Draft subject to CBO approval

BANK DHOFAR SAOG

FINANCIAL STATEMENTS

31 DECEMBER 2018

Registered and principal place of business:

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

THE BOARD OF DIRECTORS' REPORT FOR THE FINANCIAL YEAR ENDED 31st DECEMBER 2018

Dear Shareholders,

On behalf of the Board of Directors of Bank Dhofar S.A.O.G., I am pleased to present you the Bank's Financial Statements and the Auditors' Report for the financial year ended 31st December 2018.

Financial overview in year 2018

Despite the current challenging economic and financial situation driven by volatile oil prices and rising interest rates, the bank continued to grow its net profit in 2018 achieving 5.57% growth year-on year from RO 47.63 million (USD 123.71 million) as of 31st of December 2017 to RO 50.28 million (USD 130.60 million) as of 31st of December 2018. The Net Loans, Advances and Financing to customers reached RO 3.16 billion (USD 8.21 billion) at December 2018, compared to RO 3.25 billion (USD 8.44 billion) at the end of 2017. In line with a decline in Loans and Financing book, Customer deposits, including Islamic deposits, also decreased by 4.88% from RO 3.07 billion (USD 7.97 billion) at the end of 2017 to reach RO 2.92 billion (USD 7.58 billion) at the end of 2018. Total assets reached RO 4.21 billion (USD 10.94 billion) in December 2018 as compared to RO 4.25 billion (USD 11.04 billion) at end of 2017, a marginal decline of 0.94%.

The key profitability indicators showed a positive growth with net interest and financing income to achieve a growth of 7.05% to reach RO 99.70 million (USD 258.96 million) for the year 2018 as compared to RO 93.13 million (USD 241.90 million). Non-funded income increased by 1.86% year-on-year reaching RO 34.43 million (USD 89.43 million) in 2018 as against RO 33.80 million (USD 87.79 million) during the same period of last year. The total operating income is RO 134.12 million (USD 348.36 million) for the year 2018 as compared to RO 126.93 million (USD 329.69 million) for the year 2017.

Total Operating Expenses is RO 67.27 million (USD 174.73 million) for the year 2018 as compared to RO 58.99 million (USD 153.22 million) for the year 2017. The Cost to Income ratio as of 31st of December 2018 stood at 50.50% as compared to 46.48% in 2017. The provision for loan impairment, net of recovery, during the year 2018 decreased to RO 6.65 million (USD 17.27 million) as against RO 11.90 million (USD 30.91 million) for the year 2017. The impairment allowance on investments during the year decreased to RO 0.20 million (USD 0.52 million) from RO 0.36 million (USD 0.94 million) in 2017.

Non-performing loans (funded) to gross loans & financing at Bank level increased from 3.11% as at 31st December 2017 to 3.68% as at 31st December 2018; Non-performing loans (funded), net of interest suspense, to gross loans & financing increased from 1.72 % at 31st December 2017 to 1.99% as at 31st December 2018 year-on-year.

Maisarah- Islamic Banking Services

Maisarah Islamic Banking Services has achieved a strong growth in profitability of 86.21% net profit before tax of RO 5.94 million (USD 15.43 million) compared to a net profit before tax of RO 3.19 million (USD 8.29 million) in 2017.

The gross financing income from Financing, Placement and Investment increased by 17.09% to RO 23.50 million (USD 61.04 million) from RO 20.07 million (USD 52.13 million). The net financing income increased to RO 11.91 million (USD 30.94 million) for the year 2018 compared to RO 9.75 million (USD 25.32 million) achieved in the previous year of 2017, a growth of 22.15%. Non Funded income has also increased by 48.67% to RO 1.68 million (USD 4.36 million) in 2018 from RO 1.13 million (USD 2.94 million) in 2017.

The gross financing portfolio has grown 3.54% from RO 387.78 million (USD 1.07 billion) as at 31st December 2017 to RO 401.49 (USD 1.04 billion) million as 31st of at December 2018. The Sukuk investment portfolio increased by 28.63% from RO 32.34 million (USD 84 million) as at 31st of December 2017 to RO 41.60 million (108.05) as at 31st of December 2018.

As at December 2018 the total customer deposit stood at RO 353.39 million (USD 917.90 million), compared to RO 376.78 million (USD 978.88 million) at same period last year. The total assets is at RO 512.43 million (USD 1.33 billion) at December 2018 compared to RO 543.28 million (USD 1.41 billion) at December 2017.

Funding and Capital Raising initiatives

In continuation of its capital augmentation to strengthen the capital base, the Bank has successfully raised capital of RO 95 million in the following forms:

a) a rights issue of its ordinary shares by RO 55 million which forms part of the Bank's Core Equity Tier 1 Capital (CET1);
b) Additional Tier 1 Perpetual Bond of RO 40 million which forms part of Tier 1 Capital.

This takes the CET-1 Ratio to healthy 11.88% and total Capital Adequacy Ratio (CAR) to 17.33% compared to the Regulatory requirements of 8.375% and 12.875% as at 31st December 2018

Top Management Changes

As part of Bank's long term strategy, the following senior management changes took place during the year 2018:

- Dhofar International Development & Investment Holding Co. SAOG has replaced their representative in Bank Dhofar Board of Directors' Mr. Shiekh Qais Mustahil Al Mashani by their new member Mr. Faisal Mohammed Moosa Al Yousef.
- Appointment of Mr. Jose K. Joseph as Deputy General Manager & Chief Risk Officer
- Appointment of Mr. Duraid Taher Ali Jamali as Deputy General Manager & Head of Legal

Corporate Governance

The Bank has fully complied with all directives of the Code of Corporate Governance issued by the Capital Market Authority. The Bank has also assessed and reviewed the internal control procedures of the Bank during the year 2018.

In compliance with Article (101) of the Commercial Companies Law No. 4/1974 and its amendments, the Board of Directors would like to disclose that the total amount received in 2018 as sitting fees was RO 76,200 and the proposed remuneration & sitting fees is RO 123,800 complying with total cap of RO 200,000.

Proposed Dividends

The Board of Directors in their meeting held on 29th January 2019 proposed a cash dividend of 10% (2017: 12%) for the year ended 31st December 2018 amounting to RO 28.00 million (2017: RO 27.09 million) and a bonus share issue of 7% (2017: 8%) amounting to 196,022,990 shares (2017: 180,268,618 shares) of RO 0.100 each subject to Regulatory and Shareholders Approvals.

The percentage of dividends distributed to the Shareholders in the last five years is as follows:

Year	2013	2014	2015	2016	2017
Cash Dividends	14%	5%	15%	13.5%	12%
Bonus Shares	11%	15%	10%	7.5%	8%

Corporate Social Responsibility (CSR) initiatives

During the year 2018 Bank Dhofar Board of Directors contributed RO 1 million in a demonstration of Bank's support to the citizens in Dhofar and Wusta governorates to support the repair and restoration efforts for the damages caused by Cyclone Mekunu that hit southern part of the country, particularly Dhofar region in May 2018. Moreover, the bank has also participated in supporting Football National team, Conference of Geographic Information, and other CSR initiatives.

Awards and Accolades during 2018

Bank Dhofar won the following rewards during the year 2018 and those awards are testimony to the continued efforts put in by the Bank:

- No. 1 in Large Sized Banks Category at Best Banks Report by Oman Economic Review (OER)
- Best Islamic bank in Oman - Maisarah Islamic Banking Services at the Middle East Banking Awards 2017 (EMEA Finance)
- Best Corporate Banking Institution – Oman in The Business Awards 2017 by MEA Markets
- Best Islamic Retail Bank Oman 2017 – Maisarah Islamic Banking by Global Banking & Finance Review
- The Business Excellence Award from the BIZZ AWARDS (World Confederation of Business) 2018
- Best mobile app from Pan Arab Web Awards 2018
- Best Private Bank Oman 2017 – Bank Dhofar by Global Banking & Finance Review
- Best Bank for Human Resources Oman 2017 by the Global Business Outlook Award 2017
- Straight-Through-Processing (STP) Excellence Award from CITI bank
- Best Digital Bank Oman 2018 from International Business Magazine Award
- Best Business Leaders award to CEO for Bank Dhofar at the prestigious MENA awards 2018

The Year Ahead (2019)

State National 2019 budget has been announced by the government of Oman projecting a deficit of approximately RO 2.8 billion i.e. 9% of GDP as compared to RO 2.9 billion projected in 2018 budget. The 2019 deficit is expected to be financed from domestic and international borrowings (86%) the remainder from internal reserves. The 2019 budget aims at achieving fiscal sustainability so as to enable the national economy in achieving economic growth, diversification, and targeted rates of domestic and foreign investment. Average price per barrel of oil assumed in the State Budget is USD 58 per barrel. Aggregate revenue is estimated at RO 10.1 billion, increasing by 6% as compared to estimated revenue for 2018 with Oil and gas revenue to represent 74% of total revenue and remained from non-oil revenue. Total public spending is budgeted at about RO 12.9 billion, increasing by RO 400 million i.e. 3% compared with the budgeted figures of 2018 Budget focusing on investment spending needed mainly for development and infrastructure projects.

Acknowledgment

On behalf of the Board, I would like to thank our valuable customers for their patronage and confidence they have reposed in the Board of Directors and the Executive Management. Also I thank the shareholders for their continuous support and Chairman, members of Sharia Supervisory Board of Maisarah Islamic Banking Services, Management and Staff for their efforts and contributions in the year 2018.

The Board of Directors also wishes to thank the Central Bank of Oman for its valuable guidance to the local banking sector.

Finally, on behalf of the Board of Directors, employees and the management I would like to express our most sincere gratitude to His Majesty Sultan Qaboos Bin Said for his wise leadership and generous support to the private sector.

Eng. Abdul Hafidh Salim Rajab Al-Aujaili
Chairman

BANK DHOFAR SAOG

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STATEMENT OF FINANCIAL POSITION

As at 31 December

	Notes	2018 RO'000	2017 RO'000
Assets			
Cash and balances with Central Bank of Oman	*5*	**301,505**	326,819
Loans, advances and financing to banks	*6*	**329,059**	299,896
Loans, advances and financing to customers	*7*	**3,158,844**	3,248,873
Investment securities	*8*	**304,332**	290,855
Intangible asset	*9*	**794**	1,191
Property and equipment	*10*	**14,917**	9,524
Other assets	*11*	**104,039**	69,552
Total assets		**4,213,490**	4,246,710
Liabilities			
Due to banks	*12*	**368,983**	387,742
Deposits from customers	*13*	**2,924,504**	3,068,409
Other liabilities	*14*	**157,966**	114,677
Subordinated loans	*15*	**63,875**	88,875
Total liabilities		**3,515,328**	3,659,703
Shareholders' equity			
Share capital	*16(a)*	**280,033**	225,786
Share premium	*17*	**95,656**	77,564
Legal reserve	*18(a)*	**55,878**	50,254
Special reserve	*18(d)*	**18,488**	18,488
Special reserve – restructured loans	*18(e)*	**1,281**	1,281
Special Impairment reserve – IFRS 9	*18(f)*	**4,562**	-
Special revaluation reserve – Investment IFRS 9	*18(g)*	**(709)**	-
Subordinated loan reserve	*18(b)*	**30,100**	42,325
Investment revaluation reserve	*18(c)*	**(1,789)**	507
Retained earnings	*19*	**59,162**	55,302
Total equity attributable to the equity holders of the Bank		**542,662**	471,507
Perpetual Tier 1 capital securities	*16 (b)*	**155,500**	115,500
Total equity		**698,162**	587,007
Total liabilities and equity		**4,213,490**	4,246,710
Net assets per share (Rial Omani)	*20*	**0.194**	0.209
Contingent liabilities and commitments	*28*	**1,010,814**	1,018,969

The financial statements were authorised on 29 January 2019 for issue in accordance with the resolution of the Board of Directors.

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Eng. Abdul Hafidh Salim Rajab Al-Aujaili
Chairman

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Abdul Hakeem Omar Al Ojaili
Chief Executive Officer

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

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STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December

	Notes	2018 RO'000	2017 RO'000
Interest income		**174,766**	161,499
Interest expense		**(85,037)**	(76,894)
Net interest income	*21*	**89,729**	84,605
Income from Islamic financing		**21,556**	18,842
Unrestricted investment account holders' share of profit and profit expense		**(11,587)**	(10,321)
Net income from Islamic financing and investment activities	*21*	**9,969**	8,521
Fees and commission income		**20,603**	20,898
Fees and commission expense		**(4,999)**	(3,646)
Net fees and commission income	*29*	**15,604**	17,252
Other income	*22*	**18,822**	16,549
Operating income		**134,124**	126,927
Staff and administrative costs	*23*	**(64,059)**	(55,673)
Depreciation	*10*	**(3,668)**	(3,321)
Operating expenses		**(67,727)**	(58,994)
Profit from operations		**66,397**	67,933
Net impairment losses on financial instruments	*7*	**(6,650)**	(11,541)
Bad debts written-off		**(4)**	(3)
Impairment of available-for-sale investments	*18 (c)*	**-**	(358)
Profit from operations after provision		**59,743**	56,031
Income tax expense	*24*	**(9,462)**	(8,404)
Profit for the year		**50,281**	47,627
Other comprehensive income:			
Items that will not be reclassified to profit or loss			
Movement in fair value reserve (FVOCI equity instrument)	*18(d)*	**(759)**	-
Items that are or may be reclassified to profit or loss in subsequent periods:			
Movement in fair value reserves			
- FVOCI debt instruments	*18(d)*	**(1,537)**	-
- Available for sale investments		**-**	(952)
Other comprehensive income for the year		**(2,296)**	(952)
Total comprehensive income for the year		**47,985**	46,675
Earnings per share (basic and diluted) (Rial Omani)	*25*	**0.017**	0.016

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

STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December

	Notes	Share capital RO'000	Share premium RO'000	Legal reserve RO'000	Special reserve RO'000	Special reserve restructured loan RO'000	Special impairment reserve IFRS 9 RO'000	Special revaluation reserve IFRS 9 RO'000	Subordinated loans reserve RO'000	Investment revaluation reserve RO'000	Retained earnings RO'000	Total RO'000	Perpetual Tier 1 capital securities RO'000	Total equity RO'000
Balances as at 1 January 2018		**225,786**	**77,564**	**50,254**	**18,488**	**1,281**	**-**	**-**	**42,325**	**507**	**55,302**	**471,507**	**115,500**	**587,007**
Adjustment on initial application of IFRS 9, net of tax	*2.7*	-	-	-	-	-	**3,527**	**(709)**	-	-	**709**	**3,527**	-	**3,527**
Restated balance on 1 January 2018		**225,786**	**77,564**	**50,254**	**18,488**	**1,281**	**3,527**	**(709)**	**42,325**	**507**	**56,011**	**475,034**	**115,500**	**591,157**
Profit for the period		-	-	-	-	-	-	-	-	-	**50,281**	**50,281**	-	**50,281**
Other comprehensive income for the period:														
Net changes in fair value reserve														
- FVOCI equity instrument	*18(c)*	-	-	-	-	-	-	-	-	**(759)**	-	**(759)**	-	**(759)**
- FVOCI debt instruments	*18(c)*	-	-	-	-	-	-	-	-	**(1,537)**	-	**(1,537)**	-	**(1,537)**
Total comprehensive income for the period		-	-	-	-	-	-	-	-	**(2,296)**	**50,281**	**47,985**	-	**47,985**
Transfer to special impairment reserve IFRS 9	*18(f)*	-	-	-	-	-	**1,035**	-	-	-	**(1,035)**	-	-	-
Transfer to legal reserve	*18(a)*	-	-	**5,028**	-	-	-	-	-	-	**(5,028)**	-	-	-
Excess of receipts over right issue expenses	*18(a)*	-	-	**596**	-	-	-	-	-	-	-	**596**	-	**596**
Transfer to subordinated loan reserve		-	-	-	-	-	-	-	**12,775**	-	**(12,775)**	-	-	-
Transfer to retained earnings	*18(b)*	-	-	-	-	-	-	-	**(25,000)**	-	**25,000**	-	-	-
Perpetual Tier 1 capital securities:														
- Proceeds from issuance		-	-	-	-	-	-	-	-	-	-	-	**40,000**	**40,000**
- Issuance cost		-	-	-	-	-	-	-	-	-	**(223)**	**(223)**	-	**(223)**
- Payment towards perpetual additional Tier 1 coupon		-	-	-	-	-	-	-	-	-	**(7,912)**	**(7,912)**	-	**(7,912)**
Transactions with owners recorded directly in equity														
Issue of right shares		**36,184**	**18,092**	-	-	-	-	-	-	-	-	**54,276**	-	**54,276**
Dividend for 2017	*35*	-	-	-	-	-	-	-	-	-	**(27,094)**	**(27,094)**	-	**(27,094)**
Bonus shares issued for 2017	*35*	**18,063**	-	-	-	-	-	-	-	-	**(18,063)**	-	-	-
Balances as at 31 December 2018		**280,033**	**95,656**	**55,878**	**18,488**	**1,281**	**4,562**	**(709)**	**30,100**	**(1,789)**	**59,162**	**542,662**	**155,500**	**698,162**

