

Bank of Sharjah P.J.S.C.

**Consolidated financial statements
for the year ended 31 December 2018**

Bank of Sharjah P.J.S.C.

**Consolidated financial statements
for the year ended 31 December 2018**

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Bank of Sharjah P.J.S.C.

Board of Directors' report

The Board has pleasure in submitting their report and the audited consolidated financial statements for the year ended 31 December 2018.

INCORPORATION AND REGISTERED OFFICE

Bank of Sharjah P.J.S.C. (the "Bank") is a Public Joint Stock Company incorporated by an Amiri Decree issued on 22 December 1973 by His Highness The Ruler of Sharjah and was registered in February 1993 under Commercial Companies Law Number 8 of 1984 (as amended). The Bank commenced operations under a banking license issued from United Arab Emirates Central Bank dated 26 January 1974.

The Bank's registered office is located at Al Khan Road, P.O. Box 1394, Sharjah, United Arab Emirates.

PRINCIPAL ACTIVITIES

The Bank's principal activities are commercial and investment banking.

RESULTS

The profit for the year ended 31 December 2018 amounted to AED 130 million (2017: AED 265 million). The total comprehensive income for the year ended 31 December 2018 amounted to AED 3 million (2017: loss of AED 155 million) after taking into consideration the unrealised losses on revaluation of financial assets and financial liabilities measured at fair value through other comprehensive income and through profit or loss due to credit risk, respectively, amounting to AED 127 million (2017: AED 420 million).

The detailed results are set out in the attached consolidated financial statements.

DIRECTORS

The Directors during the year were:

- | | |
|--|---|
| 1. Mr. Ahmed Abdalla Al Noman (Chairman) | 7. Mr. Saud Al Besharah |
| 2. Sheikh Mohammed Bin Saud Al Qassimi (Vice Chairman) | 8. Mr. Francois Dauge |
| 3. Sheikh Seif Bin Mohd Bin Butti Al Hamed | 9. Mr. Salem Al Ghammai |
| 4. H.E. Humeid Naser Al Owais | 10. Mr. Salad Bin Butti Al Mheiri |
| 5. Mr. Abdul Aziz Hassan Al Midfa | 11. Mr. Abdulla Mohamed Sharif Al Fahim |
| 6. Mr. Abdul Aziz Mubarak Al Hassawi | |

On behalf of the Board



16 JUN 2019

Mr. Ahmed Abdalla Al Noman
Chairman
Sharjah



KPMG Lower Gulf Limited
2002, Al Batha Tower
Buhaira Corniche, Sharjah, UAE
Tel. +971 (6) 517 0700, Fax (6) 5723773

Independent Auditors' Report

To the Shareholders of Bank of Sharjah P.J.S.C.

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of Bank of Sharjah P.J.S.C. ("the Bank") and its subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2018, the consolidated statements of profit or loss, profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2018, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in the United Arab Emirates, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.



Key Audit Matters (continued)

Impairment of loans and advances to customers

Refer to note 4.10, 5.2, 9, 32 and 37 of the consolidated financial statements.

The Expected Credit Loss ('ECL') requirements of IFRS 9 "Financial Instruments" (IFRS 9) were adopted by the Group on 1 January 2018 and have resulted in:

- change in accounting for impairment from an incurred loss model to an ECL model which involves complex estimates and judgements;
- transition adjustments recognised in retained earnings on 1 January 2018, being the date of adoption of IFRS 9;
- use of statistical models and methodologies for determination of expected credit losses;
- significant change in processes, data and controls that have not been subject to testing previously; and
- complex disclosure requirements regarding impact of initial application of IFRS 9 and explanation of key judgements and material inputs used in determination of expected credit losses.

Given the inherently judgemental nature of computation of ECL for loans and advances, this is considered a key audit matter.

Our response

We have performed end to end process walkthroughs to identify the key systems, applications and controls used in the ECL Process and to understand the governance framework around model adoption and approval of ECL coefficients, data gathering, its integrity and underlying estimates and assumptions used by the management.

Controls Testing

- Testing key controls over modelling process, including model review and approval;
- Testing key controls over the accuracy of key inputs and appropriateness of key assumptions and judgment's used in the model;
- Testing key controls over significant increase in credit risk (SICR) criteria involved testing controls relating to authorisation of the criteria and the application of the criteria in the models;
- Testing key controls over internal credit grading (which is a key driver in determining SICR) and monitoring the process; to assess if the risk grades allocated to counterparties were appropriately identified and updated on a timely basis;



Key Audit Matters (continued)

Impairment of loans and advances to customers (continued)

Our response (continued)

Controls Testing (continued)

- Testing key controls relating to the selection and implementation of material macro-economic variables and the controls over the scenario selection and probabilities; and
- Testing controls over the assessment of model outputs and authorisation and review of post model adjustments and management overlays.

Involvement of Specialists

- We involved our accounting specialists to assist in reviewing the reasonableness of the Group's IFRS 9 policy including the appropriateness of the assumptions being used and for the portfolios examined we have involved our financial risk modelling specialists to assist in evaluating the appropriateness of the SICR criteria including assessing the IFRS 9 ECL methodology, macro-economic scenarios and probabilities used by the management in the Group's IFRS 9 ECL models. As part of this work we assessed probability of default ('PD'), loss given default ('LGD') and exposure at default ('EAD') assumptions.
- We have involved our information technology specialists to assist in testing the relevant General IT and Applications Controls over Key Systems used in ECL Process.

Substantive Testing

- Sample testing over key inputs and assumptions impacting ECL calculations including macro-economic forecasts and weightages to confirm the accuracy of information used;
- Re-performing key aspects of the Group's SICR determinations and selecting samples of financial instruments to determine whether a SICR was appropriately identified;
- Selecting a sample of post model adjustments and management overlays in order to assess the reasonableness of the adjustments by challenging key assumptions, inspecting the calculation methodology and tracing a sample back to source data;
- Performing credit assessments for a sample of selected corporate customers, including Stage 3 customers, to test the appropriateness of the credit grades at a given point in time and assess the financial performance of the borrower, source of repayment and future cash flows of the borrower to assess recoverability and ECL by comparing key assumptions to progress against business plans and our own understanding of relevant industries and business environment and where possible to externally derived evidence such as business performance and real estate valuations for assessing the appropriateness of collateral values held by the Group; and



Key Audit Matters (continued)

Impairment of loans and advances to customers (continued)

Our response (continued)

Substantive Testing (continued)

- Assessing the adequacy of the Group's disclosure in relation to transition impact arising from first time application of IFRS 9 and use of significant estimates and judgement by reference to the requirements of the relevant accounting standards.

Valuation of Level 3 financial instruments

Refer to note 5.2, 10 and 39 of the consolidated financial statements.

The risk is that the valuation of financial instruments maybe misstated due to the application of valuation techniques which often involve the exercise of significant judgement and the use of assumptions and estimates.

Of the financial instruments that are held at fair value through profit or loss or as FVTOCI in the Group's statement of financial position, 40% (2017: 69%) were measured using level 3 inputs in the fair value hierarchy as at 31 December 2018.

Financial instruments are classed at Level 3 because significant pricing inputs to them are unobservable. The determination of these prices is inherently more subjective and as such due to the uncertainty in estimating some of the fair values, this is considered as a key audit matter.

Our response

Our audit procedures included:

1. The assessment of controls over the identification, measurement and management of valuation risk, evaluating the methodologies, reasonableness of inputs and assumptions used by the Group in determining fair values.
2. Assessing, for a selection of investments, key inputs, assumptions used by management and supporting to key factors.
3. Additionally, we assessed whether the consolidated financial statements disclosures of fair value risks and sensitivities appropriately reflect the Group's exposure to valuation risk.



Key Audit Matters (continued)

Valuation of investment properties and properties held-for-sale

Refer to note, 11 and 13 of the consolidated financial statements.

The Group's accounting policy is to state its investment properties at fair value and properties held-for-sale at lower of cost or net realisable value at each reporting date.

Due to the significance of these properties, the general slowdown in the UAE real estate sector and the impact on the consolidated statement of profit or loss and related estimation uncertainty, this is considered as a key audit matter.

The valuation of the portfolio is a significant judgment area and is underpinned by a number of assumptions. The existence of significant estimation uncertainty warrants specific audit focus in this area as any bias or error in determining the fair value, whether deliberate or not, could lead to an overstatement (or understatement) of profit or loss for the year.

Our response

Our audit procedures included:

1. We assessed the competence, independence and integrity of the external valuers and read their terms of engagement with the Group to determine whether there were any matters that might have affected their objectivity or may have imposed scope limitations on their work;
2. We obtained the external valuation reports for all properties and confirmed that the valuation approach is in accordance with international standards and suitable for use in determining the carrying value in the consolidated statement of financial position;
3. We carried out procedures on the selected samples, to test whether property specific standing data supplied to the external valuers by management reflected the underlying property records held by the Group and which has been tested during our audit; and
4. Based on the outcome of our evaluation we determined the adequacy of the disclosure in the consolidated financial statements.



Other Information

Management is responsible for the other information. The other information comprises the Directors' report, which we obtained prior to the date of this auditors' report, and the Group's 2018 Annual Report which is expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we have obtained prior to the date of this auditors' report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

When we will read the report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance and take appropriate actions in accordance with ISAs.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs and their preparation in compliance with the applicable provisions of the UAE Federal Law No. (2) of 2015, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.



Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.



*Auditors' Responsibilities for the Audit of the Consolidated Financial Statements
(continued)*

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

Further, as required by the UAE Federal Law No. (2) of 2015, we report that:

- i) we have obtained all the information and explanations we considered necessary for the purposes of our audit;
- ii) the consolidated financial statements have been prepared and comply, in all material respects, with the applicable provisions of the UAE Federal Law No. (2) of 2015;
- iii) the Group has maintained proper books of account;
- iv) the financial information included in the Directors' report, in so far as it relates to these consolidated financial statements, is consistent with the books of account of the Group;
- v) as disclosed in note 10 to the consolidated financial statements, the Group has purchased shares during the year ended 31 December 2018;
- vi) note 34 to the consolidated financial statements discloses material related party transactions and the terms under which they were conducted;
- vii) based on the information that has been made available to us, nothing has come to our attention which causes us to believe that the Group has contravened during the financial year ended 31 December 2018 any of the applicable provisions of the UAE Federal Law No.(2) of 2015 or in respect of the Bank, its Articles of Association, which would materially affect its activities or its consolidated financial position as at 31 December 2018; and



Report on Other Legal and Regulatory Requirements (continued)

viii) note 33 to the consolidated financial statements discloses the social contributions made during the year.

Further, as required by Article (114) of the Decretal Federal Law No. (14) of 2018, we report that we have obtained all the information and explanations we considered necessary for the purposes of our audit.

KPMG Lower Gulf Limited

Emilio Pera
Registration No: 1146
Dubai, United Arab Emirates
Date: 16 JUN 2019

Consolidated statement of financial position
As at 31 December

	Notes	2018 AED'000	2017 AED'000
ASSETS			
Cash and balances with central banks	6	4,636,343	5,587,606
Deposits and balances due from banks	7	507,785	503,218
Reverse-repo placements	8	849,188	1,867,798
Loans and advances, net	9	16,214,334	17,476,329
Other financial assets measured at fair value	10	817,319	813,286
Other financial assets measured at amortised cost	10	671,554	794,585
Investment properties	11	608,473	584,858
Goodwill and other intangibles	12	416,056	421,966
Other assets	13	3,984,954	2,192,732
Property and equipment	15	304,577	268,822
Total assets		29,010,583	30,511,200
LIABILITIES AND EQUITY			
Liabilities			
Customers' deposits	17	20,119,169	21,630,471
Deposits and balances due to banks	18	304,931	87,122
Other liabilities	19	1,217,596	1,018,866
Issued bonds	20	3,589,972	3,706,810
Total liabilities		25,231,668	26,443,269
Equity			
Capital and reserves			
Share capital	21 (a)	2,100,000	2,100,000
Statutory reserve	21 (b)	1,050,000	1,050,000
Contingency reserve	21 (c)	600,000	560,000
General and other reserves	9 (d) & 21 (d)	250,257	100,000
Investment fair value reserve		(535,375)	(400,782)
Retained earnings		300,324	647,251
Equity attributable to equity holders of the Bank		3,765,206	4,056,469
Non-controlling interests		13,709	11,462
Total equity		3,778,915	4,067,931
Total liabilities and equity		29,010,583	30,511,200



Mr. Ahmed Abdalla Al Noman
Chairman

16 JUN 2019



Mr. Varouj Nergulizian
General Manager

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

**Consolidated statement of profit or loss
for the year ended 31 December**

	Notes	2018 AED'000	2017 AED'000
Interest income	27	1,268,889	1,152,819
Interest expense	28	(756,166)	(686,982)
Net interest income		512,723	465,837
Net fee and commission income	29	172,866	236,883
Exchange profit		14,928	21,322
Income on investments	30	31,303	31,561
Revaluation loss on properties	11, 13	(25,635)	(9,515)
Other income	31	15,292	33,898
Operating income		721,477	779,986
Net impairment loss on financial assets	32	(251,785)	(210,793)
Net operating income		469,692	569,193
General and administrative expenses	33	(317,400)	(290,172)
Amortisation of intangible assets	12	(5,910)	(5,910)
Profit before taxes		146,382	273,111
Income tax expense - overseas		(16,680)	(8,257)
Net profit for the year		129,702	264,854
Attributable to:			
Equity holders of the Bank		127,455	266,088
Non-controlling interests		2,247	(1,234)
Net profit for the year		129,702	264,854
Basic and diluted earnings per share (AED)	22	0.06	0.13

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

**Consolidated statement of profit or loss and other comprehensive income
for the year ended 31 December**

	2018 AED'000	2017 AED'000
Net profit for the year	129,702	264,854
Other comprehensive income items		
<i>Items that will not be reclassified subsequently to consolidated statement of profit or loss:</i>		
Net changes in fair value of financial assets measured at fair value through other comprehensive income	(220,519)	(343,130)
Net changes in fair value of financial liabilities measured at fair value through profit or loss due to credit risk	93,408	(76,591)
Other comprehensive loss for the year	(127,111)	(419,721)
Total comprehensive income/ (loss) for the year	2,591	(154,867)
Attributable to:		
Equity holders of the Bank	344	(153,633)
Non-controlling interests	2,247	(1,234)
Total comprehensive income/ (loss) for the year	2,591	(154,867)

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

Bank of Sharjah P.J.S.C.

Consolidated statement of changes in equity
for the year ended 31 December

	Share capital AED'000	Statutory reserve AED'000	Contingency reserve AED'000	General and other reserves AED'000	Investment fair value reserve AED'000	Retained earnings AED'000	Total equity attributable to owners of the parent AED'000	Non- controlling interests AED'000	Total equity AED'000
Balance at 1 January 2017	2,100,000	1,050,000	510,000	100,000	22,836	606,035	4,388,871	210,857	4,599,728
Profit for the year	-	-	-	-	-	266,088	266,088	(1,234)	264,854
Reclassification on disposal of FVOCI investment	-	-	-	-	(3,897)	3,897	-	-	-
Other comprehensive loss	-	-	-	-	(419,721)	-	(419,721)	-	(419,721)
Total comprehensive loss for the year	-	-	-	-	(423,618)	269,985	(153,633)	(1,234)	(154,867)
Transactions with owners of the Group									
Directors' remuneration (Note 23)	-	-	-	-	-	(10,409)	(10,409)	(727)	(11,136)
Charity donations (Note 23)	-	-	-	-	-	(7,500)	(7,500)	-	(7,500)
Transfer to contingency reserve	-	-	50,000	-	-	(50,000)	-	-	-
Indirect acquisition of a non-controlling interest in a subsidiary (Note 12)	-	-	-	-	-	-	-	(208,661)	(208,661)
Acquisition of a subsidiary (Note 12)	-	-	-	-	-	-	-	-	-
Cash Dividends (Note 23)	-	-	-	-	-	(160,860)	(160,860)	12,696	12,696
Balance at 31 December 2017	2,100,000	1,050,000	560,000	100,000	(400,782)	647,251	4,056,469	11,462	4,067,931
Profit for the year	-	-	-	-	-	127,455	127,455	2,247	129,702
Other comprehensive loss	-	-	-	-	(127,111)	-	(127,111)	-	(127,111)
Total comprehensive income for the year	-	-	-	-	(127,111)	127,455	344	2,247	2,591
Transactions with owners of the Group									
Effect of adopting IFRS9 (Note 2.5)	-	-	-	-	-	(265,158)	(265,158)	-	(265,158)
Effect of adopting IFRS9 for a subsidiary	-	-	-	-	(7,482)	-	(7,482)	-	(7,482)
Transfer to IFRS9 reserves (Note 9d)	-	-	-	150,257	-	(150,257)	-	-	-
Transfer to contingency reserve	-	-	40,000	-	-	(40,000)	-	-	-
Directors' remuneration (Note 23)	-	-	-	-	-	(11,467)	(11,467)	-	(11,467)
Charity donations (Note 23)	-	-	-	-	-	(7,500)	(7,500)	-	(7,500)
Balance at 31 December 2018	2,100,000	1,050,000	600,000	250,257	(535,375)	300,324	3,765,206	13,709	3,778,915

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

Bank of Sharjah P.J.S.C.
Consolidated statement of cash flows
for the year ended 31 December

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	2018 AED'000	2017 AED'000
Cash flows from operating activities		
Profit for the year	129,702	264,854
Adjustments for:		
Depreciation of property and equipment	27,915	28,796
Amortisation of other intangible assets	5,910	5,910
Amortisation of premium/ (discount) on debt instruments	506	(3,901)
Gain on sale of investment properties	-	(6,796)
Loss/ (gain) on sale of property and equipment	15	(42)
Net fair value gain on issued debt securities	(54,874)	(32,916)
Net fair value loss on interest rate swaps	54,874	32,916
Net fair value loss on other financial assets	(17,145)	(30,101)
Fair value loss on revaluation of investment properties	12,138	9,515
Unrealized loss on assets acquired in settlement of debts	13,497	6,162
Net impairment loss on financial assets	251,785	210,793
Dividends income	(15,091)	(2,434)
Operating profit before changes in operating assets and liabilities	409,232	482,756
Changes in		
Deposits and balances due from banks maturing after three months	(28,134)	(46,042)
Statutory deposits with central banks	69,468	(185,307)
Loans and advances	1,010,211	(612,125)
Other assets	(1,798,519)	(442,430)
Customers' deposits	(1,511,302)	1,893,554
Other liabilities	135,047	143,594
Cash (used in)/ generated from operating activities	(1,713,997)	1,234,000
Payment of directors' remuneration and charity donations	(18,967)	(18,636)
Net cash (used in)/ generated from operating activities	(1,732,964)	1,215,364
Cash flows from investing activities		
Purchase of property and equipment	(63,992)	(23,663)
Proceeds from sale of property and equipment	307	283
Purchase of other financial assets	(210,944)	(253,057)
Proceeds from sale of investment properties	-	70,414
Additions to investment properties	(35,753)	(376,655)
Acquisition of subsidiaries	-	(395,516)
Proceeds from sale of other financial assets	117,828	184,128
Dividends received	15,091	2,434
Net cash used in investing activities	(177,463)	(791,632)
Cash flows from financing activities		
Dividends paid	-	(162,329)
Issued bonds	-	1,836,500
Net cash generated from financing activities	-	1,674,171
Net (decrease)/ increase in cash and cash equivalents	(1,910,427)	2,097,903
Cash and cash equivalents at the beginning of the year	5,113,748	3,015,845
Cash and cash equivalents at the end of the year (Note 25)	3,203,321	5,113,748

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

Notes to the consolidated financial statements for the year ended 31 December 2018

1 General information

Bank of Sharjah P.J.S.C. (the "Bank"), is a public joint stock company incorporated by an Amiri Decree issued on 22 December 1973 by His Highness The Ruler of Sharjah and was registered in February 1993 under the Commercial Companies Law Number 8 of 1984 (as amended). The Bank commenced its operations under a banking license issued by the United Arab Emirates Central Bank dated 26 January 1974. The Bank is engaged in commercial and investment banking activities.

