OMAN ARAB BANK SAOC

Report and financial statements for the year ended 31 December 2018

Building a better
working world

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PR No. HMH/15/2015; HMA/9/2015

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF OMAN ARAB BANK SAOC

Report on the audit of the financial statements

Opinion

We have audited the financial statements of Oman Arab Bank SAOC (the "Bank"), which comprise the statement of financial position as at 31 December 2018, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2018 and its financial performance and 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 Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Bank in accordance with the *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 financial statements in the Sultanate of Oman, 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 financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the Auditor's responsibilities for the audit of the financial statements section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF OMAN ARAB BANK SAOC (CONTINUED)

Key audit matters (continued)

1. Impairment provision for loans, advances and financing activities for customers subject to credit risk

<table>
<tr><th>Key audit matters</th><th>How our audit addressed the key audit matters</th></tr>
<tr><td>
At 31 December 2018 the Bank reported gross loans, advances and financing activities for customers amounting to RO 1,888.04 million and RO 55.22 million of expected credit loss allowances.
Due to the inherently judgmental nature of the computation of expected credit losses ("ECL") for loans, advances and financing activities for customers, there is a risk that the amount of ECL may be misstated.
The key areas of judgement include:

The identification of exposure with a significant deterioration in credit quality.
Assumptions used in the ECL model such as financial condition of counterparty, expected future cash flows, forward looking macroeconomic factors etc.
The need to apply additional overlays to reflect current or future external factors that might not be captured by the expected credit loss model.

The accounting policies relating to estimating impairment provision on loans, advances and financing activities for customers, critical accounting estimates and judgements, and the disclosures relating to impairment of loans, advances and financing activities for customers are set out in notes 2.4.1, 2.5, 3.1 and 9 to the financial statements.
</td><td>
Our audit procedures in this area included the following:

Evaluated the appropriateness of the Bank's IFRS 9 based impairment provisioning policy and compared it with the requirements of IFRS 9;
We performed audit procedures on the opening balances to gain assurance on the transition. This included evaluating the accounting interpretations for compliance with IFRS 9 and testing the adjustments and disclosures made on transition.
Obtained an understanding of the design and tested the operating effectiveness of relevant controls over ECL model, including model build and approval, ongoing monitoring / validation, model governance and mathematical accuracy. We have also checked completeness and accuracy of the data used and the reasonableness of the management assumptions;
Evaluated Bank's key judgments and estimates made in the ECL computation and involved specialists to assist in evaluating the judgments and estimates relating to probability of default, macro-economic variables and recovery rates;
For a sample of exposures, we performed procedures to evaluate:
- Appropriateness of exposure at default, probability of default and loss given default (including collateral values used) in the calculation of ECL;
- Timely identification of exposures with a significant increase in credit risk and appropriateness of the Bank's staging; and
- ECL calculation.
Checked the completeness of the loans, advances and financing activities for customers (including off balance sheets) in the ECL calculation as of 31 December 2018. We understood the theoretical soundness and tested the mathematical integrity of the models;
Checked the consistency of various inputs and assumptions used by the Bank's management to determine impairment provisions; and
Considered the adequacy of the disclosures in the financial statements in relation to impairment of loans, advances and financing activities for customers and other financial assets subject to credit risk as required under IFRS 9.

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF
OMAN ARAB BANK SAOC (CONTINUED)

Other information included in the Bank's 2018 Annual Report
Those charged with governance and management are responsible for the other information. Other information consists of the information included in the Bank's 2018 Annual Report other than the financial statements and our auditor's report thereon. We obtained the following information prior to the date of our auditor's report, and we expect to obtain the published 2018 Annual Report after the date of our auditor's report:

- Corporate governance report
- Management discussion and analysis
- Financial statements of the Islamic Banking Window
- Basel II Pillar III and Basel III Report of the Bank
- Basel II Pillar III and Basel III Report of the Islamic Banking Services

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the 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 obtained prior to the date of the auditor's 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.

Responsibilities of management and those charged with governance for the financial statements
Those charged with governance are responsible for the preparation and fair presentation of the financial statements in accordance with IFRS and the relevant requirements of the Commercial Companies Law of 1974, as amended, and the Capital Market Authority ("the CMA") of the Sultanate of Oman, and for such internal control as those charged with governance determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, those charged with governance are responsible for assessing the Bank'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 those charged with governance either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

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

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's 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 financial statements.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF OMAN ARAB BANK SAOC (CONTINUED)

Auditor's responsibilities for the audit of the financial statements (continued)

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

- Identify and assess the risks of material misstatement of the 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 expressing an opinion on the effectiveness of the Bank'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 those charged with governance 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 Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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 to 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 financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's 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.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF
OMAN ARAB BANK SAOC (CONTINUED)

Report on other legal and regulatory requirements

In our opinion, the financial statements comply, in all material respects, with the relevant disclosure requirements of the Commercial Companies Law of 1974, as amended, and CMA of the Sultanate of Oman.

Ernst & Young LLC

Muscat
18 March 2019

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س.ت: ١٢٢٤٠١٣
ص.ب: ١٧٥٠ روي – ١١٢، سلطنة عمان
ERNST & YOUNG LLC
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P.O. Box 1750 - P.C. 112, Sultanate of Oman

STATEMENT OF FINANCIAL POSITION
At 31 December 2018

	Notes	2018 RO'000	2017 RO'000
ASSETS			
Cash and balances with the Central Bank of Oman	7	**194,801**	161,987
Due from banks	8	**91,272**	108,868
Loans & advances and financing to customers	9	**1,832,817**	1,654,013
Investment securities	10	**131,176**	138,421
Property and equipment	11	**30,245**	29,430
Other assets	12	**48,507**	46,280
Total assets		**2,328,818**	2,138,999
LIABILITIES			
Due to banks	13	**15,207**	4,011
Deposits from customers	14	**1,870,558**	1,746,856
Other liabilities	15	**60,241**	57,693
Subordinated debt	17	**20,000**	20,000
Taxation	18	**5,936**	4,891
Total liabilities		**1,971,942**	1,833,451
EQUITY			
Share capital	19	**134,620**	134,620
Legal reserve	20	**41,490**	38,476
General reserve	21	**25,560**	25,560
Subordinated debt reserve	22	**12,000**	8,000
Special reserve	23	**3,915**	2,760
Fair value reserve		**(2,059)**	(1,845)
Retained earnings		**68,797**	67,977
Total equity attributable to the equity holders of the Bank		**284,323**	275,548
Perpetual Tier 1 capital bonds	24	**72,553**	30,000
Total equity		**356,876**	305,548
Total equity and liabilities		**2,328,818**	2,138,999
Contingent liabilities and commitments	36(a)	**785,370**	897,448

The financial statements were authorised for issue by the Board of Directors on 28 January 2019 and signed by:

Rashad Muhammed Al Zubair
Chairman

Rashad Al-Musafir
Chief Executive Officer

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The accompanying notes 1 to 41 form part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME
Year ended 31 December 2018

	Notes	2018 RO'000	2017 RO'000
Interest income	26	**100,584**	88,115
Interest expense	27	**(34,061)**	(32,516)
Net interest income		**66,523**	55,599
Net fee and commission income	28	**14,738**	14,393
Net Investment income	29	**101**	1,140
Other operating income	30	**6,282**	6,606
Total income		**87,644**	77,738
Operating expenses	31	**(46,960)**	(45,403)
Allowance for credit losses - customer loans	9	**(11,142)**	(8,276)
Recoveries/release from allowance for credit losses	9	**6,269**	8,132
Credit loss / impairment on investment securities	10	**(9)**	(728)
Profit before tax		**35,802**	31,463
Income tax expense	18	**(5,662)**	(4,916)
Profit for the year		**30,140**	26,547
Other comprehensive expense:			
Items that will not be reclassified to profit or loss in the subsequent periods (net of tax):			
Revaluation loss on equity instruments at fair value through other comprehensive income (FVOCI)		**(681)**	-
Items that may be reclassified to profit or loss in subsequent periods (net of tax):			
Net movement on AFS investments		-	(1,773)
Other comprehensive expense for the year		**(681)**	(1,773)
Total comprehensive income for the year		**29,459**	24,774
Earnings per share:			
Basic and diluted (RO)	32	**0.020**	0.018

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The accompanying notes 1 to 41 form part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2018

	Notes	Share capital	Legal reserve	General reserve	Subordinated debt reserve	Special reserve	Fair value reserve	Retained earnings	Sub total	Perpetual Tier 1 capital bonds	Total
		RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
Balance at 1 January 2018		**134,620**	**38,476**	**25,560**	**8,000**	**2,760**	**(1,845)**	**67,977**	**275,548**	**30,000**	**305,548**
Impact of adopting IFRS 9	4.1	**-**	**-**	**-**	**-**	**-**	**467**	**(3,575)**	**(3,108)**	**-**	**(3,108)**
Restated opening balance under IFRS9		**134,620**	**38,476**	**25,560**	**8,000**	**2,760**	**(1,378)**	**64,402**	**272,440**	**30,000**	**302,440**
Dividends paid		**-**	**-**	**-**	**-**	**-**	**-**	**(14,808)**	**(14,808)**	**-**	**(14,808)**
Profit for the year		**-**	**-**	**-**	**-**	**-**	**-**	**30,140**	**30,140**	**-**	**30,140**
Unrealised loss on FVOCI		**-**	**-**	**-**	**-**	**-**	**(681)**	**-**	**(681)**	**-**	**(681)**
Transfer to special reserve	23	**-**	**-**	**-**	**-**	**1,155**	**-**	**(1,155)**	**-**	**-**	**-**
Realised loss on FVOCI		**-**	**-**	**-**	**-**	**-**	**-**	**(220)**	**(220)**		**(220)**
Transfer to legal reserve	20	**-**	**3,014**	**-**	**-**	**-**	**-**	**(3,014)**	**-**	**-**	**-**
Transfer to subordinated debt reserve	22	**-**	**-**	**-**	**4,000**	**-**	**-**	**(4,000)**	**-**	**-**	**-**
Issuance of Perpetual Tier 1 capital bonds	24	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**42,553**	**42,553**
Interest distribution of Perpetual Tier 1 capital bonds		**-**	**-**	**-**	**-**	**-**	**-**	**(2,307)**	**(2,307)**	**-**	**(2,307)**
Perpetual Tier 1 issuance cost		**-**	**-**	**-**	**-**	**-**	**-**	**(241)**	**(241)**	**-**	**(241)**
At 31 December 2018		**134,620**	**41,490**	**25,560**	**12,000**	**3,915**	**(2,059)**	**68,797**	**284,323**	**72,553**	**356,876**

The accompanying notes 1 to 41 form part of these financial statements.

STATEMENT OF CHANGES IN EQUITY (continued)
Year ended 31 December 2018

	Notes	Share capital RO'000	Legal reserve RO'000	General reserve RO'000	Subordinated debt reserve RO'000	Special reserve RO'000	Fair value reserve RO'000	Retained earnings RO'000	Sub-total RO'000	Perpetual Tier 1 capital bonds RO'000	Total RO'000
At 1 January 2017		127,000	35,821	25,560	54,000	2,400	(72)	8,390	253,099	30,000	283,099
Profit for the year		-	-	-	-	-	-	26,547	26,547	-	26,547
Other comprehensive expense, net of tax		-	-	-	-	-	(1,773)	-	(1,773)	-	(1,773)
Total comprehensive income (expense) for the year		-	-	-	-	-	(1,773)	26,547	24,774	-	24,774
Issue of bonus shares		7,620	-	-	-	-	-	(7,620)	-	-	-
Transfer to special reserve	23	-	-	-	-	360	-	(360)	-	-	-
Transfer to legal reserve	20	-	2,655	-	-	-	-	(2,655)	-	-	-
Transfer to retained earnings	22			-	(50,000)	-		50,000	-	-	-
Transfer to subordinated debt reserve	22	-	-	-	4,000	-		(4,000)	-	-	-
Interest distribution of Perpetual Tier 1 capital bonds	24	-	-	-	-	-	-	(2,325)	(2,325)	-	(2,325)
At 31 December 2017		134,620	38,476	25,560	8,000	2,760	(1,845)	67,977	275,548	30,000	305,548

The accompanying notes 1 to 41 form part of these financial statements.

STATEMENT OF CASH FLOWS
Year ended 31 December 2018

	Notes	2018 RO'000	2017 RO'000
Operating activities			
Profit before tax		**35,802**	31,463
Adjustments:			
Depreciation	12	**4,052**	3,680
Impairment for credit losses	9	**11,096**	8,276
Recoveries/release from impairment for credit losses	9	**(6,245)**	(8,132)
Net impairment on due from banks		**46**	-
Allowance for impairment on Amortised Cost Securities		**9**	728
Income from held to collect / held-to-maturity investments	10	**(4,895)**	(2,211)
Dividend Income		**(346)**	(648)
Loss on sale of property and equipment	12	**9**	-
Interest on subordinated debt		**1,100**	2,087
Change in fair value of financial assets at fair value through profit or loss	10	**245**	3
Operating profit before working capital changes		**40,873**	35,246
Loans and advances and financing to customers		**(187,251)**	(59,357)
Due from banks		**(2,000)**	(18,000)
Other assets		**(2,226)**	(879)
Deposits from customers		**123,701**	109,704
Other liabilities		**2,548**	(1,810)
Cash (used in) / from operations		**(24,355)**	64,904
Tax paid		**(4,376)**	(4,187)
Net cash (used in) / from operating activities		**(28,731)**	60,717
Investing activities			
Held-to-maturity investments matured		**126,102**	326,560
Purchase of held-to-maturity investments		**(123,629)**	(354,484)
Purchase of investments FVOCI / available-for-sale		**(113)**	(17,037)
Financial assets at fair value through profit or loss		**38**	9
Proceeds from sale of investment securities		**3,911**	17,962
Income from maturing of held-to-maturity investments		**4,895**	2,211
Purchase of property and equipment	12	**(4,877)**	(4,460)
Proceeds from sale of property and equipment		**1**	-
Dividend Income		**346**	648
Net cash (used in) investing activities		**6,674**	(28,591)
Financing activities			
Proceeds from issuance of Perpetual Tier 1 capital bonds	24	**42,553**	-
Repayment of subordinated debt	22	**-**	(50,000)
Interest on subordinated debt		**(1,100)**	(2,087)
Interest on Perpetual Tier 1 capital bonds		**(2,325)**	(2,325)
Issue expenses of Perpetual Tier 1 capital bonds		**(241)**	-
Dividends paid		**(14,808)**	-
Net cash from (used in) financing activities		**24,079**	(54,412)
Net increase / (decrease) in cash and cash equivalents		**2,022**	(22,286)
Cash and cash equivalents at the beginning of the year		**248,344**	270,630
Cash and cash equivalents at the end of the year	34	**250,366**	248,344

The accompanying notes 1 to 41 form part of these financial statements.

1. Legal status and principal activities

Oman Arab Bank SAOC ("the Bank" or "OAB") was incorporated in the Sultanate of Oman on 1 October 1984 as a closed joint stock company. It is principally engaged in commercial banking activities through a network of branches in the Sultanate of Oman. The Bank operates in Oman under a banking licence issued by the Central Bank of Oman ("CBO") and is covered by its deposit insurance scheme. The registered address of the bank is North Al Ghoubra, P. O. Box 2240, Al-Udhayabah, Postal Code 130, Muscat, and Sultanate of Oman. The Bank's Islamic Banking window under the name – "Al Yusr", commenced operations from 14 July 2013 and operates under the Islamic banking licence granted by the CBO. The principal activities of Al Yusr is providing Shari'a compliant financing, accepting Shari'a compliant deposits and other activities permitted under CBO's regulated Islamic Banking Services as defined in the licensing framework.

2. Basis of preparation

2.1 Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), the applicable regulations of the CBO and the applicable requirements of the Commercial Companies Law of 1974, as amended.