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

STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December

	Notes	Share capital RO'000	Share premium RO'000	Legal reserve RO'000	Special reserve RO'000	Special reserve - restructured loans RO'000	Subordinated loans reserve RO'000	Investment revaluation reserve RO'000	Retained earnings RO'000	Total RO'000	Perpetual Tier 1 capital securities RO'000	Total equity RO'000
Balances as at 1 January 2017		189,920	59,618	45,176	18,488	-	31,550	1,459	72,289	418,500	115,500	534,000
Profit for the year		-	-	-	-	-	-	-	47,627	47,627	-	47,627
Other comprehensive income for the year												
Net change in fair value of available-for-sale investments		-	-	-	-	-	-	(1,266)	-	(1,266)	-	(1,266)
Reclassification adjustment on sale of available-for-sale investments		-	-	-	-	-	-	(44)	-	(44)	-	(44)
Impairment of available-for-sale investments		-	-	-	-	-	-	358	-	358	-	358
Total comprehensive income for the year		-	-	-	-	-	-	(952)	47,627	46,675	-	46,675
Transfer to legal reserve	*18*	-	-	4,763	-	-	-	-	(4,763)	-	-	-
Transfer to subordinated loan reserve	*18*	-	-	-	-	-	10,775	-	(10,775)	-	-	-
Issue of right shares	*17*	21,622	17,946	-	-	-	-	-	-	39,568	-	39,568
Excess of receipts over rights issue expenses	*17*	-	-	315	-	-	-	-	-	315	-	315
Transfer to special reserve – restructured loans	*18*	-	-	-	-	1,281	-	-	(1,281)	-	-	-
Payment towards Perpetual Tier 1 coupon		-	-	-	-	-	-	-	(7,912)	(7,912)	-	(7,912)
Transactions with owners recorded directly in equity												
Dividend paid for 2016	*35*	-	-	-	-	-	-	-	(25,639)	(25,639)	-	(25,639)
Bonus shares issued for 2016	*35*	14,244	-	-	-	-	-	-	(14,244)	-	-	-
Balances as at 31 December 2017		225,786	77,564	50,254	18,488	1,281	42,325	507	55,302	471,507	115,500	587,007

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

STATEMENT OF CASH FLOWS
For the year ended 31 December

	2018 RO'000	2017 RO'000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit for the year before taxation	**59,743**	56,031
Adjustment for:		
Depreciation and amortisation	**4,065**	3,719
Net impairment on financial instruments	**6,650**	11,541
Impairment on available-for-sale investments	**-**	358
End of service benefits provision for the year	**332**	408
Gain on disposal of property and equipment	**(46)**	(4)
Loss / (gain) on sale of investments	**299**	(169)
Operating profit before working capital changes	**71,043**	71,884
Change in working capital:		
Due to banks	**(18,641)**	37,526
Due from banks	**8,609**	77,145
Loans & advances and financing	**87,529**	(271,822)
Investment securities	**(16,072)**	(66,090)
Other assets	**(33,521)**	23,262
Customer deposits	**(143,905)**	183,220
Other liabilities	**39,623**	(16,336)
Cash used in operations	**(5,335)**	38,789
Taxes paid	**(7,357)**	(6,108)
End of service benefits paid	**(360)**	(121)
Net cash (used in) / from operating activities	**(13,052)**	32,560
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	**(9,061)**	(4,573)
Proceeds from sale of property and equipment	**46**	60
Net cash used in investing activities	**(9,015)**	(4,513)
CASH FLOWS FROM FINANCING ACTIVITIES		
(Repayment) / proceeds from subordinated debt	**(25,000)**	35,000
Dividend paid	**(27,094)**	(25,639)
Proceeds from Tier 1 perpetual subordinated bond	**40,000**	-
Perpetual Tier 1 capital securities issuance cost	**(223)**	-
Proceeds from rights issue of share capital, net of expense	**54,872**	39,883
Interest on Tier 1 perpetual subordinated bond	**(7,912)**	(7,912)
Net cash from financing activities	**34,643**	41,332
NET CHANGE IN CASH AND CASH EQUIVALENTS	**12,576**	69,379
Cash and cash equivalents at 1 January	**414,879**	345,500
Cash and cash equivalents at 31 December	**427,455**	414,879
Cash and cash equivalent comprises of:		
Cash and balances with Central Bank of Oman	**301,505**	326,819
Capital deposit with Central Bank of Oman	**(500)**	(500)
Due from banks	**126,917**	89,145
Due to banks	**(467)**	(585)
	427,455	414,879

STATEMENT OF CASH FLOWS
For the year ended 31 December

Reconciliation of liabilities and equity arising from financing activities:

	December 2018 RO'000	December 2017 RO'000
Subordinated loan		
Balance at beginning of the period	**88,875**	88,875
Cash flows	**(25,000)**	-
Balance at end of the period	**63,875**	88,875
Retained earnings		
Balance at beginning of the period	**55,302**	72,289
Changes on initial application of IFRS 9	**709**	-
Profit for the period	**50,281**	47,627
Transfer to legal reserve	**(5,028)**	(4,763)
Transfer to Subordinate reserve	**(12,775)**	(10,775)
Transfer from Subordinate to retained earning	**25,000**	-
Additional Tier 1 coupon	**(7,912)**	(7,912)
Perpetual tier 1 capital securities issuance cost	**(223)**	-
Transfer to special reserve (IFRS 9)	**(1,035)**	-
Transfer to special reserve restructure	**-**	(1,281)
Bonus shares issued	**(18,063)**	(14,244)
Dividend transfer	**(27,094)**	(25,639)
Balance at end of the period	**59,162**	55,302

The accompanying notes form an integral 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 55 million from the core paid up capital of the shareholders. The Bank has a primary listing of its ordinary shares on the Muscat Securities Market ("MSM"), Bank's Additional Tier I Perpetual Bonds are listed on the Irish Stock Exchange ('ISE") and Muscat Securities Market ("MSM"). The Bank's principal place of business is its Head Office located at Capital Business District ("CBD"), Muscat, Sultanate of Oman.

2 BASIS OF PREPARATION

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, the disclosure requirements of the Capital Market Authority of the Sultanate of Oman and the applicable regulations of the Central Bank of Oman ("CBO").

The Bank also 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 the 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 the CBO. The IBWs financial statements are then converted into International Financial Reporting Standards (IFRS) compliant financial statements and included in these financial statements. All balances and transactions between Bank and IBW are eliminated in these financial statements.

2.2 Basis of measurement

The financial statements have been prepared under the historical cost convention except for derivative financial instruments, financial instruments at fair value through profit or loss (FVTPL) and financial instruments at fair value through other comprehensive income (FVOCI) (applicable from 1 January 2018) and available-for-sale investments (applicable upto 31 December 2017).

This is the first set of the Bank's annual financial statements in which IFRS 9 "Financial Instruments" and IFRS 15 "Revenue from Contracts with Customers" have been applied. Changes to significant accounting policies are described in note 2.7.

2.3 Functional and presentation currency

The financial statements are presented in Rial Omani ("RO"), which is the Bank's functional (currency of primary economic environment in which the Bank operates) and presentation currency, rounded to the nearest thousand unless otherwise stated.

2.4 Use of estimates and judgements

The preparation of financial statements in conformity with IFRSs 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 Standards, amendments and interpretations effective in 2018 and relevant for the Bank's operations

For the year ended 31 December 2018, the Bank has adopted applicable 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 or after 1 January 2018.

The following are the accounting standards which are relevant to the Bank and have been applied in the preparation of these financial statements which has resulted in changes to the Bank's accounting policies and has not affected the amounts reported for prior periods. Differences in the carrying amount of financial assets and liabilities resulting from adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018.

IFRS 9: Financial Instruments

On 1 January 2018 the Bank adopted IFRS 9 "Financial Instruments" (as revised in July 2014) which replaces IAS 39 "Financial Instruments: Recognition and Measurement". IFRS 9 introduces new requirements for:

(1) The classification and measurement of financial assets and financial liabilities;
(2) Impairment of financial assets; and
(3) General hedge accounting.

The standard also requires entities to provide users of financial statements with more informative and relevant disclosures. Refer to the Note 2.7 "IFRS 9 Financial Instruments" for impact on account of adoption of IFRS 9, Note 3.2 and 3.3 for the significant accounting policies and Note 32 for risk disclosures in accordance with the standard.

IFRS 15: Revenue from Contracts with Customers

The Bank has adopted IFRS 15 as issued by IASB with effective date from 1 January 2018. This standard has superseded all revenue recognition requirements under the earlier standard and provides a principle based approach for revenue recognition with the introduction of concept for revenue recognition for performance obligation as they are satisfied. The Bank has assessed the impact of IFRS 15 and concluded that the application of this standard does not have any material impact on the timing or amount of the Bank's fees and commission income from contracts with customers. The impact of IFRS 15 was limited to the new disclosure requirements (note 29).

2.6 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 2018:

IFRS 16 Leases; effective for annual periods commencing 1 January 2019

IFRS 16 "Leases" replaces the existing guidance and interpretations including IAS 17 "Leases", IFRIC 4 "Determining whether an arrangement contains a lease", SIC 15 "Operating leases - Incentives" and SIC 27 "Evaluating the substance of transactions involving the legal form of a lease". Under IAS 17, leases were required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). IFRS 16 now required lessees to recognise a lease liability reflecting future lease payments and a 'right of use asset' for virtually all lease contracts. It included an optional exemption for certain short term leases and leases of low value assets. However, this exemption can only be applied by lessees. Lessor accounting remains similar to the current standard IAS 17, i.e. lessors continue to classify leases as finance or operating leases.

The Bank will adopt the new standard on the required effective date using the modified retrospective approach. The Bank has performed an initial impact assessment of IFRS 16 and concluded that the standard may not have any material impact on the Bank's financial statements.

2 BASIS OF PREPARATION *(continued)*

2.7 Changes in accounting policies

A. IFRS 9 Financial instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement.

As permitted by the transitional provisions of IFRS 9, the Bank elected not to restate comparative figures. Accordingly, any adjustments to the carrying amounts of financial assets and financial liabilities at the date of transition were recognised in the opening retained earnings and other reserves of the current year. As permitted by IFRS 9, the bank has elected to continue to apply the hedge accounting requirements of IAS 39.

The adoption of IFRS 9 has resulted in changes to accounting policies for recognition, classification and measurement of financial assets and financial liabilties and impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments such as IFRS 7 "Financial Instruments: Disclosure".

Impairment of financial assets
IFRS 9 replaces the 'incurred loss' model in IAS 39 with an ' expected credit loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments. Further details of the impairment requirements are described in more detail in Note 3.3.

Transition
Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below:

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.

- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application:
  - The determination of the business model within which a financial asset is held.
  - The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.
  - The designation of certain investments in equity instruments not held for trading as at FVOCI.
  - For financial liabilities designated as at FVTPL, the determination of whether presenting the effects of changes in the financial liability’s credit risk in OCI would create or enlarge an accounting mismatch in profit or loss.

- If a debt security had low credit risk at the date of initial application of IFRS 9, then the Bank has assumed that credit risk on the asset had not increased significantly since its initial recognition.

Following are the changes and implications resulting from the adoption of IFRS 9:

2 BASIS OF PREPARATION *(continued)*

2.7 Changes in accounting policies *(continued)*

A. **IFRS 9 Financial instruments** *(continued)*

Transition *(continued)*

(a) The table reconciles the original measurement categories and carrying amounts in accordance with IAS 39 and the new measurement categories with those under IFRS 9 for the Bank's financial assets and financial liabilities as at 1 January 2018.

RO'000

	Original Classification under IAS 39	New classification under IFRS 9	Original carrying amount	Re-measure-ment [note 18 (f)]	Impact of IFRS 9 Re-classification [note 18 (g)]	New carrying amount
Financial assets						
Cash and balances with Central Bank of Oman	Loans and receivables	Amortised cost	326,819	-	-	326,819
Loans, advances and financing to banks	Loans and receivables	Amortised cost	299,896	(495)	-	299,401
Loans and advances to customers	Loans and receivables	Amortised cost	3,248,873	16,370	-	3,265,243
Investment securities – equity	Available-for-sale	FVOCI	4,550	-	(709)	3,841
Investment securities – debt	Available-for-sale	FVOCI	26,437	(67)	-	26,370
Investment securities – equity	Available-for-sale	FVTPL	4,825	-	-	4,825
Investment securities	Held to maturity	Amortised cost	255,043	-	-	255,043
Other assets *	Loans and receivables	Amortised cost	69,441	(676)	-	68,765
Property and equipment			9,524	-	-	9,524
Intangible asset			1,191	-	-	1,191
Derivative financial instruments (net)	FVTPL	FVTPL	111	-	-	111
			4,246,710	15,132	(709)	4,261,133
Financial liabilities						
Due to banks	Amortised cost	Amortised cost	387,742	-	-	387,742
Customer deposits	Amortised cost	Amortised cost	3,068,409	-	-	3,068,409
Other liabilities #	Amortised cost	Amortised cost	104,561	11,605	-	116,166
Subordinated debt	Amortised cost	Amortised cost	88,875	-	-	88,875
Income tax payable			10,116	-	-	10,116
			3,659,703	11,605	-	3,671,308
Net				3,527	(709)	

Note:
* Re-measurement includes impact of deferred tax liability on special impairment reserve of RO 623 thousand; and
# RO 11,605 thousand represents impairment allowance on loan commitment, financial guarantee, acceptances and unutilised limits

2 BASIS OF PREPARATION *(continued)*

2.7 Changes in accounting policies *(continued)*

A. **IFRS 9 Financial instruments** *(continued)*

Transition *(continued)*

The impact from the adoption of IFRS 9 as at 1 January 2018 has been increase in retained earnings by RO 709 thousand, decrease the fair value reserve by same amount:

	Retained earnings	**Special impairment reserve IFRS 9**	***RO'000*** **Special revaluation reserve [note 18(f)]**
Closing balance under IAS 39 (31 December 2017)	**55,302**	-	-
Impact on reclassification and measurements:		-	
Investment securities (equity) from available-for-sale to those measured at fair value through other comprehensive income (FVOCI)	**709**	-	(709)
Re-measurement impact on transition	**-**	**3,527**	-
Opening balance under IFRS 9 on date of initial application of 1 January 2018	**56,011**	**3,527**	(709)

3 SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all the years presented in these financial statements, except changes in accounting policies resulting from the adoption of IFRS 9 and IFRS 15 as described in note 2.7.

3.1 Foreign currency transactions

Transactions in foreign currencies are translated into the respective functional currencies of the operations at the spot exchange rates at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange at the reporting date. Any resulting exchange differences are included in 'other income' in the statement of comprehensive income.

The non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date the fair value is determined. Foreign exchange differences arising on translation are recognised in the statement of comprehensive income, except for non-monetary financial assets, such as securities classified as available-for-sale (before 1 January 2018), which are included in other comprehensive income. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

3.2 Financial assets and liabilities

3.2.1 Recognition and initial measurement

The Bank initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

3.2.2 Classification

(a) Financial assets

Policy applicable from 1 January 2018

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL).

On initial recognition, a financial asset is classified as measured at; amortised cost, FVOCI or FVTPL.

Financial assets measured at amortised cost

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

It is initially recognised at fair value plus directly attributable transaction costs and subsequently measured at amortised cost less impairment.

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.2 Financial assets and liabilities *(continued)*

3.2.2 Classification *(continued)*

(a) Financial assets *(continued)*

Financial assets measured at fair value through other comprehensive income

i) Debt Instruments

Investment in debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as FVTPL;

- The asset is held within business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

These debt instruments are initially recognised at fair value plus directly attributable transaction costs and subsequently measured at fair value. Gains and losses arising from changes in fair value are included in other comprehensive income within a separate component of equity.

ii) Equity Instruments

For an equity instrument that is not held for trading, the Bank may elect at initial recognition to irrecovably designate those instruments under FVOCI. This election is made on an investment on investment basis. Amounts presented in other comprehensive income are not subsequently transferred to the statement of profit or loss.

Financial assets measured at fair value through profit or loss

Financial assets at fair value through profit or loss comprises of investments held for trading and designated as FVTPL on initial recognition. It is initially recognised at fair value with transaction costs recognised in the statement of profit or loss as incurred. Subsequently, they are measured at fair value and any gains or losses are recognised in the statement of profit or loss.

Business model assessment

Business model assessment involves determining how financial assets are managed in order to generate cash flows. The Bank's business model assessment is based on the following categories:

- Held to collect: The objective of the business model is to hold assets and collect contractual cash flows. Any sales of the asset are incidental to the objective of the model.
- Held to collect and for sale: Both collecting contractual cash flows and sales are integral to achieving the objectives of the business model.
- Other business model: The business model is neither held-to-collect nor held-to-collect and for sale.

