

**United Arab Bank P.J.S.C.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**31 DECEMBER 2016**



## *Independent auditor's report to the board of directors of United Arab Bank P.J.S.C.*

### *Report on the audit of the consolidated financial statements*

#### **Our opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of United Arab Bank P.J.S.C (the "Bank") and its subsidiary (together referred to as the "Group") as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board.

#### What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2016;
- the consolidated statement of income for the year then ended;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of cash flows for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

#### **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 consolidated financial statements* section of our report.

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

#### Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements that are relevant to our audit of the financial statements in the United Arab Emirates. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

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Douglas O'Mahony, Paul Suddaby, Jacques Fakhoury and Mohamed ElBorno are registered as practising auditors with the UAE Ministry of Economy



## *Independent auditor's report to the board of directors of United Arab Bank P.J.S.C. (continued)*

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### *Our audit approach*

#### **Overview**

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|-------------------|--|
| Key Audit Matters | <ul style="list-style-type: none"><li>• Impairment of credit facilities</li><li>• Restatement of hedge ineffectiveness identified in prior years</li></ul> |
|-------------------|--|
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As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on consolidated the financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

#### **Key Audit Matters**

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



## Independent auditor's report to the board of directors of United Arab Bank P.J.S.C (continued)

### Key Audit Matters (continued)

#### Key Audit Matter

#### How our audit addressed the Key Audit Matter

##### **Impairment of credit facilities**

Impairment allowances represent management's best estimate of the losses incurred within the credit portfolio at the balance sheet date. They are calculated on a collective basis for portfolios of performing loans of a similar nature and on an individual basis for non-performing loans. The calculation of both collective and individual impairment allowances is inherently judgemental.

The calculation of collective provision is based on statistical models which approximate the impact of current economic and credit conditions on portfolios of similar loans. The inputs to these models, including probabilities of default, loss given default, are subject to management judgement.

For specific impairments, judgement is required to determine when an impairment event has occurred and then to estimate the expected future cash flows related to that loan.

The Bank has reassessed and increased its impairment provisions during the year by applying incremental provisions and judgemental overlays, specifically to sectors impacted by continuing macro economic stress caused by the decline in oil prices and contraction in liquidity. The Bank has consequently recognised significant impairment losses of AED 1,011 million in 2016 (AED 888 million in 2015), in order to establish additional provisions against certain non-core higher risk portfolios which the Bank is in the process of liquidating.

We focused on this area because of the materiality of the credit portfolio and because management make subjective judgements over both timing of recognition of impairment and the estimation of the size of any impairment. Please refer to note 7 in the accompanying consolidated financial statements for additional details.

We assessed and tested the design and operating effectiveness of the controls over impairment data and calculations. These controls included those over the identification of which credit facilities were impaired, particularly with respect to credit facilities in certain non-core higher risk portfolios, the data transfer from source systems to impairment models and model output to the general ledger, and the calculation of collective and specific impairment provisions.

In addition, we performed detailed testing on the collective impairment models used to calculate impairment. This testing included testing of the extraction of data used in the model, assessing the appropriateness of the assumptions used in the models and re-performance of the impairment calculations with the assistance from our valuation specialists.

Where impairment was individually calculated, we tested controls over the timely identification of potentially impaired loans, approval and booking of impairment losses.

We also tested a sample of credit facilities to ascertain whether the loss event (the point at which impairment is recognised) had been identified in a timely manner, particularly with respect to credit facilities in certain non-core higher risk portfolios.

We also tested the completeness of the customer accounts that are included in the specific impairment calculation, including how unidentified impairment (customers that have had a loss event that has not yet manifested itself in a missed payment or other indicator) and forbearance are taken account of.

Where impairment had been identified, we examined the forecasts of future cash flows prepared by management to support the calculation of the impairment on a sample basis, challenging the assumptions and comparing estimates to external evidence where available, and re-performed the impairment calculation.