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

These are the first set of annual financial statements in which IFRS 9 and IFRS 15 have been applied. Changes to significant accounting policies are described in note 2.4.1 and the related transition impact is set out in note 4.

2.2 Functional and presentation currency

The financial statements are presented in Omani Rials ("RO"), which is the Bank's functional and presentation currency.

2.3 Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 3.

The Bank presents its statement of financial position in descending order of liquidity, as this presentation is more appropriate to the Bank's operations.

2. Basis of preparation (continued)

2.4 Basis of measurement

The financial statements are prepared under the historical cost basis except for the following:

- derivative financial instruments are measured at fair value;
- financial instruments classified as trading and at fair value through profit or loss (FVTPL) are measured at fair value;
- financial assets at fair value through other comprehensive income (applicable from 1 January 2018);
- available-for-sale financial assets are measured at fair value (before 1 January 2018);
- recognised assets and liabilities that are hedged are measured at fair value in respect of the risk that is hedged.

The accounting policies have been consistently applied by the Bank and are consistent with those of the previous year, except for the adoption of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* with effect from 1st January 2018. The policies related to IFRS 9 *Financial Instruments* are set out in note 2.4.1.

2.4.1 Financial assets and liabilities (policies applied from 1 January 2018)

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

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

Classification
From 1 January 2018, the Bank has applied IFRS 9 and classifies its financial assets in the following measurement categories:

- Fair value through profit or loss (FVTPL);
- Fair value through other comprehensive income (FVOCI); or
- Held to collect.

A financial asset is measured at held to collect if it meets both of the following conditions and is not designated as 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.

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

- the asset is held within 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.

2. Basis of preparation (continued)

2.4.1 Financial assets and liabilities (policies applied from 1 January 2018) (continued)

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.

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 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.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

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

Assessment whether contractual cash flows are solely payments of principal and interest ('SPPI')
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.

2. Basis of preparation (continued)

2.4.1 Financial assets and liabilities (policies applied from 1 January 2018) (continued)

Assessment whether contractual cash flows are solely payments of principal and interest ('SPPI') (continued)

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 Bank's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

The Bank holds a portfolio of long-term fixed rate loans for which the Bank 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 Bank has determined that the contractual cash flows of these loans are solely payments of principal and interest 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.

Contractual terms that introduce a more than the minimum exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

Loans and advances and financing activities for customers

Loans and advances and financing activities for customers' captions in the statement of financial position include:

- loans and advances and financing activities for customers measured at amortised cost; they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method;
- loans and advances and financing activities for customers mandatorily measured at FVTPL or designated as at FVTPL; these are measured at fair value with changes recognised immediately in profit or loss;
- the Bank has not designated its loans and advances at FVTPL.

When the Bank purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date (reverse repo or stock borrowing), the arrangement is accounted for as a loan or advance, and the underlying asset is not recognised in the Bank's financial statements.

2. Basis of preparation (continued)

2.4.1 Financial assets and liabilities (policies applied from 1 January 2018) (continued)

Loans and advances and financing activities for customers (continued)
For debt securities measured at FVOCI, gains and losses are recognised in OCI, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- interest revenue using the effective interest method;
- Expected credit loss (ECL) and reversals; and
- foreign exchange gains and losses.

When debt security measured at FVOCI is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss. The Bank elects to present in OCI changes in the fair value of certain investments in equity instruments that are not held for trading. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable. Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised in profit or loss. Dividends are recognised in profit or loss unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in OCI. Cumulative gains and losses recognised in OCI are transferred to retained earnings on disposal of an investment.

Reclassifications
Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets.

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

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

The amount presented separately in OCI related to changes in own credit risk of a designated financial liability at FVTPL are not recycled to profit or loss, even when the liability is derecognised and the amounts are paid. Instead, own credit gains and losses should be reclassified to retained earnings within equity upon derecognition of the relevant liability.

2. Basis of preparation (continued)

2.4.1 Financial assets and liabilities (policies applied from 1 January 2018) (continued)

Derecognition

From 1 January 2018, any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities.

If the terms of a financial asset are modified, the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value.

De-recognition due to substantial modification of terms and conditions

The Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be purchased or originated credit impaired ("POCI").

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, to the extent that an impairment loss has not already been recorded.

De-recognition other than for substantial modification

Financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when the rights to receive cash flows from the financial asset have expired. The Bank also derecognises the financial asset if it has both transferred the financial asset and the transfer qualifies for derecognition.

The Bank has transferred the financial asset if, and only if, either:

- The Bank has transferred its contractual rights to receive cash flows from the financial asset

Or

- It retains the rights to the cash flows, but has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass–through' arrangement

2. Basis of preparation (continued)

2.4.1 Financial assets and liabilities (policies applied from 1 January 2018) (continued)

Derecognition (continued)
Pass-through arrangements are transactions whereby the Bank retains the contractual rights to receive the cash flows of a financial asset (the 'original asset'), but assumes a contractual obligation to pay those cash flows to one or more entities (the 'eventual recipients'), when all of the following three conditions are met:

- The Bank has no obligation to pay amounts to the eventual recipients unless it has collected equivalent amounts from the original asset, excluding short-term advances with the right to full recovery of the amount lent plus accrued interest at market rates
- The Bank cannot sell or pledge the original asset other than as security to the eventual recipients
- The Bank has to remit any cash flows it collects on behalf of the eventual recipients without material delay.

In addition, the Bank is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents including interest earned, during the period between the collection date and the date of required remittance to the eventual recipients.

A transfer only qualifies for derecognition if either:

- The Bank has transferred substantially all the risks and rewards of the asset; or
- The Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.
- The Bank considers control to be transferred if and only if, the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer.

When the Bank has neither transferred nor retained substantially all the risks and rewards and has retained control of the asset, the asset continues to be recognised only to the extent of the Bank’s continuing involvement, in which case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration the Bank could be required to pay. If continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the continuing involvement is measured at the value the Bank would be required to pay upon repurchase. In the case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Modifications of financial assets and financial liabilities
If the cash flows of the modified asset carried at amortised cost are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, the Bank recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in profit or loss. If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income.

If the terms of a financial asset were modified because of financial difficulties of the borrower and the asset was not derecognised, then impairment of the asset was measured using the pre-modification interest rate.

2. Basis of preparation (continued)

2.4.1 Financial assets and liabilities (policies applied from 1 January 2018) (continued)

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;
- financial guarantee contracts issued; and
- loan commitments issued.

No impairment loss is recognised on equity investments. The Bank measures loss allowances at an amount equal to lifetime ECL, except for other financial instruments on which credit risk has not increased significantly since their initial recognition which they are measured as 12-month ECL.

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

Measurement of ECL
ECL are a probability-weighted estimate of credit losses. They are measured as follows:
- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);
- 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;
- unutilized loan commitments: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive; and
- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

Overview of the ECL principles
The adoption of IFRS 9 has fundamentally changed the Bank's financing loss impairment method by replacing incurred loss approach with a forward-looking ECL approach. From 1 January 2018, the Bank has been recording the allowance for expected credit losses for all financing exposure and other debt financial assets not held at FVPL, together with financing commitments and financial guarantee contracts. Equity instruments are not subject to impairment under IFRS 9.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss (LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12-month ECL).

The 12 month ECL is the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Both LTECLs and 12 month ECLs are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments.

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument.

2. Basis of preparation (continued)

2.4.1 Financial assets and liabilities (policies applied from 1 January 2018) (continued)

Overview of the ECL principles (continued)

Based on the above process, the Bank groups its financing exposure into Stage 1, Stage 2, and Stage 3, as described below:

Stage 1

When financing are first recognised, the Bank recognises an allowance based on 12 month ECLs. Stage 1 financing exposure also include facilities where the credit risk has improved and the financing exposure has been reclassified from Stage 2. The Bank considers following types of debts as 'low credit risk (LCR)':

- All local currency sovereign exposures funded in local currency
- All local currency exposures to the Government of Oman or CBO

It is assumed that the credit risk has not increased significantly for those debt securities who carry low credit risk at the date of initial application of IFRS 9.

Stage 2

When a financing exposure has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. Stage 2 financing exposure also include facilities, where the credit risk has improved and the financing exposure has been reclassified from Stage 3.

Stage 3

Financing exposure considered credit-impaired. The bank records an allowance for the LTECLs.

At initial recognition of a financial asset, the Bank recognises a loss allowance equal to 12-month expected credit losses. After initial recognition, the three stages under the proposals would be applied as follows:

Stage 1

Credit risk has not increased significantly since initial recognition – recognise 12-month expected credit losses.

Stage 2

Credit risk has increased significantly since initial recognition – recognise lifetime expected losses (this is recognising a provision earlier than under IAS 39 Financial assets: Recognition and Measurement) with revenue being calculated based on the gross amount of the asset.

Stage 3

There is objective evidence of impairment as at the reporting date to recognise lifetime expected losses, with revenue being based on the net amount of the asset (that is, based on the impaired amount of the asset).

2. Basis of preparation (continued)

2.4.1 Financial assets and liabilities (policies applied from 1 January 2018) (continued)

Overview of the ECL principles (continued)
Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and profit is subsequently recognised based on a credit-adjusted effective interest rate (EIR). ECLs are only recognised or released to the extent that there is a subsequent change in the expected credit losses. For financial assets for which the Bank has no reasonable expectations of recovering either the entire outstanding amount, or a proportion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) derecognition of the financial asset.

When estimating Lifetime ECLs for unutilised loan commitments, the Bank estimates the expected portion of the loan commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the loan is drawn down, based on a probability-weighting. The expected cash shortfalls are discounted at an approximation to the expected EIR on the loan. For credit cards and revolving facilities that include both a loan and an unutilised commitment, ECLs are calculated and presented together with the loan. For loan commitments and letters of credit, the ECL is recognised within Provisions.

The calculation of ECLs
The Bank calculates ECLs based on a three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. The mechanics of the ECL calculations are outlined below and the key elements are, as follows:
- PD – The Probability of Default is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.
- EAD – The Exposure at Default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and profit, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued profit from missed payments.
- LGD - The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the Bank would expect to receive, including from the realisation of any collateral, if any. It is usually expressed as a percentage of the EAD. The Bank has applied a LGD of 0% on Government Development Bonds (GDB) & Treasury Bills (T-Bills) issued by Government of Oman which are classified as investments under amortised cost.

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

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

2. Basis of preparation (continued)

2.4.1 Financial assets and liabilities (policies applied from 1 January 2018) (continued)

Credit-impaired financial assets
At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

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

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail loan that is overdue for 90 days or more is considered impaired.

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;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision;

Write-off
Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

2. Basis of preparation (continued)

2.5 Financial instruments – initial recognition and subsequent measurement (policies applied before 1 January 2018)

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and advances, held-to-maturity investments and available-for-sale investments. Management determines the classification of its investments at initial recognition. The Bank classifies its financial liabilities into deposits from customers, subordinated debts and due to banks.

2.5.1 Date of recognition

All financial assets and liabilities are initially recognised on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. This includes "regular way trades": purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

2.5.2 Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on the purpose and the management's intention for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus transaction costs, except in the case of financial assets and financial liabilities recorded at fair value through profit or loss.

2.5.3 Financial assets at fair value through profit or loss

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

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

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

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

Financial assets and financial liabilities at fair value through profit or loss are recorded in the statement of financial position at fair value. Changes in fair value are recorded in investment income -net. Interest earned or incurred is accrued in interest income or interest expense, respectively, using the EIR, while dividend income is recorded in investment income –net, when the right to the payment has been established.

2. Basis of preparation (continued)

2.5 Financial instruments – initial recognition and subsequent measurement (policies applied before 1 January 2018) (continued)

2.5.4 Available-for-sale investments

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

The Bank has not designated any loans or receivables as available-for-sale. After initial measurement, available-for-sale financial investments are subsequently measured at fair value. Unrealised gains and losses are recognised directly in equity (other comprehensive income) in the cumulative changes in fair value. When the investment is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the profit or loss in other operating income. Where the Bank holds more than one investment in the same security, they are deemed to be disposed of on a first–in first–out basis. Interest earned whilst holding available-for-sale financial investments is reported as interest income using the effective interest rate. Dividends earned whilst holding available-for-sale financial investments are recognised in the profit or loss as other operating income when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the profit or loss in ‘Impairment of investments available-for-sale’ and removed from the cumulative changes in fair value of investments available-for-sale.

2.5.5 Held-to-maturity investments

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

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

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

2.5.6 Loans and advances to customers and due from banks

Loans and receivables to customers and due from banks are non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market.

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

2. Basis of preparation (continued)

2.5 Financial instruments – initial recognition and subsequent measurement (policies applied before 1 January 2018) (continued)

2.5.7 De-recognition

i) Financial assets

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

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

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

ii) Financial liabilities

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

2.5.8 Identification and measurement of impairment of financial assets

a) Assets carried at held to collect

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

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

2. Basis of preparation (continued)

2.5 Financial instruments – initial recognition and subsequent measurement (policies applied before 1 January 2018) (continued)

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

a) Assets carried at held to collect (continued)

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

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

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

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

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

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

If in a subsequent period, the amount of impairment loss decreases and decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the profit or loss.

b) Renegotiated loans

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

2. Basis of preparation (continued)

2.6 Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, including: cash and non-restricted balances with the CBO, treasury bills and other eligible bills, loans and advances to banks, amounts due from other banks, amounts due to other banks and short-term government securities. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

2.7 Offsetting of financial instruments

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

2.8 Property and equipment

Property and equipment are initially recorded at cost and are subsequently carried at cost less accumulated depreciation and accumulated impairment losses, if any. Depreciation on the assets except land is calculated using the straight-line basis to allocate their cost over the estimated useful lives, as follows:

	Years
Building	25
Leasehold improvements	5
Software	5
Equipment, furniture and fixtures	5
Motor vehicles	5

The assets’ residual values and useful lives are reviewed at each reporting date to assess whether they are recorded in excess of their recoverable amount, and where carrying values exceed this recoverable amount, assets are written down to their recoverable amount. Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit. Repairs and renewals are charged to the statement of comprehensive income when the expense is incurred. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditure is recognised in the profit or loss as an expense as incurred.

2.9 Impairment of non-financial assets

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset’s recoverable amount. An asset’s recoverable amount is the higher of an asset’s fair value less costs to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. 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. In determining fair value less costs to sell, an appropriate valuation model is used.

2. Basis of preparation (continued)

2.9 Impairment of non-financial assets (continued)

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Bank estimates the asset's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceeds the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the profit or loss.

2.10 Collateral pending sale

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

2.11 Borrowings

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

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

2.12 Perpetual bonds

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instrument. The Bank's perpetual bonds are not redeemable by holders and bear an entitlement to distribution that is non-cumulative and at the discretion of the board of directors. Accordingly, they are presented as component within equity along with the related interest and issue expense.

2.13 Employee terminal benefits

End of service benefits are accrued in accordance with the terms of employment of the Bank's employees at the reporting date, having regard to the requirements of the Oman Labour Law 2003 as amended. Employee entitlements to annual leave and leave passage are recognised when they accrue to employees and an accrual is made for the estimated liability arising as a result of services rendered by employees up to the reporting date. These accruals are included in other liabilities.

Contributions to a defined contribution retirement plan for Omani employees in accordance with the Omani Social Insurance Law 1991 are recognised as an expense in the statement of comprehensive income as incurred.

2. Basis of preparation (continued)

2.14 Voluntary end of service benefits

Voluntary end of service benefits are recognised as an expense when the Bank is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if it is probable that the offer made by the Bank will be accepted, and the number of acceptances can be estimated reliably.