The Bank makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- The stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.2 Financial assets and liabilities *(continued)*

3.2.2 Classification *(continued)*

(a) Financial assets *(continued)*

Business model assessment *(continued)*

- How the performance of the portfolio is evaluated and reported to the Bank's management;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- How managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- The frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Assessment whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition.

Modifications of financial assets

If the cash flows of the modified asset carried at amortised cost are not substantially different, then the modification does not result in de-recognition of the financial asset. In this case, the Bank recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in profit or loss.

Financial guarantee contracts and loan commitments

For financial guarantee contracts and loan commitments, the loss allowance is recognised as impairment as described in note 3.3. The Bank has issued no loan commitment that are measured at FVTPL. Impairment arising from financial guarantee and loan commitments are included within impairment allowance under other liabilities in statement of financial position.

Loans & advances and financing receivables

Policy applicable from 1 January 2018

Loans & advances and financing 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 method less allowance for impairment losses which are recognised in the statement of profit or loss.

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.2 Financial assets and liabilities *(continued)*

3.2.2 Classification *(continued)*

(a) Financial assets *(continued)*

Loans & advances and financings receivables *(continued)*

Policy applicable before 1 January 2018

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

Loans & advances and financing 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 method less specifically identified and collective allowance for impairment losses are recognised in the statement of profit or loss as 'impairment for credit losses'. Specific provisions were made against the carrying amount of loans and financings receivables that are identified as being impaired based on regular reviews of outstanding balances to reduce the impaired loans and receivables to their recoverable amounts. Loans and financings receivables are reported in the statement of financial position as loans & advances and financing, net. Interest on loans is included in the statement of profit or loss and is reported as 'interest income'.

Investments

Policy applicable from 1 January 2018

Investments which are recognised in the statement of financial position includes:
(i) Debt securities measured at FVOCI;
(ii) Equity investment securities designated at FVTPL and these are at fair value with changes recognised immediately in profit or loss;
(iii) Equity investment securities measured at FVOCI

For debt securities measured at FVOCI, gain and losses are recognised in 'Other Comprehensive income' and when it is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss. The bank elects to present in other comprehensive income the changes in the fair value of certain investments in equity instruments that are measured at FVOCI. The election is made on an instrument by instrument basis on initial recognition.

Policy applicable before 1 January 2018

Fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term. Derivatives are also categorised as held for trading unless they are designated as hedging instruments.

Financial assets at fair value through profit or loss are initially recognised at fair value, which is the cash consideration paid, and measured subsequently at fair value. All the realised and unrealised gains and losses are recognised in the statement of profit or loss. Interest earned or dividends received are recognised in the statement of profit or loss under 'interest income' and 'other income' respectively.

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.2 Financial assets and liabilities *(continued)*

3.2.2 Classification *(continued)*

(a) Financial assets *(continued)*

Policy applicable before 1 January 2018

Held to maturity financial assets

Held to maturity financial assets are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold till maturity.

These are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate.

Interest on held to maturity investments is included in the statement of profit or loss and reported as 'interest income'. In the case of impairment, the impairment loss is reported as a deduction from the carrying value of the investment and recognised in the statement of profit or loss as 'impairment on investments'. Held to maturity investments includes debt securities.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories.

Available-for-sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices or that are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit or loss.

Available-for-sale financial assets are initially recognised at fair value, which is the cash consideration including any transaction costs, and measured subsequently at fair value with gains and losses being recognised in the statement of other comprehensive income, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognised. If an available for sale financial asset is determined to be impaired/derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified in the profit or loss. However, interest calculated using the effective interest method, and foreign currency gains and losses on monetary assets classified as available for sale are recognised in the profit or loss. Dividends on available for sale equity instruments are recognised in profit or loss as 'other income' when the Bank's right to receive is established.

(b) Financial liabilities

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognized in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- the remaining amount of change in the fair value is presented in profit or loss.

3.2.3 Recognition

The Bank initially recognises loans, advances and financing to customers, deposits from customers, 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 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.2 Financial assets and liabilities *(continued)*

3.2.4 De-recognition

Financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On de-recognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss.

From 1 January 2018 any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on de-recognition of such securities. Any interest in transferred financial assets that qualify for de-recognition that is created or retained by the Bank is recognised as a separate asset or liability.

Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

3.2.5 Modifications of financial assets and financial liabilities

Financial assets

If the terms of a financial asset are modified or an existing financial asset is replaced with a new one, an assessment is made to determine if the existing financial asset should be derecognized. Where a modification does not result in de-recognition, the date of origination continues to be used to determine significant increase in credit risk (SICR). Where a modification results in de-recognition, the new financial asset is recognized at its fair value on the modification date. The modification date is also the date of origination for this new asset.

The Bank may modify the contractual terms of loans for either commercial or credit reasons. The terms of a loan in good standing may be modified for commercial reasons to provide competitive pricing to borrowers. Loans are also modified for credit reasons where the contractual terms are modified to grant a concession to a borrower that may be experiencing financial difficulty.

For all financial assets modifications of the contractual terms may result in de-recognition of the original asset when the changes to the terms of the loans are considered substantial. These terms include interest rate, authorized amount, term, or type of underlying collateral. The original loan is derecognized and the new loan is recognized at its fair value. The difference between the carrying value of the derecognized asset and the fair value of the new asset is recognized in the statement of profit or loss.

For all loans, performing and credit-impaired, where the modification of terms did not result in the de-recognition of the loan, the gross carrying amount of the modified loan is recalculated based on the present value of the modified cash flows discounted at the original effective interest rate and any gain or loss from the modification is recorded in the provision for credit losses line in the statement of profit or loss.

Financial liabilities

The Bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and consideration paid is recognised in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.2 Financial assets and liabilities *(continued)*

3.2.5 Modifications of financial assets and financial liabilities *(continued)*

Financial liabilities *(continued)*

If the modification of a financial liability is not accounted for as de-recognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

3.2.6 Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank currently has a legally enforceable right to set off the amounts and it intends either to settle them 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 under IFRS, or for gains and losses arising from a Bank of similar transactions such as in the Bank's trading activity.

3.2.7 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.

3.2.8 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 31.

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)*

3.2.9 Designation at fair value through profit or loss

Financial assets

At initial recognition, the Bank designate certain financial assets as at FVTPL because this designation eliminates or significantly reduces an accounting mismatch, which would otherwise arise.

Before 1 January 2018, the Bank also designated certain financial assets as at FVTPL because the assets were managed, evaluated and reported internally on a fair value basis.

Financial liabilities

The Bank designates certain financial liabilities as at FVTPL in either of the following circumstances:

- the liabilities are managed, evaluated and reported internally on a fair value basis; or
- the designation eliminates or significantly reduces an accounting mismatch that would otherwise arise.

3.3 Impairment

Policy applicable from 1 January 2018

The Bank recognises loss allowances for expected credit losses (ECL) on the following financial instruments that are not measured at FVTPL:

- Balances with banks
- Due from banks
- Debt investment securities
- Loans, advances & financings to customers
- Loan commitment
- Financial guarantee
- Other assets (acceptances and interest receivables)

No impairment loss is recognised on equity investments.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured at 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition.

The Bank considers a debt investment security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Bank does not apply the low credit risk exemption to any other financial instruments.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as 'Stage 1 financial instruments'.

Life-time ECL are the ECL that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised but which are not credit-impaired are referred to as 'Stage 2 financial instruments'.

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Policy applicable from 1 January 2018

3.3 Impairment *(continued)*

Impairment allowances are measured using a three-stage approach based on the extent of credit deterioration since origination:

- Stage 1 – Where there has not been a significant increase in credit risk (SICR) since initial recognition of a financial instrument, an amount equal to 12 months expected credit loss is recorded. The expected credit loss is computed using a probability of default occurring over the next 12 months. For those instruments with a remaining maturity of less than 12 months, a probability of default corresponding to remaining term to maturity is used.
- Stage 2 – When a financial instrument experiences a SICR subsequent to origination but is not considered to be in default, it is included in Stage 2. This requires the computation of expected credit loss based on the probability of default over the remaining estimated life of the financial instrument.
- Stage 3 – Financial instruments that are considered to be in default are included in this stage. Similar to Stage 2, the allowance for credit losses captures the lifetime expected credit losses.

The key inputs into the measurement of ECL are the term structure of the following variables:

- Probability of default (PD);
- Loss given default (LGD); and
- Exposure at default (EAD).

These parameters are generally derived from internally developed statistical models and other historical data. They are adjusted to reflect forward-looking information.

Details of these statistical parameters/inputs are as follows:

- PD – The probability of default is an estimate of the likelihood of default over a given time horizon.
- EAD – The exposure at default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date.
- LGD – The loss given default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realization of any collateral. It is usually expressed as a percentage of the EAD.

(a) Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive); and
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows.

However for unfunded exposures, ECL is measured as follows:

- undrawn loan commitments: at the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive; and
- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Policy applicable from 1 January 2018

3.3 Impairment *(continued)*

(b) Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised and ECL are measured as follows:

- If the expected restructuring will not result in de-recognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in de-recognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its de-recognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of de-recognition to the reporting date using the original effective interest rate of the existing financial asset.

(c) Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt securities carried at FVOCI are credit-impaired.

A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Credit impaired financial assets are referred to as Stage 3 assets. Evidence of credit-impairment includes observable data regarding the following events:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise; or
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation

It may not be possible to identify a single discrete event—instead, the combined effect of several events may have caused financial assets to become credit-impaired. The Bank assesses whether debt instruments that are financial assets measured at amortised cost or FVOCI are credit-impaired at each reporting date. To assess if sovereign and corporate debt instruments are credit impaired, the Bank considers the following factors:

- The market's assessment of creditworthiness as reflected in the bond yields;
- The rating agencies' assessments of creditworthiness;
- The country's ability to access the capital markets for new debt issuance; and
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.

A loan is considered credit-impaired when a concession is granted to the borrower due to a deterioration in the borrower's financial condition, unless there is an evidence that as a result of granting the concession the risk of not receiving the contractual cash flows has reduced significantly and there are no other indicators of impairment.

For financial assets where concessions are contemplated but not granted, the asset is deemed credit impaired when there is observable evidence of credit-impairment including meeting the definition of default. The definition of default (refer note 3.3 (g)) includes unlikeliness to pay indicators and a backstop if amounts are overdue for 90 days or more.

(d) *Forward-looking information*

The measurement of expected credit losses for each stage and the assessment of significant increases in credit risk considers information about past events and current conditions as well as reasonable and supportable forecasts of future events and economic conditions. The estimation and application of forward-looking information requires significant judgement.

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Policy applicable from 1 January 2018

3.3 Impairment *(continued)*

(e) Macroeconomic factors

In impairment models, the Bank relies on a broad range of forward looking information as economic inputs, such as: real gross domestic product (GDP) growth and oil revenue (as % of GDP). The inputs and models used for calculating expected credit losses may not always capture all characteristics of the market at the reporting date. To reflect this, qualitative adjustments or overlays are made as temporary adjustments using expert credit judgement.

(f) Assessment of significant increase in credit risk

The Bank assesses whether there has been a significant increase in credit risk for exposures since initial recognition by comparing the risk of default occurring over the remaining expected life from the reporting date and the date of initial recognition. The assessment considers counterparty quantitative and qualitative information without consideration of collateral, and the impact of forward-looking macroeconomic factors.

The common assessments for SICR on financial assets include macroeconomic outlook, management judgement, and delinquency and monitoring. Forward-looking macroeconomic factors are a key component of the macroeconomic outlook. The importance and relevance of each specific macroeconomic factor depends on the type of product, characteristics of the financial instruments and the counterparty and the geographical region. Quantitative models may not always be able to capture all reasonable and supportable information that may indicate a significant increase in credit risk. Qualitative factors may be assessed to supplement the gap. Examples of situations include changes in adjudication criteria for a particular group of counterparties; changes in portfolio composition; and natural disasters impacting certain portfolios. With regards to delinquency and monitoring, there is a rebuttable presumption that the credit risk of the financial instrument has increased since initial recognition when contractual payments are more than 30 days overdue.

(g) Definition of default

The Bank considers a financial asset to be in default when:

- The counterparty is unlikely to pay its credit obligations to the Bank in full without recourse by the Bank to actions such as realising security held (if any); or

- The counterparty is past due more than 90 days on any material credit obligation to the Bank.

Overdrafts are considered as being past due if the outstanding balance remains continuously in excess of 10% of the sanctioned / authorized limit or in cases where there are not enough credits in the account to cover the interest charged or unauthorized drawings have frequently been allowed.

In assessing whether a borrower is in default, the Bank considers indicators that are:

- Qualitative – e.g. breaches of covenant;

- Quantitative – e.g. overdue status and non-payment on another obligation of the same issuer to the Bank; and

- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

The Bank follows the definition of default as stipulated in CBO guidelines (BM 977 and subsequent).

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Policy applicable from 1 January 2018

3.3 Impairment *(continued)*

(h) Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

Impairment allowances for ECL are presented in the statement of financial position as follows:

- Financial assets measured at amortized cost: as a reduction from the gross carrying amount of the financial assets;

- Debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve; and

- Off-balance sheet credit risks include undrawn lending commitments, letters of credit and letters of guarantee: as an impairment allowance on off-balance sheet items on other liabilities.

(i) Write-off

Loans & advances and financing receivables together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the financing impairment account. If a write-off is later recovered, the recovery is credited to the statement of profit or loss. The policy on write off's remains unchanged.

(j) *Hedge accounting*

IFRS 9 introduces a new hedge accounting model that expands the scope of hedged items and risks eligible for hedge accounting and aligns hedge accounting more closely with risk management objectives and strategy with more qualitative approach to assess hedge effectiveness. IFRS 9 also introduces new requirements on rebalancing hedge relationships and prohibiting voluntary discontinuation of hedge accounting.

The Bank has entered into interest rate swaps to hedge the variability in cash flows arising from changes in interest rates relating to investments. The types of hedge accounting relationships that the Bank currently designates meet the requirements of IFRS 9 and are aligned with the Bank’s risk management strategy and objective.

Based on the Bank’s assessment, there is no impact from the adoption of new standard on hedge accounting.

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Policy applicable from 1 January 2018

3.3 Impairment *(continued)*

(k) Identification and measurement of impairment of financial assets – Assets carried at amortised cost

An assessment is made at each reporting date to determine whether there is any objective evidence that a specific financial asset or a group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset or a group of financial assets is determined and any impairment loss, based on the net present value of future anticipated cash flows, is recognised in the statement of profit or loss and credited to a loan, advances and financing impairment account.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loans & advances and financing by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

The present value of the estimated future cash flows for loans & advances and financings receivables and other interest bearing financial assets is discounted at the financial asset's original effective interest rate. If a loan and financing has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. 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.

In addition to specific provisions against individually significant financial assets, the Bank also makes portfolio impairment provisions on groups of financial assets, which although not identified as requiring a specific provision, have a greater risk of default than the risk at initial recognition. Financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms and the collective impairment provision is estimated for any such group where credit risk characteristics of the group of financial assets has deteriorated. Factors such as any deterioration in country risk, industry, technological obsolescence as well as identified structural weaknesses or deterioration in cash flows are taken into consideration and the amount of the provision is based on the historical loss pattern within each group, adjusted to reflect current economic changes.

3.4 Cash and cash equivalents

Cash and cash equivalents consist of cash in hand and balance with CBO, balances with Bank, treasury bills, money market placements and deposits with original maturity of less than three months. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

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 profit or loss.

Repairs and renewals are charged to the statement of profit or loss 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 profit or loss 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 profit or loss.

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 effective interest rate (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 or in other comprehensive income.

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 re-pledge 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.

3.14 Derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date derivative contracts are entered into and are subsequently re-measured 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:

- hedges of the fair value of recognised assets or liabilities or a firm commitment (fair value hedge);
- Hedges of a particular risk associated with a recognised asset or liability or a highly probable forecast transaction (cash flow hedge); or
- hedges of a net investment in a foreign operation (net investment hedge).

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.15 Derivative financial instruments and hedging activities *(continued)*

On initial designation of the derivative as hedging instrument, the Bank formally documents the relationship between the hedging instrument and hedged item, including risk management objectives and strategy in undertaking the hedge transaction and the hedged risk, together with the method to assess the effectiveness of the hedging relationship. The Bank makes an assessment, both at the inception of the hedging relationship as well as ongoing basis, of whether the hedging instrument are expected to be highly effective in offsetting the changes in fair value or cash flows of the respective hedged items attributable to the hedge risk.

In relation to cash flow hedges, the gain or loss on hedging instruments is recognised initially in other comprehensive income to the extent that the hedge is effective and is transferred to the profit or loss in the period in which the hedged transaction impacts the profit or loss. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in other comprehensive income is transferred to profit or loss.

The Bank does not have any derivatives designated as hedging instruments.

3.16 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, at the present value of the minimum lease payments if lower. 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 profit or loss on a straight-line basis over the lease term.

3.17 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 profit or loss as incurred.

The obligation is calculated using the projected unit credit method and is discounted to its present value.