We examined a sample of credit facilities which had not been identified by management as potentially impaired and formed our own judgement as to whether that was appropriate including the use of external evidence in respect of the relevant counterparties.



## *Independent auditor's report to the board of directors of United Arab Bank P.J.S.C (continued)*

### **Key Audit Matters** (continued)

#### *Key Audit Matter*

#### *How our audit addressed the Key Audit Matter*

##### ***Restatement of hedge ineffectiveness identified in prior years***

The Bank enters into interest rate swaps to hedge fair value interest rate risk arising on its fixed rate bonds portfolio classified as available-for-sale. In previous years the Bank assumed that the hedges were effective on the basis that critical terms of the hedging instrument and the hedged item matched and, accordingly, the Bank did not perform detailed hedge effectiveness testing.

During the current year, the Bank, with the assistance of an independent expert, performed hedge effectiveness tests for all its hedging relationships. These tests demonstrated that while the hedges met the required hedge accounting criteria, there were cumulative hedge ineffectiveness losses of AED 32 million related to previous years that had not been recognised in the statement of income.

Management have rectified the errors by restating the prior year financial information in the consolidated financial statements for the year ended 31 December 2016. Note 32 to the consolidated financial statements sets out the details of the adjustments to reduce retained earnings as at 31 December 2014 and to record an additional loss in the comparative consolidated statement of income for the year ended 31 December 2015.

We focused on this area due to the complexity and judgements involved in the hedge effectiveness testing and the requirement to restate prior year comparatives to recognise the losses arising from hedge ineffectiveness.

We examined the Bank's independent price verification process and reviewed its reasonableness by inspecting the inputs to the independent pricing system and substantively comparing the independent valuation reports to the derivative valuations provided by the counterparties.

We re-performed the hedge effectiveness test for a sample of hedging relationships and reviewed the hedge effectiveness test for the remaining relationships, both prospectively and retrospectively. We also ensured the competence of the management's expert involved in performing this test.

We tested compliance with the hedge accounting criteria under IAS 39 and we checked the computation and booking of the relevant hedge accounting entries, including ineffectiveness relating to the current period and each of the prior periods

We assessed whether the Group's disclosures included in note 32 properly meet the requirements of IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors.



## *Independent auditor's report to the board of directors of United Arab Bank P.J.S.C (continued)*

### **Other information**

Management is responsible for the other information. The other information comprises The Director's Report (but does not include the consolidated financial statements and our auditor's report thereon) which we obtained prior to the date of this auditor's report.

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

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

If, based on the work we have performed, 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.

### **Other matters**

The consolidated financial statements of the Group as at and for the year ended 31 December 2015 were audited by another auditor, whose report dated 25 January 2016 expressed an unmodified audit opinion.

### **Responsibilities of management and those charged with governance for the consolidated financial statements**

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

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

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

### **Auditor's responsibilities for the audit of the consolidated financial statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an 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 consolidated financial statements.



## *Independent auditor's report to the board of directors of United Arab Bank P.J.S.C (continued)*

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

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

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

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 consolidated 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 board of directors of United Arab Bank P.J.S.C (continued)*

**Report on other legal and regulatory requirements**

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

- (i) we have obtained all the information we considered necessary for the purposes of our audit;
- (ii) the consolidated financial statements have been prepared and comply, in all material respects, with the applicable provisions of the UAE Federal Law No. (2) of 2015;
- (iii) the Group has maintained proper books of account;
- (iv) the financial information included in the report and Directors' report is consistent with the books of account of the Group;
- (v) as disclosed in note 9 to the consolidated financial statements, the Group has not purchased or invested in any shares during the year ended 31 December 2016;
- (vi) note 27 to the consolidated financial statements discloses material related party transactions and the terms under which they were conducted;
- (vii) note 25 to the consolidated financial statements discloses the social contributions made during the year; and
- (viii) based on the information that has been made available to us, nothing has come to our attention which causes us to believe that the Group has contravened during the financial year ended 31 December 2016 any of the applicable provisions of the UAE Federal Law No. (2) of 2015 or in respect of the Bank, its Memorandum and Articles of Association which would materially affect its activities or its financial position as at 31 December 2016.