The Bank's registered office is located at Al Khan Road, P.O. Box 1394, Sharjah, United Arab Emirates. The Bank operates through six branches in the United Arab Emirates located in the Emirates of Sharjah, Dubai, Abu Dhabi, and City of Al Ain.

The accompanying consolidated financial statements combine the activities of the Bank and its subsidiaries (collectively the "Group").

2 Application of new and revised International Financial Reporting Standards ("IFRSs")

2.1 Relevant new and revised IFRS applied with no material effect on the consolidated financial statements

The following new and revised IFRS have been adopted in these consolidated financial statements. The application of these new and revised IFRS has not had any material impact on the amounts reported for the current and prior periods.

	Effective for annual periods beginning on or after
• Annual Improvements to IFRS Standards 2014 – 2016 Cycle amending IFRS 1 and IAS 28 to remove short-term exemptions and clarifying certain fair value measurements	1 January 2018
• IFRIC 22 'Foreign Currency Transactions and Advance Consideration'	1 January 2018
• Amendments to IFRS 1 'First-time Adoption of International Financial Reporting Standards' deleting short-term exemptions for first-time adopters	1 January 2018
• Amendments to IFRS 2 'Share Based Payment' clarifying the classification and measurement of share based payment transactions	1 January 2018
• Amendments to IFRS 7 'Financial Instruments' related to disclosures about the initial application of IFRS 9	1 January 2018
• IFRS 15 'Revenue from Contracts with Customers'	1 January 2018
• Amendments to IAS 28 Investments in Associates and Joint Ventures providing clarification on measuring investees at fair value through profit or loss is an investment-by-investment choice	1 January 2018
• Amendments to IAS 40 'Investment Property' clarifying transfers of property to, or from, investment property	1 January 2018

Other than the above, there are no other significant IFRSs and amendments that were effective for the first time for the financial year beginning on or after 1 January 2018.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

**2 Application of new and revised International Financial Reporting Standards (“IFRSs”)
(continued)**

2.2 New and revised standards in issue but not yet effective

The Group has not early adopted the following new and revised standards that have been issued but are not yet effective. The management is in the process of assessing the impact of the new requirements.

New and revised IFRSs	Effective for annual periods beginning on or after
<ul style="list-style-type: none"> IFRS 16 Leases: IFRS 16 specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16’s approach to lessor accounting substantially unchanged from its predecessor, IAS 17. 	1 January 2019
<ul style="list-style-type: none"> Amendment to IAS 19 Employee Benefits 	1 January 2019
<ul style="list-style-type: none"> IFRIC 23 Uncertainty over Income Tax Treatments 	1 January 2019
<ul style="list-style-type: none"> Amendments to IAS 28 Investment in Associates and Joint Ventures 	1 January 2019
<ul style="list-style-type: none"> Annual Improvements to IFRS Standards 2015 – 2017 Cycle amending IFRS 3, IFRS 11, IAS 12 and IAS 23 	1 January 2019
<ul style="list-style-type: none"> Amendments to IFRS 10 Consolidated Financial Statements 	Effective date deferred indefinitely. Adoption is still permitted.

Management anticipates that these IFRS and amendments will be adopted in the consolidated financial statements in the initial period when they become mandatorily effective.

2.3 Changes in accounting policies

The accounting policies applied in these consolidated financial statements are the same as those applied in the last annual financial statements except for changes resulting from adoption of the following:

- Revised version of IFRS 9 relating to the recognition of expected credit losses based on there stage model for measurement of impairments.
- IFRS 15 – Revenue from Contracts with Customers

The key changes to the Bank’s accounting policies resulting from its adoption of IFRS 9 are summarised below.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

**2 Application of new and revised International Financial Reporting Standards (“IFRSs”)
(continued)**

2.3 Changes in accounting policies (continued)

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied as follows:

Comparative periods have not been restated and differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in the retained earnings as of 1 January 2018.

Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and is therefore not comparable to the information presented for the period under IFRS 9.

Classification and measurement were early adopted. Hence only expected loss mode based on three stage model is now adopted.

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 or previous designations of certain financial assets and financial liabilities measured at FVPL.

As permitted by IFRS 9, the Group has elected to continue to apply the hedge accounting requirements of IAS 39.

IFRS 7 Financial Instruments – Disclosures

IFRS 7 Financial Instruments: Disclosures, which was updated to reflect the differences between IFRS 9 and IAS 39, was also adopted by the Group together with IFRS 9, for the year beginning 1 January 2018.

Renegotiated financial facilities

The Bank sometimes makes concessions or modifications to the original terms of financing as a response to the borrower’s financial difficulties, rather than taking possession or to otherwise enforce collection of collateral. The Bank considers a financing forborne when such concessions or modifications are provided as a result of the borrower’s present or expected financial difficulties and the Bank would not have agreed to them if the borrower had been financially healthy. Indicators of financial difficulties include defaults on covenants or that a customer may not be in a position to honour contractual commitments. Forbearance may involve extending the payment arrangements and the agreement of new financing conditions. Once the terms have been renegotiated, any impairment is measured using the original effective profit rate as calculated before the modification of terms. It is the Bank’s policy to monitor forborne financing to help ensure that future payments continue to be likely to occur. Classification between Stage 2 and Stage 3 are determined on a case-by-case basis. If these procedures identify a loss in relation to a financing, it is disclosed and managed as an impaired Stage 3 forborne asset until it is collected or written off.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

**2 Application of new and revised International Financial Reporting Standards (“IFRSs”)
(continued)**

2.3 Changes in accounting policies (continued)

Renegotiated financial facilities (continued)

When the financing has been renegotiated or modified but not derecognised, the Bank also reassesses whether there has been a significant increase in credit risk. The Bank also considers whether the assets should be classified as Stage 3. Once an asset has been classified as forborne, it will remain forborne for a minimum 12-month probation period. In order for the financing to be reclassified out of the forborne category, the customer has to meet all of the following criteria:

- All of its facilities has to be considered performing;
- The probation period of one year has passed from the date the forborne contract was considered performing; and
- Regular payments of more than an insignificant amount of principal or interest have been made during the probation period.

Impairment

The Bank recognises loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments;
- lease receivables;
- financial guarantee contracts issued; and
- loan commitments issued.
- balances with Central banks and due from banks.

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 as 12-month ECL:

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

Loss allowances for lease receivables are always measured at an amount equal to lifetime ECL.

12-month ECL is the portion of ECL that results from default events on a financial instrument that are possible within the 12 months after the reporting date.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

**2 Application of new and revised International Financial Reporting Standards (“IFRSs”)
(continued)**

2.3 Changes in accounting policies (continued)

Measurement of ECL

Credit loss 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.

ECLs are an unbiased probability-weighted estimate of the present value of credit losses that is determined by evaluating a range of possible outcomes. For funded exposures, ECL is measured as follows:

- for 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 Group expects to receive arising from the weighting of multiple future economic scenarios, discounted at the asset’s effective interest rate (EIR);
- 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:

For undrawn loan commitments, as the present value of the difference between the contractual cash flows that are due to the Group if the holder of the commitment draws down the loan and the cash flows that the Group expects to receive if the loan is drawn down; and for financial guarantee contracts, the expected payments to reimburse the holder of the guaranteed debt instrument less any amounts that the Group expects to receive from the holder, the debtor or any other party.

The Group measures ECL on an individual basis, or on a collective basis for portfolios of loans that share similar economic and credit risk characteristics. The measurement of the loss allowance is based on the present value of the asset’s expected cash flows using the asset’s original EIR, regardless of whether it is measured on an individual basis or a collective basis.

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

- probability of default (PD);
- loss given default (LGD);
- exposure at default (EAD)

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

**2 Application of new and revised International Financial Reporting Standards (“IFRSs”)
(continued)**

2.3 Changes in accounting policies (continued)

Measurement of ECL (continued)

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 – PD estimates are estimates at a certain date, which are calculated based on statistical rating models currently used by the Group, and assessed using rating tools tailored to the various categories and sizes of counterparties .
- EAD – EAD represents the expected exposure upon default of an obligor. The Group derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default. For lending commitments, the EADs are potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts. For financial guarantees, the EAD represents the amount of the guaranteed exposure when the financial guarantee becomes payable.

EAD is calculated as below:

- For Direct Facilities: Limit or Exposure whichever is higher
- For Letters of Credit & Acceptances: Limit or Exposure whichever is higher
- For Guarantees: Exposure
- For Direct Payment Guarantees: Exposure

- LGD – 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 the proceeds from liquidation of any collateral. The LGD models for secured assets consider forecasts of future collateral valuation taking into account sale discounts, time to realisation of collateral, cross-collateralization and seniority of claim, cost of realization of collateral and cure rates (i.e. exit from non-performing status). LGD models for unsecured assets consider time of recovery, recovery rates and seniority of claims.

LGD is derived as below:

- Senior Unsecured: 45%
- Subordinated Unsecured: 75%
- Eligible Securities as per Basel lower LGD, taking into consideration applicable Basel haircuts on collateral as well as LGD floors to certain collateral

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

**2 Application of new and revised International Financial Reporting Standards (“IFRSs”)
(continued)**

2.3 Changes in accounting policies (continued)

Measurement of ECL (continued)

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics that include:

- instrument type;
- credit risk grading;
- collateral type;
- date of initial recognition;
- remaining term of maturity;
- industry;
- geography location of the borrower;
- size of counterparty; and
- segment of counterparty.

The groupings are subject to regular review to ensure that exposure within a particular group remain appropriately homogenous.

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.

Macroeconomic factors

In its models, the Group relies on a broad range of forward looking information as economic inputs, such as: GDP growth and oil prices. The inputs and models used for calculating expected credit losses may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are made as temporary adjustments using expert credit judgement.

Assessment of significant increase in credit risk

The assessment of a significant increase in credit risk is done on a relative basis. To assess whether the credit risk on a financial asset has increased significantly since origination, the Group compares the risk of default occurring over the expected life of the financial asset at the reporting date to the corresponding risk of default at origination, using key risk indicators that are used in the Group’s existing risk management processes. At each reporting date, the assessment of a change in credit risk will be individually assessed for those considered individually significant.

This assessment is symmetrical in nature, allowing credit risk of financial assets to move back to Stage 1, if certain criteria are met, if the increase in credit risk since origination has reduced and is no longer deemed to be significant.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

**2 Application of new and revised International Financial Reporting Standards (“IFRSs”)
(continued)**

2.3 Changes in accounting policies (continued)

Assessment of significant increase in credit risk (continued)

The group assesses whether credit risk has increased significantly since initial recognition at each reporting date. Determining whether an increase in credit risk is significant depends on the characteristics of the financial instrument and the borrower, and the geographical region. What is considered significant differs for different types of lending, in particular between wholesale and retail.

As a general indicator credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Group’s quantitative modelling:

- the remaining lifetime PD is determined to have increased by more than 100 % of the corresponding amount estimated on initial recognition; and
- if the absolute change is annualised, lifetime PD since initial recognition is greater than 36 basis points

The credit risk may be deemed to have increased significantly since initial recognition based on qualitative factors linked to the Group’s credit risk management process that may not otherwise be fully reflected in its quantitative analysis on a timely basis. This will be the case for exposures that meet certain heightened risk criteria, such as placement on a watch list. Such qualitative factors are based on its expert judgement and relevant historical experiences.

As a backstop, the group considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower.

If there is evidence that there is no longer a significant increase in credit risk relative to the initial recognition, then the loss allowance on an instrument returns to being measured as 12-month ECL. Some qualitative indicators of an increase in credit risk, such as delinquency or forbearance, may be indicative of an increased risk of default that persists after the indicator itself has ceased to exist. In these cases, the Group determines a probation period during which the financial asset is required to demonstrate good behaviour to provide evidence that its credit risk has declined sufficiently. When contractual terms of a loan have been modified, evidence that the criteria for recognising lifetime ECL are no longer met includes a history of up-to-date payment performance against the modified contractual terms.

The group monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- the criteria do not align with the point in time when an asset becomes 30 days past due;
- the average time between the identification of a significant increase in credit risk and default appears reasonable;
- exposures are not generally transferred directly from 12-month ECL measurement to credit impaired; and
- there is no unwarranted volatility in loss allowance from transfers between 12-month PD [stage 1] and lifetime PD [stage 2]

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

2 Application of new and revised International Financial Reporting Standards (“IFRSs”) (continued)

2.3 Changes in accounting policies (continued)

Improvement in credit risk profile

If there is evidence that there is no longer a significant increase in credit risk relative to initial recognition, then the loss allowance on an instrument returns to being measured as 12-month ECL.

The Group has defined below criteria in accordance with regulatory guidelines to assess any improvement in the credit risk profile which will result into upgrading of customers moving from Stage 3 to Stage 2 and from Stage 2 to Stage 1.

- Significant decrease in credit risk will be upgraded stage-wise (one stage at a time) from Stage 3 to Stage 2 after and from Stage 2 to Stage 1 after meeting the curing period of at least 12 months.
- Restructured cases will be upgraded if repayments of 3 installments (for quarterly instalments) have been made or 12 months (for installments longer than quarterly) curing period is met.

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:

- financial assets measured at amortised cost: (as a deduction from the gross carrying amount of the assets);
- where a financial instrument includes both a drawn and an undrawn component, and the Group cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Group presents a combined loss allowance for both components. The combined amount is presented as deduction from the gross carrying amount of the drawn component.
- 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.

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Group’s historical experience and expert credit assessment and including forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- The remaining lifetime probability of default (PD) as at the reporting date; with
- The remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations)

The Group uses three criteria for determining whether there has been a significant increase in credit risk:

- quantitative test based on movement in PD;
- quantitative indicators
- a backstop of 30 days past due.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

**2 Application of new and revised International Financial Reporting Standards ("IFRSs")
(continued)**

2.3 Changes in accounting policies (continued)

Definition of default

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

- the borrower is unlikely to pay its credit obligations to the Bank in full without recourse by the Bank to actions such as realising security (if any is held); or
- the borrower is past due more than 90 days on any material credit obligation to the Bank.
- it is becoming probable that the borrower will restructure the asset as a result of bankruptcy due to the borrower's inability to pay its credit obligations.

Overdrafts are considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than the current amount outstanding.

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.

2.4 Impact on components of statement of financial position balances from IAS 39 to IFRS 9

Explanations in respect of change in measurement of categories of financial assets in accordance with IFRS 9 as at 1 January 2018 primarily comprise the following:

- Net loans and advances- an opening adjustment of AED 243 million has resulted in decrease in value of AED 17.48 billion at 31 December 2017 to AED 17.23 billion.
- Cash and balances with central banks - an opening adjustment of AED 14 million has resulted in decrease in value of AED 5.59 billion at 31 December 2017 to AED 5.57 billion.
- Deposits and balances due from banks - an opening adjustment of AED 1.87 million has resulted in decrease in value of AED 503 million at 31 December 2017 to AED 501 million.
- Reverse-repo placements - an opening adjustment of AED 363 thousand has resulted in decrease in value of AED 1.87 billion at 31 December 2017 to AED 1.87 billion.
- Investment in debt securities at amortised cost - an opening adjustment of AED 6 million has resulted in decrease in value of AED 795 million at 31 December 2017 to AED 789 million.