2.15 Deposits from customers

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

2.16 Taxation

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

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

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

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

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

2.17 Fair value measurement principles

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

2. Basis of preparation (continued)

2.17 Fair value measurement principles (continued)

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

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

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

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

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

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

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

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

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

At each reporting date, the Bank analyses the movements in the values of assets and liabilities which are required to be re-measured or re-assessed as per the Bank's accounting policies. For this analysis, the Bank verifies the major inputs applied in the latest valuation by agreeing the information in the Valuation computation to contracts and other relevant documents. The Bank also compares the changes in the fair value of each asset and liability with relevant external sources to determine whether the change is reasonable.

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

2. Basis of preparation (continued)

2.18 Interest income and expense

Interest income and expense are recognised in the statement of comprehensive income for all instruments measured at amortised cost using the effective interest method, unless collectability is in doubt. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses.

The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Interest distribution on perpetual bonds, which are classified as equity, are recorded in the statement of changes in equity, when declared.

2.19 Fee and commission income

Fees and commission income and expenses that are in integral to the effective interest rate on a financial asset or liabilities are included in the measurement of the effective interest rate. Other fees and commission income are accounted for in accordance with IFRS 15 and IFRS 9 and are recognised as the related services are performed. Fees that relate to transaction and service are expense as the services are received.

2.20 Acceptances

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

2.21 Derivative financial instruments

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

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

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

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

The Bank makes use of derivative instruments to manage exposures to interest rate, foreign currency and credit risks, including exposures arising from highly probable forecast transactions and firm commitments. In order to manage particular risks, the Bank applies hedge accounting for transactions which meet specified criteria. Changes in the fair value of any such derivative instruments are recognised immediately in the profit or loss within ‘Other operating income’.

2. Basis of preparation (continued)

2.22 Financial guarantees contracts

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

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

2.23 Dividends on shares

Dividends on shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders. Dividends for the year that are approved after the reporting date are disclosed as an event after the reporting date.

2.24 Repurchase and resale agreements

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

2.25 Foreign currencies

(i) Transactions in foreign currencies are translated into Rial Omani at exchange rates ruling at the value dates of the transactions.

(ii)Monetary assets and liabilities denominated in foreign currencies are translated into Rial Omani at exchange rates ruling at the reporting date. The foreign currency gain or loss on monetary items is the difference between amortised costs in the Rial Omani at the beginning of the period, adjusted for effective interest and payments during the period and the amortised costs in foreign currency translated at the exchange rate at the end of the period. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

(iii) Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to Rial Omani at the exchange rate at the date that the fair value was determined. Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available-for-sale, are included in other comprehensive income.

2. Basis of preparation (continued)

2.26 Provisions

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

2.27 Directors' remuneration

The Directors' remuneration is governed as set out in the Articles of Association of the Bank, the Commercial Companies Law of the Sultanate of Oman and regulations issued by the Capital Market Authority.

The Annual General Meeting shall determine and approve the remuneration and the sitting fees for the Board of Directors and its sub-committees provided that such fees shall not exceed 5% of the annual net profit after deduction of the legal reserve and the optional reserve and the distribution of dividends to the shareholders provided that such fees shall not exceed RO 200,000. The sitting fees for each director shall not exceed RO 10,000 in one year.

2.28 Segment reporting

A segment is a distinguishable component of the Bank that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. The Bank currently operates only in the Sultanate of Oman. The Bank's primary format for reporting segmental information is business segments, based upon management and internal reporting structure. The Bank's segmental reporting is based on the following operating segments: Retail banking, Corporate banking and support and unallocated functions. The segment information is set out in note 41.

3. Critical accounting estimates and judgments in applying accounting policies

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

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

3.1 Impairment losses on financial assets (applicable to 2018 only)

The measurement of impairment losses under IFRS 9 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit

3. Critical accounting estimates and judgments in applying accounting policies (continued)

3.1 Impairment losses on financial assets (policy after 1 January 2018) (continued)

risk. These estimates are driven by number of factors, changes in which can result in different levels of allowances.

The Bank's ECL calculations are outputs of complex models with number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Bank's internal credit grading model
- The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a Lifetime Expected Credit Losses (LTECL) basis and the qualitative assessment
- The segmentation of financial assets when their ECL is assessed on a collective basis
- Development of ECL models, including the various formulas and the choice of inputs
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on Probability of Default (PD), Exposure At Default (EAD) and Loss Given Default (LGD)
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

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

3.3 Impairment of available-for-sale investments (applicable to 2017 only)

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost or objective evidence of impairment exists. This determination of what is considered to be significant or prolonged requires judgement. However, any decline in fair value of an equity investment below its cost for a continuous period of more than 12 months is considered as prolonged, by the end of the current financial year. In applying judgement, the Bank evaluates among other factors, the volatility in share price. Objective evidence of impairment may be due to deterioration in the financial health of the investee, industry and sector performance.

3. Critical accounting estimates and judgments in applying accounting policies (continued)

3.4 Taxes (applicable to 2017 and 2018)

Uncertainties exist with respect to the interpretation of tax regulations and the amount and timing of future taxable income. Given the wide range of business relationships and nature of existing contractual agreements, differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate future adjustments to tax income and expense already recorded. The Bank establishes provisions, based on reasonable estimates, for possible consequences of finalisation of tax assessments of the Bank. The amount of such provisions is based on various factors, such as experience of previous tax assessments and differing interpretations of tax regulations by the taxable entity and the responsible tax authority.

3.5 Going concern (applicable to 2017 and 2018)

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

3.6 Classification of investments (applicable to 2017 only)

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

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

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

3.7 Classification of financial assets (applicable to 2018 only)

Classification of financial assets in the appropriate category depends upon the business model and SPPI test. Determining the appropriate business model and assessing whether the cash flows generated by the financial asset meet the SPPI test is complex and requires significant judgements by management. The Bank applies judgement while carrying out SPPI test and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

3. Critical accounting estimates and judgments in applying accounting policies (continued)

3.8 Fair value of financial instruments (applicable to 2017 and 2018)

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but if this is not available, judgment is required to establish fair values.

4. Adoption of new and revised International Financial Reporting Standards (IFRS)

4.1 New and amended standards and interpretations to IFRS relevant to the Bank

For the year ended 31 December 2018, the bank has adopted all of the following new and revised standards and interpretations issued by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for periods beginning on 1 January 2018.

- IFRS 9 Financial Instruments
- IFRS 15 Revenue from Contracts with Customers
- IFRIC 22 Foreign Currency Transactions and Advance Consideration

The adoption of above standards and interpretations has not resulted in significant changes to the Bank's accounting policies and has not affected the amounts reported and disclosures for the current and prior periods except as noted below.

IFRS 9 Financial Instruments
IFRS 9 has significant impact on the Bank's financial statements and details are set out below:

The Bank has adopted IFRS 9 as issued by the IASB in July 2014 with a date of transition of 1 January 2018, which resulted in changes in accounting policies and adjustments to the amounts recognised in the financial statements. The Bank did not early adopt IFRS 9 in any previous periods. As permitted by the transitional provisions of IFRS 9, the bank elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognised in the opening retained earnings and other reserves of the current period. Consequently, for notes disclosures, the consequential amendments to IFRS 7 disclosures have been applied only to the current period. The comparative period notes disclosures repeat those disclosures made in the prior year.

The adoption of IFRS 9 has resulted in changes in the Bank's accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments such as IFRS 7 'Financial Instruments: Disclosures'.

4. Adoption of new and revised International Financial Reporting Standards (IFRS) (continued)

4.1 New and amended standards and interpretations to IFRS relevant to the Bank (continued)

IFRS 9 Financial Instruments (continued)

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

Classification of financial assets and financial liabilities
IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification of financial assets is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification.

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

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

There were no changes to the classification and measurement of financial liabilities.

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

Hedge accounting
IFRS 9 introduced a new hedge accounting model to simplify hedge accounting outcomes and provide a better linkage between an entity's risk management strategy, the rationale for hedging and the impact of hedging on the financial statements. Some of the key improvements in the standard impacting the Bank include:

Hedge effectiveness: IFRS 9 standard requires that the hedge effectiveness assessment be forward-looking and does not prescribe defined effectiveness parameters. Under IAS 39, an entity had to test effectiveness both retrospectively and prospectively subject to 80 to 125 percent effectiveness requirement.

4. Adoption of new and revised International Financial Reporting Standards (IFRS) (continued)

4.1 New and amended standards and interpretations to IFRS relevant to the Bank (continued)

IFRS 9 Financial Instruments (continued)

Hedge accounting (continued)

Hedge discontinuation: IFRS 9 standard provides that discontinuation of hedge accounting will only happen under specified circumstances. Under IAS 39, the Bank may revoke the hedging relationship if it seems fit.

These changes have not had a material impact on the statement of comprehensive income of the Bank. The Bank does not entered into any hedging arrangement during the previous and current year.

Transition

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

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.
- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.
  - The determination of the business model within which a financial asset is held.
  - The designation and revocation of previous designations of certain financial assets as measured at FVTPL
  - For hedging relationships under IAS 39, determination of whether these qualify for hedge accounting in accordance with the criteria of IFRS 9, after taking into account any rebalancing of the hedging relationship on transition, shall be regarded as continuing hedging relationships.

The CBO has issued guidelines relating to implementation of IFRS 9. The relevant requirements relating to transition are set out below:

- Should the existing loan loss impairment computed in accordance with the requirements of IAS 39 and CBO guidelines be higher than the impairment allowance computed under IFRS 9, the related difference (net of tax) be transferred to a loan loss impairment reserve from retained earnings as of 1 January 2018.
- In the subsequent years, where the allowance for loan loss impairment computed in accordance with CBO requirements is higher than the allowance for loan loss impairment loss computed under IFRS 9, the difference (net of tax) should be transferred to the aforementioned loan loss impairment reserve from retained earnings.
- The related impairment reserve will not be available for dividend distribution or for inclusion in the regulatory capital. Any subsequent utilisation of the impairment reserve would require prior approval of the CBO.

4.Adoption of new and revised International Financial Reporting Standards (IFRS) (continued)

4.1 New and amended standards and interpretations to IFRS relevant to the Bank (continued)

IFRS 9 Financial Instruments (continued)

Impact of adopting IFRS 9
Set out below is the impact of initial application of IFRS 9 on the Bank's financial statements:

	Retained earnings RO'000	**Fair value reserve RO'000**
Closing balance under IAS 39 (31 December 2017)	67,977	(1,845)
Impact on reclassification and remeasurements :		
Investment securities transferred from available-for-sale investments to those measured at fair value through profit or loss	(467)	467
	67,510	**(1,378)**
Impact on recognition of Expected Credit Losses		
Due from banks	(492)	-
Expected credit losses under IFRS 9 for loan and advances at amortised cost including loan commitments and financial guarantees	(2,613)	-
Expected credit losses under IFRS 9 for debt securities at held to collect	(3)	-
Estimated adjusted opening balance under IFRS 9 on date of initial application of 1 January 2018	**64,402**	**(1,378)**

4. Adoption of new and revised International Financial Reporting Standards (IFRS) (continued)

4.1 New and amended standards and interpretations to IFRS relevant to the Bank (continued)

IFRS 9 Financial Instruments (continued)

Expected credit loss / Impairment allowances

The following table reconciles the closing impairment allowance for financial assets in accordance with IAS 39 as at 31 December 2017 to the opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2018:

	31 December 2017 RO'000	Re-measurement RO'000	01 January 2018 RO'000
Loans and advances to customers	43,147	49	43,196
Due from banks	-	492	492
Available-for-sale debt investment securities under IAS 39/debt financial assets at FVOCI under IFRS 9	-	3	3
Loan Commitments and Financial Guarantees	-	2,563	2,563
	43,147	**3,107**	**46,254**

Classification and Measurement of Financial Instruments

The Bank performed a detailed analysis of its business models for managing financial assets as well as analysing their cash flow characteristics. The below table reconciles the original measurement categories and carrying amounts of financial assets in accordance with IAS 39 and the new measurement categories under IFRS 9 as at 31 December 2017.

					Impact of IFRS 9	
	Original classification under IAS 39	*New classificationunder IFRS 9*	*Original carrying amount RO'000*	*Re-measure-ment RO'000*	*Re-classifica-tion RO'000*	*New carrying amount RO'000*
Financial assets						
Cash and balances with central banks	Loans and receivables	Amortised cost	161,987	-	-	161,987
Due from banks	Loans and receivables	Amortised cost	108,868	(492)	-	108,376
Loans and advances to customers	Loans and receivables	Amortised cost	1,654,013	(2,612)	-	1,651,401
Investment securities – debt	Available-for-sale	FVOCI	-	-	-	-
Investment securities – debt	Available-for-sale	FVTPL	-	-	-	-
Investment securities – debt	Held-for-trading	Amortised cost	-	-	-	-
Investment securities – debt	Held-to-maturity	Amortised cost	123,847	(3)	900	124,744
Investment securities – equity	FVTPL	FVTPL	562	-	3,753	4,315
Investment securities – equity	Available-for-sale	FVOCI	13,958	-	(4,599)	9,359
Investment securities – equity	Held-for-trading	FVOCI	54	-	(54)	-
Accrued interest receivable	Loans and receivables	Amortised cost	12,379	-	-	12,379
Derivatives with positive fair value	FVTPL	FVTPL	321	-	-	321
Others	Loans and receivables	Amortised cost	63,010	-	-	63,010

Adoption of IFRS 9 did not result in any change in classification or measurement of financial liabilities.

4. Adoption of new and revised International Financial Reporting Standards (IFRS) (continued)

4.1 New and amended standards and interpretations to IFRS relevant to the Bank (continued)

IFRS 15 - Revenue from Contracts with Customers
IFRS 15 was issued in May 2014, and amended in April 2016, and establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The new revenue standard will supersede all current revenue recognition requirements under IFRS. The Bank adopted the new standard on the required effective date using the modified retrospective approach. The Bank performed an impact assessment and concluded that the impact is not material as in majority of the Bank's facility agreements with customers generally expected to be the only performance obligation and accordingly, adoption of IFRS 15 did not result in any material impact on the Bank's income and profit or loss. The related accounting policies are set out in note 2.18.

4.2 Standards issued but not yet effective

The following new standards and amendments have been issued by the International Accounting Standards Board (IASB) but are not yet mandatory for the year ended 31 December 2018:

IFRS 16 – Leases: The IASB issued IFRS 16 Leases (IFRS 16), which requires lessees to recognise assets and liabilities for most leases. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). For lessors, there is little change to the existing accounting in IAS 17 Leases. The Bank will perform a detailed assessment in the future to determine the extent. The new standard will be effective for annual periods beginning on or after 1 January 2019. IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17. Based on the initial assessment, the above standard has no material impact on the financial statements of the Bank as at the reporting date. The actual impact of adopting the standard on 1 January 2019 may change. The Bank will recognise new assets and liabilities for its operating leases. The nature of expenses relating to these leases will now change because IFRS 16 replaces the straight line operating lease expenses with a depreciation charge for right of use assets and interest expense on lease liabilities.

5. Financial risk management

Effective risk management is of primary importance for the bank. The bank's risk management process evaluates, monitors and manages the risks associated with the businesses the bank conducts in line with the defined risk appetite. The principal types of risks that the bank faces are credit risk, liquidity risk, market risk (price risk, interest rate risk and currency risk) and operational risk. The Board of Directors defines risk limits and sets suitable policies in this regard for management of credit risk, liquidity risk as well as market risk in both the trading and the banking book of the Bank. Risk Management is carried out by the Risk Management Department in accordance with documented policies approved by the Board of Directors.

A bank risk committee, comprising the bank's most senior risk professionals, provides a forum for the review and approval of risk measurement methodologies, risk control processes and the approval of new products, including approval of LGDs and eligible collateral for ECL calculations. The bank risk committee also reviews all risk policies and limits. The risk management control process is based on a detailed structure of policies, procedures and limits, and comprehensive risk measurement and management information systems for the control, monitoring and reporting of risks.

