	176,874	2,482,179	175,013	716,075

(b) Customer concentrations

	Assets			Liabilities		
	Gross loans, Advances and financing to banks	**Gross Loans, Advances and financing**	**Investment Securities**	**Deposits from customers**	**Due to banks**	**Contingent liabilities**
	RO'000	**RO'000**	**RO'000**	**RO'000**	**RO'000**	**RO'000**
31 December 2015						
Personal	**-**	**1,362,625**		**604,342**		**445**
Corporate	**138,445**	**1,383,776**	**48,656**	**890,532**	**308,864**	**823,906**
Government	**-**	**81,523**	**156,537**	**1,097,497**	**-**	**19,967**
	138,445	**2,827,924**	**205,193**	**2,592,371**	**308,864**	**844,318**
31 December 2014						
Personal	-	1,048,120	-	529,288	-	2,639
Corporate	91,603	1,157,466	88,007	876,723	175,013	711,538
Government	-	136,723	88,867	1,076,168	-	1,898
	91,603	2,342,309	176,874	2,482,179	175,013	716,075

35 Financial risk management *(continued)*

Credit risk *(continued)*

(c) Economic sector concentrations

	Assets	Liabilities	
	Gross loans, advances and financing	**Deposits from customers**	**Contingent Liabilities**
	RO'000	**RO'000**	**RO'000**
31 December 2015			
Personal	**1,362,625**	**604,342**	**445**
International trade	**111,978**	**55,307**	**51,392**
Construction	**453,547**	**160,658**	**506,845**
Manufacturing	**221,150**	**43,450**	**46,780**
Wholesale and retail trade	**30,861**	**8,791**	**33,622**
Communication and utilities	**77,710**	**44,536**	**5,099**
Financial services	**137,453**	**77,022**	**70,294**
Government	**81,523**	**1,097,497**	**19,967**
Other services	**149,593**	**123,336**	**80,751**
Others	**201,484**	**377,432**	**29,123**
	2,827,924	**2,592,371**	**844,318**
31 December 2014			
Personal	1,048,120	529,288	2,639
International trade	97,168	52,119	45,260
Construction	327,648	131,840	407,296
Manufacturing	230,627	41,999	55,645
Wholesale and retail trade	38,084	8,928	19,627
Communication and utilities	89,171	47,647	5,111
Financial services	122,527	65,474	105,790
Government	136,723	1,076,168	1,898
Other services	105,518	113,336	61,543
Others	146,723	415,380	11,266
	2,342,309	2,482,179	716,075

(d) Gross credit exposure

	Total gross exposure		Monthly average gross exposure	
	2015	2014	**2015**	2014
	RO'000	RO'000	**RO'000**	RO'000
Overdrafts	**149,261**	130,591	**138,275**	119,691
Loans	**2,299,290**	1,953,070	**2,170,684**	1,887,113
Loans against trust receipts	**111,700**	79,484	**94,955**	91,232
Bills discounted	**6,867**	10,445	**3,671**	10,776
Advance against credit cards	**7,684**	7,705	**7,623**	7,599
Advance against receivable	**43,207**	27,980	**35,434**	22,715
Islamic Banking Window financing	**209,915**	133,034	**171,713**	84,994
Total	**2,827,924**	2,342,309	**2,622,355**	2,224,120

35 Financial risk management *(continued)*

Credit risk *(continued)*

(e) Geographical distribution of exposures:

	Sultanate of Oman RO'000	Other countries RO'000	Total RO'000
31 December 2015			
Overdrafts	**149,261**	**-**	**149,261**
Loans	**2,294,169**	**5,121**	**2,299,290**
Loans against trust receipts	**111,670**	**30**	**111,700**
Bills discounted	**4,077**	**2,790**	**6,867**
Advance against credit cards	**7,684**	**-**	**7,684**
Others	**43,207**	**-**	**43,207**
Islamic Banking Window financing	**209,915**	**-**	**209,915**
	2,819,983	**7,941**	**2,827,924**
31 December 2014			
Overdrafts	130,591	-	130,591
Loans	1,948,054	5,016	1,953,070
Loans against trust receipts	78,950	534	79,484
Bills discounted	10,445	-	10,445
Advance against credit cards	7,705	-	7,705
Others	27,980	-	27,980
Islamic Banking Window financing	133,034	-	133,034
	2,336,759	5,550	2,342,309

35 Financial risk management *(continued)*

Credit risk *(continued)*

(f) Industry type distribution of exposures by major types of credit exposures:

	Overdrafts	Loans	Bills discounted	Others	Total	Off balance sheet exposure
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
31 December 2015						
Import trade	**11,107**	**84,823**	**599**	**15,212**	**111,741**	**48,667**
Export trade	**185**	**37**	**-**	**15**	**237**	**2,725**
Wholesale/retail trade	**8,514**	**19,628**	**-**	**2,719**	**30,861**	**33,622**
Mining and quarrying	**4,166**	**22,501**	**388**	**18**	**27,073**	**1,291**
Construction	**72,622**	**303,019**	**318**	**77,588**	**453,547**	**506,845**
Manufacturing	**11,580**	**153,141**	**2,164**	**54,265**	**221,150**	**46,780**
Electricity, gas and water	**7**	**33,130**	**-**	**-**	**33,137**	**305**
Transport and Communication	**113**	**44,460**	**-**	**-**	**44,573**	**4,794**
Financial institutions	**6,286**	**130,559**	**608**	**-**	**137,453**	**70,294**
Services	**20,505**	**127,705**	**-**	**1,383**	**149,593**	**80,751**
Personal loans	**3,929**	**1,351,212**	**-**	**7,484**	**1,362,625**	**445**
Agriculture and allied Activities	**3,490**	**9,695**	**-**	**93**	**13,278**	**1,695**
Government	**-**	**81,523**	**-**	**-**	**81,523**	**22,927**
Non-resident lending	**-**	**5,151**	**2,790**	**-**	**7,941**	**22,811**
Others	**6,757**	**142,621**	**-**	**3,814**	**153,192**	**366**
	149,261	**2,509,205**	**6,867**	**162,591**	**2,827,924**	**844,318**
31 December 2014						
Import trade	10,612	60,486	30	26,035	97,163	45,260
Export trade	5	-	-	-	5	-
Wholesale/retail trade	8,630	26,101	-	3,353	38,084	19,627
Mining and quarrying	3,917	39,973	287	7	44,184	2,614
Construction	51,567	232,238	1,227	42,616	327,648	407,296
Manufacturing	11,396	186,443	-	32,788	230,627	55,645
Electricity, gas and water	34	41,341	-	402	41,777	723
Transport and Communication	120	47,274	-	-	47,394	4,388
Financial institutions	7,693	108,281	6,552	1	122,527	105,790
Services	22,333	81,672	272	1,241	105,518	61,543
Personal loans	4,835	1,035,743	-	7,542	1,048,120	2,639
Agriculture and allied Activities	3,541	8,840	32	46	12,459	1,435
Government	-	136,723	-	-	136,723	1,898
Non-resident lending	-	5,016	-	534	5,550	-
Others	5,908	75,973	2,045	604	84,530	7,217
	130,591	2,086,104	10,445	115,169	2,342,309	716,075

35 Financial risk management *(continued)*

Credit risk *(continued)*

(g) Residual contractual maturities of the portfolio by major types of credit exposures:

	Overdrafts RO'000	**Loans RO'000**	**Bills discounted RO'000**	**Others RO'000**	**Total RO'000**	**Off balance sheet exposures RO'000**
31 December 2015						
Upto 1 month	**7,463**	**49,766**	**6,867**	**4,276**	**68,372**	**382,814**
1 - 3 months	**7,463**	**86,512**	**-**	**3,489**	**97,464**	**49,263**
3 - 6 months	**7,463**	**30,638**	**-**	**4,605**	**42,706**	**43,513**
6 - 9 months	**7,463**	**3,914**	**-**	**6,740**	**18,117**	**28,831**
9 - 12 months	**7,463**	**11,750**	**-**	**10,316**	**29,529**	**17,297**
1 - 3 years	**37,315**	**143,185**	**-**	**71,395**	**251,895**	**176,540**
3 – 5 years	**37,315**	**149,363**	**-**	**18,199**	**204,877**	**112,296**
Over 5 years	**37,316**	**2,034,077**		**43,571**	**2,114,964**	**33,764**
	149,261	**2,509,205**	**6,867**	**162,591**	**2,827,924**	**844,318**
31 December 2014						
Upto 1 month	6,530	21,599	10,445	7,278	45,852	288,321
1 - 3 months	6,530	79,559	-	3,346	89,435	38,662
3 - 6 months	6,530	96,564	-	3,290	106,384	54,167
6 - 9 months	6,530	18,204	-	16,285	41,019	36,740
9 - 12 months	6,530	58	-	16,556	23,144	50,748
1 - 3 years	32,647	157,830	-	12,337	202,814	140,141
3 – 5 years	32,647	137,140	-	24,663	194,450	87,659
Over 5 years	32,647	1,575,150	-	31,414	1,639,211	19,637
	130,591	2,086,104	10,445	115,169	2,342,309	716,075

35 Financial risk management *(continued)*

Credit risk *(continued)*

(h) Distribution of impaired loans, past due and not past due loans by type of industry:

	Performing loans RO'000	Non-performing loans RO'000	General provisions held RO'000	Specific provisions held RO'000	Interest reserve RO'000	Specific provision during the year RO'000	Advances written off during the year RO'000
31 December 2015							
Import trade	**103,406**	**8,335**	**1,241**	**1,260**	**6,674**	**8**	**32**
Export trade	**232**	**5**	**2**	**3**	**1**	**-**	**-**
Wholesale/retail trade	**9,804**	**21,057**	**98**	**4,934**	**16,254**	**2**	**27**
Mining and quarrying	**27,069**	**4**	**271**	**580**	**2**	**578**	**2**
Construction	**450,805**	**2,742**	**4,508**	**528**	**2,180**	**18**	**21**
Manufacturing	**220,734**	**416**	**2,208**	**182**	**235**	**1**	**7**
Electricity, gas and water	**33,130**	**7**	**331**	**-**	**5**	**-**	**1**
Transport and communication	**44,573**	**-**	**446**	**-**	**-**	**-**	**1**
Financial institutions	**137,453**	**-**	**1,367**	**-**	**-**	**-**	**-**
Services	**149,362**	**231**	**1,494**	**86**	**131**	**2**	**63**
Personal loans	**1,335,946**	**26,679**	**23,215**	**14,848**	**7,478**	**8,073**	**730**
Agriculture and allied activities	**13,268**	**10**	**133**	**7**	**3**	**-**	**-**
Government	**81,523**	**-**	**815**	**-**	**-**	**-**	**-**
Non-resident lending	**2,820**	**5,121**	**28**	**4,429**	**696**	**-**	**-**
Others	**152,868**	**324**	**1,635**	**161**	**149**	**40**	**6**
	2,762,993	**64,931**	**37,792**	**27,018**	**33,808**	**8,722**	**890**
31 December 2014							
Import trade	89,651	7,512	896	1,425	5,786	12	-
Export trade	1	4	1	3	1	-	-
Wholesale/retail trade	19,090	18,994	191	4,959	14,153	22	27
Mining and quarrying	44,179	5	442	4	2	-	-
Construction	325,037	2,611	4,314	814	1,910	15	151
Manufacturing	230,135	492	2,301	264	219	114	-
Electricity, gas and water	41,743	34	417	8	3	8	-
Transport and communication	47,390	4	474	1	3	-	-
Financial institutions	122,527	-	1,227	-	-	-	-
Services	105,135	383	1,051	160	198	13	42
Personal loans	1,023,919	24,201	18,697	12,289	7,692	5,877	564
Agriculture and allied activities	12,450	9	125	7	2	-	-
Government	136,723	-	1,367	-	-	-	-
Non-resident lending	534	5,016	6	4,429	590	-	-
Others	84,033	497	840	175	158	43	-
	2,282,547	59,762	32,349	24,538	30,717	6,104	784

35 Financial risk management *(continued)*

Credit risk *(continued)*

(i) Distribution of impaired loans and gross loans by geographical distribution:

	Gross loans and financing RO'000	**Non-performing loans and financing RO'000**	**General provisions held RO'000**	**Specific provisions held RO'000**	**Interest reserve RO'000**	**Specific provision made during the year RO'000**	**Advances written off during the year RO'000**
31 December 2015							
Sultanate of Oman	**2,819,983**	**59,810**	**37,764**	**22,589**	**33,112**	**8,722**	**890**
Other countries	**7,941**	**5,121**	**28**	**4,429**	**696**	**-**	**-**
	2,827,924	**64,931**	**37,792**	**27,018**	**33,808**	**8,722**	**890**
31 December 2014							
Sultanate of Oman	2,336,759	54,746	32,343	20,109	30,127	6,104	784
Other countries	5,550	5,016	6	4,429	590	-	-
	2,342,309	59,762	32,349	24,538	30,717	6,104	784

(j) Maximum exposure to credit risk without consideration of collateral held:

	2015 RO' 000	2014 RO' 000
Treasury bills	**39,236**	61,121
Loans, advances and financing to banks	**138,036**	91,164
Loan, advances and financing to customers	**2,729,306**	2,254,705
Government development bonds	**120,155**	88,867
	3,026,733	2,495,857
Off-balance sheet items		
Financial guarantees	**679,548**	527,736
	3,706,281	3,023,593

At 31 December 2015, impairment losses would have increased by RO 1, 080,000 (2014: 1,121,483) had collateral not been obtained by the Bank for the impaired loans and advances.

35. Financial risk management *(continued)*

Liquidity risk

Liquidity risk is the potential inability to meet the Bank's liabilities that are settled by delivering cash or another financial asset as they become due. It arises when the Bank is unable to generate cash to cope with a decline in deposits or increase in assets.

Bank's Liquidity Risk Management is governed by the Treasury Risk Policy document approved by the Board of Directors as well as the provisions of relevant CBO guidelines on liquidity risk management. The Treasury risk policy also incorporates contingency plans and measures so as the Bank is always in a position to meet all maturing liabilities as well as to fund asset growth and business operations. The contingency funding plan includes effective monitoring of the cash flows on a day to day basis, holding of tradable high quality liquid assets, which may be readily disposed off in sizeable amount etc. The Bank also has in place adequate lines of credit from both local and international Banks to meet any unforeseen liquidity requirements.

The Bank monitors its liquidity risk through cash flow approach and stock approach. Under cash flow approach Bank generates Maturity of Assets and Liabilities (MAL) report which captures all the maturing assets and liabilities into various pre-set time buckets ranging from one month to five years. The mismatches in various time buckets indicate liquidity gap and Bank strictly adheres to the CBO set limit of 15% of cumulative liabilities (outflows) on mismatches (liquidity gaps) in time buckets upto one year. In addition, the Bank has also set up internal limit on mismatches in time buckets beyond one year. Under stock approach, Bank monitors the liquidity risk through liquidity ratios, which portrays the liquidity available at the reporting date.

Treasury department of the Bank controls and monitors the liquidity risk and ensures that the Bank is not exposed to undue liquidity risk and at the same time make optimum use of its funds. Middle office in Risk Management Division also monitors the liquidity position of the Bank and provide the liquidity gap to Treasury Department to meet liquidity gaps.