2.5 Reconciliation of impairment provision balance from IAS 39 to IFRS 9

The following table reconciles the closing impairment loss allowance for financial assets in accordance with IAS 39 and provisions for financing commitments and financial guarantee contracts in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets as at 31 December 2017 to the opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2018.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

**2 Application of new and revised International Financial Reporting Standards (“IFRSs”)
(continued)**

2.5 Reconciliation of impairment provision balance from IAS 39 to IFRS 9

	31 Dec 2017	Re-measure- ment	1 Jan 2018
	AED’000	AED’000	AED’000
Loans and advances at amortised cost	17,476,329	(242,648)	17,233,681
Cash and balances with central banks	5,587,606	(14,299)	5,573,307
Deposits and balances due from banks	503,218	(1,866)	501,352
Reverse-repo placements	1,867,798	(363)	1,867,435
Investment in debt securities at amortised cost	794,585	(5,982)	788,603
	<u>26,229,536</u>	<u>(265,158)</u>	<u>25,964,378</u>

2.6 Transition

The adoption of IFRS 15 did not impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Group. Accordingly, the impact on the comparative information due to adoption of IFRS 15 is limited only to new disclosure requirements (Note 4.24.1 and 4.24.2).

3 Basis of preparation

3.1 Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by International Accounting Standard Board (IASB) and applicable requirements of the laws of the U.A.E.

These consolidated financial statements include Basel III Pillar 3 disclosures in accordance with the guidelines issued by the Central Bank of the UAE.

From 1 January 2018, under Federal Decree – Law No. (8) of 2017, Value Added Tax (VAT) has been levied in United Arab Emirates. The Group complies with the executive regulations and is required to file quarterly returns. As required by the UAE Securities and Commodities Authority (SCA) notification number 85/2009 dated January 6, 2009, the Group’s exposure in cash and advances with Central Bank of the UAE, Due from Banks and Investment Securities outside the UAE have been presented under the respective notes.

3.2 Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments that are measured at fair values as explained in the accounting policies below.

Historical cost is generally based on the fair value of the consideration given in exchange for assets, goods and services.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

3 Basis of preparation (continued)

3.3 Functional and presentation currency

The consolidated financial statements are presented in Arab Emirates Dirham (AED) and all values are rounded to the nearest thousands dirham, except when otherwise indicated.

The principal accounting policies are set out below.

4 Summary of significant accounting policies

4.1 Basis of consolidation

These consolidated financial statements incorporate the financial statements of the Bank and entities controlled by the Bank. Control is achieved when the Bank has:

- power over the investee,
- exposure, or has rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect its returns.

The Bank reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Bank has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Bank considers all relevant facts and circumstances in assessing whether or not the Bank's voting rights in an investee are sufficient to give it power, including:

- the size of the Bank holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Bank, other vote holders and other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Bank has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns and previous shareholders' meetings.

Consolidation of a subsidiary begins when the Bank obtains control over the subsidiary and ceases when the Bank loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss from the date the Bank gains control until the date when the Bank ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income are attributable to the owners of the Bank and to the non-controlling interests.

Total comprehensive income of the subsidiaries is attributable to the owners of the Group and to the non-controlling interest even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

All intragroup assets, liabilities, equity, income, expenses and cash flows relating to transactions between entities of the Group are eliminated in full on consolidation.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****4 Summary of significant accounting policies****4.1 Basis of consolidation (continued)**

Changes in the Group's ownership interests in subsidiaries that do not result in the Group losing control over the subsidiaries are accounted for as equity transactions. The carrying amounts of the Group's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid/payable or received/receivable is recognised directly in equity and attributed to owners of the Group.

When the Group loses control of a subsidiary, a gain or loss is recognised in the consolidated statement of profit or loss and is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest, and (ii) the previous carrying amount of the assets (including goodwill) and liabilities of the subsidiary, and any non-controlling interests. All amounts previously recognised in other comprehensive income in relation to that subsidiary are accounted for as if the Bank had directly disposed of the related assets or liabilities of the subsidiary (i.e. reclassified to statement of profit or loss or transferred to another category of equity as specified/permitted by applicable IFRSs). The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IFRS 9 issued in 2010, when applicable, the cost on initial recognition of an investment in an associate or a joint venture.

4.2 Cash and cash equivalents

Cash and cash equivalents include cash on hand, unrestricted balances held with Central Banks, deposits and balances due from banks, items in the course of collection from or in transmission to other banks and highly liquid assets with original maturities of less than three months from the date of acquisition, which are subject to insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments. Cash and cash equivalents are carried at amortised cost in the consolidated statement of financial position.

4.3 Reverse-repo placements

Securities sold subject to a commitment to repurchase them at a predetermined price at a specified future date (repos) are continued to be recognised in the consolidated statement of financial position and a liability is recorded in respect of the consideration received under repo borrowings. The difference between sale and repurchase price is treated as interest expense using the effective interest rate yield method over the life of the agreement. Assets purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognised in the consolidated statement of financial position. Amounts placed under these agreements are included as an asset under reverse-repo placements. The difference between purchase and resale price is treated as interest income using the effective yield method over the life of the agreement.

4.4 Financial instruments**4.4.1 Initial recognition**

The Group recognises a financial asset or liability in its consolidated statement of financial position only when it becomes party to the contractual provisions of that instrument.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

4 Summary of significant accounting policies (continued)

4.4 Financial instruments (continued)

4.4.2 Initial measurement

Financial assets and liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in the consolidated statement of profit or loss.

4.4.3 Financial assets

All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

All recognised financial assets are subsequently measured in their entirety at either amortised cost or fair value, depending on the classification of the financial assets.

Classification of financial assets

Balances with central banks, due from banks and financial institutions, financial assets and certain items in receivables and other assets that meet the following conditions are subsequently measured at amortised cost less impairment loss and deferred income, if any (except for those assets that are designated as at fair value through profit or loss on initial recognition):

- the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- the contractual terms of the instrument give rise on specified dates to cash flows that are solely payments of principal and profit on the principal amount outstanding.

All other financial assets are subsequently measured at fair value.

Classification of financial assets and financial liabilities

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.

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 a 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 on the principal amount outstanding.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****4 Summary of significant accounting policies (continued)****4.4 Financial instruments (continued)****4.4.3 Financial assets (continued)**

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

- the asset is held within a 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.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Financial assets measured at amortised cost

The effective interest rate method is a method of calculating the amortised cost of those financial instruments measured at amortised cost and of allocating income over the relevant period. The effective interest rate is the rate that is used to calculate the present value of the estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial instruments, or, where appropriate, a shorter period, to arrive at the net carrying amount on initial recognition.

Income is recognised in the consolidated statement of profit or loss on an effective interest rate basis for financing and investing instruments measured subsequently at amortised cost.

Financial assets measured at FVTPL

Investments in equity instruments are classified as financial assets measured at FVTPL, unless the Group designates fair value through other comprehensive income (FVTOCI) at initial recognition.

Financial assets that do not meet the amortised cost criteria described above, or that meet the criteria but the Group has chosen to designate it as at FVTPL at initial recognition, are measured at FVTPL.

Financial assets (other than equity instruments) may be designated at FVTPL upon initial recognition if such designation eliminates or significantly reduces a measurement or recognition inconsistency that would arise from measuring assets or liabilities or recognizing the gains or losses on them on different basis.

Financial assets are reclassified from amortised cost to FVTPL when the business model is changed such that the amortised cost criteria are no longer met.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

4 Summary of significant accounting policies (continued)

4.4 Financial instruments (continued)

4.4.3 Financial assets (continued)

Financial assets measured at FVTPL (continued)

Reclassification of financial assets (other than equity instruments) designated as at FVTPL at initial recognition is not permitted.

Financial assets measured at FVTPL are measured at fair value at the end of each reporting period, with any gains or losses arising on re-measurement recognised in the consolidated statement of profit or loss at the end of each reporting period. The net gain or loss recognised in the consolidated statement of profit or loss. Fair value is determined in the manner described in note 39.

Dividend income on investments in equity instruments at FVTPL is recognised in the consolidated statement of profit or loss when the Group's right to receive the dividends is established.

Financial assets measured at FVTOCI

On initial recognition, the Group can make an irrevocable election (on an instrument-by-instrument basis) to designate investments in equity instruments as at FVTOCI. Designation at FVTOCI is not permitted if the equity investment is held for trading.

A financial asset is held for trading if:

- it has been acquired principally for the purpose of selling it in the near term;
- on initial recognition it is part of a portfolio of identified financial instruments that the Group manages together and has evidence of a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument or a financial guarantee.

Investments in equity instruments at FVTOCI are initially measured at fair value plus transaction costs. Subsequently, they are measured at fair value with gains and losses arising from changes in fair value recognised in other comprehensive income and accumulated in the investments fair value reserve. Where the asset is disposed of, the cumulative gain or loss previously accumulated in the investments fair value reserve is not transferred to consolidated statement of profit or loss.

Dividends on these investments in equity instruments are recognised in the consolidated statement of profit or loss when the Group's right to receive the dividends is established, unless the dividends clearly represent a recovery of part of the cost of the investment.

Business model assessment

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

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

4 Summary of significant accounting policies (continued)

4.4 Financial instruments (continued)

4.4.3 Financial assets (continued)

Business model assessment (continued)

duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;

- 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.

Assessments 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.

In making the assessment, the Bank considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Group's claim to cash from specified assets;
- features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

The Group holds a portfolio of long-term fixed-rate loans for which the Group has the option to propose to revise the interest rate at periodic reset dates. These reset rights are limited to the market rate at the time of revision. The borrowers have an option to either accept the revised rate or redeem the loan at par without penalty. The Group has determined that the contractual cash flows of these loans are SPPI because the option varies the interest rate in a way that is consideration for the time value of money, credit risk, other basic lending risks and costs associated with the principal amount outstanding.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

4 Summary of significant accounting policies (continued)

4.4 Financial instruments (continued)

4.4.3 Financial assets (continued)

Non-recourse loans

In some cases, loans made by the Group that are secured by collateral of the borrower limit the Group's claim to cash flows of the underlying collateral (non-recourse loans). The group applies judgment in assessing whether the non-recourse loans meet the SPPI criterion. The Group typically considers the following information when making this judgement:

- whether the contractual arrangement specifically defines the amounts and dates of the cash payments of the loan;
- the fair value of the collateral relative to the amount of the secured financial asset;
- the ability and willingness of the borrower to make contractual payments, notwithstanding a decline in the value of collateral;
- whether the borrower is an individual or a substantive operating entity or is a special-purpose entity;
- the Group's risk of loss on the asset relative to a full-recourse loan;
- the extent to which the collateral represents all or a substantial portion of the borrower's assets; and whether the Group will benefit from any upside from the underlying assets.

4.5 Definition of fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Group takes into account when pricing the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis, except for measurements that have some similarities to fair value but are not fair value such as value in use in IAS 36.

All financial instruments are recognised initially at fair value. The fair value of a financial instrument on initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received.

- The fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets is determined with reference to quoted market prices;
- The fair value of other financial assets and financial liabilities (excluding derivative instruments) is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and dealer quotes for similar instruments; and
- The fair value of derivative instruments is calculated using quoted prices. Where such prices are not available, use is made of discounted cash flow analysis using the applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

4 Summary of significant accounting policies (continued)

4.6 Investment properties

Investment properties are held to earn rental income and/or capital appreciation. Investment properties include cost of initial purchase, developments transferred from property under development, subsequent cost of development, and fair value adjustments. Investment properties are reported at valuation based on fair value at the end of the reporting period. The fair value is determined on a periodic basis by independent professional valuers. Fair value adjustments on investment property are included in the consolidated statement of profit or loss in the period in which these gains or losses arise.

Investment properties are derecognised when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. The difference between the net disposal proceeds and the carrying amount of the asset is recognised in the consolidated statement of profit or loss in the period of derecognition.

Transfers are made to or from investment property only when there is a change in use. For a transfer from investment property to owner occupied property, the deemed cost for subsequent accounting is the fair value at the date of change in use. If owner occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under property, plant and equipment up to the date of change in use.

4.7 Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation and impairment loss, if any. Historical cost includes expenditure that is directly attributable to the acquisition of the asset.

Depreciation is charged so as to write off the cost or valuation of assets, over their estimated useful lives using the straight-line method as follows:

	Years
Buildings	20 - 40
Furniture and office equipment	2 - 6
Installation, partitions and decorations	3 - 4
Leasehold improvements	5 - 10
Motor vehicles	3

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the consolidated statement of profit or loss statement when incurred.

Gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset at that date and is recognised in the consolidated statement of profit or loss.

Capital work-in-progress is carried at cost, less any accumulated impairment loss. Cost includes professional fees and, for qualifying assets, borrowing costs capitalised in accordance with the Group's accounting policy. Depreciation of these assets commences when the assets are ready for their intended use.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

4 Summary of significant accounting policies (continued)

4.8 Intangible assets acquired separately

Intangible assets acquired in a business combination and recognised separately from goodwill are initially recognised at their fair value at the acquisition date (which is regarded as their cost).

Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised on a straight-line basis over their estimated useful lives. The estimated useful life and amortisation method are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Amortisation is charged so as to write off the cost of intangible assets, over their estimated useful lives using the straight-line method as follows:

	Years
Banking license	Indefinite
Legal corporate setup in Lebanon	10
Customer base	10
Branch network	10

4.9 Impairment of tangible and intangibles

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and intangibles to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the assets is estimated in order to determine the extent of the impairment loss, if any. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in the consolidated statement of profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in the consolidated statement of profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

4.10 Impairment of financial assets (policy applicable before 1 January 2018)

Financial assets that are measured at amortised cost are assessed for impairment at the end of each reporting period.

Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial assets, the estimated future cash flows of the asset have been affected.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

4 Summary of significant accounting policies (continued)

4.10 Impairment of financial assets (policy applicable before 1 January 2018) (continued)

Objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- breach of contract, such as a default or delinquency in interest or principal payments; or
- it's becoming probable that the borrower will enter bankruptcy or financial re-organisation; or
- the disappearance of an active market for that financial asset because of financial difficulties.

The amount of the impairment loss recognised is the difference between the asset's carrying amount and the present value of estimated future cash flows reflecting the amount of collateral and guarantee, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans and advances, where the carrying amount is reduced through the use of an allowance account. When a loan is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in the consolidated statement of profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the consolidated statement of profit or loss to the extent that the carrying amount of the financial asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Individually assessed loans

Individually assessed loans mainly represent corporate and commercial loans which are assessed individually in order to determine whether there exists any objective evidence that a loan is impaired. Loans are classified as impaired as soon as there is doubt about the borrower's ability to meet payment obligations to the Group in accordance with the original contractual terms. Doubt about the borrower's ability to meet payment obligations generally arises when:

- a) Principal and interest are not serviced as per contractual terms; and
- b) When there is significant deterioration in the borrower's financial condition and the amount expected to be realised from disposal of collateral, if any, is not likely to cover the present carrying value of the loan.

Impaired loans are measured on the basis of the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

Impairment loss is calculated as the difference between the loan's carrying value and its present impaired value.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

4 Summary of significant accounting policies (continued)

4.10 Impairment of financial assets (policy applicable before 1 January 2018) (continued)

Collectively assessed loans

Impairment losses of collectively assessed loans include the allowances calculated on:

- a) Performing loans
- b) Retail loans with common features and which are not individually significant.

Performing loans

Where individually assessed loans are evaluated and no evidence of loss has been identified, these loans are classified as performing loans portfolios with common credit risk characteristics based on industry, product or loan rating. Impairment covers losses which may arise from individual performing loans that are impaired at the end of the reporting period but were not specifically identified as such until sometime in the future. The estimated impairment is calculated by the Group's management for each identified portfolio based on historical experience and the assessed inherent losses which are reflected by the economic and credit conditions.

4.11 Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the asset's cash flows expire (including expiry arising from a modification with substantially different terms), or when the financial asset and substantially all the risks and rewards of ownership of the asset are transferred to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

In the case where the financial asset is derecognised, the loss allowances for ECL is remeasured at the date of derecognition to determine the net carrying amount of the asset at that date. The difference between this revised carrying amount and the fair value of the new financial asset with the new terms will lead to a gain or loss on derecognition. The new financial asset will have a loss allowance measured based on 12-month ECL except in the rare occasions where the new loan is considered to be originated credit impaired. This applies only in the case where the fair value of the new loan is recognised at a significant discount to its revised par amount because there remains a high risk of default which has not been reduced by the modification. The Group monitors credit risk of modified financial assets by evaluating qualitative and quantitative information, such as if the borrower is in past due status under the new terms.

On derecognition of a financial asset in its entirety, the difference between the carrying amount allocated to the part that is no longer recognised and the sum of the consideration received for the part no longer recognised and any cumulative gain / loss allocated to it that had been recognised in OCI is recognised in consolidated statement of profit or loss.

Applicable 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 the consolidated statement of profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****4 Summary of significant accounting policies (continued)****4.12 Offsetting**

Financial assets and liabilities are offset and reported net in the consolidated financial position only when there is a legally enforceable right to set off the recognised amounts and when the Group intends to settle either on a net basis, or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the Group trading activity.

The Group is party to a number of arrangements, including master netting agreements, that give it the right to offset financial assets and financial liabilities but where it does not intend to settle the amounts net or simultaneously and therefore the assets and liabilities concerned are presented on a gross basis.

4.13 Assets acquired in settlement of debt

The Group often acquires real estate and other collateral in settlement of certain loans and advances. Such real estate and other collateral are stated at the lower of the net realisable value of the loans and advances and the current fair value of such assets at the date of acquisition. Gains or losses on disposal and unrealised losses on revaluation are recognised in the consolidated statement of profit or loss.