5. Financial risk management (continued)

5.1 Credit risk

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. Credit exposures arise principally from lending activities, investment activities and other assets in the Bank's asset portfolio. There is also credit risk in off-balance sheet financial instruments, such as loan commitments and financial guarantees.

Credit risk is one of the most significant risks for the Bank. The Bank has a robust credit risk framework and policies for each of the businesses it operates. The policies are aligned with the risk appetite and credit limits are set up based on the counter party risk rating, industry sector, and as per the guidelines of Central Bank of Oman. Credit risk is actively managed and rigorously monitored in accordance with well-defined credit policies and procedures. Prior to the approval of a credit proposal, a detailed credit risk assessment is carried out which includes an analysis of the obligor financial condition, market position, business environment and quality of management. The credit risk management and control are centralised in the credit risk management team which is divided into corporate, financial institutions and retail groups. The credit risk in corporate and financial institutions portfolio is primarily managed by the Credit Department while the Retail Banking Department manages the credit risk in the retail portfolio. The Risk Management Department reviews the credit risk independently and directly reports to the Audit and Risk Management Committee of the Board of Directors. The risk management framework also includes policies with respect to problem recognition, early warning lists, watch lists, classification parameters and risk rating adjustments.

Significant increase in credit risk
When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the bank 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 Bank's historical experience and taking into consideration both internal and external indicators, expert credit assessment, guidelines issued by CBO and inclusion of forward-looking information. Besides assessing the qualitative characteristics, the Bank's assessment of probability of default of individual counterparties is mainly linked with the number of days the borrower was in default as defined by the CBO circular number BM 977 dated 25 September 2004 and the special dispensation for specific projects of Government owned entities. In addition, the Bank assesses the adequacy of the security and financial performance of the borrowers in further downgrading the classification.

Debt investment securities are considered to have low credit risk when their credit risk rating is equivalent to an investment grade rating or a debt investment security with similar credit risk characteristics. The criteria for determining whether credit risk has increased significantly vary by portfolio and include quantitative changes in the probability of default (PDs) and qualitative factors, including whether the exposure has been watch-listed, whether the exposure is more than 30 days past due and as a backstop based on delinquency.

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 liquidating collateral; or the borrower is past due more than 90 days on any credit obligation to the Bank. In assessing whether a borrower is in default, the Bank considers both qualitative factors such as breaches of covenants and quantitative factors such as overdue status and non-payment on another obligation of the same issuer to the Bank.

5. Financial risk management (continued)

5.1 Credit risk (continued)

Incorporation of forward-looking information

The Bank incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. Based on consideration of a variety of external actual and forecast information, the Bank formulates a fundamental view of the future direction of relevant economic variables as well as a reasonable range of possible scenarios.

Given the nature of the bank's exposures and availability of historical statistically reliable information, the bank derives the point-in-time (PIT) probability of default (PD) using the through-the-cycle (TTC) PD data published by Moody's for each rating category. The Bank links TTC PDs with forward looking economic factors to drive PIT PD estimates for each rating category. The methodology takes into consideration forward looking economic forecasts under three scenarios (base case, negative case, and positive case), historical economic data, the asset correlation of each rating category, and TTC PDs for deriving PIT PDs. The relationship between the economic factors and default and loss rates have been developed using internal historical data and relevant external market data.

Measurement of ECL

The key input parameters into the measurement of ECL are the probability of default (PD), loss given default (LGD) and exposure at default (EAD). These parameters are derived from internally developed statistical models, other historical data using both internal and external factors, and incorporates forward-looking information.

PD estimates are estimates at a certain date, and are calculated using the banks internal recovery data after consideration of the contractual maturities of exposures and estimated prepayment rates.

The PIT PD estimates are converted to cumulative PIT PDs for exposures that have tenors in excess of one year and that are assessed on lifetime PDs. The lifetime PDs are calculated by compounding the 12-month PIT PDs.

LGD is the magnitude of the likely loss if there is a default. The bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties, based on historical data using both internal and external factors.

EAD represents the expected exposure in the event of a default. The bank derives the EAD from the current exposure to the counterparty and potential changes to the current amounts allowed under the contract including amortisation. The EAD of a financial asset is its gross carrying amount. For lending commitments and financial guarantees, the EAD is converted to balance sheet equivalents.

Subject to a maximum of 12-month PD for financial assets for which credit risk has not significantly increased, the bank measures ECL considering the risk of default over the maximum contractual period over which it is exposed to credit risk. Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics including instrument type, credit risk ratings and geographic location of the borrower.

The Bank calculates PIT PD estimates under three scenarios, a base case, negative case and positive case. A probability weighted ECL is then calculated by assigning probabilities, based on current market conditions, to each scenario. At 31 December 2018, the probabilities assigned to the base case, negative case and positive case scenarios were in the ratio of 66.66%:16.67%:16.67% respectively.

5. Financial risk management

5.1 Credit risk (continued)

Credit risk profile

The Bank monitors, manages and controls credit risk exposures based on an internal credit rating system that rates individual obligors based on a certain rating scale. The internal credit rating is a measure of the credit-worthiness of a single obligor, based on an assessment of the credit risk relating to senior unsecured, medium-term, foreign currency credit exposure. The primary objectives of the internal credit rating system are the maintenance of a single uniform standard for credit quality measurement, and to serve as the primary basis for Board-approved risk parameters and delegated credit authority limits.

The internal ratings map as follows:

Internal rating grade	***Internal classification***
Investment grade	
Rating grade 1	Standard
Rating grade 2	Standard
Rating grade 3	Standard
Rating grade 4	Standard
Rating grade 5	Standard
Sub-investment grade	
Rating grade 6	Standard
Rating grade 7	Standard
Rating grade 8	Standard
Rating grade 9	Standard
Rating grade 10	Standard
SM	Special Mention
Classified	
SS	Sub-standard
DD	Doubtful
LS	Loss

5. Financial risk management (continued)

5.1 Credit risk (continued)

Credit risk profile (continued)

The credit risk profile, based on internal credit ratings, was as follows:

	Due from banks RO 000	Investment securities RO 000	Loans and advances RO 000	Credit related contingent items RO 000
Stage 1 (12-month ECL)				
Rating grades 1 to 5	326,949	3,025	523,485	159,095
Rating grade 6 to 7	222,072	-	202,977	39,191
Rating grade 8 to 9	137	-	442,111	78,928
Rating grade 10	3	-	32,709	63,998
Equity investments	-	466	-	-
Carrying amount (net)	**549,160**	**3,491**	**1,201,282**	**341,211**
Stage 2 (Lifetime ECL but not credit-impaired)				
Rating grades 1 to 5	-	-	91,416	110,727
Rating grade 6 to 7	-	-	77,976	79,691
Rating grade 8 to 9	-	-	131,488	221,491
Rating grade 10	-	-	56,599	17,449
Special Mention	-	-	313,453	92,465
Carrying amount (net)	**-**	**-**	**670,932**	**521,824**
Stage 3 (Lifetime ECL and credit-impaired)				
Sub-Standard	-	-	2,307	-
Doubtful	-	-	4,934	-
Loss	-	-	28,413	-
Carrying amount (net)	**-**	**-**	**35,654**	**-**

The above analysis is reported net of the following provisions for impairment:

Stage	Due from banks RO 000	Investment securities RO 000	Loans and advances RO 000	Credit related contingent items RO 000
Stage 1	538	12	7,202	119
Stage 2	-	-	24,067	346
Stage 3	-	-	15,847	-
Total	**538**	**12**	**47,116**	**465**

Stage 3 financial assets represent assets for which there is objective evidence that the Bank will not collect all amounts due, including both principal and interest, in accordance with the contractual terms of the obligation.

5. Financial risk management (continued)

5.1 Credit risk (continued)

Credit risk profile (continued)

The Bank's internal credit rating grades along with the respective PDs are as below:

Internal rating grades	Internal rating grade description	12 M PD (Corporate) (%)	12 M PD (Retail) (%)
1	Exceptional	0.079	0.03
2	Excellent	0.124	0.03
3	Very Strong	0.194	0.03
4	Strong	0.303	0.153
5	Strong	0.594	0.188
6	Acceptable	0.744	0.201
7	Acceptable	1.163	0.561
8	Average	1.817	1.132
9	Average	2.833	1.645
10	Marginal	4.503	18.919

Economic variable assumptions
The following tables set out the key drivers of expected loss and the assumptions used for the Bank's base case estimate, ECLs based on the base case, plus the effect of the use of multiple economic scenarios, as at 31 December 2018.

Key drivers	ECL scenario and assigned weightage	2019	2020	2021	2022	2023
GDP growth	Base (66.6%)	2.05%	3.60%	2.95%	3.41%	3.85%
(% change)	Upside (16.7%)	5.63%	3.91%	4.00%	4.10%	4.21%
	Downside (16.7%)	2.06%	2.06%	2.09%	2.83%	3.57%
Oil revenue	Base (66.6%)	24.26%	24.71%	27.84%	29.65%	31.42%
(%GDP)	Upside (16.7%)	38.49%	31.63%	32.02%	32.41%	32.84%
	Downside (16.7%)	24.30%	24.30%	24.43%	27.36%	30.30%

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Bank considers these forecasts to represent its best estimate of the possible outcomes and has analysed the non-linearities and asymmetries within the Bank's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible scenarios.

'Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also been considered, but are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on a quarterly basis.

5. Financial risk management (continued)

5.1 Credit risk (continued)

5.1.1 Risk mitigation policies

The Bank manages limits and controls concentrations of credit risk – in particular, to individual counterparties and groups, and to industries and countries.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored and reviewed periodically by the Management Credit Committee, Audit and Risk Management committee of the Board of Directors and the Executive Committee of the Board of Directors.

The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on- and off-balance sheet exposures. Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate.

Some other specific control and mitigation measures are outlined below.

(a) Collateral

The Bank employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security for funds advanced, which is common practice. The Bank implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for loans and advances are:

- charges over business assets such as premises, inventory and accounts receivable
- lien on fixed deposits
- cash margins
- mortgages over residential and commercial properties
- pledge of marketable shares and securities

Longer-term finance and lending to corporate entities are generally secured. The housing loans are secured by mortgage over the residential property. Credit cards and similar revolving credit facilities are generally unsecured. Additionally, in order to minimise the credit loss the Bank seeks additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances.

(b) Assessment of the financial capabilities of the borrowers

The borrowers with balances above the limit specified are subject to the review of their audited financial statements. The relationship managers remain in close contact with the borrowers. The Bank assesses the financial performance of the borrowers by reviewing key performance ratios, including solvency and liquidity ratios. The annual reviews are performed by the relationship managers and are also reviewed by the Risk Management Department.

5. Financial risk management (continued)

5.1 Credit risk (continued)

5.1.1 Risk mitigation policies (continued)

(c) Credit-related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit carry the same credit risk as loans. Documentary and commercial letters of credit – which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions – are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct loan.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards.

The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments. The concentration of credit related commitments by industry sector at the year-end is set out in Note 36(a).

An analysis of the loans and advances for which collaterals or other credit enhancements are held is as follows:

	Performing loans (neither past due nor impaired) RO'000	Loans past due and not paid RO'000	Non performing loans RO'000	Gross Loans RO'000
Loans and advances with collateral available	**490,013**	**90,369**	**36,489**	**616,871**
Loans and advances with guarantees available	**29,479**	**-**	**7,906**	**37,385**
Balance as at 31 December 2018	**519,492**	**90,369**	**44,395**	**654,256**
Balance as at 31 December 2017	489,451	107,740	34,379	631,570

5.1.2 Impairment and provisioning policy (applicable to 2017 only)

Impairment allowances are recognised for financial reporting purposes only for losses that have been incurred at the reporting date based on objective evidence of impairment. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Bank about the loss events as well as considering the guidelines issued by the CBO.

The Bank's credit policy requires the review of individual financial assets on a quarterly basis or earlier when individual circumstances require. Impairment allowances on individually assessed accounts are determined by an evaluation of the incurred loss at the reporting date on a case-by-case basis, and are applied to all individually significant accounts. The assessment normally encompasses collateral held (including re-confirmation of its enforceability) and the anticipated receipts for that individual account.

5. Financial risk management (continued)

5.1 Credit risk (continued)

5.1.2 Impairment and provisioning policy (applicable to 2017 only) (continued)

Collectively assessed impairment allowances are provided for: (i) portfolios of homogenous assets that are individually not significant; and (ii) losses that have been incurred but have not yet been identified, by using the available historical experience and experienced judgment. The critical estimates used in determining the provision for impairment are explained in Note 3

5.1.3 Maximum exposure to credit risk before collateral held or other credit enhancements

Items on the statement of financial position	2018 RO' 000	2017 RO' 000
Cash and balances with Central Bank of Oman	**194,801**	161,987
Due from banks	**91,272**	108,868
Loans and advances		
Corporate loans	**1,120,627**	981,990
Personal loans	**767,409**	722,482
Other assets	**48,507**	46,280
Held to collect / held to maturity investment		
Government Development Bonds	**122,263**	85,847
Treasury Bills	**-**	38,000
	2,344,879	2,145,454
Off-Balance sheet items		
Letters of credit	**210,776**	262,250
Guarantees	**437,579**	481,340
Financial guarantees	**137,015**	153,858
	785,370	897,448
Unutilised loan commitments	**1,854**	62,767
	787,224	960,215

The above table represents the worst-case scenario of credit risk exposure to the Bank at 31 December 2018 and 31 December 2017 without taking into account the collateral held or other credit enhancements. Management is confident that the Bank has suitable policies to measure and control the credit risk. In addition, credit risk is mitigated through collaterals in the form of mortgages and guarantees wherever required.

a) 61% (2017 – 59%) of the inter-bank placements is with a local bank rated investment grade and above based on the ratings assigned by External Credit Rating Agencies.
b) Loans and advances represent 78 % (2017 – 77 %) of the total on-balance sheet items. Of the total loans and advances 80 % (2017 - 86 %) are neither past due nor impaired.
c) The impaired loans represent 2.7 % (2017 – 2.9 %) of the total loans as at 31 December 2018. The impaired personal loans constitute 0.60 % of the total loans at 31 December 2018 compared to 0.58 % at 31 December 2017.

5. Financial risk management (continued)

5.1 Credit risk (continued)

5.1.4 Loans and advances and due from banks

a) Loans and advances and due from banks are summarised as follows:

31 December 2018	**Loans and advances to customers RO' 000**	**Due from banks RO' 000**	**Total RO' 000**
Neither past due nor impaired	**848,158**	**91,810**	**939,968**
Special Mention loans	**321,628**	**-**	**321,628**
Past due but not impaired	**666,749**	**-**	**666,749**
Impaired	**51,501**	**-**	**51,501**
Gross loans and advances	**1,888,036**	**91,810**	**1,979,846**
Less: allowance for loan impairment and contractual interest not recognized	**(55,219)**	**(538)**	**(55,219)**
Net loans and advances	**1,832,817**	**91,272**	**1,924,627**

31 December 2017	Loans and advances to customers RO' 000	Due from banks RO' 000	Total RO' 000
Neither past due nor impaired	1,379,392	108,868	1,488,260
Special mention loans	191,508	-	191,508
Past due but not impaired	83,299	-	83,299
Impaired	50,273	-	50,273
Gross loans and advances	1,704,472	108,868	1,813,340
Less: allowance for loan impairment and contractual interest not recognised	(50,459)	-	(50,459)
Net loans and advances	1,654,013	108,868	1,762,881

5. Financial risk management (continued)

5.1 Credit risk (continued)

5.1.4 Loans and advances and due from banks (continued)

b) The break-up of the loans and advances to customers in respect of the risk ratings adopted by the Bank are:

31 December 2018	**Retail loans RO' 000**	**Corporate loans RO' 000**	**Total RO' 000**
Standard loans	**752,166**	**762,741**	**1,514,907**
Special mention loans	**3,988**	**317,640**	**321,628**
Substandard loans	**1,853**	**1,125**	**2,978**
Doubtful loans	**3,438**	**3,770**	**7,208**
Loss	**5,964**	**35,351**	**41,315**
	767,409	**1,120,627**	**1,888,036**

31 December 2017	Retail loans RO' 000	Corporate loans RO' 000	Total RO' 000
Standard loans	709,620	753,071	1,462,691
Special mention loans	2,901	188,607	191,508
Substandard loans	1,834	926	2,760
Doubtful loans	2,438	1,525	3,963
Loss	5,689	37,861	43,550
	722,482	981,990	1,704,472

c) Age analysis of loans and advances past due but not impaired is set out below:

	2018 RO' 000	2017 RO' 000
Past due up to 30 days	**551,154**	24,320
Past due 30-60 days	**59,221**	30,915
Past due 60-90 days	**56,374**	28,064
Total	**666,749**	83,299
Fair value of collateral	**127,218**	144,335

d) Loans and advances individually impaired

	2018 RO' 000	2017 RO' 000
Individually impaired loans	**51,510**	50,273
Fair value of collateral	**35,458**	25,897

5. Financial risk management (continued)

5.1.5 Loans and advances renegotiated

These arrangements include extended payment arrangements, deferral of payments and modification of interest rates. Following restructuring, a previously past due loan account is reclassified as a normal loan and managed with other similar loans which are neither past due nor impaired. The restructuring arrangements are based on the criteria and indicators which in the judgement of the management will indicate that the payment will most likely continue.