Further, as required by the UAE Union Law No (10) of 1980, as amended, we report that we have obtained all the information and explanations we considered necessary for the purpose of our audit.

PricewaterhouseCoopers  
20 February 2017

A handwritten signature in black ink, appearing to read 'Mohamed ElBorno', written in a cursive style.

Mohamed ElBorno  
Registered Auditor Number 946  
Dubai, United Arab Emirates



United Arab Bank P.J.S.C.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2016

	Notes	2016 AED'000	2015 AED'000 (Restated)
<b>Assets</b>			
Cash and balances with the UAE Central Bank	5	2,766,528	3,075,352
Due from other banks	6	365,076	864,386
Loans and advances	7	13,345,562	15,671,631
Investments	8	3,313,753	2,559,350
Investment property	9	-	78,000
Property, equipment and capital work-in-progress	10	584,325	587,718
Other assets	11	876,300	827,186
<b>Total assets</b>		<b>21,251,544</b>	<b>23,663,623</b>
<b>Liabilities and shareholders' equity</b>			
<b>Liabilities</b>			
Due to banks	12	1,095,482	1,037,946
Customers' deposits	13	15,538,015	16,775,043
Medium term borrowings	14	1,524,005	2,313,549
Other liabilities	15	1,007,325	967,130
<b>Total liabilities</b>		<b>19,164,827</b>	<b>21,093,668</b>
<b>Shareholders' equity</b>			
Share capital	16	1,375,033	1,375,033
Special reserve	16	412,659	412,659
Statutory reserve	16	495,214	495,214
General reserve	16	9,311	9,311
Revaluation reserve	16	673	714
Retained earnings		(167,856)	354,794
Cumulative changes in fair values	16	(38,317)	(77,770)
<b>Total shareholders' equity</b>		<b>2,086,717</b>	<b>2,569,955</b>
<b>Total liabilities and shareholders' equity</b>		<b>21,251,544</b>	<b>23,663,623</b>

The financial statements were approved by the Board of Directors on 20<sup>th</sup> February 2017 and signed on its behalf by:



.....  
Sheikh Faisal Bin Sultan Bin Salem Al Qassimi  
Chairman



.....  
Samer Tamimi  
Acting Chief Executive Officer

The attached notes 1 to 32 form part of these consolidated financial statements.

United Arab Bank P.J.S.C.

CONSOLIDATED STATEMENT OF INCOME

At 31 December 2016

	<i>Notes</i>	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i> <i>(Restated)</i>
Interest income	17	<b>943,988</b>	1,216,833
Interest expense	18	<b>(310,378)</b>	(229,613)
<b>Net interest income</b>		<b>633,610</b>	987,220
Net fees and commission income	19	<b>83,870</b>	103,247
Foreign exchange income	20	<b>68,275</b>	75,947
Other operating income	21	<b>75,614</b>	29,683
<b>Operating income</b>		<b>861,369</b>	1,196,097
Net impairment losses	7	<b>(1,011,434)</b>	(887,791)
<b>Net operating (loss) / income</b>		<b>(150,065)</b>	308,306
Employee benefit expenses		<b>(225,404)</b>	(280,969)
Depreciation		<b>(34,350)</b>	(31,465)
Other operating expenses	22	<b>(112,872)</b>	(178,968)
<b>Total operating expenses</b>		<b>(372,626)</b>	(491,402)
<b>Net loss for the year</b>		<b>(522,691)</b>	(183,096)
<b>Losses per share (basic and diluted in AED)</b>	23	<b>(0.38)</b>	(0.13)

The attached notes 1 to 32 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME

At 31 December 2016

	<b>2016</b> <b>AED'000</b>	2015 AED'000 <i>(Restated)</i>
<b>Net loss for the year</b>	<b>(522,691)</b>	(183,096)
<b>Other comprehensive income</b>		
<i>Items that are or may be reclassified subsequently to the consolidated statement of income</i>		
Net changes in fair value of available for sale investments	<b>7,423</b>	(45,673)
Available for sale investments – reclassified to the consolidated statement of income	<b>32,030</b>	19,649
	<u><b>39,453</b></u>	<u>(26,024)</u>
<b>Total comprehensive loss for the year</b>	<u><b>(483,238)</b></u>	<u>(209,120)</u>

# United Arab Bank P.J.S.C.

## CONSOLIDATED STATEMENT OF CASH FLOWS

At 31 December 2016

	<i>Notes</i>	<b>2016</b> <i>AED'000</i>	<b>2015</b> <i>AED'000</i> <i>(Restated)</i>
<b>Operating activities</b>			
Net loss for the year		<b>(522,691)</b>	(183,096)
Adjustments for:			
Depreciation	10	<b>34,350</b>	31,465
Loss on write off of property and equipment	10	<b>11,578</b>	1,156
Net impairment losses	7	<b>1,011,434</b>	887,791
Amortisation of premium paid on investments		<b>25,959</b>	14,189
Net fair value gain on disposal of investments		<b>(39,929)</b>	(9,662)
Net fair value loss / (gain) on disposal of investment property	9	<b>3,000</b>	(1,089)
Operating profit before working capital changes		<b>523,701</b>	740,754
Changes in operating assets and liabilities:			
Loans and advances		<b>1,294,733</b>	1,381,481
Balances with UAE Central Bank maturing after three months		<b>(97,235)</b>	228,452
Due from other banks maturing after three months		<b>(33,193)</b>	(91,807)
Cash margin held by counterparty banks against borrowings and derivative transactions	6	<b>40,842</b>	(20,920)
Other assets	11	<b>(29,212)</b>	190,968
Due to banks maturing after three months		<b>(23,413)</b>	519,193
Customers' deposits	13	<b>(1,237,028)</b>	(1,943,254)
Other liabilities	15	<b>16,196</b>	(232,056)
Net cash generated from operating activities		<b>455,391</b>	772,811
<b>Investing activities</b>			
Purchase of property, equipment and capital work-in-progress	10	<b>(42,535)</b>	(211,224)
Purchase of investments		<b>(5,169,198)</b>	(2,873,787)
Proceeds from redemption / sale of investments		<b>4,492,217</b>	2,767,644
Proceeds from sale of investment properties	9	<b>75,000</b>	15,883
Net cash used in investing activities		<b>(644,516)</b>	(301,484)
<b>Financing activities</b>			
Net (repayment of) / proceeds from medium term borrowings	14	<b>(789,544)</b>	293,894
Directors' remuneration		-	(10,800)
Cash dividends paid	16	-	(114,586)
Net cash (used in) / generated from financing activities		<b>(789,544)</b>	168,508
<b>Net change in cash and cash equivalents</b>		<b>(978,669)</b>	639,835
Cash and cash equivalents at 1 January		<b>2,610,146</b>	1,970,311
<b>Cash and cash equivalents at 31 December</b>		<b>1,631,477</b>	2,610,146
Cash and cash equivalents comprise the following statement of financial position amounts with original maturities of three months or less:			
Cash and balances with UAE Central Bank		<b>1,647,961</b>	2,054,020
Due from other banks		<b>216,008</b>	707,669
Due to other banks		<b>(232,492)</b>	(151,543)
		<b>1,631,477</b>	2,610,146

The attached notes 1 to 32 form part of these consolidated financial statements.