3 SIGNIFICANT ACCOUNTING POLICIES (*continued)*

3.18 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 profit or loss 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.

3.19 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 comprehensive income over the period of the borrowings using the effective interest rate 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. 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, the fee is capitalised as a pre-payment for liquidity services and amortised over the period of the facility to which it relates.

3.20 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 reporting date.

3.21 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.

3.22 Revenue and expense recognition

I. Interest income and expense

Policy applicable from 1 January 2018

Interest income and expense is recognised in the statement of profit or loss using the effective interest rate method. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the gross carrying amount or the amortised cost of the financial asset or liability. The calculation of effective interest rate includes transaction costs and fees paid/ received that are an integral part of effective interest rate. Transaction costs includes incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

The amortized cost is the amount at which the financial asset or financial liability is measured at initial recognition minus the principle repayments, plus or minus the cumulative amortization using the effective interest rate method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for loss allowance.

The gross carrying amount of a financial asset is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.22 Revenue and expense recognition *(continued)*

I. Interest income and expense *(continued)*

Policy applicable from 1 January 2018

Interest income and expense presented in the statement of comprehensive income include:

(i) Interest on financial assets and liabilities at amortised cost on an effective interest rate basis; and

(ii) Interest on debt investment securities on an effective interest rate basis.

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

Policy applicable before 1 January 2018

Interest income and expense is recognised in the statement of profit or loss using the effective interest rate method. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability.

Interest income and expense presented in the statement of profit or loss include:

(i) Interest on financial assets and liabilities at amortised cost on an effective interest rate basis; and

(ii) Interest on available for sale investment on an effective interest basis;

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

II. Fees and commission income

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income include account servicing fees, credit related fees, administration fees and other management fees, sales commission, placement fees, advisory fees and syndication fees. Fees and commission income is measured based on the consideration specified in the contract with the customers. The Bank satisfies its performance obligation upon completion of the related services as mentioned in the contract and revenue is recognised accordingly.

3.23 Dividends

Dividend income is recognised in the statement of profit or loss in 'Other income', when the Bank's right to receive income is established.

3.24 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.

3.25 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 which are regularly reviewed by the Bank's chief operating decision maker (CODM). The Bank's main business segments are corporate and retail banking. Segmental information pertaining to Islamic Banking Window is also disclosed in note 34.

3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.26 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.

3.27 Perpetual Tier 1 capital securities

Perpetual Tier 1 Capital Securities of the Bank are recognised under equity and the corresponding distribution on those instruments are accounted as a debit to retained earnings. The Tier 1 securities constitute direct, unconditional, subordinated and unsecured obligations of the Bank and are classified as equity in accordance with IFRS 9: Financial Instruments. The Tier 1 securities do not have a fixed redemption or final maturity date and is redeemable by the Bank at its sole discretion on the first call date or thereafter on any interest payment date.

4 CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINITY

The preparation of financial statements requires management to make judgements, estimates and assumptions that may affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses.

Policy applicable from 1 January 2018

4.1 Financial asset classification

Assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding.

Business model assessment: Classification and measurement of financial assets depends on the results of the SPPI and the business model test. The Bank determines the business model at a level that reflects how Bank's financial assets are managed together to achieve a particular business objective. This assessment includes judgement reflecting all relevant evidence including how the performance of the assets is evaluated and their performance measured, the risks that affect the performance of the assets and how these are managed and how the managers of the assets are compensated. The Bank monitors financial assets measured at amortised cost or fair value through other comprehensive income that are derecognised prior to their maturity to understand the reason for their disposal and whether the reasons are consistent with the objective of the business for which the asset was held. Monitoring is part of the Bank's continuous assessment of whether the business model for which the remaining financial assets are held continues to be appropriate and if it is not appropriate whether there has been a change in business model and so a prospective change to the classification of those assets.

4.2 Significant increase in credit risk

ECL are measured as an allowance equal to 12-month ECL for Stage 1 assets, or lifetime ECL assets for Stage 2 or Stage 3 assets. An asset moves to Stage 2 when its credit risk has increased significantly since initial recognition. IFRS 9 does not define what constitutes a significant increase in credit risk. In assessing whether the credit risk of an asset has significantly increased the Bank takes into account qualitative and quantitative reasonable and supportable forward looking information.

4 CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINITY *(continued)*

4.3 Establishing Bank's assets with similar credit risk characteristics

When ECLs are measured on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics. The Bank monitors the appropriateness of the credit risk characteristics on an ongoing basis to assess whether they continue to be similar. This is required in order to ensure that should credit risk characteristics change there is appropriate re-segmentation of the assets. This may result in new portfolios being created or assets moving to an existing portfolio that better reflects the similar credit risk characteristics of the asset of that Bank. Re-segmentation of portfolios and movement between portfolios is more common when there is a significant increase in credit risk (or when that significant increase reverses) and so assets move from 12-month to lifetime ECLs, or vice versa, but it can also occur within portfolios that continue to be measured on the same basis of 12 month or lifetime ECLs but the amount of ECL changes because the credit risk of the portfolios differ.

4.4 Models and assumptions used

The Bank uses various models and assumptions in estimating ECL. Judgement is applied in identifying the most appropriate model for each type of asset, as well as for determining the assumptions used in these models, including assumptions that relate to key drivers of credit risk.

4.5 Taxes

Uncertainties exist with respect to the interpretation of tax regulations and the amount and timing of future taxable income. The Bank establishes provisions, based on reasonable estimates, for possible consequences of finalisation of tax assessments of the Bank. The amount of such provisions is based on various factors, such as experience of previous tax assessments and differing interpretations of tax regulations by the Bank and the relevant tax authority.

4.6 Going concern

The Bank's management has made an assessment of its ability to continue as going concern and is satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, Management is not aware of any material uncertainties that may cast significant doubt on the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

4.7 Key sources of estimation uncertainty

The following are key estimations that have been used in the process of applying the Bank's accounting policies:

- Establishing the number and relative weightings of forward-looking scenarios for each type of product and determining the forward looking information relevant to each scenario: When measuring ECL the Bank uses reasonable and supportable forward looking information, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other.

- Probability of default: PD constitutes a key input in measuring ECL. PD is an estimate of the likelihood of default over a given time horizon, the calculation of which includes historical data, assumptions and expectations of future conditions.

- Loss Given Default: LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from collateral and integral credit enhancements.

5. Cash and balances with Central Bank of Oman

	2018	2017
	RO'000	RO'000
Cash in hand	**31,422**	30,085
Balances with the Central Bank of Oman	**126,863**	240,909
Placements with Central Bank of Oman	**143,220**	55,825
	301,505	326,819

Balances with CBO includes capital deposit of RO 500,000 (2017: RO 500,000). This is not available for day to day operations of the Bank and cannot be withdrawn without the Central Bank of Oman approval.

Cash and balances with Central Bank is classified under stage 1 as per IFRS 9. However, there are no expected credit losses and hence no provision has been recognised.

6. Loans, advances and financing to banks

Syndicated loans to other banks	**81,104**	55,247
Placements with other banks	**230,060**	233,744
Current clearing accounts	**18,732**	11,314
	329,896	300,305
Less: impairment allowance	**(837)**	(409)
	329,059	299,896

At 31 December 2018, placement with one local bank individually represented 20% or more of the Bank's placements (2017: One local bank represented 20%).

Movement of the impairment allowance as below:

Opening balance as on 1 January	**409**	409
IFRS 9 transition impact	**495**	-
Less: Reversal during the year	**(67)**	-
Closing balance as on 31 December	**837**	409

7. Loans, advances and financing to customers

Overdrafts	**165,880**	173,297
Loans	**2,547,049**	2,628,663
Loans against trust receipts	**99,393**	116,350
Bills discounted	**70,969**	72,082
Advance against credit cards	**8,921**	8,516
Islamic Banking Window financing	**401,733**	387,917
Gross loans, advances and financing to customers	**3,293,945**	3,386,825
Less: Impairment allowance including reserved interest	**(135,101)**	(137,952)
Net Loans, advances and financing to customers	**3,158,844**	3,248,873

7. Loans, advances and financing to customers *(continued)*

Details of Islamic Banking Window Financing

	2018	2017
	RO'000	RO'000
Housing finance	**158,610**	148,718
Corporate finance	**232,301**	230,644
Consumer finance	**10,822**	8,555
	401,733	387,917
Less: Impairment allowance	**(4,649)**	(4,472)
Net financing to customers	**397,084**	383,445

Impairment allowance includes the amount of profit reserve of RO 249 thousand and RO 136 thousand for 2018 and 2017 respectively.

The movement in the impairment allowance is analysed below:

(a) Allowance for loan impairment

	2018	2017
1 January	**90,740**	79,242
IFRS 9 transition impact	**(16,370)**	-
Allowance for the year	**11,320**	17,588
Released to profit or loss during the year	**(6,354)**	(6,047)
Written off during the year	**(28)**	(43)
31 December	**79,308**	90,740

(b) Reserved interest

	2018	2017
1 January	**47,212**	39,640
Reserved during the year	**10,146**	8,671
Released to profit or loss during the year	**(1,398)**	(948)
Written-off during the year	**(167)**	(151)
31 December	**55,793**	47,212
Total impairment allowance	**135,101**	137,952

Movement in special impairment reserve IFRS 9:

	31 December 2018	1 January 2018
	RO'000	RO'000
Provisions required as per CBO norms	**98,806**	90,740
Impairment allowance on loans and advances to Banks – as per IAS 39	**-**	409
Impairment allowance as per IFRS 9	**(93,621)**	(86,999)
Special impairment reserve IFRS 9	**5,185**	4,150
Deferred tax liability – netted from reserve	**(623)**	(623)
	4,562	3,527

7. Loans, advances and financing to customers *(continued)*

Movement in special impairment reserve IFRS 9 (continued):

In accordance with CBO requirements, where the aggregate provision on portfolio & specific basis computed as per CBO norms is higher than the impairment allowance computed under IFRS 9, the difference, net of the impact of taxation, is transferred to an impairment reserve as an appropriation from the retained earnings.

Comparison of provision held as per IFRS 9 and required as per CBO norms

Disclosure requirements containing the risk classification –wise gross and net amount outstanding, provision required as per CBO norms, allowance made as per IFRS 9, interest recognized as per IFRS 9 and reserve interest required as per CBO are given below based on CBO circular BM 1149.

In accordance with CBO circular BM 1149 Banks should continue to maintain and update the risk classification (i.e. standard, special mention, substandard, etc.) of accounts as per the extant CBO norms, including those on restructuring of loans accounts for regulatory reporting purposes.

RO'000

Asset Classification as per CBO Norms	Asset Classification as per IFRS 9	Gross Amount	Provision required as per CBO Norms	Provision held as per IFRS 9	Difference between CBO provision required and provision held	Net Amount as per CBO norms*	Net Amount as per IFRS 9	Interest recognised in P&L as per IFRS 9	Reserve interest as per CBO norms
(1)	(2)	(3)	(4)	(5)	(6) = (4)-(5)	(7)=(3)-(4)-(10)	(8) = (3)-(5)	(9)	(10)
	Stage 1	2,506,302	35,628	13,349	22,279	2,470,674	2,492,953	-	-
Standard	Stage 2	411,703	4,868	5,859	(991)	406,637	405,844	-	198
	Stage 3	-	-	-	-	-	-	-	-
Subtotal		2,918,005	40,496	19,208	21,288	2,877,310	2,898,797	-	198
	Stage 1	78	2	1	1	76	77	-	-
Special Mention	Stage 2	254,563	6,968	18,699	(11,731)	247,595	235,864	-	-
	Stage 3	-	-	-	-	-	-	-	-
Subtotal		254,641	6,970	18,700	(11,730)	247,671	235,941	-	-
	Stage 1	-	-	-	-	-	-	-	-
Substandard	Stage 2	-	-	-	-	-	-	-	-
	Stage 3	9,611	2,515	3,936	(1,421)	6,748	5,675	-	348
Subtotal		9,611	2,515	3,936	(1,421)	6,748	5,675	-	348
	Stage 1	-	-	-	-	-	-		
Doubtful	Stage 2	-	-	-	-	-	-	-	-
	Stage 3	7,835	3,159	2,952	207	4,017	4,883	-	659
Subtotal		7,835	3,159	2,952	207	4,017	4,883	-	659
	Stage 1	-	-	-	-	-	-	-	-
Loss	Stage 2	-	-	-	-	-	-		
	Stage 3	103,853	45,173	34,512	10,661	4,092	69,341		54,588
Subtotal		103,853	45,173	34,512	10,661	4,092	69,341		54,588
Other items not covered under CBO circular BM 977 and related instructions	Stage 1	1,923,599	493	5,857	(5,364)	1,923,106	1,917,742	-	-
	Stage 2	375,270	-	8,456	(8,456)	375,270	366,814	-	-
	Stage 3	790	-	-	-	790	790	-	-
Subtotal		2,299,659	493	14,313	(13,820)	2,299,166	2,285,346	-	-
Total (31st December 2018)	Stage 1	4,429,979	36,123	19,207	16,916	4,393,856	4,410,772	-	-
	Stage 2	1,041,536	11,836	33,014	(21,178)	1,029,502	1,008,522	-	198
	Stage 3	122,089	50,847	41,400	9,447	15,647	80,689	-	55,595
	Total	5,593,604	98,806	93,621	5,185	5,439,005	5,499,983	-	55,793

* Net of provision and reserve interest as per CBO norms

7. Loans, advances and financing to customers *(continued)*

Comparison of provision held as per IFRS 9 and required as per CBO norms *(continued)*

Other items disclosed above includes exposure outstanding and respective provisions held against due from banks, investments, other assets, loan commitments and financial guarantees.

Interest is reserved by the Bank against loans and advances which are impaired (IFRS 9 stage 3). The details of impaired loans are as follows:

Details of impaired loans and advances as of 31 December 2017:

	2017 RO'000
Substandard	9,718
Doubtful	10,517
Loss	85,268
Total	105,503

Loans, advances and financing to customers past due but not impaired are as follows:

Past due up to 30 days	57,041
Past due 30 – 60 days	16,495
Past due 60 – 89 days	8,592
Total	82,128

7. Loans, advances and financing to customers *(continued)*

Restructured loans

RO'000

Asset Classification as per CBO Norms	Asset Classification as per IFRS 9	Gross Carrying Amount	Provision required as per CBO Norms	Provision held as per IFRS 9	Difference between CBO provision required and provision held	Net Carrying Amount as per CBO norms*	Net Carrying Amount as per IFRS 9	Interest recognised in P&L as per IFRS 9	Reserve interest as per CBO norms
(1)	(2)	(3)	(4)	(5)	(6) = (4)-(5)	(7)=(3)-(4)-(10)	(8) = (3)-(5)	(9)	(10)
Classified as performing	Stage 1	5,356	53	411	(358)	5,303	4,945	-	-
	Stage 2	43,591	598	3,180	(2,582)	42,803	40,411	-	190
	Stage 3	-	-	-	-	-	-	-	-
Subtotal		**48,947**	**674**	**3,591**	**(2,940)**	**48,106**	**45,356**	**-**	**190**
Classified as non-performing	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-	-	-
	Stage 3	4,542	2,446	1,718	728	1,177	2,824	-	919
Sub total		**4,542**	**2,446**	**1,718**	**728**	**1,177**	**2,824**	**-**	**919**
Total (31st December 2018)	**Stage 1**	5,356	53	411	(358)	5,303	4,945	-	-
	Stage 2	43,591	598	3,180	(2,582)	42,803	40,411	-	190
	Stage 3	4,542	2,446	1,718	728	1,177	2,824	-	919
	Total	**53,489**	**3,097**	**5,309**	**(2,212)**	**49,283**	**48,180**	**-**	**1,109**

* Net of provision and reserve interest as per CBO norms

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.