The total restructured loans at 31 December 2018 amounted to RO 54,520,835 (2017 – RO 12,353,105). In accordance with a related CBO circular, the restructuring provision is waived for a certain exposure pertaining to a customer.

5.1.6 Debt securities

The Bank's investments in debt securities are mainly in Government Development Bonds or treasury bills denominated in Rial Omani issued by the Government of Oman. The Bank also invests in debt securities issued by other banks based on their individual external credit rating. These investments are made to deploy the surplus liquid funds with maximum return.

5.1.7 Repossessed collateral

Repossessed properties are sold as soon as practicable with the proceeds used to reduce the outstanding balance of the debt. Repossessed assets are classified as other assets in the statement of financial position. The value of assets obtained by the Bank by taking possession held as collateral as security at 31 December 2018 is RO 803,000 (2017 – RO 183,000).

5.2 Market risk

The Bank takes on exposures to market risk which is the risk that the fair value or the future cash flows of the financial assets carried at fair value will fluctuate because of changes in market prices. Market risks arise from the open positions in interest rate, currency and equity products, all of which are exposed to changes in interest rates, credit spreads, equity prices and foreign exchange rates. The market risks are monitored by the Treasury Division and the Risk Management Department. Management is confident that the Bank has proper risk management policies in place to ensure that interest risk, liquidity risk and foreign exchange risk are mitigated considering the macroeconomic indicators affecting the banking business.

5.2.1 Price risk

The Bank holds listed securities classified as held-for-trading to take advantage of short-term and capital market movements. All investment securities present a risk of loss of capital. The Bank controls this risk through a careful selection of securities in accordance with Investment Management Policy approved by the Board. The maximum risk resulting from financial instruments is determined by the carrying amount of the financial instruments. The Bank’s market positions are reviewed periodically by the management.

A significant portion of Bank’s investments include equity securities which are publicly traded on the Muscat Securities Market (MSM). The Bank’s profits at 31 December 2018 may decrease by 1.14% (2017 – increase by 0.08%) due to increase by 10% in the MSM - 30 Index and the GCC market indices, with all the other variables held constant. The Bank’s investments have historically performed in line with the MSM - 30 Index.

5. Financial risk management (continued)

5.2 Market risk (continued)

5.2.2 Interest rate risk

Interest rate risk is the risk that the value of a financial instrument carried at fair value will fluctuate due to changes in the market interest rates. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amount of interest based assets and liabilities that mature or re-price in a given period. The Bank manages this risk by matching/re-pricing of assets and liabilities. The Bank is not excessively exposed to interest rate risk as its assets and liabilities are re-priced frequently. The Bank's Assets and Liabilities Committee (ALCO) monitors and manages the interest rate with the objective of limiting the potential adverse effects on the Bank's profitability. The table in Note 38 summarises the Bank's exposure to the interest rate risks. It includes the Bank's financial instruments at the carrying amount, categorised by the earlier of the contractual re-pricing and maturity dates.

For managing its interest rate risk in the banking book the Bank stipulates limits on open interest rate sensitive gaps for maturities up to 1 year and also periodically calculates Earnings at Risk (EaR) impact on its Net Interest Income (NII) from 100bps change in interest rates on open interest rate gaps for maturities up to 1 year. The EaR limit is stipulated as a certain percentage of the NII of the Bank for the previous year. The EAR at 31 December 2018 is 2.49% (2017 – 2.36%).

5.2.3 Currency risk

Currency risk arises when the value of a financial instrument changes due to changes in foreign exchange rates. In order to manage currency risk exposure the Bank enters into ready, spot and forward transactions in the inter-bank market as per documented policies approved by the Board of Directors.

The Bank's foreign exchange exposure comprises of forward contracts, foreign currencies cash in hand, balances with banks abroad, foreign placements and other assets and liabilities denominated in foreign currency. The management manages the risk by monitoring net open position in line with limits set by the management and approved by the Executive Committee of the Board and entering into forward contracts based on the underlying commercial transactions with the customers.

Additionally, appropriate segregation of duties exist between the front and back office functions while compliance with the net open position is independently monitored on an ongoing basis by the management and the Assets and Liabilities Committee (ALCO). The net open position of the Bank in foreign currency exposures at the yearend is set out below:

Net foreign currency exposure

	2018	2017
	RO'000	RO'000
USD	**6,827**	36,539
AED	**6,297**	1,121
GBP	**32**	12
Others	**3,663**	2,041
	16,819	39,713

Oman operates with a fixed exchange rate, and the Omani Rial is pegged to the USD at $2.5975 per Omani Rial.

5. Financial risk management (continued)

5.2 Market risk (continued)

5.2.4 Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value. It includes the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The Bank's funding activities are based on a range of instruments including deposits, other liabilities and assigned capital. Consequently, funding flexibility is increased and dependence on any one source of funds is reduced. The Bank maintains liquidity by continually assessing, identifying and monitoring changes in funding needs required to meet strategic goals set in terms of the overall strategy. In addition the Bank holds certain liquid assets as part of its liquidity risk management strategy.

The Bank manages the liquidity risk based on estimated maturities using the guidelines provided by the Central Bank of Oman for the estimates. The table in Note 36 represents cash flows receivable to and payable by the Bank under derivative and non-derivative assets and liabilities by estimated remaining maturities at the reporting date.

5.3 Operational risk

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems or from external events.

Losses from external events such as a natural disaster that has a potential to damage the Bank's physical assets or electrical or telecommunication failures that disrupt business are relatively easier to define than losses from internal problems such as employee fraud and product flaws. The risks from internal problems are more closely tied to the Bank's specific products and business lines; they are more specific to the Bank's operations than the risks due to external events. Operational risks faced by the Bank include IT Security, telecom failure, frauds, and operational errors.

Operational risk is controlled through a series of strong internal controls and audits, well-defined segregation of duties and reporting lines, operational manuals and standards. Internal audit independently reviews the effectiveness of the Bank's internal controls and its ability to minimise the impact of operational risks.

As a part of Business Continuity Management initiatives, the Bank has taken necessary actions to ensure effective measures in case of a crisis situation, e.g. evacuation drills, testing of critical systems and applications from the Disaster Recovery site. The Bank has the capability to ensure that critical banking processes are tested to ascertain availability during such situations.

5.4 Fair value estimation

The estimate of fair values of the financial instruments is based on information available to management as at 31 December 2018. Whilst management has used its best judgment in estimating the fair value of the financial instruments, there are inherent weaknesses in any estimation technique. The estimates involve matters of judgment and cannot be determined with precision. The bases adopted in deriving the fair values are as follows:

5. Financial risk management (continued)

5.4 Fair value estimation (continued)

5.4.1 Current account balances due to and from banks

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

5.4.2 Loans and advances

The fair value of non-performing loans approximates to the book value adjusted for allowance for loan impairment. For the performing loans, the fair value is taken as being equivalent to its carrying amount as the prevailing interest rates offered on similar loans are not materially different from the actual loan rates.

5.4.3 Investments at fair value through profit or loss (applicable to 2018 and 2017) and available-for-sale (applicable to 2017 only)

Quoted market prices, when available, are used as the measure for fair value. However, when the quoted market prices do not exist, fair value presented is estimated using discounted cash flow models or other valuation techniques. Changes in fair value resulting from these calculations are not material to the financial statements. Details are set out in note 10.

5.4.4 Customers' deposits

The fair value of demand, call, and savings deposits is the amount payable on demand at the reporting date, which equal to the carrying value of those liabilities. The estimated fair value of fixed rate deposits whose interest rates are materially different from the prevailing market interest rates are determined by discounting the contractual cash flows using the market interest rates currently offered for similar deposits.

5.4.5 Derivatives

The Bank usually enters into short term forward foreign exchange contracts, on behalf of its customers for the sale and purchase of foreign currencies. For forward foreign exchange contracts, it uses a valuation model with readily available market observable inputs. The model incorporates various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

5. Financial risk management (continued)

5.5 Financial instruments by category

The accounting policies for financial instruments have been applied to the line items below:

Assets as per statement of financial position	**Fair value through profit or loss (FVTPL) RO'000**	**Amortized Costs (AC) RO'000**	**Fair value through other comprehensive income (FVOCI) RO'000**	**Loans and receivables RO'000**	**Total RO'000**
31 December 2018					
Bank balances and cash	**-**	**-**	**-**	**194,801**	**194,801**
Due from banks	**-**	**-**	**-**	**91,272**	**91,272**
Loans and advances & Financing activities	**-**	**-**	**-**	**1,832,817**	**1,832,817**
Investment securities	**4,031**	**122,262**	**4,883**	**-**	**131,176**
Other assets	**-**	**-**	**-**	**48,507**	**48,507**
	4,031	**122,262**	**4,883**	**2,167,397**	**2,298,573**
31 December 2017					
Bank balances and cash	-	-	-	161,987	161,987
Due from banks	-	-	-	108,868	108,868
Loans and advances	-	-	-	1,654,013	1,654,013
Investment securities	616	123,847	13,958	-	138,421
Other assets	-	-	-	46,280	46,280
	616	123,847	13,958	1,971,148	2,109,569

Liabilities as per statement of financial position	**Other liabilities RO'000**	**Total RO'000**
31 December 2018		
Due to banks	**15,207**	**15,207**
Deposits from customers	**1,870,558**	**1,870,558**
Other liabilities	**60,241**	**60,241**
Subordinated Bonds	**20,000**	**20,000**
	1,966,006	**1,966,006**
31 December 2017		
Due to banks	4,011	4,011
Deposits from customers	1,746,856	1,746,856
Other liabilities	57,693	57,693
Subordinated bonds	20,000	20,000
	1,828,560	1,828,560

6. Capital management

The Bank's objectives of capital management are:

- to comply with the capital requirements set by the regulator i.e. the Central Bank of Oman;
- to safeguard the Bank's ability to continue as a going concern while providing adequate returns to the shareholders; and
- to maintain a strong capital base to support the development of its business.

The principal objective of the CBO capital adequacy requirements is to ensure that an adequate level of capital is maintained to withstand any losses which may result from the risks in a Bank’s statement of financial position, in particular credit risk. The CBO’s risk-based capital adequacy framework is consistent with the international standards of the Bank for International Settlements (BIS).

CBO requires the banks registered in the Sultanate of Oman to maintain the capital adequacy at a minimum of 12% based on guidelines of the Basel II accord from December 2010 onwards. In addition, CBO mandated the banks in Oman to maintain a Capital Conservation Buffer (CCB) under Basel III of 0.625% in addition to the minimum capital of 12% from 1 January 2014 to 1 January 2019. Additional CCB of 0.625% must be maintained annually between 1 January 2017 and 1 January 2019.

	2018	2017
	RO’000	RO’000
Capital		
Common Equity Tier 1 (CET 1)	**267,942**	260,267
Additional Tier 1	**72,553**	30,000
Total Tier 1	**340,495**	290,267
Tier 2	**28,756**	32,756
Total capital base	**369,251**	323,023
Risk weighted assets		
Credit risk	**2,058,470**	1,885,048
Market risk	**25,775**	30,713
Operational risk	**148,375**	143,438
Total risk weighted assets	**2,232,620**	2,059,199
Capital adequacy ratio %	**16.54%**	15.69%
CET 1 ratio	**12.00%**	12.64%
Tier 1 Capial ratio	**15.25%**	14.10%

The Tier 1 capital consists of paid-up capital, reserves and perpetual bonds. The Tier 2 capital consists of the subordinated bonds and ECL on stage 1 and stage 2 exposures in line with the circular BSD/CB/FLC/2018/17.

7. Cash and balances with the Central Bank of Oman

	2018 RO' 000	2017 RO' 000
Cash in hand	**40,308**	39,299
Balances with the Central Bank of Oman:		
- Clearing account	**85,384**	112,563
- Placements	**68,609**	9,625
- Capital deposit	**500**	500
	194,801	161,987

(i) The capital deposit cannot be withdrawn without the approval of the Central Bank of Oman. The capital deposit earns an annual interest at 1.5% (2017 – 1.0%).

(ii) During the year, average minimum balance to be kept with Central Bank of Oman as statutory reserves is RO 59.328 million (2017: RO 52.662 million).

8. Due from banks

	2018 RO'000	2017 RO'000
Placements	**84,516**	93,747
Current accounts	**7,294**	15,121
Due from banks and other money market placements	**91,810**	108,868
Less: allowance for credit losses	**(538)**	-
	91,272	108,868

Movement in allowances for the credit losses is set out below:

	2018 RO'000
Impact of adopting IFRS 9 (note 4.1)	**492**
Provided during the period	**46**
Balance at the end of the period	**538**

At 31 December 2018, 71% of the Bank's placements were with eight banks rated in the range of Aa3 to Baa3 and 22% of the placements were with Oman Housing Bank SAOC, which is owned by Government (2017– 81% of the Bank's placements were with Oman Housing Bank SAOC, which is owned by Government).

There have been no significant changes in due from banks and other money market placements gross balances, which have contributed to significant changes to the ECL over the year.

The credit quality and the maximum exposure to credit risk based on the Bank's internal credit rating system and the year-end staging classification is disclosed in note 5 to the financial statements.