35 Financial risk management *(continued)*

Liquidity risk *(continued)*

Maturity profile of assets and liabilities

	Due on demand and up to 30 days RO'000	More than 1month to 6 months RO'000	More than 6 months to 12 months RO'000	More than 1 year to 5 years RO'000	Over 5 years RO'000	Total RO'000
31 December 2015						
Cash and balances with Central Bank of Oman	439,333	-	-	-	500	439,833
Loans and advances to banks	59,874	29,323	28,729	20,110	-	138,036
Loans and advances to customers	201,330	316,280	127,884	699,309	1,384,503	2,729,306
Available-for-sale Investments	-	-	19,209	16,593	-	35,802
Held-to-maturity Investments	39,235	-	7,239	113,655	9,262	169,391
Intangible asset	-	-	-	-	8,795	8,795
Property and equipment	-	-	-	-	1,986	1,986
Other assets	5,796	45,535	14,238	4	4,339	69,912
Total assets	745,568	391,138	197,299	849,671	1,409,385	3,593,061
Due to banks	174,114	-	38,500	96,250	-	308,864
Deposits from customers	230,813	422,420	379,881	721,279	837,978	2,592,371
Other liabilities	32,664	51,910	15,187	10,638	1,023	111,422
Subordinated loans	-	-	50,000	25,000	28,875	103,875
Total equity	-	46,765	-	-	429,764	476,529
Total liabilities and shareholders' equity	437,591	521,095	483,568	853,167	1,297,640	3,593,061

35 Financial risk management *(continued)*

Liquidity risk *(continued)*

Maturity profile of assets and liabilities *(continued)*

	Due on demand and up to 30 days RO'000	More than 1month to 6 months RO'000	More than 6 months to 12 months RO'000	More than 1 year to 5 years RO'000	Over 5 years RO'000	Total RO'000
31 December 2014						
Cash and balances with Central Bank of Oman	583,870	-	-	-	500	584,370
Loans and advances to banks	17,683	47,446	18,381	7,654	-	91,164
Loans and advances to customers	174,626	338,998	147,198	513,580	1,080,303	2,254,705
Available-for-sale Investments	-	-	16,688	10,198	-	26,886
Held-to-maturity Investments	5,128	55,993	25,778	50,565	12,524	149,988
Intangible asset	-	-	-	-	2,383	2,383
Property and equipment	-	-	-	-	9,683	9,683
Other assets	4,149	54,399	9,318	1,396	5,686	74,948
Total assets	785,456	496,836	217,363	583,393	1,111,079	3,194,127
Due to banks	59,620	76,893	-	38,500	-	175,013
Deposits from customers	193,621	405,455	460,548	652,275	770,280	2,482,179
Other liabilities	21,440	55,432	10,446	13,646	6,778	107,742
Subordinated loans	-	-	-	75,000	28,875	103,875
Total equity	-	40,453	-	-	284,865	325,318
Total liabilities and shareholders' equity	274,681	578,233	470,994	779,421	1,090,798	3,194,127

35 Financial risk management *(continued)*

Market risk

Market risk includes currency risk, interest rate risk and equity price risk.

(a) Currency risk

The Bank is exposed to currency risk through its transactions in foreign currencies. The major foreign currency to which the Bank is exposed is the US Dollar which is effectively pegged to Rial Omani. The Bank finances a significant portion of its financial assets in the same currencies as the relevant measurement currencies to mitigate its foreign currency risk.

The Bank's transactional exposures give rise to foreign currency gains and losses that are recognised in the statement of income. The Bank ensures that its net exposure is kept to an acceptable level by buying and selling foreign currencies at spot rates when considered appropriate. Foreign exchange risk is computed on the average of the sum of net short positions or net long positions, whichever is higher of the foreign currency positions held by the Bank. The foreign currency exposures are given below:

Foreign currency exposures

	2015	2014
	RO'000	RO'000
Net assets denominated in US Dollars	**131,257**	47,511
Net assets denominated in other foreign currencies	**10,843**	2,013
	142,100	49,524

(b) Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities are reset at different times. Risk management activities are aimed at optimising net interest income, given market interest rate levels, consistent with the Bank's business strategies. The Bank manages mismatches by following policy guidelines and reduces risk by matching the reprising of assets and liabilities. Details relating to re-pricing mismatches and the interest rate risk thereon are placed to the ALCO in its regular meetings and also to the Risk Management Committee of the Board. Impact on earnings due to interest rate risk in the banking book is as follows:

Impact on earnings due to interest rate risk in the banking book

	+ or – 1%		**+ or – 2%**	
	2015	2014	**2015**	2014
	RO'000	RO'000	**RO'000**	RO'000
Omani Rials	**7,327**	10,031	**14,654**	20,061
US Dollars	**2,599**	1,830	**5,199**	3,660
Others currencies	**144**	181	**288**	361

35 Financial risk management *(continued)*

Market risk *(continued)*

(b) Interest rate risk *(continued)*

Interest rate sensitivity gap

Sensitivity to interest rates arises from mismatches in the period to repricing of assets and that of the corresponding liability. The Bank manages these mismatches by following policy guidelines and reduces risk by matching the repricing of assets and liabilities.