7. Loans, advances and financing to customers *(continued)*

Financial assets and financial liabilities

The following table discloses the stage-wise gross exposure, impairment and net exposure of only those financial assets that are tested for impairment under IFRS 9 as at 31 December 2018:

RO'000

Gross exposure	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Central Bank balances	143,220	-	-	143,220
Due from Banks	329,857	-	-	329,857
Sovereign	237,520	-	-	237,520
Investment Securities at amortized cost	917	-	-	917
Investment Securities at FVOCI	55,412	-	-	55,412
Loans and advances	2,506,380	666,266	121,299	3,293,945
Accrued profit	13,405	2,951	-	16,356
Total funded gross exposure	**3,286,711**	**669,217**	**121,299**	**4,077,227**
Letters of credit/guarantee	800,612	209,412	790	1,010,814
Acceptances	61,116	13,473	-	74,589
Loan commitment / unutilised limits	281,540	149,434	-	430,974
Total non-funded gross exposure	**1,143,268**	**372,319**	**790**	**1,516,377**
Total gross exposure	**4,429,979**	**1,041,536**	**122,089**	**5,593,604**
Impairment				
Central Bank balances	-	-	-	-
Due from Banks	837	-	-	837
Sovereign	-	-	-	-
Investment Securities at amortized cost	-	-	-	-
Investment Securities at FVOCI	266	-	-	266
Loans and advances	13,350	24,558	41,400	79,308
Accrued profit	61	103	-	164
Total funded impairment	**14,514**	**24,661**	**41,400**	**80,575**
Letters of credit/guarantee	3,258	6,722	-	9,980
Acceptances	92	35	-	127
Loan commitment/unutilised limits	1,343	1,596	-	2,939
Total non-funded impairment	**4,693**	**8,353**	**-**	**13,046**
Total impairment	**19,207**	**33,014**	**41,400**	**93,621**
Net exposure				
Central Bank balances	143,220	-	-	143,220
Due from Banks	329,020	-	-	329,020
Sovereign	237,520	-	-	237,520
Investment Securities at amortized Cost	917	-	-	917
Investment Securities at FVOCI	55,146	-	-	55,146
Loans and advances	2,493,030	641,708	79,899	3,214,637
Accrued Profit	13,344	2,848	-	16,192
Total funded net exposure	**3,272,197**	**644,556**	**79,899**	**3,996,652**
Letter of credit/guarantee	797,354	202,690	790	1,000,834
Acceptances	61,024	13,438	-	74,462
Loan commitment / unutilised limits	280,197	147,838	-	428,035
Total net non-funded exposure	**1,138,575**	**363,966**	**790**	**1,503,331**
Total net exposure	**4,410,772**	**1,008,522**	**80,689**	**5,499,983**

Gross exposure of loans and advances of RO 121,299 thousands under stage 3 includes reserved interest of RO 55,793 thousand. Accordingly, the principal outstanding of RO 65,506 was subject to ECL.

7. Loans, advances and financing to customers *(continued)*

Financial assets and financial liabilities *(continued)*

A. Classification of financial assets and financial liabilities

	Stage 1	Stage 2	Stage 3	*RO'000* Total
Opening Balance (Day 1 impact) – as at 1 January 2018				
- Due from banks	804	100	-	904
- Loans and advances to customers	15,672	21,335	37,363	74,370
- Investment securities at FVOCI (Debt)	67	-	-	67
- Loan commitments and financial guarantees	4,000	3,869	-	7,869
- Acceptances	23	77	-	100
- Unutilised	1,871	1,766	-	3,637
- Interest accrued	22	30	-	52
Total	**22,459**	**27,177**	**37,363**	**86,999**
Net transfer between stages				
- Loans and advances to customers	(2,827)	4,366	(1,539)	-
- Loan commitments and financial guarantees	(28)	28	-	-
Total	**(2,855)**	**4,394**	**(1,539)**	**-**
Charge for the Period (net)				
- Due from banks	33	(100)	-	(67)
- Loans and advances to customers	505	(1,143)	5,604	4,966
- Investment securities at FVOCI (Debt)	199	-	-	199
- Loan commitments and financial guarantees	(714)	2,825	-	2,111
- Acceptances	69	(42)	-	27
- Unutilised	(528)	(170)	-	(698)
- Interest accrued	39	73	-	112
Total	**(397)**	**1,443**	**5,604**	**6,650**
Written-off	**-**	**-**	**(28)**	**(28)**
Closing Balance – as at 31 December 2018				
- Due from banks	837	-	-	837
- Loans and advances to customers	13,350	24,558	41,400	79,308
- Investment securities at FVOCI (Debt)	266	-	-	266
- Loan commitments and financial guarantees	3,258	6,722	-	9,980
- Acceptances	92	35	-	127
- Unutilised	1,343	1,596	-	2,939
- Interest accrued	61	103	-	164
Total net exposure	**19,207**	**33,014**	**41,400**	**93,621**

7. Loans, advances and financing to customers *(continued)*

Financial assets and financial liabilities *(continued)*

B. Classification of financial assets and financial liabilities

The following table provides a reconciliation between line items in the statement of financial position and categories of financial instruments:

RO'000

31 December 2018	Notes	Designated as at FVTPL	FVOCI – debt instruments	FVOCI – equity instrument RO'000	Amortised cost	Total carrying amount
Cash and balances with CBO	*5*	-	-	-	301,505	301,505
Loans and advances to banks	*6*	-	-	-	329,059	329,059
Loans and advances to customers	*7*	-	-	-	3,158,844	3,158,844
Investment securities	*8*	4,140	45,147	4,118	250,927	304,332
Other assets	*11*	642	-	-	99,271	99,913
		4,782	45,147	4,118	4,139,606	4,193,653
Due to banks	*12*	-	-	-	368,893	368,893
Deposits from customers	*13*	-	-	-	2,924,504	2,924,504
Subordinated liabilities	*15*	-	-	-	63,875	63,875
Other liabilities	*14*	-	-	-	129,474	129,474
		-	-	-	3,486,746	3,486,746

Other assets includes RO 642 thousands of derivatives financial instruments mandatorily measured at FVPTL.

8 Investment securities

	2018 RO'000	2017 RO'000
Equity investments:		
Designated at FVTPL	**1,882**	-
Designated at FVOCI	**4,118**	-
Available-for-sale	**-**	7,343
Gross equity investments	**6,000**	7,343
Less: Impairment losses on investments	**-**	(358)
Net equity investments	**6,000**	6,985
Debt investments:		
Designated at FVTPL	**2,258**	-
Measured at FVOCI	**45,413**	-
Measured at amortized cost	**250,927**	-
Available-for-sale	**-**	28,827
Held to maturity	**-**	255,043
Gross debt investments	**298,598**	283,870
Total investment securities	**304,598**	290,855
Less: Impairment loss allowance	**(266)**	-
Total investment securities	**304,332**	290,855

Available-for-sale investments	-	35,812
Held to maturity investments	**-**	255,043
Investment securities designated as at FVTPL	**4,140**	-
Investment securities measured at FVOCI	**49,265**	-
Debt investments at amortised cost	**250,927**	
	304,332	290,855

8. Investments securities *(continued)*

8. 1 Categories of investments by measurement

As at 31 December 2018	Designated at FVTPL RO'000	FVOCI RO'000	Amortized cost RO'000	Total RO'000
Quoted Equities:				
Other services sector	-	1,170	-	1,170
Unit funds	220	-	-	220
Financial services sector	-	323	-	323
Industrial sector -		1,904		1,904
	220	3,397	-	3,617
Unquoted Equities:				
Local securities	-	721	-	721
Unit funds	1,662	-	-	1,662
	1,662	721	-	2,383
Gross Equity investments	1,882	4,118	-	6,000
Quoted Debt:				
Government Bonds and sukuk	-	12,570	250,010	262,580
Foreign Bonds	2,258	12,819	-	15,077
Local bonds and sukuks	-	20,024	917	20,941
Gross debt investments	2,258	45,413	250,927	298,598
Total Investment Securities	4,140	49,531	250,927	304,598
Less: Impairment losses on investments	-	(266)	-	(266)
	4,140	49,265	250,927	304,332

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2018

8. Investments securities *(continued)*

8. 2 Categories of investments by measurement

As at 31 December 2017	Available for Sale RO'000	Held to Maturity RO'000	Total RO'000
Quoted Equities:			
Other services sector	2,210	-	2,210
Financial services sector	429	-	429
Industrial sector	1,910	-	1,910
	4,549		4,549
Unquoted Equities:			
Local securities	1	-	1
Unit funds	2,435	-	2,435
	2,436	-	2,436
Net equity investments	6,985	-	6,985
Quoted Debt:			
Government Bonds	12,144	205,126	217,270
Foreign Bonds	5,520	-	5,520
Local Bonds	11,163	-	11,163
Unquoted Debt:			
Treasury Bills	-	49,917	49,917
Net debt investments	28,827	255,043	283,870
	35,812	255,043	290,855

Government Development Bonds represents Oman Government Bonds having face value of RO 237.52 million (2017: RO 195.13 million) at average coupon rate of 4.34% maturing between 2018 and 2026.

Treasury bills represents United States Treasury bills having face value of 2018: Nil (2017: RO 49.917 million with maturity period of 91 days at 0.93% average yield).

9. Intangible asset

	2018 RO'000	2017 RO'000
1 January	**1,191**	1,589
Impaired during the year	**(397)**	(398)
31 December	**794**	1,191

Intangible asset represents goodwill which resulted from the acquisition of branches of the Commercial Bank of Oman during 2001 and merger with Majan International Bank during 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 thousand (2017: 398 thousand) was recognised during the year.

10. Property and equipment

31 December 2018	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 2018	140	1,573	14,138	1,308	23,726	1,612	42,497
Additions	-	-	1,466	212	4,345	3,038	9,061
Disposals	-	-	(356)	(194)	(101)	-	(651)
31 December 2018	140	1,573	15,248	1,326	27,970	4,650	50,907
Depreciation							
1 January 2018	-	1,234	11,455	1,112	19,172	-	32,973
Charge for the year	-	58	1,219	141	2,250	-	3,668
Disposals	-	-	(356)	(194)	(101)	-	(651)
31 December 2018	-	1,292	12,318	1,059	21,321	-	35,990
Carrying value							
31 December 2018	140	281	2,930	267	6,649	4,650	14,917

10. Property and equipment *(continued)*

31 December 2017	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 2017	140	1,573	13,159	1,324	22,012	355	38,563
Additions	-	-	1,371	136	1,803	1,263	4,573
Disposals	-	-	(392)	(152)	(89)	(6)	(639)
31 December 2017	140	1,573	14,138	1,308	23,726	1,612	42,497
Depreciation							
1 January 2017	-	1,172	10,661	1,134	17,268	-	30,235
Charge for the year	-	59	1,142	127	1,993	-	3,321
Disposals	-	3	(348)	(149)	(89)	-	(583)
31 December 2017	-	1,234	11,455	1,112	19,172	-	32,973
Carrying value							
31 December 2017	140	339	2,683	196	4,554	1,612	9,524

11. Other assets

	2018 RO'000	2017 RO'000
Acceptances	**74,590**	50,661
Interest receivable	**16,575**	8,992
Prepaid expenses	**3,262**	2,045
Positive fair value of derivatives (note 30)	**642**	111
Deferred tax assets (note 24)	**1,028**	62
Other receivables	**8,106**	7,681
Less: impairment allowance	**(164)**	-
	104,039	69,552

12 Due to banks

Syndicated Inter bank borrowings	**201,041**	215,600
Inter bank borrowings	**167,475**	171,557
Payable on demand	**467**	585
	368,983	387,742

At 31 December 2018, Inter bank borrowings includes Islamic Banking Window's inter bank borrowings with other banks of RO 38,875 thousand (2017: RO 71,950 thousand).

At 31 December 2018, inter bank borrowings with one bank individually represented 20% or more of the Inter bank's borrowings (2017: one bank). The Bank has not had any defaults of principal, interest or other breaches during the year on its borrowed funds.

13. Deposits from customers

Current accounts	**568,332**	704,197
Savings accounts	**456,011**	442,972
Time and certificate of deposits	**1,531,677**	1,493,204
Margin accounts	**15,099**	51,253
Islamic Banking Window deposits	**353,385**	376,783
	2,924,504	3,068,409

Islamic Banking window deposits		
Current accounts	**56,040**	72,155
Savings accounts	**34,026**	26,278
Time deposits	**263,319**	278,350
	353,385	376,783

Current accounts and time deposits include deposits from the Government of the Sultanate of Oman and its entities amounting to RO 1,180,082 thousand as at 31 December 2018 (2017: RO 1,292,654 thousand).

14 Other liabilities

	2018 RO'000	2017 RO'000
Acceptances	**74,590**	50,661
Interest payable	**15,632**	15,784
Creditors and accruals	**39,251**	36,451
Income tax provision	**13,810**	10,116
Employee terminal benefits	**1,637**	1,665
Impairment allowance on off-balance sheet items (note 7)	**13,046**	-
	157,966	114,677

Employee terminal benefits

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

	2018 RO'000	2017 RO'000
1 January	**1,665**	1,378
Charge for the year	**332**	408
Payments made during the year	**(360)**	(121)
	1,637	1,665

15 Subordinated loans

	2018 RO'000	2017 RO'000
Subordinated loan - RO (i) & (ii)	**35,000**	60,000
Subordinated loan - US Dollar (iii)	**28,875**	28,875
	63,875	88,875

i. In January 2018, the Bank has repaid the unsecured subordinated loan amounting to RO 25 million upon maturity.

ii. In May 2017, the Bank availed RO 35 million unsecured subordinated loan for a tenure of 66 months. This carries fixed interest rate of interest, payable half yearly with principal being repaid on maturity.

iii. 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 fixed interest rate payable half yearly, with principal being repaid on maturity.

iv. Details regarding subordinated loan reserve are set out in note 18(b).

16 (a) Share capital

The authorised share capital consists of 5,000,000,000 ordinary shares of RO 0.100 each (2017: 5,000,000,000 ordinary shares of RO 0.100 each).

In 2018, the Bank issued 361,842,105 ordinary shares by way of rights issue resulting in an increase of share capital (refer note 17). Further, the Bank also issued 180,628,618 bonus shares.

At 31 December 2018, the issued and paid up share capital comprise 2,800,328,445 ordinary shares of RO 0.100 each (2017: 2,257,857,722 ordinary shares of RO 0.100 each).

Shareholders

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

	2018 No. of shares	**%**	2017 No. of shares	%
Dhofar International Development and Investment Company SAOG	**682,776,167**	**24.4%**	632,200,155	28.0%
Eng. Abdul Hafidh Salim Rajab Al Aujaili and his related Companies	**653,699,269**	**23.3%**	480,433,078	21.3%
Civil Service Employees' Pension Fund	**289,825,834**	**10.3%**	233,552,136	10.3%
Total	**1,626,301,270**	**58.0%**	1,346,185,369	59.6%
Others	**1,174,027,175**	**42.0%**	911,672,353	40.4%
	2,800,328,445	**100%**	2,257,857,722	100%

The Bank's Islamic Banking Window, "Maisarah" Islamic Banking Services has an allocated capital of RO 55,000,000 million in respect of Islamic Banking Window from the core paid up capital of the Bank as of 31 December 2018 and 2017.

16 (b) Perpetual Tier 1 Capital Securities

	2018 RO'000	2017 RO'000
Tier 1 USD Securities	**115,500**	115,500
Tier 1 RO Securities	**40,000**	-
	155,500	115,500

16(b) Perpetual Tier 1 Capital Securities *(continued)*

Tier 1 USD Securities

- On 27 May 2015, the Bank issued Perpetual Tier 1 USD Capital Securities (the "Tier 1 USD Securities"), amounting to USD 300,000 thousand. The Tier 1 USD Securities are listed on Irish Stock Exchange.

- The Tier 1 USD 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 USD Securities do not have a fixed or final maturity date. They are redeemable by the Bank at its discretion on 27 May 2020 (the "First Call Date") or on any interest payment date thereafter subject to the prior consent of the regulatory authority.

The Tier 1 USD 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.

Tier 1 RO Securities

- On 27 December 2018, the Bank issued additional Perpetual Tier 1 Capital Securities (the "Tier 1 RO Securities"), amounting to RO 40,000 thousand. The Tier 1 RO Securities are listed on Muscat Securities Market.

- The Tier 1 RO 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 RO Securities do not have a fixed or final maturity date. They are redeemable by the Bank at its discretion on 27 December 2023 (the "First Call Date") or on any interest payment date thereafter subject to the prior consent of the regulatory authority.

- The Tier 1 RO Securities bear interest on their nominal amount from the issue date to the First Call Date at a fixed annual rate of 7.50%. Thereafter the interest rate will be reset at five year intervals. Interest is payable semi-annually in arrears and treated as deduction from equity

The Bank at its sole discretion may elect not to distribute interest on both perpetual Tier 1 capital securities and this is not considered an event of default. If the Bank does not pay interest on the Tier 1 USD Securities and/or Tier 1 RO 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 USD Securities and Tier 1 RO Securities unless and until it has paid one interest payment in full on the Tier 1 USD Securities and Tier 1 RO Securities. The Tier 1 USD Securities and Tier 1 RO 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.

These securities form part of Tier 1 Capital of the Bank and comply with Basel-3 and Central Bank of Oman regulations (BM 1114).

17 Share premium

i. In 2018, the Bank issued 361,842,105 ordinary shares by way of rights issue at a price of RO 0.152 per share (with a nominal value of RO 0.100 per share, a share premium of RO 0.050 per share and issue expenses of RO 0.002 per share), resulting in an increase of share capital and share premium by RO 36,184 thousand and RO 18,092 thousand, respectively.

ii. In 2017, the Bank issued 216,216,216 shares by way of rights issue at a premium of RO 0.083 resulting in increase of share capital and share premium by RO 21,622 thousand and RO 17,946 thousand, respectively.

iii. In 2016, the Bank issued 200,000,000 shares by way of rights issue at a premium of RO. 0.098 resulting in increase of share capital and share premium by RO 20,000 thousand and RO 19,600 thousand, respectively.

iv. In 2013, the shareholders of the Bank in the annual general meeting approved the issuance of 15% bonus shares amounting to RO 13,311 thousand (133,114,993 shares of par value RO 0.100 each) from the share premium account.

v. In 2008, the Bank issued 176,921,306 shares by way of rights issue at a premium of RO 0.300 resulting in increase of share capital and share premium by RO 17,692 thousand and RO 53,076 thousand, respectively.