9. Loans and advances and financing to customers

	2018	2017
	RO' 000	RO' 000
Corporate loans		
Term loans	**819,128**	710,437
Overdrafts	**136,148**	146,469
Bills Discounted	**79,355**	74,965
Islamic Finance	**85,996**	50,119
	1,120,627	981,990
Personal loans		
Consumer loans	**443,355**	431,166
Mortgage loans	**283,065**	249,475
Overdrafts	**612**	755
Credit cards	**3,815**	8,052
Islamic Finance	**36,562**	33,034
	767,409	722,482
Gross loans and advances	**1,888,036**	1,704,472
Less: allowance for loan impairment and contractual interest not recognised (refer to note (a) below)	**(55,219)**	(50,459)
Net loans and advances	**1,832,817**	1,654,013

Allowance for the credit losses and reserved interest

The movements in the allowance for the credit losses and reserved interest were as follows:

2018	**Allowance for credit losses RO' 000**	**Contractual interest not recognised RO' 000**	**Total RO' 000**
Balance at 31 December 2017	**43,147**	**7,312**	**50,459**
Impact of Adopting IFRS 9	**2,612**	**-**	**2,612**
Balance at 1 January 2018	**45,759**	**7,312**	**53,071**
Provided during the year	**11,142**	**3,838**	**14,980**
Amounts written off during the year	**(4,424)**	**(2,139)**	**(6,563)**
Amounts released / recovered during the year	**(4,881)**	**(1,388)**	**(6,269)**
Balance at end of year	**47,596**	**7,623**	**55,219**

9. Loans and advances and financing to customers (continued)

Allowance for the credit losses and reserved interest (continued)

2017	Allowance for credit losses RO' 000	Contractual interest not recognised RO' 000	Total RO' 000
At 1 January 2017	43,788	6,275	50,063
Provided during the year	8,276	3,299	11,575
Amounts written off during the year	(2,342)	(705)	(3,047)
Amounts released / recovered during the year	(6,575)	(1,557)	(8,132)
At 31 December 2017	43,147	7,312	50,459

Total allowance for the credit losses on the performing loans as at 31 December 2018 is RO 32,284,000 (2017: RO 21,216,990). The Central Bank of Oman regulation requires that the allowance for credit losses should be in accordance with IFRS 9 and if the provision requirement as per the Central Bank of Oman guidelines is higher than IFRS 9, the difference net of tax needs to be transferred to the “Impairment Reserve” as an appropriation from net profit after tax. Loans and advances on which interest has been reserved and/or has not been accrued amounted to RO 51,509,684 (2017: RO 50,272,537).

9. Loans and advances and financing to customers (continued)

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

Asset Classification as per CBO Norms	**Asset Classification as per IFRS 9**	**Gross Amount RO 000**	**Provision required as per CBO Norms RO 000**	**Provision held as per IFRS 9 RO 000**	**Difference between CBO provision required and provision held RO 000**	**Net Amount as per CBO norms* RO 000**	**Net Amount as per IFRS 9 RO 000**	**Interest recognised in P&L as per IFRS 9 RO 000**	**Reserve interest as per CBO norms RO 000**
(1)	(2)	(3)	(4)	(5)	(6) = (4)-(5)	(7)=(3)-(4)-(10)	(8) = (3)-(5)	(9)	(10)
	Stage 1	1,152,609	16,992	7,202	9,790	1,135,617	1,145,408	-	-
	Stage 2	362,298	3,600	4,818	(1,218)	358,698	357,480	-	-
Standard	Stage 3	-	-	-	-	-	-	-	-
		1,514,907	**20,592**	**12,020**	**8,572**	**1,494,315**	**1,502,888**	**-**	**-**
								-	
	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	321,628	4,606	19,240	(14,634)	315,986	302,388	-	1,036
Special Mention	Stage 3	-	-	-	-	-	-	-	-
		321,628	**4,606**	**19,240**	**(14,634)**	**315,986**	**302,388**	**-**	**1,036**
								-	
	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-	-	-
Substandard	Stage 3	2,978	732	671	61	2,189	2,307	-	56
		2,978	**732**	**671**	**61**	**2,189**	**2,307**	**-**	**56**
	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-	-	-
Doubtful	Stage 3	7,209	2,596	2,275	321	4,381	4,934	-	232
		7,209	**2,596**	**2,275**	**321**	**4,381**	**4,934**	**-**	**232**
	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-	-	-
Loss	Stage 3	41,315	16,645	12,901	3,744	18,370	28,413	-	6,300
		41,315	**16,645**	**12,901**	**3,744**	**18,370**	**28,413**	**-**	**6,300**
Other items not covered	Stage 1	950,405	-	669	(669)	950,405	949,737	-	-
under CBO circular BM	Stage 2	533,242	-	355	(355)	533,242	532,887	-	-
977 and related instructions	Stage 3	-	-	-	-	-	-	-	-
		1,483,647	**-**	**1,024**	**(1,024)**	**1,483,647**	**1,482,624**	**-**	**-**
	Stage 1	**2,103,014**	**16,992**	**7,871**	**9,121**	**2,086,022**	**2,095,145**	**-**	**-**
	Stage 2	**1,217,168**	**8,206**	**24,413**	**(16,207)**	**1,207,926**	**1,192,755**	**-**	**1,036**
	Stage 3	**51,502**	**19,973**	**15,847**	**4,126**	**24,940**	**35,654**	**-**	**6,587**
Total		**3,371,684**	**45,171**	**48,131**	**(2,960)**	**3,318,888**	**3,323,554**	**-**	**7,623**

9. Loans and advances and financing to customers (continued)

Stage Classification at origination and Staging Guidelines

At origination, all loans shall be classified in stage 1 as IFRS 9 stipulates a deterioration in credit quality since inception as criteria for stage 2 classification.

The exposures subsequent to the classification at origination shall be classified into three categories Stage 1, Stage 2 and Stage 3 for the purposes of provisioning for credit risk losses.

The expected credit loss computation is different based on the staging of the exposure.
Upon significant deterioration in the credit quality since inception of an exposure the asset is classified as Stage 2. Finally, when a default results the asset is classified as Stage 3. The classification of an exposure in Stage 2 and 3 are based on changes in the credit quality or default.

Stage 2 classification of assets, the significant deterioration in credit quality is based on the staging criteria articulated in the table in the next paragraph.

Stage 3 classification is for exposures in default. For this purpose, the default definitions used are when the past dues are for 90 days or more.

Islamic financing

Included in the above loans and advances are the following Islamic financing contracts:

2018	**Personal RO'000**	**Corporate RO'000**	**Total RO'000**
Musharaka	**26,743**	**31,909**	**58,652**
Murabaha	**5,308**	**15,177**	**20,485**
Ijarah Muntahia Bittamleek	**4,511**	**29,754**	**34,265**
Wakala	**-**	**9,156**	**9,156**
At 31 December 2018	**36,562**	**85,996**	**122,558**

2017	Personal RO'000	Corporate RO'000	Total RO'000
Musharaka	24,851	22,384	47,235
Murabaha	4,658	8,142	12,800
Ijarah Muntahia Bittamleek	3,525	13,410	16,935
Wakala	-	6,183	6,183
At 31 December 2017	33,034	50,119	83,153

9. Loans and advances and financing to customers (continued)

Restructured loans

RO 000

Asset Classification as per CBO Norms	Asset Classification as per IFRS 9	Gross Carrying Amount	Provision required as per CBO Norms	Provision held as per IFRS 9	Difference between CBO provision required and provision held	Net Carrying Amount as per CBO norms*	Net Carrying Amount as per IFRS 9	Interest recognised in P&L as per IFRS 9	Reserve interest as per CBO norms
(1)	(2)	(3)	(4)	(5)	(6) = (4)-(5)	(7)=(3)-(4)-(10)	(8) = (3)-(5)	(9)	(10)
Classified as performing	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	51,788	516	1,852	(1,336)	51,272	49,936	-	-
	Stage 3	-	-	-	-	-	-	-	-
		51,788	**516**	**1,852**	**(1,336)**	**51,272**	**49,936**	**-**	**-**
Classified as non-performing	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-	-	-
	Stage 3	3,228	1,318	1,311	7	1,674	1,917	-	236
		3,228	**1,318**	**1,311**	**7**	**1,674**	**1,917**	**-**	**236**
Total	**Stage 1**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
	Stage 2	**51,788**	**516**	**1,852**	**(1,336)**	**51,272**	**49,936**	**-**	**-**
	Stage 3	**3,228**	**1,318**	**1,311**	**7**	**1,674**	**1,917**	**-**	**236**
	Total	**55,016**	**1,834**	**3,163**	**(1,329)**	**52,946**	**51,853**	**-**	**236**

Concentration of loans and advances

All loans and advances were granted to customers within the Sultanate of Oman. The concentration of gross loans and advances by economic sector is as follows:

	2018 RO' 000		2017 RO' 000	
Personal loans	**767,409**	**41%**	722,482	42%
Construction	**237,479**	**13%**	280,754	16%
Manufacturing	**112,822**	**6%**	114,990	7%
Mining and quarrying	**146,901**	**8%**	127,172	7%
Services	**114,877**	**6%**	89,845	5%
Import trade	**63,668**	**3%**	50,448	3%
Transportation	**114,979**	**6%**	76,472	4%
Electricity , water & gas	**54,920**	**3%**	51,827	3%
Wholesale and retail trade	**65,748**	**3%**	51,786	3%
Financial institutions	**66,114**	**4%**	55,401	3%
Agriculture and allied activities	**5,486**	**0%**	5,492	1%
Export trade	**429**	**0%**	1,066	1%
Lending to non-residents	**2,048**	**0%**	1,305	1%
Others	**135,156**	**7%**	75,432	4%
	1,888,036	**100%**	1,704,472	100%

9. Loans and advances and financing to customers (continued)

Of the above, loans with variable interest rates amount to RO 727,178,004 (2017 – RO 706,079,194), loans carrying fixed interest rates amount to RO 1,038,300 (2017 – RO 915,239,806) and Islamic finance contracts amounts to RO 122,558,004 (2017 – RO 83,152,563).

Movement in Expected credit losses (ECL)

	Stage 1 RO 000	Stage 2 RO 000	Stage 3 RO 000	Total RO 000
Exposure subject to ECL				
- Loans and Advances to Customers	809,050	183,857	51,131	**1,044,038**
- Investment Securities (Debt)	2,400	-	-	**2,400**
- Loan Commitments and Financial Guarantees	434,303	497,448	378	**932,129**
- Due from Banks, Central Banks and Other Financial Assets	550,065	-	-	**550,065**
	1,795,818	**681,305**	**51,509**	**2,528,632**
Opening Balance (Day 1 impact) - as at 1 January 2018				
- Loans and Advances to Customers	7,948	17,911	17,417	**43,276**
- Investment Securities (Debt)	3	-	-	**3**
- Loan Commitments and Financial Guarantees	1,979	504	-	**2,483**
- Due from Banks, Central Banks and Other Financial Assets	492	-	-	**492**
	10,422	**18,415**	**17,417**	**46,254**
Net transfer between stages				
- Loans and Advances to Customers	1,441	(1,840)	399	**-**
- Investment Securities (Debt)	-	-	-	**-**
- Loan Commitments and Financial Guarantees	13	(13)	-	**-**
- Due from Banks, Central Banks and Other Financial Assets	-	-	-	**-**
	1,454	**(1,853)**	**399**	**-**
Charge for the Period (net)				
- Loans and Advances to Customers	(2,213)	7,988	(1,968)	**3,807**
- Investment Securities (Debt)	9	-	-	**9**
- Loan Commitments and Financial Guarantees	(1,848)	(138)	-	**(1,986)**
- Due from Banks, Central Banks and Other Financial Assets	46	-	-	**46**
	(4,006)	**7,850**	**(1,968)**	**1,876**
Closing Balance - as at 31 December 2018				
- Loans and Advances to Customers	7,177	24,060	15,847	**47,084**
- Investment Securities (Debt)	12	-	-	**12**
- Loan Commitments and Financial Guarantees	144	352	-	**496**
- Due from Banks, Central Banks and Other Financial Assets	538	-	-	**538**
	7,871	**24,412**	**15,847**	**48,130**

Impairment charge and provisions held

	As per CBO Norms	As per IFRS 9	RO 000 Difference
Impairment loss charged to profit and loss account	(4,873)	(4,873)	-
Provisions required as per CBO norms/held as per IFRS 9	**45,171**	**48,130**	**2,959**
Gross NPL ratio	**2.73%**	**2.73%**	
Net NPL ratio	**1.54%**	**1.89%**	

10. Investment securities

	Carrying value 2018 RO'000	*Carrying value 2017 RO'000*
Fair value through profit and loss (FVTPL):		
Quoted investments- Oman		
Banking and investment sector	**3,875**	431
	3,875	431
Quoted investments- Foreign		
Banking and investment sector	**156**	-
	156	-
Unquoted investments		
Banking and investment sector	**-**	131
	-	131
Total Fair value through profit and loss	**4,031**	562
Held for trading		
Quoted investments- Oman		
Banking and investment sector	**-**	54
Total held for trading	**-**	54
Equity investments measured at FVOCI:		
Quoted investments- Oman		
Manufacturing sector	**1,020**	-
Service sector	**1,957**	-
	2,977	-
Quoted investments- Foreign		
Service sector	**199**	-
	199	-
Unquoted investments		
Banking and investment sector	**1,362**	-
Manufacturing sector	**185**	-
Service sector	**160**	-
	1,707	-
Total FVOCI– Equity investments	**4,883**	-

10. Investment securities (continued)

	Carrying value 2018 RO'000	*Carrying value 2017 RO'000*
Available for sale		
Quoted investments- Oman		
Banking and investment sector	**-**	4,625
Manufacturing sector	**-**	1,175
Service sector	**-**	3,166
	-	8,966
Quoted investments- Foreign		
Banking and investment sector	**-**	2,589
Service sector	**-**	1,545
	-	4,134
Unquoted investments		
Banking and investment sector	**-**	858
Service sector	**-**	-
	-	858
Total available for sale	**-**	13,958
Investment Held to collect		
Quoted investments- Oman		
Government Development Bonds (GDBs)	**119,238**	-
Government Sukuk	**636**	-
Banking and investment sector	**2,388**	-
Total Held to collect	**122,262**	-
Held to collect		
Quoted investments- Oman	**-**	
Government Development Bonds	**-**	85,211
Treasury Bills	**-**	38,000
Government Sukuk	**-**	636
Total Held to collect	**-**	123,847
Total financial investments	**131,176**	138,421

Movement in allowances for the credit losses for debt securities at held to collect:

	31 December 2018 RO'000	*31 December 2017 RO'000*
Impact of adopting IFRS 9 (note 4.1)	3	-
Provided during the year	9	-
Balance at the end of the year	**12**	-

10. Investment securities (continued)

Details of investments exceeding 10% of the carrying value of the Bank's investment are as follows:

	Bank's portfolio %	*Carrying value RO'000*
31 December 2018		
Government Development Bonds and sukuks	**91%**	**119,874**
31 December 2017		
Government Development Bonds and sukuks	62%	85,847

In 2018, the Bank received dividends of RO 346,491 (note 29) from its FVOCI equities (2017: RO 648,060 (note 29) for available-for-sale securities), recorded as other operating income.

The Bank has designated its equity investments previously classified as available-for-sale as equity investments at FVOCI on the basis that these are not held for trading.