4.14 Derivative financial instruments

A derivative is a financial instrument whose value changes in response to an underlying variable, that requires little or no initial investment and that is settled at a future date.

The Group enters into a variety of derivative financial instruments to manage its exposure to foreign exchange rate risks, including forward foreign exchange contracts, interest rate swaps and currency swaps.

Derivative financial instruments are initially measured at cost, being the fair value at contract date, and are subsequently re-measured at fair value. All derivatives are carried at their fair values as assets where the fair values are positive and as liabilities where the fair values are negative.

Fair values are generally obtained by reference to quoted market prices, discounted cash flow models and recognised pricing models as appropriate.

For the purpose of hedge accounting, the Group classifies hedges into two categories: (a) fair value hedges, which hedge the exposure to changes in the fair value of a recognised asset or liability; and (b) cash flow hedges, which hedge exposure to variability in cash flows that are either attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecasted transaction that will affect future reported net income.

In order to qualify for hedge accounting, it is required that the hedge should be expected to be highly effective, i.e. the changes in fair value or cash flows of the hedging instrument should effectively offset corresponding changes in the hedged item and should be reliably measurable. At inception of the hedge, the risk management objectives and strategies are documented including the identification of the hedging instrument, the related hedged item, the nature of risk being hedged, and how the Group will assess the effectiveness of the hedging relationship. Subsequently, the hedge is required to be assessed and determined to be an effective hedge on an ongoing basis.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****4 Summary of significant accounting policies (continued)****4.14 Derivative financial instruments (continued)****Fair value hedges**

Where a hedging relationship is designated as a fair value hedge, the hedged item is adjusted for the change in fair value in respect of the risk being hedged. Gains or losses on the re-measurement of both the derivative and the hedged item are recognised in the consolidated statement of profit or loss. Fair value adjustments relating to the hedging instrument are allocated to the same consolidated statement of profit or loss category as the related hedged item. Any ineffectiveness is also recognised in the same consolidated statement of profit or loss category as the related hedged item. If the derivative expires, is sold, terminated, exercised, no longer meets the criteria for fair value hedge accounting, or the designation is revoked, hedge accounting is discontinued. Any adjustment up to that point to a hedged item for which the effective interest method is used, is amortised in the consolidated statement of profit or loss as part of the recalculated effective interest rate over the period to maturity.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in the cash flow hedging reserve in equity. The ineffective part of any gain or loss is recognised immediately in the consolidated statement of profit or loss as trading revenue/loss. Amounts accumulated in equity are transferred to the consolidated statement of profit or loss in the periods in which the hedged item affects profit or loss. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the cumulative gains or losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the cumulative gains or losses recognised in other comprehensive income remain in equity until the forecast transaction is recognised, in the case of a non-financial asset or a non-financial liability, or until the forecast transaction affects the consolidated statement of profit or loss. If the forecast transaction is no longer expected to occur, the cumulative gains or losses recognised in other comprehensive income are immediately transferred to the consolidated statement of profit or loss and classified as trading revenue/loss.

Derivatives that do not qualify for hedge accounting

All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in the consolidated statement of profit or loss as trading revenue/loss. However, the gains and losses arising from changes in the fair values of derivatives that are managed in conjunction with financial instruments designated at fair value are included in net income from financial instruments designated at fair value under other non-interest revenue/loss.

Derivatives embedded in other financial instruments or other non-financial host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value with unrealised gains or losses reported in the consolidated statement of profit or loss.

4.15 Financial liabilities

Financial liabilities are classified as either financial liabilities 'at FVTPL' or 'other financial liabilities'. The Group initially recognises financial liabilities such as deposits and debt securities issued on the date at which they are originated. All other financial liabilities (including liabilities designated at fair value

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****4 Summary of significant accounting policies (continued)****4.15 Financial liabilities (continued)**

through profit or loss) are initially recognised on the trade date at which the Group becomes party to the contractual provision of the instrument.

Financial liabilities at FVTPL

Financial liabilities are classified at FVTPL where the financial liability is either held for trading or it is designated at FVTPL and measured at fair value. Determination is made at initial recognition and is not reassessed.

Financial liabilities measured at FVTPL are measured at fair value at the end of each reporting period, with any gains or losses arising on re-measurement recognised in the consolidated statement of profit or loss at the end of each reporting period. The net gain or loss recognised in the consolidated statement of profit or loss. Other changes in fair value attributable to credit risk are recognized in other comprehensive income. Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. However, the Bank may transfer the cumulative gain or loss within equity. Fair value is determined in the manner described in note 39.

The Bank has elected to designate the issued bond as at FVTPL as the Bank will be managing and evaluating the performance of the issued bond alongside a group of financial assets in such a way that measuring that group at FVTPL results in more relevant information.

Other financial liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

De-recognition of financial liabilities

Financial liabilities are derecognised when they are extinguished - that is when the obligation specified in the contract is discharged, cancelled or expired.

4.16 Customers' deposits and syndicated loan

Customers' deposits and syndicated loan are initially measured at fair value which is normally consideration received net of directly attributable transaction costs incurred, and subsequently measured at their amortised cost using the effective interest method.

4.17 Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the purchase method. The cost of the business combination is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

4 Summary of significant accounting policies (continued)

4.17 Business combinations (continued)

of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under *IFRS 3 Business Combinations* are recognised at their fair values at the acquisition date; except for non-current assets (or disposal banks) that are classified as held for sale in accordance with *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*, which are recognised and measured at fair value less costs to sell.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in the consolidated statement of profit or loss.

The interest of non-controlling shareholders in the acquiree is initially measured at the non-controlling shareholder's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

4.18 Goodwill

Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

4.19 Employees' end-of-service benefits

The Group provides end of service benefits for its expatriate employees in accordance with U.A.E. Labour Law. The entitlement to these benefits is based upon the employees' length of service and completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

Pension and national insurance contributions for the U.A.E. citizens are made by the Group in accordance with Federal Law No. 2 of 2000.

4.20 Provisions and contingent liabilities

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****4 Summary of significant accounting policies (continued)****4.20 Provisions and contingent liabilities (continued)**

surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the Group's control. Contingent liabilities are not recognised in the consolidated financial statements but are disclosed in the notes to the consolidated financial statements.

4.21 Acceptances

Acceptances arise when the Group is under an obligation to make payments against documents drawn under letters of credit. Acceptances specify the amount of money, the date and the person to which the payment is due. After acceptance, the instrument becomes an unconditional liability (time draft) of the Group and is therefore recognised as a financial liability in the consolidated statement of financial position with a corresponding contractual right of reimbursement from the customer recognised as a financial asset.

Acceptances have been considered within the scope of IFRS 9 - Financial Instruments and continued to be recognised as a financial liability in the consolidated statement of financial position with a contractual right of reimbursement from the customer as a financial asset.

Acceptances are recognised as financial liabilities in the consolidated statement of financial position with a contractual right of reimbursement from the customer as a financial asset. Therefore, commitments with respect to acceptances have been accounted for as financial assets and financial liabilities.

4.22 Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified party fails to meet its obligation when due in accordance with the contractual terms.

Financial guarantees are initially recognised at their fair value, which is the premium received on issuance. The received premium is amortised over the life of the financial guarantee. The guarantee liability (the notional amount) is subsequently recognised at the higher of this amortised amount and the present value of any expected payments (when a payment under guarantee has become probable).

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

4 Summary of significant accounting policies (continued)

4.23 Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessor

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

The Group as lessee

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

4.24 Revenue and expense recognition

4.24.1 Interest income and expense

Interest income and interest expense are recognised in consolidated statement of profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and 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. When calculating the effective interest rate, the Group estimates the future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes transactions costs, fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

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

- interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
- the effective portion of fair value changes in qualifying hedging derivatives designated in cash flow hedges of variability in interest cash flows, in the same period that the hedged cash flows affect interest income/expenses; and
- the effective portion of fair value changes in qualifying hedging derivatives designated in fair value hedges of interest rate risk.

Interest income and expense on all trading assets and liabilities are considered to be incidental to the Group's trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net income from investments.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****4 Summary of significant accounting policies (continued)****4.24 Revenue and expense recognition (continued)****4.24.1 Interest income and expense (continued)**

Fair value changes on the other derivatives held for risk management purposes, and other financial assets and financial liabilities carried at fair value through profit and loss (FVTPL) are presented in net trading income from foreign currencies and net income from investment securities in the consolidated statement of profit or loss.

Policy applicable from 1 January 2018**Effective interest rate**

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through. The expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Group estimates future cash flows considering all contractual terms of the financial instrument, but not ECL. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including ECL.

The calculation of the effective interest rate includes transaction cost and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issuance of a financial asset or financial liability.

Calculation of interest income and expense

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest. The effective interest rate is also revised for fair value hedge adjustments at the date amortisation of the hedge adjustment begins.

However, for financial assets that have become credit impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

4 Summary of significant accounting policies (continued)

4.24 Revenue and expense recognition (continued)

4.24.2 Fees and commission income and expense

Fees and commission income and expense 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 are generally recognised on an accrual basis when the related services are performed by the Group. When a loan commitment is not expected to result in the draw-down of a loan, commitment fees are recognised on a straight line basis over the commitment period.

Other fees and commission expenses are expensed as the related services are received.

A contract with a customer that results in a recognized financial instrument in the Group's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Group first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to residual.

4.24.3 Dividend income

Dividend income is recognised in the consolidated statement of profit or loss when the Group's right to receive such income is established. Usually this is the ex-dividend date for equity securities.

Presentation

Interest income calculated using the effective interest method presented in the statement of profit or loss and OCI includes:

- Interest on financial assets and financial liabilities measured at amortised cost;
- Interest on debt instruments measured at FVOCI;
- The effective portion of fair value changes in qualifying hedging derivatives designated in cash flow hedges of variability in interest cash flows, in the same period as the hedged cash flows affect interest income/expense; and
- The effective portion of fair value changes in qualifying hedging derivatives designated in fair value hedges of interest rate risk

Other interest income presented in the statement of profit or loss and OCI includes interest income on finance leases.

Interest expense presented in the statement of profit or loss and OCI includes:

- Financial liabilities measured at amortised cost; and
- The effective portion of fair value changes in qualifying hedging derivatives designated in cash flows hedges of variability in interest cash flows; in the same period as the hedged cash flows affect interest income/expense

Interest income and expenses on all trading assets and liabilities were considered to be incidental to the Groups trading operations and were presented together with all other changes in the fair value of trading assets and liabilities in net trading income.

Interest income and expense on other financial assets and financial liabilities carried at FVTPL were presented in net income from other financial instruments at FVTPL.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****4 Summary of significant accounting policies (continued)****4.25 Foreign currency transactions**

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange prevailing at the consolidated statement of financial position date. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using rate of exchange at the date of initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Foreign currency differences are generally recognised in the statement of profit or loss.

For financial assets measured at FVTPL, the foreign exchange component is recognised in the consolidated statement of profit or loss. For financial assets measured at FVTOCI any foreign exchange component is recognised in other comprehensive income.

For foreign currency denominated debt instruments measured at amortised cost, the foreign exchange gains and losses are determined based on the amortised cost of the asset and are recognised in the consolidated statement of profit or loss.

4.26 Foreign operations

In the consolidated financial statements, the assets, including related goodwill where applicable, and liabilities of branches, subsidiaries, joint ventures and associates whose functional currency is not AED, are translated into the Group's presentation currency at the rate of exchange ruling at the consolidated statement of financial position date. The results of branches, subsidiaries, joint ventures and associates whose functional currency is not AED are translated into AED at the average rates of exchange for the reporting period. Exchange differences arising from the retranslation of opening foreign currency net investments, and exchange differences arising from retranslation of the result for the reporting period from the average rate to the exchange rate prevailing at the period end, are recognised in other comprehensive income and accumulated in equity in the 'foreign exchange reserve'.

On disposal or partial disposal (i.e. of associates or jointly controlled entities not involving a change of accounting basis) of a foreign operation, exchange differences relating thereto and previously recognised in reserves are recognised in the consolidated statement of profit or loss on proportionate basis except in the case of partial disposal (i.e. no loss of control) of a subsidiary that includes a foreign operation, the proportionate share of accumulated exchange differences are re-attributed to non-controlling interests and are not recognised in consolidated statement of profit or loss.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the closing rate.

4.27 Fiduciary activities

The Group acts as trustee/manager and in other capacities that result in holding or placing of assets in a fiduciary capacity on behalf of trusts or other institutions. Such assets and income arising thereon are not included in the Group's consolidated financial statements as they are not assets of the Group.

4.28 Taxation

Provision is made for current and deferred taxes arising from operating results of overseas subsidiary in accordance with the fiscal regulations of the respective country in which the subsidiary operate.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****4 Summary of significant accounting policies (continued)****4.29 Current tax**

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of profit or loss because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible.

4.30 Deferred tax

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty and actual results may therefore differ, resulting in future changes in these estimates.

5 Use of estimates and judgements**5.1 Critical judgements in applying the Group's accounting policies**

In particular, considerable management judgment is required in respect of the following issues:

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.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****5 Use of estimates and judgements (continued)****5.1 Critical judgements in applying the Group's accounting policies (continued)****Financial asset classification (continued)**

Business model assessment: Classification and measurement of financial assets depends on the results of the SPPI and the business model test. The Group determines the business model at a level that reflects how groups of 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 Group 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 Group'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.

Significant increase in credit risk

As explained in note 2.3, 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 Group takes into account qualitative and quantitative reasonable and supportable forward looking information.

Establishing groups of 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. Refer to note 2.3 for details of the characteristics considered in this judgement. The Group 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 that group of assets. 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.

Models and assumptions used

The Group uses various models and assumptions in measuring fair value of financial assets as well as 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. See note 2.3 for more details on ECL.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

5 Use of estimates and judgements (continued)

5.1 Critical judgements in applying the Group's accounting policies (continued)

Going concern

The Group'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 Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

5.2 Key sources of estimation uncertainty

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

- Establishing the number and relative weightings of forward-looking scenarios for each type of product / market and determining the forward looking information relevant to each scenario: When measuring ECL the Group 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.
- Fair value measurement and valuation process: In estimating the fair value of a financial asset or a liability, the Group uses market-observable data to the extent it is available. Where such Level 1 inputs are not available the Group uses valuation models to determine the fair value of its financial instruments. Refer to note 39 for more details on fair value measurement.

6 Cash and balances with central banks

(a) The analysis of the Group's cash and balances with central banks is as follows:

	2018 AED'000	2017 AED'000
Cash on hand	57,144	58,403
Statutory deposits (note 6.1)	1,069,087	1,323,862
Current accounts	858,287	450,268
Certificates of deposits	2,660,207	3,755,073
	<u>4,644,725</u>	<u>5,587,606</u>
Expected credit loss	(8,382)	-
	<u>4,636,343</u>	<u>5,587,606</u>

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

6 Cash and balances with central banks (continued)

(b) The geographical analysis of the cash and balances with central banks is as follows:

	2018 AED'000	2017 AED'000
Banks abroad	1,725,320	3,838,043
Banks in the U.A.E.	2,919,405	1,749,563
	<u>4,644,725</u>	<u>5,587,606</u>
Expected credit loss	(8,382)	-
	<u>4,636,343</u>	<u>5,587,606</u>

6.1 The Group is required to maintain statutory deposits with Central Bank of UAE and Central Bank of Lebanon on demand, time and other deposits as per the statutory requirements. The statutory deposits with the Central Banks are not available to finance the day to day operations of the Group. However, as per notice 4310/2008, the Central Bank of the U.A.E. has allowed banks to borrow up to 100% of their AED and US\$ reserve requirement limit. As at 31 December 2018, the statutory deposits with the Central Bank of the U.A.E. amounted to AED 488 million (31 December 2017: AED 718 million).