	Effective average interest rate %	Due on demand and within 30 days RO'000	Due within 1 to 6 months RO'000	Due within 7 to 12 months RO'000	Due within 1 to 5 years RO'000	Due after 5 years RO'000	Non-interest bearing RO'000	Total RO'000
31 December 2015								
Cash and balances with Central Bank of Oman	0.15%	170,170	-	-	-	500	269,163	439,833
Loans, advances and financing to banks	1.0%	65,561	72,475	-	-	-	-	138,036
Loans, advances and financing to customers	5.1%	201,330	316,280	127,884	699,309	1,384,503	-	2,729,306
Available-for-sale Investments	5.0%	-	-	-	16,593	-	19,209	35,802
Held-to-maturity investments	1.9%	39,235	-	7,239	113,655	9,262	-	169,391
Intangible asset		-	-	-	-	-	1,986	1,986
Property and equipment		-	-	-	-	-	8,795	8,795
Other assets		-	-	-	-	-	69,912	69,912
Total assets		476,296	388,755	135,123	829,557	1,394,265	369,065	3,593,061
Due to banks	0.7%	172,425	38,500	-	96,250	-	1,689	308,864
Deposits from customers	1.3%	116,475	313,621	369,546	650,723	45,164	1,096,842	2,592,371
Other liabilities		-	-	-	-	-	111,422	111,422
Subordinated loan	5.3%	-	-	50,000	25,000	28,875	-	103,875
Shareholders' equity		-	46,765	-	-	115,500	314,264	476,529
Total liabilities and equity		288,900	398,886	419,546	771,973	189,539	1,524,217	3,593,061
On-balance sheet gap		187,396	(10,131)	(284,423)	(57,584)	1,204,726	(1,155,152)	
Cumulative interest sensitivity gap		187,396	177,265	(107,158)	(49,574)	1,155,152		

35 Financial risk management *(continued)*

(b) Interest rate risk *(continued)*

Interest rate sensitivity gap *(continued)*

31 December 2014	Effective average interest rate %	Due on demand and within 30 days RO'000	Due within 1 to 6 months RO'000	Due within 7 to 12 months RO'000	Due within 1 to 5 years RO'000	Due after 5 years RO'000	Non-interest bearing RO'000	Total RO'000
Cash and balances with Central Bank of Oman	0.13%	310,000	-	-	-	500	273,870	584,370
Loans and advances to banks	1.1%	28,950	62,214	-	-	-	-	91,164
Loans and advances to customers	5.3%	174,626	338,998	147,198	513,580	1,080,303	-	2,254,705
Available-for-sale Investments	5.0%	-	-	-	10,198	-	16,688	26,886
Held-to-maturity investments	1.9%	5,128	55,993	25,778	50,565	12,524	-	149,988
Intangible asset		-	-	-	-	-	2,383	2,383
Property and equipment		-	-	-	-	-	9,683	9,683
Other assets		-	-	-	-	-	74,948	74,948
Total assets		518,704	457,205	172,976	574,343	1,093,327	377,572	3,194,127
Due to banks	0.7%	58,822	26,843	88,550	-	-	798	175,013
Deposits from customers	1.4%	64,208	238,001	472,624	570,461	34,821	1,102,064	2,482,179
Other liabilities		-	-	-	-	-	107,742	107,742
Subordinated loan	5.3%	-	-	-	75,000	28,875		103,875
Shareholders' equity		-	40,453	-	-	-	284,865	325,318
Total liabilities and equity		123,030	305,297	561,174	645,461	63,696	1,495,469	3,194,127
On-balance sheet gap		395,674	151,908	(388,198)	(71,118)	1,029,631	(1,117,897)	
Cumulative interest sensitivity gap		395,674	547,582	159,384	88,266	1,117,897		

35. Financial risk management *(continued)*

Market risk *(continued)*

(c) Investment Price risk

Bank is exposed to the volatility in the prices of the securities held under equity and debt portfolio. Equity and debt investments held are for strategic/long term rather than for trading purposes and hence, Bank does not hold trading positions in equity and debt investments. However, Bank's portfolio is marked to market on regular basis and the difference in the book value and market value are adjusted against investment revaluation reserve in shareholder's equity and for impaired investments to comprehensive statement of income.

Further, Bank also conducts stress testing and sensitivity analysis to take an informed decision on equity and debt risk exposure.

If price for listed equity and debt instrumentss had been 5% lower:

If there is adverse impact of 5% on equity portfolio, the value of the portfolio may decrease by RO 712,000. (2014: decrease by RO 708,000).

If price for unlisted equity and debt instruments had been 5% lower:

The financial statements include holdings in unlisted shares and bonds which are measured at fair value. Fair value is estimated using either Net Asset Value (NAV) provided by the fund managers or book value per share of the investee company. If the estimation were 5% lower / higher while all other variables were held constant, the carrying amount of the unlisted shares and bonds would decrease / increase by RO 248,000 (2014: decrease / increase by RO 127,000.

Operational risk

Operational risk is the deficiencies in information systems/internal controls or uncontrollable external events leading to financial/ non-financial losses for the Bank. The risk is associated with human error, systems failure and inadequate procedures or control and external causes. As per the Basel Committee on Banking Supervision (BCBS), operational risk is the risk of losses resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes legal risk but excludes strategic and reputational risk.