The Bank sold RO 3.91 million of FVOCI equity instruments in 2018 (2017: RO 17.96 million)

During the year ended 31 December 2018, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

11. Property and equipment

	Land and buildings RO'000	*Computer equipment RO'000*	*Equipment, furniture & fixtures RO'000*	*Motor vehicles RO'000*	*Capital work in progress RO '000*	*Total RO'000*
2018						
Cost						
At 1 January 2018	**21,571**	**21,506**	**14,369**	**667**	**992**	**59,105**
Additions	**-**	**2,751**	**1,445**	**1**	**680**	**4,877**
Transfers	**-**	**221**	**10**	**-**	**(231)**	**-**
Disposals	**-**	**(2,168)**	**(1,754)**	**(22)**	**-**	**(3,944)**
At 31 December 2018	**21,571**	**22,310**	**14,070**	**646**	**1,441**	**60,038**
Depreciation						
At 1 January 2018	**2,753**	**16,756**	**9,687**	**479**	**-**	**29,675**
Charge for the year	**590**	**1,871**	**1,524**	**67**	**-**	**4,052**
Relating to disposals	**-**	**(2,167)**	**(1,745)**	**(22)**	**-**	**(3,934)**
At 31 December 2018	**3,343**	**16,460**	**9,466**	**524**	**-**	**29,793**
Net book value						
At 31 December 2018	**18,228**	**5,850**	**4,604**	**122**	**1,441**	**30,245**

11. Property and equipment (continued)

	Land and buildings RO'000	*Computer Equipment RO'000*	*furniture & fixtures RO'000*	*Motor vehicles RO'000*	*work in progress RO '000*	*Total RO'000*
2017						
Cost						
At 1 January 2017	21,571	19,713	11,406	656	1,341	54,687
Additions	-	1,250	2,941	11	258	4,460
Transfers	-	546	61	-	(607)	-
Disposals	-	(3)	(39)	-	-	(42)
At 31 December 2017	21,571	21,506	14,369	667	992	59,105
Depreciation						
At 1 January 2017	2,163	14,889	8,580	404	-	26,036
Charge for the year	590	1,869	1,146	75	-	3,680
Relating to disposals	-	(2)	(39)	-	-	(41)
At 31 December 2017	2,753	16,756	9,687	479	-	29,675
Net book value						
At 31 December 2017	18,818	4,750	4,682	188	992	29,430

12. Other assets

	2018 RO 000	2017 RO 000
Customers' indebtedness against acceptances	**21,691**	25,021
Fees receivable	**4,314**	3,722
Interest receivable	**15,957**	8,657
Prepayments	**2,176**	1,849
Positive fair value of derivatives (note 35)	**249**	321
Others	**4,120**	6,710
	48,507	46,280

13. Due to banks

	2018 RO'000	2017 RO'000
Current accounts	**6,207**	4,011
Placements	**9,000**	-
	15,207	4,011

14. Deposits from customers

a) By type

	2018	2017
	RO'000	RO'000
Term deposits	**871,785**	738,813
Demand and call accounts	**708,266**	736,032
Saving accounts	**290,507**	272,011
	1,870,558	1,746,856

b) By sector

	2018	2017
	RO'000	RO'000
Private	**1,357,168**	1,351,964
Government	**513,390**	394,892
	1,870,558	1,746,856

Islamic customers' deposits

Included in the above customers' deposits are the following Islamic customer deposits:

	2018	2017
	RO'000	RO'000
Wakala acceptances	**105,700**	72,008
Current account - Qard	**12,714**	14,679
Mudaraba accounts	**3,730**	3,218
	122,144	89,905

15. Other liabilities

	2018 RO'000	2017 RO'000
Liabilities against acceptances	**21,691**	25,021
Interest payable	**20,687**	17,901
Accrued expenses and other payables	**10,053**	8,610
Cheques and trade settlement payable	**5,329**	3,364
Staff terminal benefits (note 16)	**830**	1,158
Interest and commission received in advance	**1,497**	1,349
Negative fair value of derivatives (note 35)	**154**	290
	60,241	57,693

16. Staff terminal benefits

	2018 RO'000	2017 RO'000
At 1 January	**1,158**	1,429
Charge for the year	**225**	225
Payment to employees during the year	**(553)**	(495)
At 31 December	**830**	1,158

17. Subordinated debt

In order to enhance the capital adequacy and to meet the funding requirements, the Bank has raised capital in the form of subordinated loans.

	2018 RO'000	2017 RO'000
Subordinated loans	**20,000**	20,000

The Bank obtained subordinated loans of RO 20 Million, which comply with Basel III requirements for tier-2 capital, for a tenor of five years and six months in November 2015. The loans carry a fixed rate of 5.5 % per annum, payable semi-annually with the principal payable on maturity.

18. Taxation

	2018	2017
	RO' 000	RO' 000
Statement of profit or loss:		
Current year	**5,182**	4,725
Prior years	**-**	120
Deferred tax	**480**	71
	5,662	4,916
Statement of financial position		
Current year	**5,363**	4,798
Deferred tax	**573**	93
	5,936	4,891
Deferred tax liability		
At 1 January	**93**	22
Movement for the year	**480**	71
At 31 December	**573**	93

The Bank is liable for income tax in accordance with the income tax laws of the Sultanate of Oman. The tax rate applicable to the Bank is 15% (2017: 15%). For determining the tax expense for the year, the accounting profit for the year has been adjusted for tax purposes. Adjustments for tax purposes include items relating to both income and expense. After giving effect to these adjustments, the average effective tax rate is estimated to be 15.51% (2017 – 15.02%). The deferred tax liability has been recognised at the effective rate of 15% (2017 - 15%).

	2018	2017
	RO' 000	RO' 000
Profit before tax	**35,802**	31,463
Tax at the applicable rate of 15%	**5,370**	4,719
Tax effect of temporary differences	**480**	74
Tax effect of income that is not taxable and expenses that are not deductible in determining taxable profit	**(668)**	(68)
Prior Period	**-**	120
Deferred tax liability created during the year	**480**	71
Tax expense for the year	**5,662**	4,916

Status of tax assessments

The assessments for the years up to 2013 are complete. The assessments for 2014 to 2017 are not yet finalised by the Tax Authorities. Management believes that no significant further liabilities will be incurred by the Bank on completion of the pending tax assessments as compared to the existing provision established.

19. Share capital

The authorised capital of the Bank is RO 200,000,000 and the issued share capital comprises 1,346,200,000 fully paid shares of RO 0.100 each (2017: 1,346,200,000 fully paid shares of RO 0.100 each).

RO 17,000,000 has been assigned as capital for the Islamic Banking services of the Bank (2017: RO 14,000,000)

	Country of incorporation	**Share holding %**	**2018 RO'000**	2017 RO'000
Oman International Development and Investment Company SAOG	Oman	**50.99**	**68,643**	68,643
Arab Bank Plc	Jordan	**49.00**	**65,964**	65,964
Oman Real Estate Investment Services SAOC	Oman	**0.01**	**13**	13
			134,620	134,620

20. Legal reserve

In accordance with Article 106 of the Commercial Companies Law of 1974, as amended of the Sultanate of Oman, the Bank is required to transfer 10% of its profit after tax for the year to legal reserve until the accumulated balance of the reserve equals at least one third of the Bank's paid up share capital. This reserve is not available for distribution.

21. General reserve

The Bank has established a policy to set aside a portion of the profit each year to a 'General reserve' in order to meet any unforeseen contingencies. No transfers were made from / to general reserve during the year 2018.

22. Subordinated debt reserve

The subordinated debt reserve has been created by a transfer of 20% of the subordinated loans out of the profit after tax for the year. The Central Bank of Oman requires that a reserve be set aside annually for the subordinated loans which are due to mature within five years (refer note 17). The reserve is available for transfer back to retained earnings upon maturity of the subordinated loans.

23. Special reserve

During 2015, the Bank sold its old head office premises at Ruwi since the head office operations have moved to the new premises at Al Ghoubra. The profit on sale of the premises amounting to RO 2,400,000 has been set aside as a special reserve, which requires prior approval of the Central Bank of Oman for any distribution.

On 20 June 2017, CBO issued a circular in relation to the reserve requirements for restructured accounts and the same stands withdrawn as on 18 November 2018. The special reserve is required to be held until the restructure accounts are upgraded. Accordingly, the Bank has transferred an amount of RO 1,515,810 (2017: RO 360,489) from retained earnings to special reserve.

24. Perpetual Tier 1 Capital Bonds

On 29 December 2016, the Bank issued unsecured perpetual Tier 1 bonds of RO 30 million (30,000,000 units of RO 1 each through private placement). The bonds are listed in the Muscat Securities Market and are transferable through trading. The bonds carry a fixed coupon rate of 7.75% per annum payable semi-annually in arrears and treated as deduction from equity. Interest is non-cumulative and payable at Bank's discretion. The bonds form part of Tier 1 Capital of the Bank and comply with Basel-3 and Central Bank of Oman regulation.

The Tier 1 bonds constitute direct, unconditional, subordinated and unsecured obligations of the Bank and are classified as equity in accordance with IAS 32: Financial Instruments – Classification. The Tier 1 bonds do not have a fixed or final maturity date and are redeemable by the Bank at its sole discretion on 29 January 2021 (the "First Call Date") or on any interest payment date thereafter subject to the prior consent of the regulatory authority.

Additionally, on 17 October 2018, the Bank issued another series of unsecured perpetual Tier 1 bonds of RO 42.5 million (42,553,000 units of RO 1 each through private placement). The bonds carry a fixed coupon rate of 7.5% per annum payable semi-annually in arrears and treated as deduction from equity. Interest is non-cumulative and payable at Bank's discretion. The bonds are in pari-passu with earlier issue.

25. Dividend proposed and paid

The Board of Directors proposed a cash dividend of RO 0.011 per share totalling to RO 14.81 million for the year ended 31 December 2018 (2017 - cash dividend of RO 0.011 per share totalling to RO 14.81 million). A resolution to approve the dividend will be presented to the shareholders at the Annual General Meeting.

During the year, a cash dividend of RO 0.011 per share totalling to RO 14.81 million was paid as approved by shareholders in their annual general meeting held on 28 March 2018.

26. Interest income

	2018 RO'000	2017 RO'000
Loans and advances	**93,583**	84,320
Oman Government Development Bonds and Sukuk	**4,895**	2,211
Treasury Bills	**744**	540
Amounts deposited with banks	**1,362**	1,044
	100,584	88,115

27. Interest expense

	2018 RO'000	2017 RO'000
Time deposits	**24,971**	23,522
Subordinated Debt	**1,100**	2,087
Call accounts	**3,128**	1,826
Amounts deposited by banks	**2,607**	2,801
Savings accounts	**2,255**	2,280
	34,061	32,516

28. Net fee and commission income

	2018 RO'000	2017 RO'000
Fee and commission on funded facilities	**15,648**	15,331
Fee and commission expense	**(910)**	(938)
	14,738	14,393

29. Net income from investment securities

	2018 RO'000	2017 RO'000
Fair value changes	**(244)**	(3)
Profit (loss) on sale of investments	**(1)**	495
Dividend income	**346**	648
	101	1,140

30. Other operating income

	2018 RO'000	2017 RO'000
Exchange income	**6,107**	5,763
Other income	**175**	843
	6,282	6,606

31. Operating expenses

	2018 RO'000	2017 RO'000
Staff costs (refer below)	**28,036**	27,190
Other operating expenses	**14,695**	14,399
Depreciation	**4,052**	3,680
Directors' remuneration	**177**	134
	46,960	45,403

Details of staff costs are as follows:

	2018	2017
Salaries	**19,067**	18,366
Allowances	**3,963**	3,912
Social security costs	**1,923**	1,898
End of service benefits	**224**	225
Other costs	**2,859**	2,789
	28,036	27,190

32. Earnings per share

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

	2018	2017
Profit for the year (RO'000)	**30,140**	26,547
Less: Issue expenses of Perpetual Tier 1 capital bonds (RO'000)	**(241)**	-
Less: Interest distribution of Perpetual Tier 1 capital bonds (RO'000)	**(2,325)**	(2,325)
Profit for the period attributable to equity holders of the Bank	**27,574**	24,222
Weighted average number of shares outstanding during the year	**1,346,200,000**	1,346,200,000
Basic earning per share (RO)	**0.020**	0.018

32. Earnings per share (continued)

The basic earnings per share is the profit for the period divided by the weighted average number of shares outstanding. No figure for diluted earnings per share has been presented, as the Bank has not issued any instruments, which would have an impact on earnings per share when exercised.

33. Related party transactions

Management service agreement with a shareholder

The Bank has a management agreement with Arab Bank Plc Jordan, a shareholder. During the year ended 31 December 2018, the management fees in accordance with the agreement amounted to RO 90,420 (2017: RO 79,641).

Other related parties transactions

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

2018	**Major shareholders RO'000**	**Others RO'000**	**Total RO'000**
Loans and advances	**6,004**	**60,888**	**66,892**
Customers' deposits	**1,624**	**32,375**	**33,999**
Due from banks	**33,460**	**-**	**33,460**
Due to banks	**878**	**-**	**878**
Stand by line of credit	**48,125**	**-**	**48,125**
Letters of credit, guarantees and acceptances	**155,661**	**3,615**	**159,276**

2017	Major shareholders RO'000	Others RO'000	Total RO'000
Loans and advances	11,500	56,007	67,507
Customers' deposits	619	22,566	23,185
Due from banks	35,725	-	35,725
Due to banks	1,538	-	1,538
Stand by line of credit	48,125	-	48,125
Letters of credit guarantees and acceptances	153,179	16,090	169,269

33. Related party transactions (continued)

Movement of loans and advances given to related parties:

	2018 RO'000	2017 RO'000
At 1 January 2018	**67,507**	58,060
Disbursed during the year	**236,451**	258,055
Paid during the year	**(234,047)**	(248,608)
At 31 December 2018	**69,911**	67,507

None of the loans and advances given to related parties were identified as impaired and no provision for any impairment has been recognised (2017: none identified or recognised)

The statement of comprehensive income includes the following amounts in relation to the transactions with related parties:

31 December 2018	**Major shareholders RO'000**	**Others RO'000**	**Total RO'000**
Interest and commission income	**1,018**	**2,438**	**3,456**
Interest expense	**523**	**622**	**1,145**

31 December 2017	Major shareholders RO'000	Others RO'000	Total RO'000
Interest and commission income	937	2,397	3,334
Interest expense	561	152	713

Key management compensation

The Directors' remuneration is set out in Note 31. The remuneration of other members of key management during the year was as follows:

	2018 RO'000	2017 RO'000
Salaries and other short-term benefits	**923**	1,261
End of service benefits	**26**	174
	949	1,435

34. Cash and cash equivalents

	2018 **RO'000**	2017 RO'000
Cash and balances with the Central Bank of Oman (CBO) (note 7)	**194,801**	161,987
Due from banks	**71,272**	90,868
Less: due to banks (note 13)	**(15,207)**	(4,011)
Restricted deposits included under balances with the CBO	**(500)**	(500)
	250,366	248,344

35. Derivative financial instruments

At the reporting date, there were outstanding forward foreign exchange contracts, all maturing within one year, entered into on behalf of customers for the sale and purchase of foreign currencies. These financial instruments have been recognised at prices in active markets for identical assets or liabilities. These fair values and the notional contracted amounts are summarised below:

31 December 2018	***Positive fair value RO'000 (note 11)***	***Negative fair value RO'000 (note 15)***	***Notional amount RO'000***	***Within 3 months RO'000***	***3 - 12 months RO'000***
Purchase contracts	**249**	**-**	**78,458**	**59,384**	**19,188**
Sale contracts	**-**	**(154)**	**(78,354)**	**(59,396)**	**(19,072)**
	249	**(154)**	**104**	**(12)**	**116**

31 December 2017	*Positive fair value RO'000 (note 11)*	*Negative fair value RO'000 (note 15)*	*Notional amount RO'000*	*Within 3 months RO'000*	*3 - 12 months RO'000*
Purchase contracts	321	-	33,548	26,104	7,444
Sale contracts	-	(290)	(33,516)	(26,085)	(7,431)
	321	(290)	32	19	13

Derivative financial instruments are fair valued as level 2.

36. Contingent liabilities and commitments

(a) Letters of credit and guarantees

The Bank is a party to financial instrument with off-balance sheet credit risk in the normal course of business to meet the financing needs of its customers. These financial instruments include standby letters of credit, financial guarantees to third parties, commitments to extend credit and others. The Bank's exposure to credit loss in the event of non-performance by the other party to such financial instruments is represented by the contract value or the notional amount of the instrument. However, generally the credit risk on these transactions is lower than the contract value or the notional amount.

The risk involved is essentially the same as the credit risk involved in extending loan facilities and therefore these transactions are subject to the same credit organisation, portfolio maintenance and collateral requirements for customers applying for loans and advances.

The outstanding contract value or the notional amounts of these instruments at 31 December were as follows:

	2018	2017
	RO'000	*RO'000*
Guarantees	**574,594**	635,198
Letters of credit	**210,776**	262,250
Unutilised commitment of facilities	**1,854**	62,767
	787,224	960,215

Letters of credit and guarantees amounting to RO 464,392,178 (2017: RO 557,458,987) were counter guaranteed by other banks.

(i) The allowances for credit losses for commitments and financial guarantees is included under note 9(b).