18 Reserves

(a) Legal reserve

	2018	2017
	RO'000	RO'000
1 January	**50,254**	45,176
Appropriation for the year (i)	**5,028**	4,763
Increase in legal reserve (ii), (iii)	**596**	315
31 December	**55,878**	50,254

(i) In accordance with Article 106 of the Commercial Companies Law of 1974, annual appropriations of 10% of net 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.

(ii) During the year 2018, the Bank received RO 724 thousand towards rights issue expenses and incurred RO 128 thousand towards the issue expenses. Accordingly, excess of receipts over expenses towards share issue expenses amounting to RO 596 thousand has been transferred to the legal reserve.

(iii) In 2017, the Bank received RO 432 thousand towards rights issue expenses and incurred RO 117 thousand towards the issue expenses. Accordingly, excess of receipts over expenses towards share issue expenses amounting to RO 315 thousand was transferred to the legal reserve.

18 Reserves *(continued)*

(b) Subordinated loans reserve

	2018 RO'000	2017 RO'000
1 January	**42,325**	31,550
Appropriation for the year:		
Subordinated loan reserve	**12,775**	10,775
Transfer to retained earnings (refer note 15)	**(25,000)**	-
31 December	**30,100**	42,325

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 investment revaluation reserve comprises of the cumulative net change in the fair value of equity securities measured at FVOCI (2017: available-for-sale financial assets) and the cumulative net change in the fair value of debt securities measured at FVOCI (2017: available-for-sale financial assets) until the assets are derecognised or reclassified.

The movement in the investment revaluation reserve is analysed below:

1 January	**507**	1,459
Decrease in fair value	**(2,296)**	(1,266)
Transfer to profit or loss on sale of available-for-sale investments	**-**	(44)
Impairment of available-for-sale investments	**-**	358
31 December	**(1,789)**	507

(d) Special reserve

During 2013, the Bank recognised in profit or loss, 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, and which was approved by the Shareholders in the annual general meeting held on 28 March 2012) to a special reserve to strengthen its capital. Prior approval of CBO is required for any distribution from this 'special reserve account'.

(e) Special reserve – restructured loans

In accordance with Central Bank of Oman circular BSD/2017/BKUP/Bank and FLC's/467 dated 20 June 2017, the banks are required to create a special reserve of 15% for all restructured financing after the date of circular. The amount is computed as an appropriation from net profit and is not eligible to be considered for the purpose of regulatory capital and dividend distribution.

Requirement to create special reserve at 15% has been dispensed on immediate effect based on Central Bank of Oman circular BSD/CB/FLC/2018/15 dated 18 November 2018.

18 Reserves *(continued)*

(f) Special Impairment reserve IFRS 9

CBO circular BM 1149 requires the Bank to create a reserve for the difference between provisions under CBO norms and IFRS 9 provisions, if CBO provisions are higher than IFRS 9 provisions. Refer note 7 for details.

The Bank in its first quarterly financial statements has reported Special impairment reserve of RO 8,455 thousands on the date of initial application. During the fourth quarter, certain adjustments and rectifications were made in the impairment model resulting in revised amount of RO 3,527 thousand, net of tax on date on initial application.

(g) Special investment revaluation reserve IFRS 9

From 1 January 2018, the Bank classified its portfolio of equity investments as FVOCI (elected). Certain investments were previously impaired, with the impairment allowance of RO 709 thousand charged to statement of profit or loss. A one off adjustment was recorded on 1 January 2018 to retained earnings to account this as part of transition adjustments of the Bank under IFRS 9. This reserve will be released to retained earnings on disposal of investments.

19 Retained earnings

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

20 Net assets per share

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

	2018	2017
Net assets (RO)	**542,662,000**	471,507,000
Number of shares outstanding at 31 December	**2,800,328,445**	2,257,857,722
Net assets per share (RO)	**0.194**	0.209

21 Net interest income

	2018 **RO'000**	2017 RO'000
Loans and advances to customers	**162,274**	153,692
Treasury bills	**364**	317
Money market placements	**12,085**	7,469
Others	**43**	21
Total interest income	**174,766**	161,499
Deposits from customers	**(74,236)**	(68,989)
Money market deposits	**(10,801)**	(7,905)
Total interest expense	**(85,037)**	(76,894)
Net interest income	**89,729**	84,605

Included in interest expenses on deposits from customers is interest on subordinated loan against related parties of RO 3,634 thousand (2017: RO 4,056 thousand).

22 Other income

	2018 RO'000	2017 RO'000
Foreign exchange	**4,562**	4,357
Investment income (see below)	**11,315**	9,232
Miscellaneous income	**2,945**	2,960
	18,822	16,549

Investment income

	2018 RO'000	2017 RO'000
Dividend income	**286**	352
(Loss) / gain on disposal of FVOCI debt instrument / available-for-sale investments	**(299)**	169
Income on Sukuk investments	**1,942**	1,228
Interest income on Government Development Bonds and other bonds	**9,386**	7,483
	11,315	9,232

23 Staff and administrative costs

(a) Staff costs

	2018	2017
Salaries and allowances	**33,992**	32,047
Other personnel costs	**7,767**	6,714
Scheme costs	**598**	566
Non-Omani employees terminal benefit	**332**	343
	42,689	39,670

At 31 December 2018, the Bank had 1,600 employees (2017: 1,514 employees).

(b) Administrative costs

	2018	2017
Occupancy costs	**4,816**	3,883
Operating and administration cost	**15,463**	11,089
Impairment of goodwill	**397**	398
Others	**694**	633
	21,370	16,003
	64,059	55,673

24 Income tax

	2018 RO'000	2017 RO'000
(a) Income tax expense:		
Current tax		
Current year charge	**9,436**	9,036
Prior years	**1,615**	(632)
	11,051	8,404
Deferred tax		
Current year	**(153)**	(542)
Prior years	**(1,436)**	542
	(1,589)	-
Tax expense for the year	**9,462**	8,404

The Bank is subject to income tax at the rate of 15% of taxable profits.

Interest on Additional Tier 1 Securities is reflected in the statement of changes in equity for the years ended 31 December 2015 to 31 December 2018. The Bank sought confirmation from the Secretariat General for Taxation (SGT) of the Bank's position on the deductibility of interest expense in Additional Tier1 securities. However, in view of no confirmation received from the SGT in this regard, the Bank has created a current tax provision against the disallowance of the interest on Additional Tier 1 Securities.

(b) Reconciliation:

	2018 RO'000	2017 RO'000
Profit before tax	**59,743**	56,031
Income tax as per rates mentioned above	**8,961**	8,404
Tax exempt revenue	**(43)**	(53)
Non-deductible expenses	**365**	143
Prior years	**179**	(90)
Tax expense for the year	**9,462**	8,404

24 Income tax *(continued)*

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

Particulars	2017	Recognised in profit or loss	Recognised in equity	2018
				RO '000
Property and equipment	(461)	167	-	(294)
Impairment allowance on financial instruments	523	1,397	-	1,920
Investment revaluation reserve (Non listed)	-	121	-	121
Fair value derivatives	-	(96)	-	(96)
Special impairment reserve for loan loss IFRS 9	-	-	(623)	(623)
Net deferred tax asset/(liability)	62	1,589	(623)	1,028

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

The tax returns of the Bank for the years 2014 to 2017 have not yet been agreed with the Secretariat General for Taxation at the Ministry of Finance.

The Board of Directors 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 2018.

25 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:

	2018	2017
	RO	RO
Profit for the year (RO)	50,281,000	47,627,000
Less : Additional Tier 1 Coupon	(7,912,000)	(7,912,000)
Profit for the period attributable to equity holders of the Bank	42,369,000	39,715,000
Weighted average number of shares outstanding during the year	2,510,887,294	2,496,017,071
Earnings per share basic and diluted (RO)	0.017	0.016

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 8% bonus shares and bonus element (180,628,618 shares) in respect of bonus shares issued during the year.

26 Related parties transactions

In the ordinary course of business, the Bank conducts certain transactions on mutually agreed terms 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:

	2018 RO'000	2017 RO'000
Loans and advances		
Directors and shareholders holding 10% or more interest in the Bank	**35,993**	36,588
Other related parties	**26,055**	18,345
	62,048	54,933
Subordinated loans		
Directors and shareholders holding 10% or more interest in the Bank	**23,663**	36,663
Other related parties	**19,775**	31,775
	43,438	68,438
Deposits and other accounts		
Directors and shareholders holding 10% or more interest in the Bank	**143,240**	176,576
Other related parties	**161,701**	129,123
	304,941	305,699
Contingent liabilities and commitments		
Directors and shareholders holding 10% or more interest in the Bank	**562**	308
Other related parties	**6,203**	2,767
	6,765	3,075
Remuneration paid to Directors		
Chairman		
– remuneration paid	**16**	15
– sitting fees paid	**10**	10
Other Directors		
– remuneration paid	**108**	107
– sitting fees paid	**66**	68
	200	200
Other transactions		
Rental payment to related parties	**486**	480
Other transactions	**81**	80
Remuneration and fees proposed to Sharia' Board of Islamic Banking Window	**43**	**46**
Key management compensation		
– salaries and other benefits	**1,612**	1,534

27 Single borrower and senior members

	2018 RO'000	2017 RO'000
(a) Single borrower		
Total direct exposure	**157,162**	179,415
Number of members	**4**	3
(b) Senior members		
Total exposure:		
Direct	**67,434**	60,052
Indirect	**6,764**	3,150
	74,198	63,202
Number of members	**44**	25

28 Contingent liabilities and commitments

(a) Credit related contingent items

Letters of credit, guarantees and other commitments provided by the Bank to the customers are as follows:

Letters of credit	**91,920**	132,067
Guarantees and performance bonds	**918,894**	886,902
	1,010,814	1,018,969

At 31 December 2018, letters of credit, guarantees and other commitments amounting to RO 292,171 thousand (2017: RO 240,088 thousand) are counter guaranteed by other banks.

At 31 December 2018, the unutilised limits towards the loans, advances and financing to customer amount to RO 822,935 thousand (2017: 832,992 thousand).

(b) Capital and investment commitments

Contractual commitments for property and equipment	**1,902**	1,157

29 Disaggregation of net fees and commission income

	Retail banking RO'000	Corporate banking RO'000	Treasury and investment banking RO'000	Total RO'000
Transactional services	3,506	4,141	108	7,755
Trade services	-	6,446	146	6,592
Syndication and other financing related services	1,232	1,908	168	3,308
Advisory and asset management services	-	474	354	828
Net fee and commission income	4,738	12,969	776	18,483

The total of RO 18,483 thousands includes service charges income of RO 2,879 thousand included under other income as miscellaneous income (note 22).

30 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:

30 Derivative financial instruments (Continued)

At December 2018		**Fair value increase / decrease**	
	Contract / notional amount RO'000	**Assets RO'000**	**Liabilities RO'000**
Derivatives:			
Currency forward - purchase contracts	**1,217,263**	**-**	**453**
Currency forward - sales contracts	**1,209,823**	**1,095**	**-**
Interest rate swaps – purchase contracts	**41,610**	**652**	**-**
Interest rate swaps – sales contracts	**41,610**	**-**	**652**
At December 2017			
Derivatives:			-
Currency forward - purchase contracts	610,561	1,132	
Currency forward - sales contracts	605,837	-	1,243
Interest rate swaps – purchase contracts	43,093	200	-
Interest rate swaps – sales contracts	43,093	-	200

The following table indicates the year in which the cash flows associated with derivatives that are expected to impact profit or loss.

	Assets		**Liabilities**	
	2018 RO'000	2017 RO'000	**2018 RO'000**	2017 RO'000
Expected cash flows	**642**	-	**-**	111

31 Fair value information

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 2018	**Level 1 RO '000**	**Level 2 RO '000**	**Level 3 RO '000**	**Total RO '000**	**Cost RO '000**
Financial assets					
Investments at FVOCI	**48,810**	**-**	**721**	**49,531**	**51,319**
Investments at FVTPL	**2,478**	**-**	**1,662**	**4,140**	**4,440**
Derivative financial instruments					
Forward foreign exchange contracts	**-**	**642**	**-**	**642**	**-**
Total	**51,288**	**642**	**2,383**	**54,313**	**55,759**

At 31 December 2017					
Financial assets					
Available-for-sale investments					
Equity instruments	10,354	-	3,116	13,470	13,167
Sukuk	12,144	10,198	-	22,342	22,138
Derivative financial instruments					
Forward foreign exchange contracts	-	111	-	111	-
Total	22,498	10,309	3,116	35,923	35,305

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.

Transfer between level 1 and level 2

There were no transfers between level 1 and level 2 of the fair value hierarchy during the year.

32 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 (RMD) 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 its various sub-committees. The Risk Management Committee of the Board is responsible for reviewing and recommending to the full Board for approval of 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.

A. Credit Risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations arising principally from the loans, advances and Islamic financing, amounts due from banks and investment in debt securities. Bank has an independent credit risk management function which identifies, assess and manages the credit risk at an individual or entity level. All the Corporate credit proposals are assessed independently by RMD before they are considered by the appropriate approving authorities. Bank has defined various levels of authorities for credit approval with Board Credit Committee being the final credit approving authority of the Bank and mainly responsible for approving all credit proposals beyond the authority level set for the management. This committee is also the final authority for approving investments beyond the set authority of the management. The Management Credit Committee ("MCC") is the credit decision making body at the management level which is empowered to consider all credit related issues up to certain limit.

Bank has established robust credit risk management policies and procedures and a risk grading system for analysing 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/Bank 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 leading external 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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

32 Financial risk management

A. Credit risk *(continued)*

1. Credit Exposure

The following table informs about the Credit Exposure to customers of the Bank:

(a) Geographical concentrations

	Assets			Liabilities		
	Gross loans, advances and financing to banks	Gross loans, advances and financing to customers	Investment securities	Deposits from customers	Due to banks	Contingent liabilities
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
31 December 2018						
Sultanate of Oman	**87,610**	**3,287,406**	**299,531**	**2,922,039**	**51,855**	**883,964**
Other GCC countries	**102,311**	**5,664**	**1,555**	**2,024**	**253,940**	**40,622**
Europe and North America	**80,415**	**875**	**2,809**	**4**	**40,280**	**58,029**
Africa and Asia	**59,560**	**-**	**703**	**437**	**22,908**	**28,199**
	329,896	**3,293,945**	**304,598**	**2,924,504**	**368,983**	**1,010,814**
31 December 2017						
Sultanate of Oman	80,975	3,381,130	285,335	3,065,864	59,132	889,881
Other GCC countries	102,301	5,695	2,011	2,373	215,227	47,027
Europe and North America	59,322	-	3,127	4	96,250	42,280
Africa and Asia	57,707	-	382	168	17,133	39,781
	300,305	3,386,825	290,855	3,068,409	387,742	1,018,969

Other assets and liabilities are predominately concentrated in the Sultanate of Oman.