The Bank has detailed policies and procedures that are regularly updated to ensure that a sound internal control environment exists. Risk Management Committee (RMC), a sub-committee of the Board, drives the implementation of the risk management framework, approved by the Board, at the apex level. The RMC ensure that the risk policies developed clearly spell out the quantitative prudential limits on various segments of the Bank's operations and also ensures implementation of Central Bank of Oman's guidelines on Risk Management/Basel II/Basel III and internationally accepted best practices in the area of risk management including Operational risk management. Management Risk Committee (MRC), comprising of Senior Management of the Bank, precedes RMC in reviewing, evaluating and monitoring of operational risk. Business Units are responsible for management of operational risks within their respective scope of duties. In the financial year 2015, the Bank's operational risks were well controlled and losses from operational risks were kept at low level. Trained and competent staff oversees the various operational functions of the Bank.

Taking the New Capital Accord Implementation as an opportunity, the Bank has developed a comprehensive operational risk management framework comprising of the Operational Risk Management (ORM) policy, Risk Control and Self-Assessment, Key Risk Indicator, Loss Data Management (LDM) Framework. The ORM policy of the Bank provides the ORM framework which includes ORM components, management process, measurement process and governance, roles and responsibilities. The Bank has also set up Operational Risk Management Software to aid assessment of operational risk as well as collection and analysis of operational losses and key risk indicators.

35. Financial risk management *(continued)*

The Risk Control and Self-Assessment (RCSA) framework enables the Bank to identify the operational weaknesses in the process and procedures by conducting self-assessment workshops. A team of experts in various departments assess the operational weaknesses in various processes and its likely impact.. RMD in association with business units has been able to complete the RCSA exercise for all the departments and branches of the conventional banking. During RCSA exercise, processes in various departments were reviewed from operational risk point of view and wherever high risk events were identified, the extant controls were reviewed. With the completion of the RCSA exercise, risk register has been created, which inter-alia includes inherent risk events, control effectiveness and residual risks.

The Key Risk Indicator (KRI) framework enables the Bank to identify and monitor the key risks. KRIs of all the departments in conventional banking have been identified and are being monitored on monthly basis. Loss Data Management framework lays down the procedure to identify, record and report the internal and external loss events. The data on operational loss is collated on regular basis and is presented to the Management and Board level committees. In order to avoid unexpected shocks to the financial position of the Bank, a reporting system on “Potential Losses” has also been introduced. Potential Loss can be defined as an operational event that has not actually crystallized into actual loss but has a potential of adversely impacting Bank’s bottom-line.

Operational Risk Unit (ORU) in RMD is responsible for implementation, development and coordination of all the operational risk activities of the Bank, while working towards achievement of stated goals and objectives. Risk Management Division (RMD) conducts regular training programs for staff at various levels to inculcate ‘risk awareness’ and to spread the general ‘risk management culture’ in the Bank. Professional training in diversified forms is also imparted to improve the employees’ risk management skills.

Business Continuity Planning (BCP)

Business Continuity Management is the implementation and management of preventative measures, planning and preparation to ensure the Bank can continue to operate following an incident, significant unplanned event or major operational disruption. The Bank ensures that its systems and procedures are resilient to ensure business continuity through potential situations of failure. Bank has adopted Business Continuity / Disaster Recovery Plan with a view to continue business operations and critical customers services at all times both at Conventional and Maisarah. The plan addresses employee health and safety, potential disruptions from the unanticipated loss of services or infrastructure and resumption of business operations in the face of an emergency or disaster. Business Impact Analysis, Business Continuity/ Disaster Recovery testing, Awareness Programs etc. are conducted in tune with the regulatory guidelines for meeting any unforeseen circumstances. The key initiatives on the business continuity readiness included the following:

- Business Continuity Management (BCM) Steering Committee, a Management level committee has been set up and entrusted with the responsibility of overall supervision for the implementation and maintaining a sound BCM for the Bank. The committee ensures that plans formulated are implemented and tested.
- Bank maintains an alternate / Business Continuity Plan (BCP) site equipped with redundancy and contingency features to ensure business continuity for resuming critical business activities in emergent scenarios. Bank has strengthened BCP site seating capacity and infrastructure considering various worst case scenarios. Additional workspace has been created for critical business units to resume business services in the event of a disaster.
- Bank wide BCP testing exercise and Information Technology Disaster Recovery Drill is conducted to test check the resilience of technical as well as business recovery. Testing was conducted in coordination with business units to test check transaction systems using business test cases and also to test the preparedness, recovery of applications, recovery timings, assembly of key resources, functioning of equipments, coordination of business units / branches etc. The testing results along with the gaps and action taken are apprised to the risk committees at the Management and Board level.

35 Financial risk management – Operation risk*(continued)*

- For the cause of human safety and security, fire drill exercises are also conducted in Head Office building. Through fire drills, the preparedness and recovery capabilities of the coordinators /floor leaders /fire wardens are tested and security procedures are reinforced.

- As part of creating awareness, specific as well as comprehensive awareness programme are also conducted to imbibe the importance of BCP amongst staff.

- The communication numbers of key persons are provided to all the staff so that they can contact the relevant person in case of emergency.

Internal Capital Adequacy Assessment Process (ICAAP):

The Bank has put in place Internal Capital Adequacy Assessment Process (ICAAP) with an objective to explain the Risk policies adopted, Risk policy principles, Target risk structure and Capital planning, the process of assessing the capital adequacy for all the three risks viz., Credit Risk, Market Risk and Operational Risk, Specific assessment procedures for all material risks like interest rate risk in banking book, reputational risk, credit concentration risk etc, the process of Internal Control Mechanism and the stress testing methodologies adopted by the Bank.