(ii) Contingent liabilities include RO 378,364 (2017– RO 467,951) relating to non-performing loans.

The table below analyses the concentration of contingent liabilities by economic sector:

	2018		2017	
	RO'000		RO'000	
Construction	**319,586**	**41%**	322,321	36%
Utilities	**187,620**	**24%**	236,007	26%
Export trade	**154,109**	**20%**	235,188	26%
Government	**23,472**	**3%**	45,064	5%
Import trade	**80,184**	**10%**	25,303	3%
Transportation	**4,206**	**1%**	16,046	2%
Wholesale and retail trade	**9,375**	**1%**	11,711	1%
Services	**3,023**	**0%**	2,823	1%
Manufacturing	**2,114**	**0%**	2,929	0%
Mining & Quarrying	**1,681**	**0%**	56	0%
	785,370	**100%**	897,448	100%

36. Contingent liabilities and commitments

(a) Letters of credit and guarantees (continued)

Credit-related financial instruments include unutilised commitments to extend credit, standby letters of credit and guarantees which are designed to meet the financing requirements of customers. The credit risk on these transactions is generally less than the contractual amount. The notional principal amounts of outstanding credit-related contingent items and the risk-weighted exposures calculated were as follows:

	31-Dec-18		31-Dec-17	
	Notional principal amount	**Risk-weighted exposure**	Notional principal amount	Risk-weighted exposure
Guarantees	**574,594**	**114,919**	635,198	127,040
Letters of credit	**210,776**	**42,155**	262,250	52,450
Unutilised credit of facilities	**1,854**	**927**	62,767	31,384
	787,224	**158,001**	960,215	210,874

(b) Capital commitments

At the reporting date, outstanding capital commitments in respect of premises and equipment purchases were RO 4,407,948 (2017: RO 4,645,780).

(c) Legal claims

Litigation is a common occurrence in the banking industry due to the nature of the business. The Bank has an established protocol for dealing with such legal claims. Once professional advice has been obtained and the amount of damages reasonably estimated, the Bank makes adjustments to account for any adverse effects which the claims may have on its financial standing. At year end, the Bank had certain unresolved legal claims which are not expected to have any significant implication on the Bank’s financial statements (2017: Nil).

37. Assets and liabilities maturity profile

The Bank has established policies to manage the liquidity risk arising from the mismatch in the final maturity of the assets and liabilities on the statement of financial position as explained in note 5.2.4. The table below represents cash flows receivable to and payable by the Bank under derivative and non-derivative assets and liabilities by estimated remaining maturities at the reporting date.

2018	On demand or within 3 months	3 to 12 months	Sub total	1 to 5 Years	Over 5 years	Total
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
Assets						
Cash and balances with the Central Bank of Oman	152,931	19,328	172,259	10,056	12,486	194,801
Due from banks	91,272	-	91,272	-	-	91,272
Loans and advances	406,197	160,820	567,017	449,912	815,888	1,832,817
Investment securities	11,356	20,000	31,356	28,326	71,494	131,176
Other assets	41,101	7,392	48,493	-	14	48,507
Property and equipment	-	-	-	-	30,245	30,245
Total assets	**702,857**	**207,540**	**910,397**	**488,294**	**930,127**	**2,328,818**
Liabilities						
Due to banks	15,207	-	15,207	-	-	15,207
Deposits from customers	377,641	695,819	1,073,460	362,033	435,065	1,870,558
Other liabilities	42,658	9,644	52,302	7,434	505	60,241
Subordinated loans	-	-	-	20,000	-	20,000
Taxation	5,363	573	5,936	-	-	5,936
Total liabilities	**440,869**	**706,036**	**1,146,905**	**389,467**	**435,570**	**1,971,942**
Net assets	**261,988**	**(498,496)**	**(236,508)**	**98,827**	**494,557**	**356,876**
Forward exchange contracts at notional amounts (note 35)						
Purchase contracts	59,384	19,188	78,572	-	-	78,572
Sale contracts	(59,396)	(19,072)	(78,468)	-	-	(78,468)
	(12)	**116**	**104**	**-**	**-**	**104**

37. Assets and liabilities maturity profile (continued)

2017	On demand or within 3 months RO'000	3 to 12 months RO'000	Sub total RO'000	1 to 5 years RO'000	Over 5 years RO'000	Total RO'000
Assets						
Cash and balances with the CBO	124,132	15,460	139,592	12,449	9,946	161,987
Due from banks	108,868	-	108,868	-	-	108,868
Loans and advances and financing to customers	198,126	216,046	414,172	436,272	803,569	1,654,013
Investment securities	37,613	19,000	56,613	28,667	53,141	138,421
Other assets	37,562	8,700	46,262	-	18	46,280
Property and equipment	-	-	-	-	29,430	29,430
	506,301	259,206	765,507	477,388	896,104	2,138,999
Liabilities						
Due to banks	4,011	-	4,011	-	-	4,011
Deposits from customers	435,823	539,644	975,467	435,949	335,440	1,746,856
Other liabilities	40,275	10,982	51,257	5,951	485	57,693
Subordinated bond	-	-	-	20,000	-	20,000
Taxation	4,798	93	4,891	-	-	4,891
	484,907	550,719	1,035,626	461,900	335,925	1,833,451
Net assets	21,394	(291,513)	(270,119)	15,488	560,179	305,548
Forward exchange contracts at notional amounts (note 35)						
Purchase contracts	26,104	7,444	33,548	-	-	33,548
Sale contracts	(26,085)	(7,431)	(33,516)	-	-	(33,516)
	19	13	32	-	-	32

37. Assets and liabilities maturity profile (continued)

The following table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments. For issued guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

2018	**On demand or within 3 months RO'000**	**3 to 12 months RO'000**	**1 to 5 years RO'000**	**Over 5 years RO'000**	**Total RO'000**
Letters of guarantee	**236,478**	**325,608**	**63,278**	**281**	**625,645**
Letters of credit	**158,692**	**1,033**	**-**	**-**	**159,725**
Total commitments and contingencies	**395,170**	**326,641**	**63,278**	**281**	**785,370**
2017					
Letters of guarantee	277,811	169,699	187,688	-	458,248
Letters of credit	255,688	6,562	-	-	439,200
Total commitments and contingencies	533,499	176,261	187,688	-	897,448

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The details of Bank's capital commitments and unutilised loan commitments are disclosed in note 36.

38. Assets and liabilities re-pricing profile

The re-pricing profile is based on contractual re-pricing or maturity dates, whichever dates are earlier. The Bank's assets and liabilities are included at carrying amounts.

2018	Average effective interest rate %	Within 3 months RO'000	4 to 6 months RO'000	7 to 12 months RO'000	> 1 to 5 years RO'000	Over 5 years RO'000	Non-interest bearing RO'000	Total RO'000
Assets								
Cash and balances with the								-
Central Bank of Oman	1.00	-	-	-	-	500	194,301	194,801
Due from banks	1.72	83,978	-	-	-	-	7,294	91,272
Loans and advances	5.27	653,364	62,205	11,683	1,069,564	36,001	-	1,832,817
Investment securities								
at FVTPL & FVOCI		-	-	-	-	-	8,914	8,914
Investment at Held to collect	4.57	-	-	20,000	30,714	71,548	-	122,262
Other assets		15,957	-	-	-	-	32,550	48,507
Property and equipment		-	-	-	-	-	30,245	30,245
Total assets		**753,299**	**62,205**	**31,683**	**1,100,278**	**108,049**	**273,304**	**2,328,818**
Liabilities								
Due to banks		-	5,000	-	4,000	-	6,207	15,207
Deposits from customers	1.73	306,328	215,448	253,627	173,190	-	921,965	1,870,558
Other liabilities		5,329	-	-	-	-	54,912	60,241
Subordinated debt	5.50	-	-	-	20,000	-	-	20,000
Taxation		-	-	-	-	-	5,936	5,936
Total liabilities		**311,657**	**220,448**	**253,627**	**197,190**	**-**	**989,020**	**1,971,942**
Total interest sensitivity gap		**441,642**	**(158,243)**	**(221,944)**	**903,088**	**108,049**	**(715,716)**	**356,876**

38. Assets and liabilities re-pricing profile (continued)

2017	Average effective interest rate %	Within 3 months RO'000	4 to 12 months RO'000		1 to 5 years RO'000	Over 5 years RO'000	Non-interest bearing RO'000	Total RO'000
Assets								
Cash and balances with the Central Bank of Oman	1.00	-	-	-	-	500	161,487	161,987
Due from banks	0.94	93,747	-	-	-	-	15,121	108,868
Loans and advances	5.08	528,730	124,585	38,570	913,657	48,471	-	1,654,013
Investment securities at fair value		-	-		-	-	14,574	14,574
Investment–held to maturity	1.67	23,000	15,000	4,000	28,668	53,179	-	123,847
Other assets		8,657	-	-	-	-	37,623	46,280
Property and equipment		-	-	-	-	-	29,430	29,430
Total assets		654,134	182,155	42,570	942,325	102,150	258,235	2,138,999
Liabilities								
Due to banks		-	-		-	-	4,011	4,011
Deposits from customers	1.58	426,011	208,157	123,181	175,924	-	813,583	1,746,856
Other liabilities		3,364	-	-	-	-	54,329	57,693
Subordinated debt	5.50	-	-	-	20,000	-	-	20,000
Taxation		-	-	-	-	-	4,891	4,891
Total liabilities		429,375	208,157	123,181	195,924	-	876,814	1,833,451
Total interest sensitivity gap		224,759	(68,572)	(80,611)	746,401	102,150	(618,579)	305,548

39. Geographical distribution of assets and liabilities

2018	Sultanate of Oman RO'000	Other GCC countries RO'000	Europe RO'000	United States of America RO'000	Others RO'000	Total RO'000
Assets						
Cash and balances with the Central Bank of Oman	**194,801**	**-**	**-**	**-**	**-**	**194,801**
Due from banks	**53,755**	**33,653**	**2,131**	**670**	**1,063**	**91,272**
Loans and advances	**1,832,817**	**-**	**-**	**-**	**-**	**1,832,817**
Investment securities	**128,993**	**1,082**	**-**	**-**	**1,101**	**131,176**
Other assets	**48,507**	**-**	**-**	**-**	**-**	**48,507**
Property and equipment	**30,245**	**-**	**-**	**-**	**-**	**30,245**
Total assets	**2,289,118**	**34,735**	**2,131**	**670**	**2,164**	**2,328,818**
Liabilities						
Due to banks	**12,231**	**2,001**	**875**	**-**	**100**	**15,207**
Deposits from customers	**1,870,558**	**-**	**-**	**-**	**-**	**1,870,558**
Other liabilities	**60,241**	**-**	**-**	**-**	**-**	**60,241**
Subordinated bonds	**20,000**	**-**	**-**	**-**	**-**	**20,000**
Taxation	**5,936**	**-**	**-**	**-**	**-**	**5,936**
Total liabilities	**1,968,966**	**2,001**	**875**	**-**	**100**	**1,971,942**

2017	Sultanate of Oman RO'000	Other GCC countries RO'000	Europe RO'000	United States of America RO'000	Others RO'000	Total RO'000
Assets						
Cash and balances with the Central Bank of Oman	161,987	-	-	-	-	161,987
Due from banks	55,395	38,427	13,380	779	887	108,868
Loans and advances	1,654,013	-	-	-	-	1,654,013
Investment securities	132,977	4,134	-	-	1,310	138,421
Other assets	46,280	-	-	-	-	46,280
Property and equipment	29,430	-	-	-	-	29,430
Total assets	2,080,082	42,561	13,380	779	2,197	2,138,999
Liabilities						
Due to banks	680	2,261	430	-	640	4,011
Deposits from customers	1,746,856	-	-	-	-	1,746,856
Other liabilities	57,693	-	-	-	-	57,693
Subordinated bonds	20,000	-	-	-	-	20,000
Taxation	4,891	-	-	-	-	4,891
Total liabilities	1,830,120	2,261	430	-	640	1,833,451

40. Customer concentration

2018	Due from banks RO'000	Gross loans and advances RO'000	Investment securities RO'000	Deposits from customers RO'000	Due to banks RO'000	Contingent liabilities RO'000
Personal	**-**	**767,409**	**-**	**525,847**	**-**	**512**
Corporate	**91,272**	**1,120,627**	**11,302**	**831,321**	**15,207**	**777,256**
Government	**-**	**-**	**119,874**	**513,390**	**-**	**7,602**
	91,272	**1,888,036**	**131,176**	**1,870,558**	**15,207**	**785,370**

2017		Assets			Liabilities	
	Due from banks RO'000	Gross loans and advances RO'000	Investment securities RO'000	Deposits from customers RO'000	Due to banks RO'000	Contingent liabilities RO'000
Personal	-	722,482	-	506,106	-	511
Corporate	108,868	981,990	14,574	845,859	4,011	888,446
Government	-	-	123,847	394,891	-	8,491
	108,868	1,704,472	138,421	1,746,856	4,011	897,448

41. Segment information

The Bank mainly operates in only one geographical location, the Sultanate of Oman. The Bank has however earned interest income and incurred interest expenses on account of money market placements and borrowings with banks outside the Sultanate of Oman as of 31 December 2018. The information regarding the bank's due from banks and due to banks based on the geographical locations for the years ended 31 December 2018 and 2017 is set out in note 39.

For management purposes, the conventional operations of the Bank is organised into four operating segments based on products and services. The Islamic banking services are offered under the brand name – "Al Yusr". The operating segments are as follows:

Retail banking	Individual personal loan, overdraft, credit card and funds transfer facilities.
Corporate banking	Loans and other credit facilities for corporate and institutional customers.
Treasury	Bonds, placements, bank borrowings, foreign exchange.
Head office and support	Other central functions and Head office.
Islamic Banking	Sharia' compliant Islamic banking products and services including Ijarah, Murabaha, Mudarbah and Diminishing Musharakah.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss which in certain respects is measured differently from operating profit or loss in the financial statements. The costs incurred by the central functions are managed on a group basis and are not allocated to operating segments.

41. Segment information (continued)

Cash and balances with Central Bank of Oman, Certificate of Deposits, due from banks, property and equipment and other assets are unallocated assets. No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Bank's total revenue in 2018 or 2017.

2018	**Retail banking RO'000**	**Corporate banking RO'000**	**Treasury RO'000**	**Head office and support RO'000**	**Islamic banking "Al Yusr" RO'000**	**Total RO'000**
Interest income	**38,476**	**55,108**	**6,677**	**323**	**-**	**100,584**
Interest expense	**(5,305)**	**(12,346)**	**(400)**	**(16,010)**	**-**	**(34,061)**
Other operating income	**6,023**	**9,208**	**2,662**	**170**	**3,058**	**21,121**
Total operating income	**39,194**	**51,970**	**8,939**	**(15,517)**	**3,058**	**87,644**
Assets	**730,847**	**1,034,631**	**382,979**	**34,131**	**146,230**	**2,328,818**
Liabilities	**501,833**	**1,246,581**	**47,008**	**51,575**	**124,945**	**1,971,942**
Allowance for impairment	**8,992**	**44,371**	**538**	**-**	**1,318**	**55,219**

2017	Retail banking RO'000	Corporate banking RO'000	Treasury RO'000	Head office and support RO'000	Islamic banking "Al Yusr" RO'000	Total RO'000
Interest income	37,558	46,762	3,521	274	-	88,115
Interest expense	(5,268)	(10,560)	(14)	(16,674)	-	(32,516)
Other operating income	7,753	8,499	2,629	1,256	2,002	22,139
Total operating income	40,043	44,701	6,136	(15,144)	2,002	77,738
Assets	689,448	931,871	375,260	38,943	103,477	2,138,999
Liabilities	488,072	1,168,879	2,985	81,371	92,144	1,833,451
Allowance for impairment	17,707	31,769	-	-	983	50,459