(b) Customer concentrations

	Assets			Liabilities		
	Gross loans, Advances and financing to banks	Gross Loans, Advances and financing to customers	Investment Securities	Deposits from customers	Due to banks	Contingent liabilities
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
31 December 2018						
Personal	**-**	**1,375,140**	**-**	**625,887**	**-**	**174**
Corporate	**329,896**	**1,650,688**	**48,101**	**1,118,535**	**368,983**	**999,970**
Government	**-**	**268,117**	**256,497**	**1,180,082**	**-**	**10,670**
	329,896	**3,293,945**	**304,598**	**2,924,504**	**368,983**	**1,010,814**
31 December 2017						
Personal	-	1,482,882	-	608,967	-	184
Corporate	300,305	1,678,979	22,734	1,166,788	387,742	1,003,486
Government	-	224,964	268,121	1,292,654	-	15,299
	300,305	3,386,825	290,855	3,068,409	387,742	1,018,969

32 Financial risk management *(continued)*

A. Credit risk *(continued)*

(c) Economic sector concentrations

	Assets	Liabilities	
	Gross loans, advances and financing to customers	**Deposits from customers**	**Contingent Liabilities**
	RO'000	**RO'000**	**RO'000**
31 December 2018			
Personal	**1,375,140**	**625,887**	**174**
International trade	**107,375**	**51,174**	**35,718**
Construction	**496,901**	**172,005**	**465,775**
Manufacturing	**213,220**	**39,277**	**49,235**
Wholesale and retail trade	**60,798**	**22,248**	**32,727**
Communication and utilities	**144,420**	**20,044**	**100,138**
Financial services	**140,850**	**89,281**	**248,862**
Government	**268,117**	**1,180,082**	**10,670**
Other services	**199,183**	**169,101**	**38,319**
Others	**287,941**	**555,405**	**29,196**
	3,293,945	**2,924,504**	**1,010,814**
31 December 2017			
Personal	1,482,882	608,967	184
International trade	100,624	34,880	28,307
Construction	467,643	130,394	372,333
Manufacturing	159,772	28,139	34,860
Wholesale and retail trade	53,586	25,660	29,937
Communication and utilities	76,843	9,322	87,764
Financial services	155,621	141,432	210,532
Government	224,964	1,292,654	15,299
Other services	170,179	164,107	67,972
Others	494,711	632,854	171,781
	3,386,825	3,068,409	1,018,969

32 Financial risk management *(continued)*

A. Credit risk *(continued)*

(d) Gross credit exposure

	Total gross exposure		Monthly average gross exposure	
	2018	2017	**2018**	2017
	RO'000	RO'000	**RO'000**	RO'000
Overdrafts	**165,880**	173,297	**177,624**	164,179
Loans	**2,547,049**	2,628,663	**2,549,067**	2,893,419
Loans against trust receipts	**99,393**	116,350	**119,580**	119,546
Bills discounted	**70,969**	72,082	**70,772**	78,076
Advance against credit cards	**8,921**	8,516	**8,833**	7,986
Islamic Banking Window financing	**401,733**	387,917	**381,140**	360,020
Total	**3,293,945**	3,386,825	**3,307,016**	3,623,226

(e) Geographical distribution of exposures:

	Sultanate of Oman	Other countries	Total
	RO'000	**RO'000**	**RO'000**
31 December 2018			
Overdrafts	**165,880**		**165,880**
Loans	**2,541,596**	**5,453**	**2,547,049**
Loans against trust receipts	**99,393**		**99,393**
Bills discounted	**10,552**	**1,086**	**11,638**
Advance against credit cards	**8,921**		**8,921**
Others	**59,331**		**59,331**
Islamic Banking Window financing	**401,733**		**401,733**
	3,287,406	**6,539**	**3,293,945**
31 December 2017			
Overdrafts	173,297	-	173,297
Loans	2,623,323	5,340	2,628,663
Loans against trust receipts	116,350	-	116,350
Bills discounted	12,993	355	13,348
Advance against credit cards	8,516	-	8,516
Others	58,734	-	58,734
Islamic Banking Window financing	387,917	-	387,917
	3,381,130	5,695	3,386,825

32 Financial risk management *(continued)*

A. Credit risk *(Continued)*

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

	Overdrafts RO'000	Loans including Islamic financing RO'000	Bills discounted RO'000	Others RO'000	Total RO'000	Off balance sheet exposure RO'000
31 December 2018						
Import trade	**15,573**	**76,260**	**-**	**15,314**	**107,147**	**29,026**
Export trade	**172**	**51**	**-**	**5**	**228**	**6,692**
Wholesale/retail trade	**13,086**	**44,356**	**-**	**3,356**	**60,798**	**32,727**
Mining and quarrying	**5,722**	**30,481**	**1,930**	**1,612**	**39,745**	**1,719**
Construction	**62,741**	**338,266**	**6,598**	**89,296**	**496,901**	**465,775**
Manufacturing	**21,372**	**161,416**	**1,307**	**29,125**	**213,220**	**48,994**
Electricity, gas and water	**586**	**137,917**	**-**	**-**	**138,503**	**92,763**
Transport and Communication	**2,420**	**3,114**	**-**	**383**	**5,917**	**7,375**
Financial institutions	**1,987**	**138,606**	**257**	**-**	**140,850**	**248,862**
Services	**24,845**	**171,743**	**-**	**2,595**	**199,183**	**38,319**
Personal loans	**1,045**	**1,365,684**	**-**	**8,411**	**1,375,140**	**174**
Agriculture and allied Activities	**4,004**	**6,231**	**-**	**1,888**	**12,123**	**696**
Government	**-**	**268,114**	**-**	**3**	**268,117**	**10,670**
Non-resident lending	**-**	**5,453**	**1,086**	**-**	**6,539**	**241**
Others	**12,327**	**201,090**	**460**	**15,657**	**229,534**	**26,781**
	165,880	**2,948,782**	**11,638**	**167,645**	**3,293,945**	**1,010,814**
31 December 2017						
Import trade	13,957	74,610	-	11,380	99,947	24,578
Export trade	93	584	-	-	677	3,729
Wholesale/retail trade	12,371	37,701	-	3,514	53,586	29,937
Mining and quarrying	5,099	30,493	531	1,508	37,631	730
Construction	45,384	345,113	5,210	71,936	467,643	372,333
Manufacturing	13,584	121,173	1,132	23,883	159,772	34,860
Electricity, gas and water	295	65,072	-	276	65,643	80,711
Transport and Communication	512	10,688	-	-	11,200	7,053
Financial institutions	1,402	149,767	4,452	-	155,621	210,532
Services	24,644	143,737	-	-	170,179	67,972
Personal loans	2,116	1,472,584	-	8,182	1,482,882	184
Agriculture and allied Activities	3,647	6,887	-	1,149	11,683	339
Government	2,773	222,191	-	-	224,964	15,299
Non-resident lending	-	5,340	355	-	5,695	240
Others	47,420	330,640	1,668	59,974	439,702	170,472
	173,297	3,016,580	13,348	181,802	3,386,825	1,018,969

32 Financial risk management *(continued)*

A. Credit risk *(continued)*

(g) Maximum exposure to credit risk (net of impairment) without consideration of collateral held:

	2018 RO' 000	2017 RO' 000
Treasury bills	**-**	49,917
Loans, advances and financing to banks	**329,059**	299,896
Loan, advances and financing to customers	**3,158,844**	3,248,873
Government development bonds	**250,927**	195,126
	3,738,830	3,793,812
Off-balance sheet items		
Financial guarantees	**918,894**	886,902
	4,657,724	4,680,714

As at 31 December 2018, Bank has total gross impaired loans of RO 121,299 (RO 105,503) thousand which includes interest reserved of RO 55,594 (2017: RO 58,291) thousand against principal outstanding of RO 65,705 (2017: RO 47.212) expected credit losses of RO 41,400 (2017: RO 47,543) thousands have been carried. The fair value of collateral against impaired exposure is RO 8,958 (2017: RO 9,274) thousands.

Credit Quality Analysis

The financial assets have been segregated into various portfolios like exposure to Banks, Sovereign, Wholesale Banking and Retail customers. Exposure to Retail customer includes personal loans, housing loans and credit cards. Exposure to Wholesale Banking customer includes exposure other than retail and bank exposure.

The following table sets out information about the credit quality of financial assets measured at amortised cost, FVOCI debt investments (2018) and available-for-sale debt assets (2017). Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

Explanation of the terms 'Stage 1', 'Stage 2' and 'Stage 3' is included in note 3.3. The following table provides the exposure to non-trading financial assets measured at amortized cost & FVOCI. Exposure to financial asset includes outstanding as at 31 December 2018

	Stage 1 RO'000	**Stage 2 RO'000**	**Total RO'000**
31 December 2018			
Exposure			
Banks	**767,020**	**1,028**	**768,048**
Sovereigns	**239,384**	**-**	**239,384**
Wholesale banking	**2,084,903**	**1,001,862**	**3,086,765**
Retail banking	**1,282,342**	**38,646**	**1,320,988**
Investments	**56,330**	**-**	**56,330**
Total	**4,429,979**	**1,041,536**	**5,471,515**
Expected credit losses	**19,207**	**33,014**	**52,221**

32 Financial risk management *(continued)*

Amounts arising from Expected Credit Loss (ECL)

Inputs, assumptions and techniques used for estimating impairment

Significant increase in credit risk (SICR)

The assessment of SICR since origination of a financial asset considers borrower-specific quantitative and qualitative information without consideration of collateral, and the impact of forward-looking information. Quantitative models may not always be able to capture all reasonable and supportable information that may indicate a significant increase in credit risk. Qualitative factors may be assessed to supplement the gap.

For retail exposures, a significant increase in credit risk cannot be assessed using forward looking information at an individual account level. Therefore, the assessment is done at the segment level. Segment migration thresholds exist for each PD model by product which considers the proportionate change in PD as well as the absolute change in PD. The thresholds used for PD migration are reviewed and assessed at least annually, unless there is a significant change in credit risk management practices in which case the review is brought forward.

For non-retail exposures the Bank uses an internal risk rating scale (IG codes) for its non-retail exposures. All non-retail exposures have an IG code assigned that reflects the probability of default of the borrower. Both borrower specific and non-borrower specific (i.e. macroeconomic) forward looking information is considered and reflected in the IG rating. Significant increase in credit risk is evaluated based on the migration of the exposures among IG codes.

Incorporation of forward looking information

The Bank incorporates forward-looking information into both the assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and the measurement of ECL. The Bank formulates three economic scenarios: a base case, which is the median scenario assigned a 50% probability of occurring, and two less likely scenarios, one upside and one downside, each assigned a 25% probability of occurring. External information considered includes economic data and forecasts published by monetary authorities and selected private-sector forecasters. A comprehensive review is performed at least annually on the design of the scenarios by the Bank's senior management.

Economic variable assumptions

The Bank uses the macroeconomic forecast to convert the Through the Cycle (TTC) PD into Point in Time (PIT) PD. Real GDP growth rate and Oil Revenue to GDP are considered for establishing the relationship with historical non-performing loans (NPLs) data of the banking system, as they were observed to be more statistically significant parameters reflecting the state of economy. The forecast of macro-economic indicators are considered for next 3 years with time lag of 1 year. The macroeconomic indicators used as at 31 December 2018 including the projections used is presented as under:

Real GDP growth (%)	Present	2.0%	**Oil revenue (%GDP)**	Present	21.1%
	Year 1 Projection	2.0%		Year 1 Projection	24.3%
	Year 2 Projection	3.6%		Year 2 Projection	24.7%
	Year 3 Projection	1.9%		Year 3 Projection	23.8%

Predicted relationships between the macroeconomic indicators, default and loss rates on various portfolios of financial assets have been developed based on analysing historical data over the past 15 years.

32 Financial risk management *(continued)*

Loss Allowance

The following table presents the ECL for non-performing loans i.e. Exposure under Stage 3.

	No. of borrowers RO'000	**Exposure RO'000**	**Reserved interest RO'000**	**Net exposure RO'000**	**ECL RO'000**	**% of ECL RO'000**
31 December 2018						
Wholesale banking	**218**	**63,099**	**40,968**	**22,131**	**15,463**	**69.9%**
Retail banking	**2,262**	**58,990**	**14,626**	**44,364**	**25,937**	**58.5%**
Total	**2,480**	**122,089**	**55,594**	**66,495**	**41,400**	**62.3%**
31 December 2017						
Wholesale banking	223	51,947	35,439	16,508	13,644	82.7%
Retail banking	2,099	53,442	11,773	41,669	22,001	52.8%
Total	2,322	105,389	47,212	58,177	35,645	61.3%

32 Financial risk management *(continued)*

	Stage 1		Stage 2		Stage 3		Total	
	ECL	**Exposure**	**ECL**	**Exposure**	**ECL**	**Exposure**	**ECL**	**Exposure**
BANKS								
High Investment Grade	18	214,348	-	-	-	-	18	214,348
Moderate Investment Grade	99	194,734	-	-	-	-	99	194,734
Sub Investment Grade	719	65,338	-	-	-	-	719	65,338
Non-performing			-	-	-	-	-	-
Total	**837**	**474,420**	**-**	**-**	**-**	**-**	**837**	**474,420**
SOVEREIGN								
High Investment Grade	-	237,520	-	-	-	-	-	237,520
Moderate Investment Grade	-	-	-	-	-	-	-	-
Sub Investment Grade	-	-	-	-	-	-	-	-
Non-performing	-	-	-	-	-	-	-	-
Total	**-**	**237,520**	**-**	**-**	**-**	**-**	**-**	**237,520**
FINANCING TO CUSTOMERS								
Corporate	0	0	0	0	0	0	-	-
High Investment Grade	628	421,893	203	41,723	-	-	831	463,616
Moderate Investment Grade	2,599	629,507	2,011	256,535	-	-	4,610	886,042
Sub Investment Grade	1,392	175,987	13,651	329,506	-	-	15,044	505,494
Non-performing	-	-	-	-	15,463	62,309	15,463	62,309
Total	**4,619**	**1,227,386**	**15,865**	**627,765**	**15,463**	**62,309**	**35,947**	**1,917,460**
RETAIL (Personal)								
High Investment Grade	3,323	604,230	-	-	-	-	3,323	604,230
Moderate Investment Grade	2,136	84,600	15	193	-	-	2,152	84,793
Sub Investment Grade	2,652	30,303	6,113	30,416	-	-	8,765	60,719
Non-performing	-	-	-	-	22,442	51,290	22,442	51,290
Total	**8,112**	**719,133**	**6,128**	**30,609**	**22,442**	**51,290**	**36,682**	**801,032**

32 Financial risk management *(continued)*

Retail (Housing loan and credit card receivables)								
High Investment Grade	-	-	-	-	-	-	-	-
Moderate Investment Grade ***	619	558,517	2,026	7,892	-	-	2,645	566,409
Sub Investment Grade	-	-	-	-	-	-	-	-
Non-performing	-	-	-	-	3,495	7,700	3,495	7,700
Sub-total	**619**	**558,517**	**2,026**	**7,892**	**3,495**	**7,700**	**6,140**	**574,109**
Total loans and advances to customers	**13,349**	**2,505,037**	**24,558**	**666,266**	**41,400**	**121,299**	**79,307**	**3,292,601**
Investments	-	-	-	-	-	-	-	-
High Investment Grade	4	26,295	-	-	-	-	4	26,296
Moderate Investment Grade	263	30,010	-	-	-	-	263	30,010
Sub Investment Grade	-	24	-	-	-	-	-	24
Non-performing	-	-	-	-	-	-	-	-
Total	**267**	**56,329**	**-**	**-**	**-**	**-**	**267**	**56,330**
Unfunded exposure								
Corporate & SME	2,292	543,719	6,722	208,693	-	790	9,014	753,202
Retail	9	629	-	-	-	-	9	629
Banks	958	256,495	-	1,026	-	-	958	257,521
Total	**3,259**	**800,843**	**6,722**	**209,719**	**-**	**790**	**9,981**	**1,011,352**
Others								
Unutilised	1,342	281,539	1,596	149,434	-	-	2,939	430,973
Acceptances	92	60,886	35	13,166	-	-	126	74,053
Accrued profit	61	13,405	103	2,951	-	-	164	16,355
GRAND TOTAL	**19,207**	**4,429,979**	**33,014**	**1,041,536**	**41,400**	**122,089**	**93,621**	**5,593,604**

*** The Housing loan portfolio is not rated and is presently categorised based on days past due bucket.
The above table does not include reserve interest figures in the ECL for stage 3.

32 Financial risk management *(continued)*

The following table presents the distribution of impaired loans, past due and not past due loans by type of industry:

	Performing loans	Non-performing loans	Expected Credit Loss for Stage 1 & 2 Exposure	Expected Credit Loss for Stage 3 Exposure	Interest reserve	Stage 3 Expected Credit Loss during the year	Advances written off during the year
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
31 December 2018							
Import trade	**94,488**	**12,659**	**871**	**1,743**	**10,548**	**596**	**1**
Export trade	**222**	**6**	**17**	**4**	**3**	**2**	**-**
Wholesale/retail trade	**30,598**	**30,200**	**230**	**4,906**	**25,045**	**(90)**	**-**
Mining and quarrying	**39,735**	**10**	**689**	**3**	**5**	**(37)**	**-**
Construction	**488,548**	**8,353**	**5,907**	**2,416**	**3,253**	**1,519**	**1**
Manufacturing	**213,039**	**181**	**1,175**	**31**	**141**	**16**	**-**
Electricity, gas and water	**138,467**	**36**	**761**	**9**	**1**	**8**	**-**
Transport and communication	**5,709**	**208**	**202**	**84**	**6**	**108**	**-**
Financial institutions	**140,850**	**-**	**310**	**-**	**-**	**10**	**-**
Services	**197,750**	**1,433**	**797**	**537**	**306**	**-**	**-**
Personal loans	**1,316,151**	**58,989**	**16,885**	**25,937**	**14,625**	**8,252**	**26**
Agriculture and allied activities	**12,114**	**9**	**43**	**5**	**4**	**-**	**-**
Government	**268,117**	**-**	**234**	**-**	**-**	**-**	**-**
Non-resident lending	**1,086**	**5,453**	**1**	**4,380**	**1,027**	**-**	**-**
Others	**225,772**	**3,762**	**9,786**	**1,345**	**829**	**35**	**-**
	3,172,646	**121,299**	**37,908**	**41,400**	**55,793**	**10,419**	**28**
31 December 2017							
Import trade	89,215	10,732	909	1,269	9,089	186	-
Export trade	671	6	1	4	2	-	-
Wholesale/retail trade	27,058	26,528	287	4,932	21,720	15	-
Mining and quarrying	37,622	9	366	253	4	1	-
Construction	462,162	5,481	4,424	4,634	2,917	780	-
Manufacturing	159,325	447	1,626	87	174	150	-
Electricity, gas and water	65,643	-	670	-	-	-	-
Transport and communication	11,200	-	113	-	-	-	-
Financial institutions	155,621	-	1,588	-	-	-	-
Services	169,350	829	1,717	464	211	260	-
Personal loans	1,429,437	53,445	24,648	29,983	11,773	13,712	43
Agriculture and allied activities	11,675	8	119	5	3	-	-
Government	224,964	-	2,295	-	-	-	-
Non-resident lending	355	5,340	4	4,429	915	-	-
Others	437,024	2,678	4,430	1,483	404	947	-

3,281,322	105,503	43,197	47,543	47,212	16,051	43

32 Financial risk management *(continued)*

The following table presents the distribution of impaired loans and gross loans by geographical distribution:

	Exposure to Stage 1 & 2 RO'000	Exposure to Stage 3 RO'000	Stage 1 & 2 ECL RO'000	Stage 3 `ECL RO'000	Interest reserve RO'000	Stage 3 ECL during the year RO'000	Advances written off during the year RO'000
31 December 2018							
Sultanate of Oman	**3,171,560**	**115,846**	**37,907**	**37,020**	**54,766**	**10,419**	**28**
Other countries	**1,086**	**5,453**	**1**	**4,380**	**1,027**	**-**	**-**
	3,172,646	**121,299**	**37,908**	**41,400**	**55,793**	**10,419**	**28**
31 December 2017							
Sultanate of Oman	3,381,130	100,163	43,193	43,114	46,297	16,051	43
Other countries	5,695	5,340	4	4,429	915	-	-
	3,386,825	105,503	43,197	47,543	47,212	16,051	43

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%, 20% and 25% of cumulative liabilities (outflows) on mismatches (liquidity gaps) in time buckets up to 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.