As a part of capital planning process, ICAAP provides a detailed assessment of its current capital adequacy, and also project future capital requirement to meet the regulatory capital adequacy ratios in line with approved business plans. The process covers a forward looking plan for the next 3 years. The overall framework has introduced a structured methodology for a comprehensive forward-looking assessment of capital based on the Bank's risk profile. It is also expected that the establishment of ICAAP in the Bank will facilitate the awareness for risk sensitive topics when it comes to strategic decisions like acquisitions, launch of new products or organic growth targets. ICAAP is approved by the Board of Directors through Board Risk Committee. On a quarterly basis, reporting is done to the Board on the adequacy of capital. The Bank believes that its current and foreseen capital endowment is suitable to support its business strategy in a soothing market environment. The capital planning is reviewed on half yearly basis and the entire ICAAP document is updated at least annually for a forward-looking planning period of 3 years.

In order to determine the Bank's capability to withstand adverse conditions, in addition to the base case, scenario and sensitivity analysis is also carried out. The scenario analysis entails boom in the economy & rise in oil prices, Decline in GDP due to economic downturn or due to decline in oil prices and capital adequacy sensitivity due to increase & decrease in growth of loans and advances. Besides this, Bank also conducts stress testing to assess the potential impact of the stress situations on the Bank's earnings & capital position and enable the Bank to understand its risk profile & adjusting it in accordance with the risk appetite.

36 Capital risk management

The Bank manages its capital to ensure that it will be able to continue as a going concern while maximising the return to shareholders within acceptable risk return framework. The Bank's overall strategy remains unchanged from prior year.

The capital base of the Bank consists of debt, which includes borrowings disclosed in note 17, and equity attributable to shareholders of the Bank comprising issued share capital, share premium, reserves and retained earnings and Perpetual Tier I Capital securities,as disclosed in notes 18 to 21.

36 Capital risk management *(continued)*

Capital adequacy

The ratio of equity to risk weighted assets, as formulated by the Basel II and Basel III, for the year ended 31 December 2015 is 14.70% (2014: 14.05%).

Capital structure	**2015 RO'000**	2014 RO'000
Common Equity Tier (CET) I/ TIER I CAPITAL		
Paid up capital	**154,473**	134,324
Legal reserve	**40,214**	35,537
Share premium	**40,018**	40,018
Special reserve	**18,488**	18,488
Subordinated loan reserve	**62,025**	41,250
Retained earnings	**6,866**	28,882
Proposed bonus shares	**15,447**	20,149
CET I/Tier I Capital	**337,531**	318,648
Additional Tier I regulatory adjustments:		
Deferred tax Assets	**(62)**	-
Goodwill	**(1,986)**	(2,383)
Negative investment revaluation reserve	**(804)**	(1,634)
Total CET 1 capital	**334,679**	314,631
Additional Tier I capital (AT1)	**115,500**	-
Total Tier 1 Capital (T1=CET1+AT1)	**450,179**	314,631
TIER II CAPITAL		
Investment revaluation reserve	**444**	620
General provision	**38,201**	32,788
Subordinated loan	**33,100**	62,625
Total Tier II capital	**71,745**	96,033
Total eligible capital	**521,924**	410,664
Risk weighted assets		
Banking book	**3,239,902**	2,674,461
Trading book	**111,079**	70,357
Operational risk	**198,703**	178,817
Total	**3,549,684**	2,923,635
Total Tier 1 Capital (T1=CET1+AT1)	**450,179**	314,631
Tier II capital	**71,745**	96,033
Tier III capital	**-**	-
Total regulatory capital	**521,924**	410,664
Common Equity Tier 1 ratio	**9.43%**	10.76%
Tier I capital ratio	**12.68%**	10.76%
Total capital ratio	**14.70%**	14.05%

37 Segmental information

The Bank is organised into three main business segments:

1) Retail banking – incorporating, private customer current accounts, savings, deposits, investment savings products, custody, credit and debit cards, consumer loans and mortgages;
2) Corporate banking – incorporating direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency and derivative products; and
3) Treasury and investments

Other operations comprise investment management and institutional finance neither of which constitutes a separately reportable segment.

Transactions between the business segments are on normal commercial terms and conditions. Funds are ordinarily allocated between segments, resulting in funding cost transfers disclosed in operating income. Interest charged for these funds is based on the Bank's cost of capital. There are no other material items of income or expense between the business segments.

Segment assets and liabilities comprise operating assets and liabilities, being the majority of the statement of financial position, but exclude items such as taxation and borrowings.

Internal charges and transfer pricing adjustments have been reflected in the performance of each business. Revenue sharing agreements are used to allocate external customer revenues to a business segment on a reasonable basis.