7 Deposits and balances due from banks

(a) The analysis of the Group's deposits and balances due from banks is as follows:

	2018 AED'000	2017 AED'000
Demand	276,592	289,304
Time	232,074	213,914
	<u>508,666</u>	<u>503,218</u>
Expected credit loss	(881)	-
	<u>507,785</u>	<u>503,218</u>

(b) The geographical analysis of the deposits and balances due from banks is as follows:

	2018 AED'000	2017 AED'000
Banks abroad	426,731	471,395
Banks in the U.A.E.	81,935	31,823
	<u>508,666</u>	<u>503,218</u>
Expected credit loss	(881)	-
	<u>507,785</u>	<u>503,218</u>

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

8 Reverse-repo placements

The analysis of the Group's repurchase agreements is as follows:

	2018 AED'000	2017 AED'000
Banks abroad	-	272,821
Banks in the U.A.E.	849,534	1,594,977
	849,534	1,867,798
Expected credit loss	(346)	
	849,188	1,867,798

9 Loans and advances, net

(a) The analysis of the Group's loans and advances measured at amortised cost is as follows:

	2018 AED'000	2017 AED'000
Overdrafts	7,192,041	6,617,800
Commercial loans	9,355,962	10,142,743
Bills discounted	1,072,325	2,136,416
Other advances	707,229	541,211
Gross amount of loans and advances	18,327,557	19,438,170
Less: Allowance for impairment	(2,113,223)	(1,961,841)
Net loans and advances	16,214,334	17,476,329

(b) The geographic analysis of the gross loans and advances of the Group is as follows:

	2018 AED'000	2017 AED'000
Loans and advances in the U.A.E.	15,617,879	16,782,025
Loans and advances abroad	2,709,678	2,656,145
	18,327,557	19,438,170

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

9 Loans and advances, net (continued)

(c) An analysis of changes in the gross carrying and the corresponding ECL allowances is as follows:

	Stage 1 AED'000	Stage 2 AED'000	Stage 3 AED'000	Total AED'000
Gross carrying as at 1 January 2018	8,986,922	7,320,059	3,131,189	19,438,170
Net transfers between stages	447,156	254,562	(701,718)	-
Net additions / (repayments)	(439,148)	(366,283)	186,498	(618,933)
Amounts written off	(1,295)	-	(490,385)	(491,680)
Gross amount of loans and advances as at 31 December 2018	8,993,635	7,208,338	2,125,584	18,327,557

	Stage 1 AED'000	Stage 2 AED'000	Stage 3 AED'000	Total AED'000
ECL allowance as at 1 January 2018	41,705	361,379	1,835,511	2,238,595
Net transfers between stages	(64,253)	52,605	11,648	-
Net (reversals) / impairment charge	159,672	347,136	(15,067)	491,741
Recoveries	(114,069)	(6,016)	(5,348)	(125,433)
Amounts written off	(1,295)	-	(490,385)	(491,680)
Closing balance 31 December 2018	21,760	755,104	1,336,359	2,113,223

	Interest suspended AED'000	Specific provisions AED'000	Collective provisions AED'000	Total AED'000
Opening balance 1 January 2017	321,604	1,357,269	226,282	1,905,155
Interest not recognised / new provisions raised/ Transfer between provisions	108,518	320,025	37,566	466,109
Less:				
Written-off	(17,911)	(250,874)	-	(268,785)
Recoveries / reversal to income	(5,492)	(126,699)	(8,447)	(140,638)
Closing balance 31 December 2017	406,719	1,299,721	255,401	1,961,841

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

9 Loans and advances, net (continued)

(d) IFRS 9 reserve

In accordance with CBUAE circular, in case where provision under CBUAE guidance exceeds provision under IFRS 9, the excess is required to be transferred to IFRS 9 reserve. The details of the same are below:

	Bank 2018 AED'000
<i>Impairment reserve – Specific</i>	
Specific provisions and interest in suspense under Circular 28/2010 of CBUAE	1,389,130
Stage 3 provisions under IFRS 9	1,252,614
Specific provision transferred to the impairment reserve	136,516
	Bank 2018 AED'000
<i>Impairment reserve – Collective</i>	
Collective provisions under Circular 28/2010 of CBUAE	719,927
Stage 1 and Stage 2 provisions under IFRS 9	706,186
Collective provision transferred to the impairment reserve	13,741

(e) The composition of the loans and advances portfolio by industry is as follows:

	2018 AED'000	2017 AED'000
Economic sector		
Services	5,124,260	5,976,427
Trading	4,506,478	5,610,067
Manufacturing	2,709,191	2,493,138
Personal loans for commercial purposes	2,677,525	2,145,998
Government	1,406,793	1,211,384
Construction	951,657	720,921
Financial institutions	265,242	441,751
Transport and communication	313,278	365,704
Mining and quarrying	132,359	4,021
Personal loans for individual purposes	115,881	325,229
Agriculture	70,774	63,017
Public utilities	-	2,727
Other	54,119	77,786
	18,327,557	19,438,170
Less: Allowance for impairment	(2,113,223)	(1,961,841)
	16,214,334	17,476,329

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

9 Loans and advances, net (continued)

(f) The composition of the non-performing loans and advances portfolio by industry is as follows:

	2018 AED'000	2017 AED'000
Economic sector		
Trading	1,451,643	1,104,213
Manufacturing	333,233	194,862
Services	164,643	1,225
Personal loans for commercial purposes	122,786	21,094
Construction	41,948	15,181
Personal loans for individual purposes	7,947	7,400
Transport and communication	3,384	56,455
Total non-performing loans	2,125,584	1,400,430

10 Other financial assets

(a) The analysis of the Group's other financial assets is as follows:

	2018 AED'000	2017 AED'000
Other financial assets measured at fair value		
(i) Investments measured at FVTPL		
Quoted equity	143,446	103,453
	143,446	103,453
(ii) Investments measured at FVTOCI		
Quoted equity	160,069	145,416
Unquoted equity	323,239	564,417
Debt Securities	190,565	-
	673,873	709,833
Total other financial assets measured at fair value	817,319	813,286
Other financial assets measured at amortised cost		
Debt securities	675,585	794,585
Expected credit losses	(4,031)	-
	671,554	794,585
Total other financial assets	1,488,873	1,607,871

The majority of the quoted investments are listed on the securities exchanges in the U.A.E. (Abu Dhabi Securities Exchange and Dubai Financial Market).

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

10 Other financial assets (continued)

(b) The composition of the other financial assets by geography is as follows:

	2018 AED'000	2017 AED'000
United Arab Emirates	693,747	474,196
Middle East (other than G.C.C. countries)	769,040	1,103,552
Europe	30,117	30,123
	<u>1,492,904</u>	<u>1,607,871</u>
Expected credit losses	(4,031)	-
	<u>1,488,873</u>	<u>1,607,871</u>

(c) Other financial assets measured at FVTOCI are strategic equity investments that are not held to benefit from changes in their fair value and are not held for trading. The management believes therefore that designating these investments as at FVTOCI provides a more meaningful presentation of its medium to long-term interest in its investments rather than fair valuing through profit and loss.

During the year ended 31 December 2018, 25 million shares of equity securities were acquired at an amount of AED 23 million.

(d) During the year ended 31 December 2018, dividends received from financial assets measured at FVTOCI amounting to AED 15 million (2017: AED 2 million) have been recognised as investment income in the consolidated statement of profit or loss.

11 Investment properties

Details of investment properties are as follows:

	Plots of land in the U.A.E. AED'000	Commercial and residential units in the U.A.E. AED'000	Total AED'000
Fair value at 1 January 2017	36,377	244,960	281,337
Decrease in fair value during the year	(2,401)	(7,114)	(9,515)
Additions /disposals, net during the year	42	312,994	313,036
Fair value at 31 December 2017	<u>34,018</u>	<u>550,840</u>	<u>584,858</u>
Decrease in fair value during the year	(3,968)	(8,170)	(12,138)
Additions /disposals, net during the year	11	35,742	35,753
Fair value at 31 December 2018	<u>30,061</u>	<u>578,412</u>	<u>608,473</u>

The fair value of the Group's investment properties is estimated annually by considering recent prices for similar properties in the same location and similar conditions, with adjustments to reflect any changes in the nature, location or economic conditions since the date of the transactions that occurred at these prices.

In estimating the fair value of the properties, the highest and best use of the properties is their current use.

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

11 Investment properties (continued)

As at 31 December 2018, the valuations were carried out by professional valuers not related to the Group who hold recognised and relevant professional qualifications and have recent experience in the location and category of the investment properties being valued.

All investments properties have been classified as Level 3 in the fair value hierarchy.

12 Goodwill and other intangibles

The analysis of the Group's goodwill and other intangibles is as follows:

Emirates Lebanon Bank S.A.L

Goodwill represents the excess of the cost of acquisition over the fair value of the Group's share in the net identifiable assets, liabilities and contingent liabilities of a Lebanese branch of a multinational bank acquired in 2008.

	2018 AED'000	2017 AED'000
Goodwill	184,733	184,733
Other intangibles		
Banking license	18,365	18,365
Legal corporate setup in Lebanon	4,299	8,593
Customer base	8,742	9,991
Branch network	365	732
	31,771	37,681
Total	216,504	222,414

The recoverable amount of the assets acquired in the business combination (cash generating unit) described above is determined based on fair value less cost of disposal which is determined to be higher than the asset's carrying value using the market approach.

The movement on other intangible assets during the year is as follows:

	Banking license AED'000	Legal corporate setup in Lebanon AED'000	Customer base AED'000	Branch network AED'000	Total AED'000
Other intangibles					
Balance as at 1 January 2017	18,365	12,887	11,240	1,099	43,591
Amortisation in 2017	-	(4,294)	(1,249)	(367)	(5,910)
Balance as at 31 December 2017	18,365	8,593	9,991	732	37,681
Amortisation in 2018	-	(4,294)	(1,249)	(367)	(5,910)
Balance as at 31 December 2018	18,365	4,299	8,742	365	31,771

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

12 Goodwill and other intangibles (continued)

Muwaileh Capital FZC

(i) On 26 April 2017, the Bank acquired 90% of Muwaileh Capital FZC. A Sharjah Airport International Free Zone company. The acquisition was in cash and the effective date acquisition was 31 May 2017. The operations of Muwaileh Capital FZC have been fully transferred to the Bank on that date. The acquisition is accounted for using the purchase method of accounting, and the financial statements of Muwaileh Capital FZC have been consolidated.

As per the sales and purchase agreement, the purchase price was finalized based on the completion of the due diligence and the negotiations for the determination of the final net assets fair value. The difference between the consideration paid and the fair value of the net assets at the transaction date has been booked under goodwill. The amount recognized in goodwill at the transaction date amounted to AED 110.73 million.

The transaction has been accounted for during the second quarter of 2017 as follows:

	Net Carrying Value AED'000
Consideration paid	225,000
Fair value of net assets acquired	(114,274)
Goodwill	<u>110,726</u>

El Capital FZC

(ii) On 14 December 2016, the Board of Directors of the Bank decided to acquire El Capital FZC that owns 20% of share capital of Emirates Lebanon Bank S.A.L.

As per the sales and purchase agreement, the purchase price was finalized based on the completion of the due diligence and the negotiations for the determination of the final net assets fair value. The difference between the consideration paid and the fair value of the net assets at the transaction date has been booked under goodwill out of which 40.23% related to some Bank of Sharjah board members and 7.54% related to some Bank of Sharjah management.

The amount recognized in goodwill at the transaction date amounted to AED 88.83 million.

The transaction has been accounted for last quarter of 2017 as follows:

	Net Carrying Value AED'000
Consideration paid	305,777
Fair value of net assets acquired	(216,951)
Goodwill	<u>88,826</u>

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

13 Other assets

	2018 AED'000	2017 AED'000
Acceptances – contra (Note 19)	732,922	629,651
Assets acquired in settlement of debt	2,113,117	1,262,546
Cheques in the course of collection	973,857	-
Clearing receivables and accrued income	65,990	97,340
Interest receivable	64,954	40,943
Prepayments	15,587	23,269
Positive fair value of derivatives (Note 14)	3,590	5,945
Other	14,937	133,038
	<u>3,984,954</u>	<u>2,192,732</u>

Assets acquired in settlement of debt amounting to AED 2,113 million (2017: AED 1,262 million) are net of AED 13 million unrealized losses (2017: AED 6 million unrealized losses). Of this amount AED 2,088 million (2017: AED 1,238 million) pertains to the properties and plots of lands acquired in settlement of debt. Fair valuations of the properties and plots of land were carried out by independent valuers having appropriate professional qualifications and are based on recent experience in the location and category of the properties and plots of land being valued. The fair value of those properties and plots of land as at 31 December 2018 amounted to AED 2,108 million (2017: AED 1,332 million) resulting in a book value which is understated by AED 20 million (2017: AED 94 million).

As per UAE Central Bank regulation, the Bank can hold the real estate assets for a maximum period of three years and can extend the holding after obtaining Central Bank approval. The Bank can also rent the properties and earn rental income.

The Group reports under other assets, positive fair value of derivative contracts used by the Group in the ordinary course of business. Refer to Note 14 below for further details about the nature and type of derivative contracts utilised by the Group, together with the notional amounts and maturities.

14 Derivative financial instruments

In the ordinary course of business the Group enters into various types of transactions that involve derivatives. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in the price of one or more underlying financial instruments, reference rate, or index. Derivative financial instruments which the Group enters into include forwards and swaps.

The Group uses the following derivative financial instruments for both hedging and non-hedging purposes.

Forward currency transactions - Currency forwards represent commitments to purchase foreign and domestic currency, including undelivered spot transactions.

Swap transactions - Currency swaps are commitments to exchange one set of cash flows for another. Currency swaps result in an economic exchange of currencies. No exchange of principal takes place, except for certain cross-currency swaps. The Group's credit risk represents the potential cost to replace the swap contracts if counterparties fail to fulfil their obligation. Under interest rate swaps, the Bank agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed notional amount.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

14 Derivative financial instruments (continued)

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 Group assesses counterparties using the same techniques as for its lending activities.

Derivative related credit risk - Credit risk with respect to derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Group. The Group enters into derivative contracts with a number of financial institutions of good credit rating.

Derivatives held or issued for hedging purposes - The Group uses derivative financial instruments for hedging purposes as part of its asset and liability management activities in order to reduce its own exposure to fluctuations in exchange rates. The Group uses forward foreign exchange contracts to hedge exchange rate risks. In all such cases the hedging relationship and objective, including details of the hedged item and hedging instrument, are formally documented and the transactions are accounted for as fair value hedges.

The following table shows the positive and negative fair values of derivative financial instruments, together with the notional amounts analysed by the term to maturity, and the nature of the risk being hedged.

The notional amounts, which provide an indication of the volumes of the transactions outstanding at the year end, do not necessarily reflect the amounts of future cash flows involved. These notional amounts, therefore, are neither indicative of the Group's exposure to credit risk, which is generally limited to the fair value of the derivatives, nor market risk.

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

14 Derivative financial instruments (continued)

	Notional amounts by term to maturity					
	Positive fair value AED'000	Negative fair value AED'000	Notional amount AED'000	Within 3 months AED'000	3-12 months AED'000	1-5 years AED'000
2018						
Interest rate swaps	3,223	(62,802)	3,945,518	272,518	-	3,673,000
Currency swaps	367	-	2,049,128	2,049,128	-	-
Forward foreign exchange contracts	-	(6)	30,912	30,912	-	-
Total	3,590	(62,808)	6,025,558	2,352,558	-	3,673,000
2017						
Interest rate swaps	4,332	(39,373)	3,853,693	-	-	3,853,693
Currency swaps	1,612	-	2,892,156	2,892,156	-	-
Forward foreign exchange contracts	1	(659)	108,067	91,142	16,925	-
Total	5,945	(40,032)	6,853,916	2,983,298	16,925	3,853,693

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

15 Property and equipment

	Land & buildings AED'000	Furniture and office equipment AED'000	Leasehold improvements, installation, partitions and decoration AED'000	Motor vehicles AED'000	Total AED'000
Cost					
At 1 January 2017	238,392	106,426	103,726	5,152	453,696
Additions	2,765	12,033	8,258	607	23,663
Disposals	-	(505)	(279)	(1,096)	(1,880)
At 31 December 2017	241,157	117,954	111,705	4,663	475,479
Additions	45,735	15,147	2,074	1,036	63,992
Disposals	-	(877)	(104)	(400)	(1,381)
At 31 December 2018	286,892	132,224	113,675	5,299	538,090
Accumulated depreciation					
At 1 January 2017	34,210	89,248	52,374	3,668	179,500
Charge for the year	5,067	11,515	11,436	778	28,796
Disposals	-	(468)	(129)	(1,042)	(1,639)
At 31 December 2017	39,277	100,295	63,681	3,404	206,657
Charge for the year	6,949	11,291	8,989	686	27,915
Disposals	-	(561)	(98)	(400)	(1,059)
At 31 December 2018	46,226	111,025	72,572	3,690	233,513
Net book value:					
At 31 December 2018	240,666	21,199	41,103	1,609	304,577
At 31 December 2017	201,880	17,659	48,024	1,259	268,822

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

16 Subsidiaries

a) The Bank's interests, held directly or indirectly, in the subsidiaries are as follows:

Name of Subsidiary	Proportion of ownership interest		Year of incorporation	Year of acquisition	Country of incorporation	Principal activities
	2018	2017				
Emirates Lebanon Bank S.A.L.	100%	100%	1965	2008	Lebanon	Financial institution
El Capital FZC	100%	100%	2007	2017	U.A.E.	Investment in a financial institution
BOS Real Estate FZC	100%	100%	2007	2007	U.A.E.	Real estate development activities
BOS Capital FZC	100%	100%	2007	2007	U.A.E.	Investment
Polyco General Trading L.L.C.	100%	100%	2008	2008	U.A.E.	General trading
Borealis Gulf FZC	100%	100%	2010	2010	U.A.E.	Investment & Real estate development activities
BOS Funding Limited	100%	100%	2015	2015	Cayman Islands	Financing activities
Muwaileh Capital FZC	90%	90%	2010	2017	U.A.E.	Developing of real estate & related activities

b) Emirates Lebanon Bank S.A.L summarised statements of financial position, comprehensive income and cash flows as at and for the years ended 31 December 2018 and 2017:

	2018 AED'000	2017 AED'000
Statement of financial position		
Total assets	5,331,495	5,761,986
Total liabilities	4,298,426	4,729,075
Equity	1,033,069	1,032,911
Dividends paid to non-controlling interests	0	1,469
Statement of comprehensive income		
Interest income	312,703	279,051
Profit for the year	46,500	34,706
Total comprehensive income	44,160	34,779

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

16 Subsidiaries (continued)

	2018 AED'000	2017 AED'000
<i>Statement of cash flows</i>		
Net cash flows generated from / (used in) operating activities	25,335	(108,991)
Net cash flows generated from / (used in) investing activities	64,507	(7,922)
Net cash flows used in financing activities	(22,038)	(29,384)
Net increase/ (decrease) in cash flows during the year	67,804	(146,297)

17 Customers' deposits

The analysis of customers' deposits is as follows:

	2018 AED'000	2017 AED'000
Current and other accounts	2,952,570	3,742,322
Saving accounts	1,595,786	1,715,952
Time deposits	15,570,813	16,172,197
	20,119,169	21,630,471

18 Deposits and balances due to banks

The analysis of deposits and balances due to banks is as follows:

	2018 AED'000	2017 AED'000
Demand	46,853	4,319
Time	258,078	82,803
	304,931	87,122

Due to banks represent due to:

	2018 AED'000	2017 AED'000
Banks in the U.A.E.	209,121	4,060
Banks abroad	95,810	83,062
	304,931	87,122

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

19 Other liabilities

	2018 AED'000	2017 AED'000
Acceptances – contra (Note 13)	732,922	629,651
Interest payable	172,668	161,576
Accrued expenses and others	92,119	84,599
Provision for employees' end of service benefits (Note 19.1)	44,808	42,569
Negative fair value of derivatives (Note 14)	62,808	40,032
Managers' cheques	15,191	34,168
Unearned income	97,080	26,271
	<u>1,217,596</u>	<u>1,018,866</u>

19.1 The movement in the provision for employees' end of service benefits is as follows:

	2018 AED'000	2017 AED'000
At 1 January	42,569	40,597
Charged during the year	6,825	6,574
Payments during the year	<u>(4,586)</u>	<u>(4,602)</u>
At 31 December	<u>44,808</u>	<u>42,569</u>

20 Issued bonds

On 8 June 2015, the Bank raised financing by way of USD 500 million (equivalent to AED 1,836 million) in senior unsecured bonds (the "Bonds") issued by BOS Funding Limited, a wholly owned subsidiary of the Bank, incorporated in the Cayman Islands. The Bonds are fully guaranteed by the Bank, carry a fixed interest rate of 3.374 per cent per annum payable semi-annually and are listed on the Irish Stock Exchange.