32 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 1 month 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 2018						
Cash and balances with Central Bank of Oman	301,005	-	-	-	500	301,505
Loan and advances to customer	305,432	333,556	139,074	834,571	1,546,211	3,158,844
Loans and advances to banks	105,474	179,559	23,041	20,985	-	329,059
Investments FVTPL	-	-	4,140	-	-	4,140
Investments FVOCI Equity	-	-	4,118	-	-	4,118
Investments FVOCI-Debt Instrument	-	-	-	26,585	18,562	45,147
Investments at amortized cost	-	22,989	21,791	126,109	80,038	250,927
Intangible asset	-	-	-	-	794	794
Property and equipment	-	-	-	-	14,917	14,917
Other assets	16,662	63,024	12,166	280	11,907	104,039
Total assets	728,573	599,128	204,330	1,008,530	1,672,929	4,213,490
Due to banks	213,250	59,483	-	96,250	-	368,983
Deposits from customers	225,298	530,666	380,152	960,549	827,839	2,924,504
Other liabilities	48,936	73,785	12,842	8,466	13,937	157,966
Subordinated loans	-	-	-	63,875	-	63,875
Total equity**	-	50,281	-	-	647,881	698,162
Total liabilities and shareholders' equity	487,484	714,215	392,994	1,129,140	1,489,657	4,213,490

** Including Perpetual Tier 1 capital securities

32 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 1 month 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 2017						
Cash and balances with Central Bank of Oman	326,319	-	-	-	500	326,819
Loans and advances to banks	124,881	134,084	37,466	3,465	-	299,896
Loans and advances to customers	276,846	366,338	167,307	834,446	1,603,936	3,248,873
Available-for-sale investments	-	-	13,470	16,567	5,775	35,812
Investments at Amortized Cost	49,917	-	40,406	80,084	84,636	255,043
Intangible asset	-	-	-	-	1,191	1,191
Property and equipment	-	-	-	-	9,524	9,524
Other assets	9,039	43,210	7,354	51	9,898	69,552
Total assets	787,002	543,632	266,003	934,613	1,715,460	4,246,710
Due to banks	183,884	49,858	96,250	57,750	-	387,742
Deposits from customers	311,080	577,735	426,434	1,078,361	674,799	3,068,409
Other liabilities	45,820	52,349	8,089	8,818	601	114,677
Subordinated loans	-	25,000	28,875	35,000	-	88,875
Total equity**	-	47,627	-	115,500	423,880	587,007
Total liabilities and shareholders' equity	540,784	752,569	559,648	1,295,429	1,099,280	4,246,710

** Including Perpetual Tier 1 capital securities

32 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 comprehensive 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

	2018	2017
	RO'000	RO'000
Net assets denominated in US Dollars	**163,412**	113,705
Net assets denominated in UAE Dirham (AED)	**14,020**	653
Net assets denominated in other foreign currencies	**1,320**	1,129
	178,752	115,487

(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 repricing 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%**	
	2018	2017	**2018**	2017
	RO'000	RO'000	**RO'000**	RO'000
Omani Rials	**8,859**	7,551	**17,718**	15,102
US Dollars	**4,083**	4,676	**8,165**	9,351
Others currencies	**232**	1,505	**464**	3,010
	13,174	13,732	**26,347**	27,463

32 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 2018								
Cash and balances with Central Bank of Oman	1.9%	143,220	-	-	-	500	157,785	301,505
Loans, advances and financing to banks	3.7%	102,702	223,317	-	-	-	3,040	329,059
Loans, advances and financing to customers	5.7%	643,680	1,155,615	108,895	683,481	567,173	-	3,158,844
Investments - FVTPL		-	-	-	-	-	4,140	4,140
Investment – FVOCI Equity		-	-	-	-	-	4,118	4,118
Investment FVOCI – Debt Instrument	5.1%	-	-	-	26,585	18,562	-	45,147
Investments at amortized cost	4.0%	-	30,315	58,952	67,156	80,039	14,465	250,927
Intangible asset		-	-	-	-	-	794	794
Property and equipment		-	-	-	-	-	14,917	14,917
Other assets		-	-	-	-	-	104,039	104,039
Total assets		889,602	1,409,247	167,847	777,222	666,274	303,298	4,213,490
Due to banks	3.6%	367,250	1,733	-	-	-	-	368,983
Deposits from customers	2.8%	162,127	432,824	412,224	972,594	40,420	904,315	2,924,504
Other liabilities		-	-	-	-	-	157,966	157,966
Subordinated loan	5.6%	-	-	-	63,875	-	-	63,875
Shareholders' equity		-	50,281	-	155,500	33,006	459,375	698,162
Total liabilities and Equity**		529,377	484,838	412,224	1,191,969	73,426	1,521,656	4,213,490
On-balance sheet gap		360,225	924,409	(244,377)	(414,747)	592,848	(1,218,358)	-
Cumulative interest sensitivity gap		360,225	1,284,634	1,040,257	625,510	1,218,358	-	-

** Including Perpetual Tier 1 capital securities

32 Financial risk management *(continued)*

(b) Interest rate risk *(continued)*

Interest rate sensitivity gap *(continued)*

31 December 2017	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	1%	55,825	-	-	-	500	270,494	326,819
Loans, advances and financing to banks	1.8%	131,400	167,315	-	-	-	1,181	299,896
Loans, advances and financing to customers	5.5%	636,821	1,144,875	117,617	729,669	619,891	-	3,248,873
Available-for-sale investments	5.0%	-	-	-	16,561	5,781	13,470	35,812
Investments at Amortized Cost	3.4%	49,917	-	40,406	80,090	84,630	-	255,043
Intangible asset							1,191	1,191
Property and equipment		-	-	-	-	-	9,524	9,524
Other assets		-	-	-	-	-	69,552	69,552
Total assets		873,963	1,312,190	158,023	826,320	710,802	365,412	4,246,710
Due to banks	2.7%	341,590	46,152	-	-	-	-	387,742
Deposits from customers	2.6%	170,661	426,559	416,431	927,686	43,698	1,083,374	3,068,409
Other liabilities		-	-	-	-	-	114,677	114,677
Subordinated loan	5.5%	25,000	-	-	63,875	-	-	88,875
Shareholders' equity	-	-	47,627	-	115,500	-	423,880	587,007
Total liabilities and Equity**		537,251	520,338	416,431	1,107,061	43,698	1,621,931	4,246,710
On-balance sheet gap		336,712	791,852	(258,408)	(280,741)	667,104	(1,256,519)	-
Cumulative interest sensitivity gap		336,712	1,128,564	870,156	589,415	1,256,519	-	-

** Including Perpetual Tier 1 capital securities

32 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, the Bank does not hold trading positions in equity and debt investments. However the 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.

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

If there is adverse impact of 5% on Level 1 portfolio, the value of the portfolio may decrease by RO 2,600 thousand (2017: decrease by RO 1,100 thousand).

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 119 thousand (2017: decrease / increase by RO 156 thousand).

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 2018, 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.

32. Financial risk management *(continued)*

Operational risk *(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 a 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 a 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.

- The 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.

- The 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 equipment’s, 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.

32. Financial risk management *(continued)*

Business Continuity Planning (BCP) *(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.

33. 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. As per CBO guidelines, the Bank needs to maintain capital adequacy ratio (CAR) at a minimum of 12.875% (including the capital conservation buffer) as at 31 December 2018 and with effect from 1 January 2019, to maintain minimum capital adequacy ratio of 13.5% (including capital conservation buffer).

The capital base of the Bank consists of debt, which includes borrowings disclosed in note 15, 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 16 to 19

33 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 2018 is **17.33**% (2017: 15.44%).

Capital structure	2018 RO'000	2017 RO'000
Common Equity Tier (CET) I/ TIER I CAPITAL		
Paid up capital	**280,033**	225,786
Legal reserve	**55,878**	50,254
Share premium	**95,656**	77,564
Special reserve	**18,488**	18,488
Subordinated loan reserve	**30,100**	42,325
Retained earnings	**11,557**	10,145
Proposed bonus shares	**19,602**	18,063
CET I/Tier I Capital	**511,314**	442,625
Additional Tier I regulatory adjustments:		
Deferred tax assets	**(1,029)**	(62)
Goodwill	**(794)**	(1,191)
Negative investment revaluation reserve	**(2,271)**	(233)
Total CET 1 capital	**507,220**	441,139
Additional Tier I capital (AT1)	**155,500**	**115,500**
Total Tier 1 Capital (T1=CET1+AT1)	**662,720**	**556,639**
TIER II CAPITAL		
Investment revaluation reserve	**134**	275
General provision	**43,606**	43,606
Subordinated loan	**33,775**	46,550
Total Tier II capital	**77,515**	90,431
Total eligible capital	**740,235**	647,070

Risk weighted assets	2018	2017
Banking book	**3,936,646**	3,881,383
Trading book	**75,779**	64,370
Operational risk	**258,086**	243,793
Total	**4,270,511**	4,189,546
Total Tier 1 Capital (T1=CET1+AT1)	**662,720**	556,639
Tier II capital	**77,515**	90,431
Total regulatory capital	**740,235**	647,070
Common Equity Tier 1 ratio	**11.88%**	10.53%
Tier I capital ratio	**15.52%**	13.29%
Total capital ratio	**17.33%**	15.44%

34 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 2018	Retail banking RO'000	Corporate banking RO'000	Treasury and investments RO'000	Total RO'000
Segment operating revenues	82,641	100,746	12,935	196,322
Other revenues	4,738	12,991	16,697	34,426
Total	87,379	113,737	29,632	230,748
Interest, Islamic Window Deposit expenses	(35,219)	(56,264)	(5,141)	(96,624)
Net operating income	52,160	57,473	24,491	134,124
Segment cost				
Operating expenses including depreciation	(33,390)	(29,168)	(5,169)	(67,727)
Impairment for loans and investment net recoveries from allowance for loans impairment	(6,650)	349	(353)	(6,654)
Profit from operations after provision	12,120	28,654	18,969	59,743
Tax expenses	(1,920)	(4,538)	(3,004)	(9,462)
Net profit for the year	10,200	24,116	15,965	50,281
Segment assets	1,444,926	2,086,191	818,742	4,349,859
Less: Impairment allowance	(57,590)	(77,676)	(1,103)	(136,369)
Total segment assets	1,387,336	2,008,515	817,639	4,213,490
Segment liabilities	659,296	2,408,677	434,309	3,502,282
Add: Impairment allowance	9	12,023	1,014	13,046
Segment liabilities	659,305	2,420,700	435,323	3,515,328

34 Segmental information *(continued)*

At 31 December 2017	Retail banking RO'000	Corporate banking RO'000	Treasury and investments RO'000	Total RO'000
Segment operating revenues	85,705	86,424	8,212	180,341
Other revenues	5,527	14,479	13,795	33,801
Total	91,232	100,903	22,007	214,142
Interest, Islamic Window Deposit expenses	(32,528)	(48,849)	(5,838)	(87,215)
Net operating income	58,704	52,054	16,169	126,927
Segment cost				
Operating expenses including depreciation	(26,530)	(28,515)	(3,949)	(58,994)
Impairment for loans and investment net recoveries from allowance for loans impairment	(9,276)	(2,268)	(358)	(11,902)
Profit from operations after provision	22,898	21,271	11,862	56,031
Tax expenses	(3,137)	(3,488)	(1,779)	(8,404)
Net profit for the year	19,761	17,783	10,083	47,627
Segment assets	1,580,149	2,070,435	734,487	4,385,071
Less: Impairment allowance	(66,404)	(71,548)	(409)	(138,361)
Total segment assets	1,513,745	1,998,887	734,078	4,246,710
Segment liabilities	640,590	2,542,029	477,084	3,659,703

34 Segmental information *(continued)*

Islamic Banking Window

At 31 December 2018	**Retail banking RO'000**	**Corporate banking RO'000**	**Treasury and investments RO'000**	**Total RO'000**
Segment operating revenues	**8,531**	**12,724**	**301**	**21,556**
Other revenues	**234**	**786**	**2,600**	**3,620**
Total	**8,765**	**13,510**	**2,901**	**25,176**
Unrestricted investment account holders' share of profit and profit expense	**(587)**	**(10,381)**	**(619)**	**(11,587)**
Net operating income	**8,178**	**3,129**	**2,282**	**13,589**
Segment cost				
Operating expenses including depreciation	**(3,093)**	**(3,114)**	**(927)**	**(7,134)**
Impairment allowance	**(133)**	**(242)**	**(141)**	**(516)**
Net profit for the year	**4,952**	**(227)**	**1,214**	**5,939**
Segment assets	**170,063**	**235,315**	**111,659**	**517,037**
Less: Impairment allowance	**(382)**	**(4,040)**	**(188)**	**(4,610)**
Total segment assets	**169,681**	**231,275**	**111,471**	**512,427**
Segment liabilities	**28,432**	**299,472**	**82,884**	**410,788**
Add: Impairment allowance	**3**	**528**	**-**	**531**
Segment liabilities	**28,435**	**300,000**	**82,884**	**411,319**

34 Segmental information *(continued)*

At 31 December 2017	Retail banking RO'000	Corporate banking RO'000	Treasury and investments RO'000	Total RO'000
Segment operating revenues	7,290	11,414	138	18,842
Other revenues	186	603	1,565	2,354
Total	7,476	12,017	1,703	21,196
Unrestricted investment account holders' share of profit and profit expense	(452)	(9,511)	(358)	(10,321)
Net operating income	7,024	2,506	1,345	10,875
Segment cost				
Operating expenses including depreciation	(2,202)	(3,374)	(791)	(6,367)
Impairment allowance	(385)	(934)	-	(1,319)
Net profit for the year	4,437	(1,802)	554	3,189
Segment assets	157,839	233,266	139,318	530,423
Less: Impairment allowance	(1,787)	(2,685)	-	(4,472)
Total segment assets	156,052	230,581	139,318	525,951
Segment liabilities	41,481	343,251	72,417	457,149

35 Dividends – proposed and declared

Further to the disclosure published in the MSM website on 15th January 2019 regarding the Initial Annual Unaudited Financial Result for 2018 The Board of Directors in their meeting held on 29 January 2019 proposed a cash dividend of 10% (2017: 12%) for the year ended 31 December 2018 amounting to RO 28.00 million (2017: RO 25.64 million) and a bonus share issue of 7% (2017: 8%) amounting to 196,022,991 shares (2017: 180,628,618 shares) of RO 0.100 each. , subject to Regulatory and Shareholders approvals A resolution to approve these distribution will be presented to the shareholders at the Annual General Meeting to be held on 27th March 2019.

During the year, unclaimed dividend amounting to RO 22,449 (2017: RO 64,389) was transferred to the Investor's Trust Fund account as per the guidelines issued by the Capital Market Authority of Oman.

The shareholders of the Bank in the annual general meeting held during March 2018 approved the issuance of 8% bonus shares comprising 180,628,618 shares of par value RO 0.100 each (2017: 142,440,105 shares of par value RO 0.100 each) and 12% (2017 – 13.5%) as cash dividend of the paid share capital of the Bank amounting to RO 27,094 thousand for the year ended 31 December 2018 (2017 – RO 25,639 thousand for the year ended 31 December 2017).