At 31 December 2015	**Retail banking RO'000**	**Corporate banking RO'000**	**Treasury and investments RO'000**	**Total RO'000**
Segment operating revenues	**69,854**	**53,602**	**2,400**	**125,856**
Other revenues	**7,262**	**10,268**	**7,489**	**25,019**
Segment operating revenues	**77,116**	**63,870**	**9,889**	**150,875**
Interest, Islamic Window Deposit expenses	**(12,768)**	**(15,895)**	**(6,986)**	**(35,649)**
Net operating income	**64,348**	**47,975**	**2,903**	**115,226**
Segment cost				
Operating expenses including depreciation	**(25,382)**	**(22,469)**	**(3,348)**	**(51,199)**
Impairment for loans and investment net recoveries from allowance for loans impairment	**(7,906)**	**(908)**	**(2,712)**	**(11,526)**
Profit from operations after provision	**31,060**	**24,598**	**(3,157)**	**52,501**
Tax expenses	**(3,394)**	**(2,687)**	**345**	**(5,736)**
Net profit for the year	**27,666**	**21,911**	**(2,812)**	**46,765**
Segment assets	**1,484,651**	**1,659,290**	**548,147**	**3,692,088**
Less: Impairment allowance	**(45,542)**	**(53,076)**	**(409)**	**(99,027)**
Total segment assets	**1,439,109**	**1,606,214**	**547,738**	**3,593,061**
Segment liabilities	**987,119**	**1,707,445**	**421,968**	**3,116,532**

37 Segmental information *(continued)*

Included in the above segment information the results of Islamic Banking Window as below:

At 31 December 2015	**Retail banking RO'000**	**Corporate banking RO'000**	**Treasury and investments RO'000**	**Total RO'000**
Segment operating revenues	**3,348**	**4,330**	**5**	**7,683**
Other revenues	**169**	**343**	**659**	**1,171**
Segment operating revenues	**3,517**	**4,673**	**664**	**8,854**
Profit expenses share of profit	**(134)**	**(1,659)**	**(161)**	**(1,954)**
Net operating income	**3,383**	**3,014**	**503**	**6,900**
Segment cost				
Operating expenses including depreciation	**(1,479)**	**(1,914)**	**(2)**	**(3,395)**
Impairment allowance	**(553)**	**(383)**	**-**	**(936)**
Net profit for the year	**1,351**	**717**	**501**	**2,569**
Segment assets	**94,576**	**117,277**	**89,981**	**301,834**
Less: Impairment allowance	**(1,165)**	**(1,265)**	**-**	**(2,430)**
Total segment assets	**93,411**	**116,012**	**89,981**	**299,404**
Segment liabilities	**17,591**	**169,514**	**63,446**	**250,551**

At 31 December 2014	Retail banking RO'000	Corporate banking RO'000	Treasury and investments RO'000	Total RO'000
Segment operating revenues	61,043	46,894	2,470	110,407
Other revenues	7,567	7,758	6,738	22,063
Segment operating revenues	68,610	54,652	9,208	132,470
Interest, Islamic Window Deposit expenses	(12,273)	(15,491)	(5,855)	(33,619)
Net operating income	56,337	39,161	3,353	98,851
Segment cost				
Operating expenses including depreciation	(22,864)	(20,211)	(3,088)	(46,163)
Impairment for loans and investment net recoveries from allowance for loans impairment	(5,188)	(1,674)	(72)	(6,934)
Profit from operations after provision	28,285	17,276	193	45,754
Tax expenses	(3,279)	(2,000)	(22)	(5,301)
Net profit for the year	25,006	15,276	171	40,453
Segment assets	1,160,090	1,492,117	629,963	3,282,170
Less: Impairment allowance	(52,330)	(35,274)	(439)	(88,043)
Total segment assets	1,107,760	1,456,843	629,524	3,194,127
Segment liabilities	671,636	1,917,840	279,333	2,868,809

37 Segmental information *(continued)*

Included in the above segment information the results of Islamic Banking Window as below:

At 31 December 2014	Retail banking RO'000	Corporate banking RO'000	Treasury and investments RO'000	Total RO'000
Segment operating revenues	1,536	2,017	72	3,625
Other revenues	89	467	532	1,088
Segment operating revenues	1,625	2,484	604	4,713
Profit expenses	(26)	(263)	(128)	(417)
Net operating income	1,599	2,221	476	4,296
Segment cost				
Operating expenses including depreciation	(1,211)	(1,590)	(57)	(2,858)
Impairment allowance	(427)	(782)	-	(1,208)
Net loss for the year	(39)	(151)	419	230
Segment assets	52,091	85,856	55,339	193,286
Less: Impairment allowance	(612)	(882)	-	(1,494)
Total segment assets	51,479	84,974	55,339	191,792
Segment liabilities	1,797	91,291	66,277	159,365

38 Proposed dividend

The Board of Directors in their meeting held on 26 January 2016 proposed a cash dividend of 15% (2014: 10%) for the year ended 31 December 2015 amounting to RO 23.17 million (2014: RO 13.43 million) and a bonus share issue of 10% (2014: 10%) amounting to 154,472,855 shares (2014: 134,324,227 shares) of RO 0.100 each.

Subsequently, Central Bank of Oman in their approval for 2014 financial statements, advised to change the dividend distribution in the form of cash dividend of 5% amounting to RO 6.7 million and a bonus share issue of 15% aggregating to amounting 201,486,332 shares of RO 0.100 each, of the share capital of the bank for the year ended 31 December 2014. A resolution to approve these dividends and the increase in share capital was presented to the shareholders at the annual general meeting on 29 March 2015 and approved accordingly.

During the year, unclaimed dividend amounting to RO 4,647 (2014: RO 6,187) was transferred to the Investor's Trust Fund account as per the guidelines issued by the Capital Market Authority of Oman.