On 28 February 2017, the Bank issued Senior Unsecured Fixed Rate Notes, totalling USD 500 million (equivalent to AED 1,836 million) for a five year maturity at mid swaps plus 225 basis point, to yield 4.23%. The Notes were issued under the Bank's recently established Euro Medium Term Note (EMTN) Programme which is listed on the Irish Stock Exchange.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

20 Issued bonds (continued)

The fair value and the change in that fair value that can be ascribed to changes in underlying credit risk are set out below:

	31 December 2018 AED'000	31 December 2017 AED'000
Fair value of issued bond	3,589,972	3,706,810
Changes in fair value of issued bond not attributable to changes in market conditions	93,408	(76,591)
Difference between carrying amount and amount contractually required to be paid at maturity	(83,028)	33,810

The Group estimates changes in fair value due to credit risk by estimating the amount of change in fair value that is not due to changes in market conditions that give rise to market risk.

21 Capital and reserves

(a) Issued and paid up capital

	2018		2017	
	Number of shares	AED'000	Number of shares	AED'000
Issued capital	<u>2,100,000,000</u>	<u>2,100,000</u>	<u>2,100,000,000</u>	<u>2,100,000</u>
	<u>2,100,000,000</u>	<u>2,100,000</u>	<u>2,100,000,000</u>	<u>2,100,000</u>

(b) Statutory reserve

In accordance with the Bank's Articles of Association and Article (239) of the UAE Federal Law No. (2) of 2015, the Bank transfers 10% of annual profits, if any, to the statutory reserve until it is equal to 50% of the paid up share capital. This reserve is not available for distribution other than in circumstances stipulated by law.

(c) Contingency reserve

In accordance with the Articles of Association of the Bank a contingency reserve is calculated at 10% of the profit for the year to be transferred to a contingency reserve until this reserve becomes 50% of the issued and paid up capital.

(d) General reserve

Transfers to general reserve are made based on the discretion of the Board of Directors and is subject to the approval of the shareholders at the annual general meeting.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

22 Earnings per share

Earnings per share are computed by dividing the profit for the year by the average number of shares outstanding during the year as follows:

Basic and diluted earnings per share	2018	2017
Profit attributable to owners of the Bank for the year (AED'000)	<u>127,455</u>	<u>266,088</u>
<i>Weighted average number of ordinary shares:</i>		
Ordinary shares at the beginning of the year	2,100,000	2,100,000
Effect of scrip dividend issued during the year	-	-
Weighted average number of shares outstanding during the year (in thousands shares)	<u>2,100,000</u>	<u>2,100,000</u>
Basic and diluted earnings per share (AED)	<u>0.06</u>	<u>0.13</u>

As at the reporting date, the diluted earnings per share is equal to the basic earnings per share as the Group has not issued any financial instruments that should be taken into consideration when the diluted earnings per share is calculated.

23 Transactions with owners and directors of the Group

Bank of Sharjah

Cash Dividends

At the Annual General Meeting of the shareholders held on 24 March 2018, the shareholders approved no cash dividends distribution (2016: 7.66% dividends distribution amounting to AED 161 million).

Directors' remuneration

At the Annual General Meeting of the shareholders held on 24 March 2018, the shareholders of the Bank approved Directors' remuneration of AED 7.5 million (2016: AED 7.5 million).

Charity donations

At the Annual General Meeting of the shareholders held on 24 March 2018, the shareholders approved charitable donations of AED 7.5 million (2016: AED 7.5 million).

Transfer to reserves

At the Annual General Meeting of the shareholders held on 24 March 2018, the shareholders approved an appropriation of AED 40 million (2016: AED 50 million) to contingency reserves.

Emirates Lebanon Bank

Cash dividends

At the Annual General Meeting held on 3 March 2018 of the shareholders of Emirates Lebanon Bank S.A.L, a subsidiary of the Bank, the shareholders approved no cash dividend distribution (2016: cash dividend of AED 7.3 million out of which the non-controlling interest share amounted to AED 1.5 million).

Directors' remuneration

At the Annual General Meeting held on 3 March 2018 of the shareholders of Emirates Lebanon Bank S.A.L, a subsidiary of the Bank, approved Directors' remuneration of AED 3.9 million (2016: AED 3.6 million out of which the non-controlling interest share amounted to AED 0.7 million).

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

24 Commitments and contingent liabilities

	2018 AED'000	2017 AED'000
Financial guarantees for loans	338,716	629,622
Other guarantees	2,405,593	1,736,696
Letters of credit	1,092,173	1,372,439
Capital commitments	-	17,496
	<u>3,836,482</u>	<u>3,756,253</u>
Irrevocable commitments to extend credit	1,577,285	1,873,569
	<u>5,413,767</u>	<u>5,629,822</u>

These contingent liabilities have off-balance sheet credit risk as only the related fees and accruals for probable losses are recognised in the statement of financial position until the commitments are fulfilled or expire. Many of the contingent liabilities will expire without being advanced in whole or in part. Therefore, the amounts do not represent expected future cash-flows.

Credit-related commitments include commitments to extend credit, standby letters of credit, and guarantees which are designed to meet the requirements of the Group's customers.

Commitments to extend credit represent contractual commitments to make loans and advances and revolving credits. Commitments generally have fixed expiry dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

Letters of credit and guarantees commit the Group to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

25 Cash and cash equivalents

	2018 AED'000	2017 AED'000
Cash and balances with central banks (Note 6)	4,636,343	5,587,606
Deposits and balances due from banks (Note 7)	507,785	503,218
Reverse-repo placements (Note 8)	849,188	1,867,798
Deposits and balances due to banks (Note 18)	(304,931)	(87,122)
	<u>5,688,385</u>	<u>7,871,500</u>
Less: Deposits and balances due from banks - original maturity more than three months	(1,415,977)	(1,433,890)
Less: Statutory deposits with central banks (Note 6)	(1,069,087)	(1,323,862)
	<u>3,203,321</u>	<u>5,113,748</u>

26 Fiduciary assets

The Group holds investments amounting to AED 0.6 billion (31 December 2017: AED 0.7 billion) which are held on behalf of customers and not treated as assets in the consolidated statement of financial position.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

27 Interest income

	2018	2017
	AED'000	AED'000
Loans and advances	1,055,553	943,043
Certificates of deposit and treasury bills with central banks and debt instruments	148,364	130,248
Net interest income on swaps	1,097	26,503
Placements with banks	28,150	30,641
Reverse-repo placements	35,725	22,384
	<u>1,268,889</u>	<u>1,152,819</u>

28 Interest expense

	2018	2017
	AED'000	AED'000
Customers' deposits	608,629	558,549
Issued bonds	139,647	125,190
Banks' deposits	7,890	3,243
	<u>756,166</u>	<u>686,982</u>

29 Net fee and commission income

	2018	2017
	AED'000	AED'000
Corporate banking credit related fees	93,876	170,035
Trade finance activities	35,034	37,657
Letters of guarantee	41,870	25,170
Other	2,086	4,021
	<u>172,866</u>	<u>236,883</u>

30 Income on investments

	2018	2017
	AED'000	AED'000
Dividends	15,091	2,434
Realized and unrealized gain on investments measured at FVTPL	17,145	30,102
Net trading loss	(933)	(975)
	<u>31,303</u>	<u>31,561</u>

31 Other income

	2018	2017
	AED'000	AED'000
Income on sale of fixed assets	-	42
Rental income and others	15,292	33,856
	<u>15,292</u>	<u>33,898</u>

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

32 Net impairment loss on financial assets

	2018 AED'000	2017 AED'000
Collective impairment of loans and advances	139,910	2,608
Specific provision of loans and advances	237,308	348,694
Total charge for the year	377,218	351,302
Write backs	(125,433)	(140,509)
	<u>251,785</u>	<u>210,793</u>

33 General and administrative expenses

	2018 AED'000	2017 AED'000
Salaries and employees related expenses	197,723	162,256
Depreciation on property and equipment (Note 15)	27,915	28,796
Rent leases	25,282	21,765
Consultancy and expert fees	3,136	7,119
Others *	63,344	70,236
	<u>317,400</u>	<u>290,172</u>

*Others include an amount of AED 6.5 million (2017: AED 8.2 million) representing social contributions made during the year ended 31 December 2018.

34 Related party transactions

The Group enters into transactions with major shareholders, directors, senior management and their related concerns in the ordinary course of business at commercial interest and commission rates. Transactions within the Group and its subsidiaries have been eliminated on consolidation and are not disclosed in this note.

The related parties balances included in the consolidated statement of financial position and the significant transactions with related parties are as follows:

	2018 AED'000	2017 AED'000
Loans and advances	492,785	647,927
Letters of credit, guarantee and acceptances	120,140	122,045
	<u>612,925</u>	<u>769,972</u>
Collateral deposits	7,281	207,313
Net exposure	605,644	562,659
Other deposits	131,559	154,394
	<u>751,769</u>	<u>1,434,288</u>
	2018 AED'000	2017 AED'000
Interest income	50,905	50,104
Interest expense	10,215	9,277

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

34 Related party transactions (continued)

Compensation of Directors and key management personnel:

	2018	2017
	AED'000	AED'000
Short term benefits	10,110	8,440
Directors fees	7,500	8,227
End of service benefits	5,489	4,014
Total compensation as at 31 December	<u>23,099</u>	<u>20,681</u>

No impairment loss has been recognised against balances outstanding with key management personnel and other related parties.

35 Segmental information

35.1 IFRS 8 Operating Segments

IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and to assess its performance.

35.2 Products and services from which reportable segments derive their revenues

Information reported to the Group's chief operating decision maker for the purposes of resource allocation and assessment of segment performance is specifically focused on the type of business activities undertaken as a Group. For operating purposes, the Group is organised into two major business segments:

- (i) Commercial Banking, which principally provides loans and other credit facilities, deposits and current accounts for corporate, government, institutional and individual customers; and
- (ii) Investment Banking, which involves the management of the Group's investment portfolio.

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

35 Segmental information (continued)

35.2 Products and services from which reportable segments derive their revenues (continued)

The following table presents information regarding the Group's operating segments for the year ended 31 December 2018:

	Commercial banking AED'000	Investment banking AED'000	Unallocated AED'000	Total AED'000
Operating income				
- Net interest income	461,292	51,431	-	512,723
- Net fee and commission income	172,866	-	-	172,866
- Exchange profit	14,928	-	-	14,928
- Investment income	-	31,303	-	31,303
- Revaluation loss on properties	-	(25,635)	-	(25,635)
- Other income	15,292	-	-	15,292
Total operating income	664,378	57,099	-	721,477
Other material non-cash items				
- Net impairment charge on financial assets	(251,785)	-	-	(251,785)
- Depreciation of property and equipment	-	-	(27,915)	(27,915)
- General and administrative expenses	(246,062)	(43,423)	-	(289,485)
- Amortization of intangible assets	-	-	(5,910)	(5,910)
- Income tax expenses – overseas	-	-	(16,680)	(16,680)
Net profit for the year	166,531	13,676	(50,505)	129,702
Segment assets	22,296,421	3,157,551	3,556,611	29,010,583
Segment liabilities	21,157,023	3,589,972	484,673	25,231,668

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

35 Segmental information (continued)

35.2 Products and services from which reportable segments derive their revenues (continued)

The following table presents information regarding the Group's operating segments for the year ended 31 December 2017:

	Commercial banking AED'000	Investment banking AED'000	Unallocated AED'000	Total AED'000
Operating income				
- Net interest income	415,361	50,476	-	465,837
- Net fee and commission income	236,883	-	-	236,883
- Exchange profit	21,322	-	-	21,322
- Investment income	-	31,561	-	31,561
- Revaluation loss on properties	-	(9,515)	-	(9,515)
- Other income	13,202	20,696	-	33,898
Total operating income	686,768	93,218	-	779,986
Other material non-cash items				
- Net impairment charge on financial assets	(210,793)	-	-	(210,793)
- Depreciation of property and equipment	-	-	(28,796)	(28,796)
- General and administrative expenses	(222,170)	(39,206)	-	(261,376)
- Amortization of intangible assets	-	-	(5,910)	(5,910)
- Income tax expenses – overseas	-	-	(8,257)	(8,257)
Net profit for the year	253,805	54,012	(42,963)	264,854
Segment assets	25,481,493	3,197,803	1,831,904	30,511,200
Segment liabilities	22,347,244	3,706,810	389,215	26,443,269

Revenue reported above represents revenue generated from external customers. There were no inter-segment sales during the year (2017: Nil). Transactions between segments, inter-segment cost of funds and allocation of expenses are not determined by management for resource allocation purpose. The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 4.

For the purposes of monitoring segment performance and allocating resources between segments:

- All assets are allocated to reportable segments except for property and equipment, goodwill and other intangibles and certain amounts included in other assets; and
- All liabilities are allocated to reportable segments except for certain amounts included in other liabilities.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

35 Segmental information (continued)

35.3 Geographical information

The Group operates in two principal geographical areas - United Arab Emirates (country of domicile) and Lebanon (referred to as 'foreign').

The Group's operating income and information about its non-current assets by geographical location are detailed below:

	Country of domicile	Foreign	Total
	AED'000	AED'000	AED'000
2018			
Operating income	597,414	124,063	721,477
Non-current assets	4,227,520	287,445	4,514,965
2017			
Operating income	664,851	115,135	779,986
Non-current assets	2,408,465	332,922	2,741,387

35.4 Information about major customers

In 2018, two customers accounted for more than 10% of the Group's net operating income each (2017: two customers accounted for more than 10% of the Group's net operating income)

36 Classification of financial assets and liabilities

- (a) The table below sets out the Group's classification of each class of financial assets and liabilities and their carrying amounts as at 31 December 2018:

	FVTPL AED'000	FVTOCI AED'000	Amortised cost AED'000	Total AED'000
Financial assets:				
Cash and balances with central banks	-	-	4,636,343	4,636,343
Deposits and balances due from banks	-	-	507,785	507,785
Reverse-repo placements	-	-	849,188	849,188
Loans and advances, net	-	-	16,214,334	16,214,334
Other financial assets measured at fair value	143,446	483,308	190,565	817,319
Other financial assets measured at amortised cost	-	-	671,554	671,554
Other assets	3,590	-	1,852,664	1,856,254
Total	147,036	483,308	24,922,433	25,552,777
Financial liabilities:				
Customers' deposits	-	-	20,119,169	20,119,169
Deposits and balances due to banks	-	-	304,931	304,931
Other liabilities	62,808	-	1,012,900	1,075,708
Issued Bonds	3,589,972	-	-	3,589,972
Total	3,652,780	-	21,437,000	25,089,780

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

36 Classification of financial assets and liabilities (continued)

- (b) The table below sets out the Group's classification of each class of financial assets and liabilities and their carrying amounts as at 31 December 2017:

	FVTPL AED'000	FVTOCI AED'000	Amortised cost AED'000	Total AED'000
Financial assets:				
Cash and balances with central banks	-	-	5,587,606	5,587,606
Deposits and balances due from banks	-	-	503,218	503,218
Reverse-repo placements	-	-	1,867,798	1,867,798
Loans and advances, net	-	-	17,476,329	17,476,329
Other financial assets measured at fair value	103,453	709,833	-	813,286
Other financial assets measured at amortised cost	-	-	794,585	794,585
Other assets	5,945	-	900,972	906,917
Total	109,398	709,833	27,130,508	27,949,739
Financial liabilities:				
Customers' deposits	-	-	21,630,471	21,630,471
Deposits and balances due to banks	-	-	87,122	87,122
Other liabilities	40,032	-	909,993	950,025
Issued Bonds	3,706,810	-	-	3,706,810
Total	3,746,842	-	22,627,586	26,374,428

37 Risk management

The Group has Senior Management committees to oversee the risk management. The Executive Committee and the Board Risk Committee, under delegation from the Board of Directors defines policies, processes, and systems to manage and monitor credit risk. It also sets policies, system and limits for interest rate risk, foreign exchange risk, and liquidity risk. The Group also has a Credit Risk function which independently reviews adherence to all risk management policies and processes. The Group's internal audit function, which is part of risk review, primarily evaluates the effectiveness of the controls addressing operational risk.

Credit risk management

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counter-parties, and continually assessing the creditworthiness of counter-parties. In addition to monitoring credit limits, the Group manages the credit exposure relating to its trading activities by entering into master netting agreements and collateral arrangements with counter-parties in appropriate circumstances, and by limiting the duration of exposure. In certain cases, the Group may also close out transactions or assign them to other counter-parties to mitigate credit risk.

Concentrations of credit risk arise when a number of counter-parties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political, or other conditions.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****37 Risk management (continued)****Credit risk management (continued)**

Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location.

Policies relating to credit are reviewed and approved by the Group's Executive Committee. All credit lines are approved in accordance with the Group's credit policy set out in the Credit Policy Manual. Credit and marketing functions are segregated. In addition, whenever possible, loans are secured by acceptable forms of collateral in order to mitigate credit risk. The Group further limits risk through diversification of its assets by economic and industry sectors.

All credit facilities are administered and monitored by the Credit Administration Department. Periodic reviews are conducted by Credit Risk and facilities are risk graded based on criterion established in the Credit Policy Manual.

Cross border exposure and financial institutions exposure limits for money market and treasury activities are approved as per guidelines established by the Group's Executive Committee and are monitored by the Senior Management on a daily basis.

The Executive Committee is responsible for setting credit policy of the Group. It also establishes industry caps, approves policy exceptions, and conducts periodic portfolio reviews to ascertain portfolio quality.

Commercial/Institutional lending underwriting

All credit applications for Commercial and Institutional lending are subject to the Group's credit policies, underwriting standards and industry caps (if any) and to regulatory requirements, as applicable from time to time. The Group does not lend to companies operating in industries that are considered by the Group inherently risky and where industry knowledge specialisation is required. In addition, the Group sets credit limits for all customers based on their creditworthiness.

All credit facilities extended by the Group are made subject to prior approval pursuant to a delegated signature authority system under the ultimate authority of the Executive Committee or the Group's Executive Director and General Manager under the supervision of the Board. At least two signatures are required to approve any commercial or institutional credit application.

Credit review procedures and loan classification

The Group's Credit Risk department subjects the Group's risk assets to an independent quality evaluation on a regular basis in conformity with the guidelines of the Central Bank of the U.A.E. and the Group's internal policies in order to assist in the early identification of accrual and potential performance problems. The Credit Risk department validates the risk ratings of all commercial clients, provides an assessment of portfolio risk by product and industry and monitors observance of all approved credit policies, guidelines and operating procedures across the Group.

All commercial/institutional loan facilities of the Group are assigned one of ten risk ratings (1-10) where 1 is being excellent and 10 being loss with no reimbursement capacity and total provisioning.

If a Loan is impaired, interest will be suspended and not be credited to the consolidated statement of profit or loss. Specific allowance for impairment of classified assets is made based on recoverability of outstanding and risk ratings of the assets.

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

37 Risk management (continued)

Credit risk management (continued)

The Group also measures its exposure to credit risk by reference to the gross carrying amount of financial assets less amounts offset, interest suspended and impairment losses, if any. The carrying amount of financial assets represents the maximum credit exposure.

As of 31 December 2018

	Stage 1		Stage 2		Stage 3		Total
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
	Exposure	Provision	Exposure	Provision	Exposure	Provision	Provision
Balances with central banks	4,587,581	8,382	-	-	-	4,587,581	8,382
Due from banks and financial institutions	467,988	880	40,678	1	-	508,666	881
Reverse repurchase agreements	849,534	346	-	-	-	849,534	346
Loans and advances	8,993,635	21,327	7,208,338	735,776	2,125,584	18,327,557	2,000,310
Amortised cost	675,585	4,031	-	-	-	675,585	4,031
Unfunded exposure	4,192,454	433	1,110,367	19,328	531,798	5,834,619	112,913
	19,766,777	35,399	8,359,383	755,105	2,657,382	30,783,542	2,126,863

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

37 Risk management (continued)

Credit risk management (continued)

Opening balance as of 1 January 2018

	Stage 1		Stage 2		Stage 3		Total	
	AED'000 Exposure	AED'000 Provision	AED'000 Exposure	AED'000 Provision	AED'000 Exposure	AED'000 Provision	AED'000 Exposure	AED'000 Provision
Balances with central banks	5,529,203	10,702	-	-	-	-	5,529,203	10,702
Due from banks and financial institutions	503,207	485	11	1	-	-	503,218	486
Reverse repurchase agreements	1,867,798	201	-	-	-	-	1,867,798	201
Loans and advances	8,986,922	40,024	7,320,059	353,840	3,131,189	1,835,511	19,438,170	2,229,375
Amortised cost	794,585	5,652	-	-	-	-	794,585	5,652
Unfunded exposure	4,596,265	1,681	847,118	7,539	593,880	-	6,037,263	9,220
	22,270,980	58,745	8,167,188	361,380	3,725,069	1,835,511	34,170,237	2,255,636

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

37 Risk management (continued)

Credit risk management (continued)

Maximum exposure to credit risk

	2017 AED'000
Carrying amount	
<i>Individually impaired</i>	
Grade (G-I) - gross amount	1,400,430
<i>Neither past due nor impaired</i>	
Grade A	487,173
Grade B	10,451,249
Grade C	3,760,937
Grade D	2,727,567
Grade E	121,190
Grade F	136,716
	<hr/> 19,085,262
Past due but not impaired	352,908
	<hr/>
Total carrying amount	19,438,170
Allowance for impairment (including interest in suspense)	<hr/> (1,961,841) <hr/>
Net carrying amount	<hr/> 17,476,329 <hr/>

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

37 Risk management (continued)

Credit risk management (continued)

Maximum exposure to credit risk (continued)

2018

Loans and advances	Stage 1 AED'000	Stage 2 AED'000	Stage 3 AED'000	Total AED'000
Grade 1	85	-	-	85
Grade 2	329,887	-	-	329,887
Grade 3	1,091,780	-	-	1,091,780
Grade 4	5,251,069	98,498	-	5,349,567
Grade 5	2,249,385	998	-	2,250,383
Grade 6	71,277	3,369,578	-	3,340,855
Grade 7	152	3,739,264	-	3,739,416
Default grades 8-10	-	-	2,125,584	2,125,584
Total gross carrying amount	8,993,635	7,208,338	2,125,584	18,327,557
Allowance for impairment losses	(21,760)	(755,104)	(1,336,359)	(2,113,223)
Net carrying amount	8,971,875	6,453,234	789,225	16,214,334

The Central Bank of the UAE classification of loans and advances

Loans and advances	Stage 1 AED'000	Stage 2 AED'000	Stage 3 AED'000	Total AED'000
Normal	7,595,116	1,713,930	3,824	9,312,870
Other loans exceptionally monitored	5,883	971,385	10,499	987,767
Substandard	1,392,636	3,766,728	244,616	5,403,980
Doubtful	-	756,295	1,826,017	2,582,312
Loss	-	-	40,628	40,628
Total gross carrying amount	8,993,635	7,208,338	2,125,584	18,327,557
Allowance for impairment losses	(21,760)	(755,104)	(1,336,359)	(2,113,223)
Net carrying amount	8,971,875	6,453,234	789,225	16,214,334

Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018

37 Risk management (continued)

The table below shows the maximum exposure to credit risk for the components of the statement of financial position, including contingent liabilities and commitments. The maximum exposure is shown, before the effect of mitigation through the use of credit enhancements, master netting and collateral agreements.

	Notes	2018 AED'000	2017 AED'000
Balances with Central Banks	6	4,579,199	5,529,203
Deposits and balances due from banks	7	507,785	503,218
Reverse-repo placements	8	849,188	1,867,798
Loans and advances , net	9	16,214,334	17,476,329
Investments in debt securities	10	671,554	794,585
Other assets (<i>excluding prepayments & assets acquired in settlement of debts</i>)		1,856,250	906,917
Total		24,678,310	27,078,050
Letters of credit	24	1,092,173	1,372,439
Guarantees	24	2,744,309	2,366,318
Undrawn loan commitments	24	1,577,285	1,873,569
Total		5,413,767	5,612,326
Total credit risk exposure		30,314,804	32,690,376

Where financial instruments are recorded at fair value the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

Aging analysis of past due but not impaired loans per class of on-balance sheet financial assets

	Less than 30 days 2018 AED'000	31 to 89 days 2018 AED'000	More than 90 days 2018 AED'000	Total 2018 AED'000
Loans and advances	23,748	9,155	394,455	427,358
	Less than 30 days 2017 AED'000	31 to 89 days 2017 AED'000	More than 90 days 2017 AED'000	Total 2017 AED'000
Loans and advances	89,569	27,997	235,342	352,908

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

37 Risk management (continued)

Collaterals held against loans and advances

The fair value of the collateral that the Group held as at 31 December 2018 for past due but not impaired loans and advances to customers covers 193% (2017: 92%) of the outstanding balance. For each loan, the value of the disclosed collateral is capped to the nominal amount of the loan that is held against.

Carrying amount per class of on-balance sheet financial assets whose terms have been renegotiated

	2018	2017
	AED'000	AED'000
Loans and advances	1,099,323	1,178,359

Impaired loans

Impaired loans are loans for which the Group determines that it is likely the collectability of all principal and interest due according to the contractual terms of the loan/securities agreement(s) would be doubtful. These loans are graded 8 to 10 in the Group's internal credit risk grading system.

Write-off policy

The Group writes off a loan balance (and any related allowances for impairment losses) when the Group determines that the loans are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

The Group holds collateral against loans and advances in the form of mortgage interests over properties, vehicles and machineries, cash margins, fixed deposits, guarantees and others. The Group accepts guarantees mainly from well-reputed local or international banks, well-established local or multinational corporate and high net worth private individuals. Management has estimated the fair value of collateral to be AED 13.4 billion (2017: AED 14.7 billion). The fair value of the collateral includes cash deposits which are not under lien and the Group has right to set-off against the outstanding facilities.

Concentration risk arises when a number of counterparties are engaged in similar business activities or activities in same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. The Group measure its exposure to credit risk by reference to gross carrying amount of financial assets less amounts offset, profit suspended and impairment losses, if any.

Concentration of credit risk by industrial sector for loans and advances are presented in notes 9e and 9f. Concentration of credit risk by geographical distribution of loans and advances and financial investments is set out in note 9b and 10b.

Liquidity risk management

Executive Committee (EC) & Board Risk Committee (BRC)

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations from its financial liabilities.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018**

37 Risk management (continued)

Liquidity risk management (continued)

In addition to its credit related activity, the Executive Committee along with the Board Risk Committee have a broad range of authority delegated by the Board of Directors to manage the Group's asset and liability structure and funding strategy. The EC and BRC review liquidity ratios; asset and liability structure; interest rate and foreign exchange exposures; internal and statutory ratio requirements; funding gaps; and general domestic and international economic and financial market conditions. The EC & BRC formulate liquidity risk management guidelines for the Group's operation on the basis of such review.

The Group's Senior Management monitors the liquidity on a daily basis and uses an interest rate simulation model to measure and monitor interest rate sensitivity and varying interest rate scenarios.

The EC members comprise of the Chairman, three Board Members, in addition to the Executive Director and General Manager. The EC meets once or more every 45 days, as circumstances dictate. The quorum requires all members to be present at the meeting and decisions taken to be unanimous.

The Group manages its liquidity in accordance with U.A.E. Central Bank requirements and the Group's internal guidelines. The U.A.E. Central Bank sets cash ratio requirements on overall deposits ranging between 1.0 percent for time deposits and 14.0 percent for demand deposits, according to the tenor of the deposits. The U.A.E. Central Bank also imposes a mandatory 1:1 utilisation ratio, whereby; loans and advances (combined with inter-bank placements having a remaining term of 'greater than three months')

should not exceed stable funds as defined by the U.A.E. Central Bank. Stable funds are defined by the U.A.E. Central Bank to mean free-own funds, inter-bank deposits with a remaining term of more than six months, and stable customer deposits. To guard against liquidity risk, the Group diversifies its funding sources and manages its assets with liquidity in mind, seeking to maintain a preferable proportion between cash, cash equivalent, and readily marketable securities. The Board Risk Committee sets and monitors liquidity ratios and regularly revises and updates the Group's liquidity management policies to ensure that the Group would be in a position to meet its obligations as they fall due. Management of liquidity risk

within the parameters prescribed by the Board Risk Committee has been delegated to an Asset and Liability Committee (ALCO) comprising the Deputy General Manager and senior executives from treasury, finance, corporate credit, and investment departments.

The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when they fall due, under both normal and stressed conditions, without incurring unacceptable losses or potential damage to the Group's reputation.

The Treasury department communicates with other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. The Treasury maintains a portfolio of short-term liquid assets to ensure liquidity is maintained within the Group's operations as a whole.

The daily liquidity position is monitored and regular liquidity stress testing is performed under a variety of scenarios covering both normal and severe market conditions. All liquidity policies and procedures are subject to review and approval by the Board Risk Committee. The Daily Position sheet, which reports the liquidity and exchange positions of the Group is reviewed by Senior Management. A summary report, including any exceptions and remedial action taken, is submitted to the Board Risk Committee.

**Notes to the consolidated financial statements (continued)
for the year ended 31 December 2018****37 Risk management (continued)****Exposure to liquidity risk**

The key measure used by the Group for measuring liquidity risk is the advances to stable resources ratio (regulatory ratio) which is 80.94% as at 31 December 2018 (2017: 77.63%). In addition, the Group also uses the following ratios/information on a continuous basis for measuring liquidity risk:

- Liquid assets to total assets ratio;
- Net loans to deposits ratio (LDR);
- Basel III ratios (including LCR, NSFR, etc.) are also monitored internally and shared with the Board on quarterly basis.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

37 Risk management (continued)

Liquidity risk management (continued)

The maturity profile of the assets and liabilities at 31 December 2018 based on the remaining period from the end of the reporting period to the contractual maturity date is as follows:

	Within 3 months AED'000	Over 3 months to 1 year AED'000	Over 1 year AED'000	Undated AED'000	Total AED'000
Assets					
Cash and balances with central banks	3,199,111	36,730	1,379,245	21,257	4,636,343
Deposits and balances due from banks	495,708	12,077	-	-	507,785
Reverse-repo placements	849,188	-	-	-	849,188
Loans and advances, net	7,962,373	1,140,388	7,107,619	3,954	16,214,334
Other financial assets measured at fair value	143,446	-	-	673,873	817,319
Other financial assets measured at amortised cost	-	100,363	563,136	8,055	671,554
Investment properties	-	-	-	608,473	608,473
Goodwill and other intangibles	-	-	-	416,056	416,056
Other assets	891,172	321,538	2,772,244	-	3,984,954
Property and equipment	-	-	-	304,577	304,577
Total assets	13,540,998	1,611,096	11,822,244	2,036,245	29,010,583
Liabilities and equity					
Customers' deposits	15,044,791	4,819,063	225,315	30,000	20,119,169
Deposits and balances due to banks	259,004	-	45,927	-	304,931
Other liabilities	1,152,825	64,771	-	-	1,217,596
Issued Bonds	-	-	1,798,044	1,791,928	3,589,972
Equity	-	-	-	3,778,915	3,778,915
Total liabilities and equity	16,456,620	4,883,834	2,069,286	5,600,843	29,010,583
Net liquidity gap	(2,915,622)	(3,272,738)	9,752,958	(3,564,598)	-

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

37 Risk management (continued)

Liquidity risk management (continued)

The maturity profile of the assets and liabilities at 31 December 2017 based on the remaining period from the end of the reporting period to the contractual maturity date is as follows:

	Within 3 months AED'000	Over 3 months to 1 year AED'000	Over 1 year AED'000	Undated AED'000	Total AED'000
Assets					
Cash and balances with central banks	4,136,514	-	1,433,888	17,204	5,587,606
Deposits and balances due from banks	483,749	19,469	-	-	503,218
Reverse-repo placements	1,867,798	-	-	-	1,867,798
Loans and advances, net	6,925,836	1,076,659	9,470,963	2,871	17,476,329
Other financial assets measured at fair value	103,453	-	7,328	702,505	813,286
Other financial assets measured at amortised cost	25,634	86,606	672,020	10,325	794,585
Investment properties	-	-	-	584,858	584,858
Goodwill and other intangibles	-	-	-	421,966	421,966
Other assets	876,941	44,609	1,265,222	5,960	2,192,732
Property and equipment	-	-	-	268,822	268,822
Total assets	14,419,925	1,227,343	12,849,421	2,014,511	30,511,200
Liabilities and equity					
Customers' deposits	14,866,344	6,511,647	252,480	-	21,630,471
Deposits and balances due to banks	41,169	-	45,953	-	87,122
Other liabilities	971,736	34,133	12,997	-	1,018,866
Issued Bonds	-	-	3,706,810	-	3,706,810
Equity	-	-	-	4,067,931	4,067,931
Total liabilities and equity	15,879,249	6,545,780	4,018,240	4,067,931	30,511,200
Net liquidity gap	(1,459,324)	(5,318,437)	8,831,181	(2,053,420)	-

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

37 Risk management (continued)

Market risk management

Market Risk is the risk that the fair value or future cash flows of the financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates, and equity prices. The Group classifies exposures to market risk into trading, or non-trading /banking book.

a) Market risk - trading book

The Executive Committee has set limits for acceptable level of risks in managing the trading book. The Group maintains a well-diversified portfolio. In order to manage the market risk in the trading book, the Group carries a limited amount of market risk based on the policy preference and this is continuously monitored by Senior Management. Proprietary trading for the account of the Group is managed by a proprietary trading limit with a stop-loss limit.

The Group's trading book mainly comprises of equity instruments in companies listed on the U.A.E. exchanges. As such, the market risk in the trading book is limited to equity price risk.

Equity price risk refers to the risk of a decrease in the fair values of equities in the Group's trading investment portfolio as a result of reasonable possible changes in levels of equity indices and the value of individual stocks.

The effect on the Group's equity investments held in the trading book due to a reasonable possible change in U.A.E. equity indices, with all other variables held constant is as follows:

Market indices	31 December 2018		31 December 2017	
	Change in equity price %	Effect on income AED'000	Change in equity price %	Effect on income AED'000
Global Stock markets	+1%	1,434	+1%	1,035
Global Stock markets	-1%	(1,434)	-1%	(1,035)

b) Market risk - non-trading or banking book

Market risk on non-trading or banking positions mainly arises from the interest rate, foreign currency exposures and equity price changes.

i) Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities.

The Group uses simulation-modelling tools to periodically measure and monitor interest rate sensitivity. The results are monitored and analysed by the Senior Management. Since most of the Group's financial assets and liabilities are floating rate, deposits and loans generally re-price simultaneously providing a natural hedge, which reduces interest rate exposure. Moreover, the majority of the Group's assets and liabilities will be re-priced within one year or less, thereby further limiting interest rate risk.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

37 Risk management (continued)

b) Market risk - non-trading or banking book (continued)

i) Interest rate risk (continued)

The Group's interest sensitivity position, based on the contractual re-pricing or maturity dates, whichever dates are earlier as at 31 December 2018 was as follows:

	Weighted Average Effective Rate	Within 3 months AED'000	Over 3 months to 1 year AED'000	Over 1 year AED'000	Non- interest sensitive AED'000	Total AED'000
Assets						
Cash and balances with central banks	1.65%	2,346,281	22,781	910,196	1,357,085	4,636,343
Deposits and balances due from banks	3.81%	294,143	-	-	213,642	507,785
Reverse-repo placements	2.72%	849,188	-	-	-	849,188
Loans and advances, net	6.35%	15,046,105	59,170	319,032	790,027	16,214,334
Other financial assets - Equity instruments	-	-	45,026	160,252	612,041	817,319
Other financial assets - Debt securities	5.46%	268,803	55,337	344,030	3,384	671,554
Investment properties	-	-	-	-	608,473	608,473
Goodwill and other intangibles	-	-	-	-	416,056	416,056
Other assets	-	-	-	-	3,984,954	3,984,954
Property and equipment, net	-	-	-	-	304,577	304,577
Total assets		18,804,520	182,314	1,733,510	8,290,239	29,010,583
Liabilities and equity						
Customers' deposits	3.30%	12,202,370	4,479,672	251,454	3,185,673	20,119,169
Deposits and balances due to banks	2.46%	246,580	6,288	45,928	6,135	304,931
Other liabilities	-	2,341	-	-	1,215,255	1,217,596
Issued Bonds	3.80%	-	-	3,589,972	-	3,589,972
Equity	-	-	-	-	3,778,915	3,778,915
Total liabilities and equity		12,451,291	4,485,960	3,887,354	8,185,978	29,010,583
On statement of financial position gap		6,353,229	(4,303,646)	(2,153,844)	104,261	-
Cumulative interest rate sensitivity gap		6,353,329	2,049,583	(104,261)	-	-

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

37 Risk management (continued)

b) Market risk - non-trading or banking book (continued)

i) Interest rate risk (continued)

The Group's interest sensitivity position, based on the contractual re-pricing or maturity dates, whichever dates are earlier as at 31 December 2017 was as follows:

	Weighted Average Effective Rate	Within 3 months AED'000	Over 3 months to 1 year AED'000	Over 1 year AED'000	Non- interest sensitive AED'000	Total AED'000
Assets						
Cash and balances with central banks	1.17%	3,398,739	-	969,250	1,219,617	5,587,606
Deposits and balances due from banks	0.93%	253,888	-	-	249,330	503,218
Reverse-repo placements	1.54%	1,867,798	-	-	-	1,867,798
Loans and advances, net	5.87%	16,553,849	246,013	61,475	614,992	17,476,329
Other financial assets - Equity instruments	-	-	-	-	813,286	813,286
Other financial assets - Debt securities	4.81%	220,355	86,598	484,597	3,035	794,585
Investment properties	-	-	-	-	584,858	584,858
Goodwill and other intangibles	-	-	-	-	421,966	421,966
Other assets	-	-	-	-	2,192,732	2,192,732
Property and equipment, net	-	-	-	-	268,822	268,822
Total assets		22,294,629	332,611	1,515,322	6,368,638	30,511,200
Liabilities and equity						
Customers' deposits	2.67%	10,872,799	6,211,144	250,223	4,296,305	21,630,471
Deposits and balances due to banks	1.62%	83,069	-	-	4,053	87,122
Other liabilities	-	2,334	-	-	1,016,532	1,018,866
Issued Bonds	3.73%	-	-	3,706,810	-	3,706,810
Equity	-	-	-	-	4,067,931	4,067,931
Total liabilities and equity		10,958,202	6,211,144	3,957,033	9,384,821	30,511,200
On statement of financial position gap		11,336,427	(5,878,533)	(2,441,711)	(3,016,183)	-
Cumulative interest rate sensitivity gap		11,336,427	5,457,894	3,016,183	-	-

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

37 Risk management (continued)

Market risk management (continued)

b) Market risk - non-trading or banking book (continued)

i) Interest rate risk (continued)

The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument, excluding non-interest bearing items. The rate is a historical rate for a fixed rate instrument carried at amortised cost and the current market rate for a floating rate instrument or for an instrument carried at fair value.

The following table depicts the sensitivity to a reasonable possible change in interest rates, with other variables held constant, on the Group's consolidated statement of profit or loss or equity. The sensitivity of the income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held as at 31 December 2018, including the effect of hedging instruments. The sensitivity of equity is calculated by revaluing the fixed rate, including the effect of any associated hedges as at 31 December 2018 for the effect of assumed changes in interest rates. The sensitivity of equity is analysed by maturity of the asset or swap. All the banking book exposures are monitored and analysed in currency concentrations and relevant sensitivities are disclosed in AED thousands.

2018 Currency	Increase in basis	Sensitivity of interest income	Sensitivity of equity
AED	+200	68,761	68,761
USD	+200	(37,748)	(37,748)
Others	+200	(2,027)	(2,027)
AED	-200	(68,761)	(68,761)
USD	-200	37,748	37,748
Others	-200	2,027	2,027
2017 Currency	Increase in basis	Sensitivity of interest income	Sensitivity of equity
AED	+200	114,597	114,597
USD	+200	(27,647)	(27,647)
Others	+200	(1,158)	(1,158)
AED	-200	(114,597)	(114,597)
USD	-200	27,647	27,647
Others	-200	1,158	1,158

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

37 Risk management (continued)

Market risk management (continued)

b) Market risk - non-trading or banking book (continued)

ii) Currency risk

Currency risk represents the risk of change in the value of financial instruments due to changes in foreign exchange rates. The Board has set limits on positions by currencies, which are monitored daily, and hedging instruments are also used to ensure that positions are maintained within the limits.

The Group's assets are typically funded in the same currency as that of the business transacted in order to eliminate foreign exchange exposure. However, in the normal course of business the Group provides foreign currency exposures to finance its client's activities. The Executive Committee sets the limits on the level of exposure by currency for both overnight and intra-day positions, which are closely monitored by Senior Management. As at 31 December 2018, the Group's net currency position was not material, and all the positions were within limits approved by the Executive Committee.

As the UAE Dirham and other GCC currencies are currently pegged to the US Dollar, balances in US Dollars are not considered to represent significant currency risk.

The table below shows the foreign currencies to which the Group has a significant exposure to:

	2018 AED'000 equivalent long (short)	2017 AED'000 equivalent long (short)
Euro	689	1,131

The analysis below calculates the effect of a possible movement of the currency rate against AED, with all other variables held constant, on the consolidated statement of profit or loss (due to the fair value of the currency sensitive non-trading monetary assets and liabilities) and equity (due to change in fair value of currency swaps and forward foreign exchange contracts used as cash flow hedges). A positive effect shows a potential increase in consolidated statement of profit or loss or equity; whereas a negative effect shows a potential net reduction in consolidated statement of profit or loss or equity.

(AED'000)			
Currency exposure as at 31 December 2018	Change in currency rate in %	Change on net profit	Change on Equity
EUR	+5%	34	34
EUR	-5%	(34)	(34)
(AED'000)			
Currency exposure as at 31 December 2017	Change in currency rate in %	Change on net profit	Change on Equity
EUR	+5%	57	57
EUR	-5%	(57)	(57)

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

37 Risk management (continued)

Market risk management (continued)

b) Market risk - non-trading or banking book (continued)

iii) Equity price risk

Equity price risk refers to the risk of a decrease in the fair value of equities in the Group's non-trading investment portfolio as a result of reasonable possible changes in levels of equity indices and the value of individual stocks.

The effect on the Group's quoted equity investments held as financial assets at FVTOCI due to reasonable possible change in equity prices, with all other variables held constant is as follows:

Market indices	31 December 2018		31 December 2017	
	Change in equity price %	Effect on equity AED'000	Change in equity price %	Effect on equity AED'000
Global stock markets	+1%	1,600	+1%	1,454
Global stock markets	-1%	(1,600)	-1%	(1,454)

Operational risk

Operational risk is the risk of loss arising from system failure, human error, fraud, or external events. When controls fail to perform, operational risks can cause damage to reputation, and may have legal or regulatory implications, or lead to financial losses. The Group would not be able to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group could minimise the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

38 Capital adequacy and capital management

Capital management process

The Group's objectives when managing capital, which is a broader concept than the 'equity' in the consolidated statement of financial positions, are:

- To comply with the capital requirements set by the Central Bank of United Arab Emirates;
- To safeguard the Group's ability to continue as a going concern and increase the returns for the shareholders; and
- To maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored on a regular basis by the Group's management, employing techniques based on the guidelines developed by the Basel Committee and the Central Bank of United Arab Emirates. The required information is filed with the authority on a quarterly basis.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)****38 Capital adequacy and capital management (continued)****Capital management process (continued)**

The Group assets are risk weighted as to their relative credit, market, and operational risk. Credit risk includes both on and off-balance sheet risks. Market risk is defined as the risk of losses in on and off-balance sheet positions arising from movements in market prices and includes profit rate risk, foreign exchange risk, equity exposure risk, and commodity risk. Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events.

The Group's regulatory capital is analysed into two tiers:

- Common equity tier 1 (CET 1) capital, which includes ordinary share capital, legal reserve, general reserve and retained earnings; and
- Tier 2 capital, which includes fair value reserves relating to unrealised gains / losses on investments classified as available-for-sale and derivatives held as cash flow hedges and collective provision.

The following limits have been applied for Tier 2 capital:

- Total Tier 2 capital shall not exceed 67% of tier 1 capital;
- Subordinated liabilities shall not exceed 50% of total Tier 1 capital; and
- Collective provision shall not exceed 1.25% of total credit risk weighted assets.

The minimum capital adequacy requirements as set out by the Central Bank are as follows:

- Minimum common equity tier 1 (CET 1) ratio of 7% of risk weighted assets (RWAs).
- Minimum tier 1 ratio of 8.5% of RWAs.
- Total capital adequacy ratio of 10.5% of RWAs.

In addition to CET 1 ratio of 7% of RWAs, a capital conservation buffer (CCB) of 1.25% of RWAs shall be maintained in the form of CET 1.

Further, counter cyclical buffer (CCyB) requirement shall be met by using CET 1. The level of CCyB to be notified by 'the Central Bank'. There is no CCyB requirement during the current period.

The Group has complied with all the externally imposed capital requirements.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

38 Capital adequacy and capital management (continued)

Capital management process (continued)

Basel III

The capital adequacy ratio is computed based on circulars issued by the U.A.E. Central Bank:

	31 December 2018 AED'000 (audited)	31 December 2017 AED'000 (unaudited)
<i>Capital base</i>		
Common Equity Tier 1	3,312,548	3,914,400
Additional Tier 1 capital	-	-
Tier 1 capital	3,312,548	3,914,400
Tier 2 capital	294,292	245,400
Total capital base	3,606,840	4,159,800
<i>Risk-weighted assets:</i>		
Credit risk	23,543,342	21,509,166
Market risk	288,487	208,783
Operational risk	1,414,857	1,481,723
Total risk-weighted assets	25,246,686	23,199,672
<i>Capital ratios</i>		
Common equity Tier 1 capital ratio	13.12%	16.87%
Tier 1 capital ratio	13.12%	16.87%
Total capital ratio	14.29%	17.93%

39 Fair value of financial instruments

Investments held at fair value through profit and loss

Investments held for trading or designated at fair value through profit and loss represent investment securities that present the Group with opportunity for returns through dividend income, trading gains and capital appreciation. Including in these investment listed equity securities for which the fair values are based on quoted prices at close of business as of 31 December 2018, and unlisted bonds for which the fair values are derived from internal valuation performed based on generally accepted pricing models, all inputs used for the valuation are supposed by observable market prices or rates.

Unquoted investments held at fair value through other comprehensive income

The consolidated financial statements include holdings in unquoted securities amounting to AED 323 million (2017: AED 564 million) which are measured at fair value. Fair values are determined in accordance with generally accepted pricing models based on comparable ratios backed by discounted cash flow analysis depending on the investment and industry. The valuation model includes some assumptions that are not supported by observable market prices or rates.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39 Fair value of financial instruments (continued)

For investments valued using comparable ratios, share prices of comparable companies represent significant inputs to the valuation model. If the share prices of the comparable companies were 5% higher/lower while all other variables were held constant, then the fair value of the securities would increase/decrease by AED 16 million (2017: AED 28 million).

The impact of the change in fair valuation from previously existing carrying amounts have been recognised as a part of cumulative changes in fair value in equity.

Fair value of financial assets carried at amortised cost

Except as detailed in the following table, the management considers that the carrying amounts of financial assets and financial liabilities measured at amortised cost in the consolidated financial statements approximate their fair values.

	2018		2017	
	Carrying amount AED'000	Fair value AED'000	Carrying amount AED'000	Fair value AED'000
Financial assets				
- Other financial assets measured at amortised cost	<u>671,554</u>	<u>663,231</u>	<u>794,585</u>	<u>790,552</u>

The fair value for other financial assets measured at amortised cost is based on market prices.

Fair value measurements recognised in the consolidated statement of financial position

The following table provides an analysis of financial instruments that are measured at fair value. They are banked 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, including over-the-counter quoted prices).
- 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).

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39 Fair value of financial instruments (continued)

	Level 1 AED'000	Level 2 AED'000	Level 3 AED'000	Total AED'000
At 31 December 2018				
<i>Other financial assets measured at fair value</i>				
Investment measured at FVTPL				
Quoted equity	143,446	-	-	143,446
<i>Investments measured at FVTOCI</i>				
Quoted equity	160,069	-	-	160,069
Unquoted equity	-	-	323,239	323,239
Unquoted debt securities	-	190,565	-	190,565
Total	303,515	190,565	323,239	817,319
<i>Other financial liabilities measured at fair value</i>				
Issued bonds measured at FVTPL				
Quoted debt securities	3,589,972	-	-	3,589,972
<i>Other assets /liabilities</i>				
Positive fair value of derivatives	-	3,590	-	3,590
Negative fair value of derivatives	-	(62,808)	-	(62,808)
At 31 December 2017				
<i>Other financial assets measured at fair value</i>				
Investment measured at FVTPL				
Quoted equity	103,453	-	-	103,453
<i>Investments measured at FVTOCI</i>				
Quoted equity	145,416	-	-	145,416
Unquoted equity	-	-	564,417	564,417
Total	248,869	-	564,417	813,286
<i>Other financial liabilities measured at fair value</i>				
Issued bonds measured at FVTPL				
Quoted debt securities	3,706,810	-	-	3,706,810
<i>Other assets /liabilities</i>				
Positive fair value of derivatives	-	5,945	-	5,945
Negative fair value of derivatives	-	(40,032)	-	(40,032)

There were no transfers between Level 1 and Level 2 during the current year.

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39 Fair value of financial instruments (continued)

Reconciliation of Level 3 fair value measurements of other financial assets measured at FVTOCI:

	2018 AED'000	2017 AED'000
Opening balance	564,417	913,010
Additions	-	37,309
Disposals	-	(8,499)
Losses recognised in other comprehensive income	(241,178)	(377,403)
Closing balance	<u>323,239</u>	<u>564,417</u>

Unobservable inputs used in measuring fair value

The effect of unobservable input on fair value measurement

Although the Group believes that its estimates of fair value are appropriate, the use of different methodologies or assumptions could lead to different measurements of fair value. For fair value measurements in Level 3, 10% change in the underlying value of these investments would have the following effects.

	<u>Effect on OCI</u>	
31 December 2018	Favorable +323	Unfavorable -323
	<u>Effect on OCI</u>	
31 December 2017	Favorable +564	Unfavorable -564

Impact on fair value of level 3 financial instruments measured at fair value of changes to key assumptions

The impact on the fair value of level 3 instruments of using reasonably possible alternative assumptions by class of instrument is negligible.

Financial Instruments not recorded at fair value

The fair values of financial instruments not recorded at fair value includes cash and balances with Central Banks, due from banks and financial institutions, loans and advances, net, other assets (excluding prepayments), due to banks, customers' deposits and other liabilities that are categorised as level two based on market observable inputs. The fair values of financial instruments not recorded at fair value are not materially different to their carrying values.

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements:

**Notes to the consolidated financial statements
for the year ended 31 December 2018 (continued)**

39 Fair value of financial instruments (continued)

Asset for which fair value approximates carrying value

For financial assets and financial liabilities that have short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without specific maturity.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognised with current market rates for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit and maturity. For other variable rate instruments an adjustment is also made to reflect the change in required credit spread since the instrument was first recognised.

40 Approval of the consolidated financial statements

The consolidated financial statements were approved by the Board of Directors and authorised for issue on 26 January 2019.