United Arab Bank P.J.S.C.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2016

	<i>Share capital AED'000</i>	<i>Special reserve AED'000</i>	<i>Statutory reserve AED'000</i>	<i>General reserve AED'000</i>	<i>Revaluation reserve AED'000</i>	<i>Retained earnings AED'000</i>	<i>Cumulative changes in fair value AED'000</i>	<i>Total AED'000</i>
At 1 January 2015	1,145,861	412,659	495,214	9,311	750	914,759	(66,893)	2,911,661
Restatement due to prior period errors (Note 32)	-	-	-	-	-	(33,147)	15,147	(18,000)
At 1 January 2015 (restated – Note 32)	1,145,861	412,659	495,214	9,311	750	881,612	(51,746)	2,893,661
Loss for the year	-	-	-	-	-	(183,096)	-	(183,096)
Other comprehensive loss for the year	-	-	-	-	-	-	(26,024)	(26,024)
Total comprehensive loss for the year	-	-	-	-	-	(183,096)	(26,024)	(209,120)
Depreciation transfer for land and buildings	-	-	-	-	(36)	36	-	-
Scrip dividend	229,172	-	-	-	-	(229,172)	-	-
Cash dividend	-	-	-	-	-	(114,586)	-	(114,586)
At 31 December 2015 (restated – Note 32)	1,375,033	412,659	495,214	9,311	714	354,794	(77,770)	2,569,955
At 1 January 2016 (restated – Note 32)	<b>1,375,033</b>	<b>412,659</b>	<b>495,214</b>	<b>9,311</b>	<b>714</b>	<b>354,794</b>	<b>(77,770)</b>	<b>2,569,955</b>
Loss for the year	-	-	-	-	-	(522,691)	-	(522,691)
Other comprehensive income for the year	-	-	-	-	-	-	39,453	39,453
Total comprehensive loss for the year	-	-	-	-	-	(522,691)	39,453	(483,238)
Depreciation transfer for land and buildings	-	-	-	-	(41)	41	-	-
<b>At 31 December 2016</b>	<b>1,375,033</b>	<b>412,659</b>	<b>495,214</b>	<b>9,311</b>	<b>673</b>	<b>(167,856)</b>	<b>(38,317)</b>	<b>2,086,717</b>

The attached notes 1 to 32 form part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

**1 Incorporation and activities**

United Arab Bank P.J.S.C. (the “Bank”) was incorporated as a public company with limited liability in the Emirate of Sharjah in 1975 by a decree of His Highness The Ruler of Sharjah and has been registered as a public joint stock company under the UAE Commercial Companies Law No. (8) of 1984 (as amended). The Bank’s registered office is located in the Emirate of Sharjah, United Arab Emirates. The address of the registered office is PO Box 25022, Sharjah, United Arab Emirates.

The Bank carries out the business of commercial banking through its offices and branches in the United Arab Emirates. The Bank also carries out Islamic banking operations through Islamic banking windows at selected branches.

**Investment in subsidiary**

On 28 November 2011, Al Sadarah Investment Company was formed as an investment company by the Bank. Al Sadarah Investment Company (“the subsidiary”) started its operations on 3 May 2012 when the share capital was introduced into the subsidiary. The company is incorporated as a fully owned subsidiary of the Bank and the financial results of the subsidiary are fully consolidated in the Bank’s consolidated financial statements for the year ended 31 December 2016. The Bank and its subsidiary are together referred to as the “Group”.

The issued and fully paid up capital of the Al Sadarah Investment Company is 100 shares of AED 3,000 each, totalling AED 300,000 (31 December 2015: AED 300,000). The principal activities of the subsidiary are to make financial investments on its own, invest in commercial projects and provide investment advisory services.

**2 Basis of preparation**

**Statement of compliance**

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) and applicable requirements of United Arab Emirates laws. UAE Federal Law No. 2 of 2015 (“Companies Law”) which is applicable to the Group has come into effect on 1 July 2015. The Group has assessed and evaluated the provisions of the Companies Law and is in the process of ensuring compliance within the transitional period of this Law which has been extended to 30 June 2017.

**3 Significant accounting policies**

**New and revised International Financial Reporting Standards**

***Standards, amendments and interpretations that are effective for the Group’s accounting period beginning on 1 January 2016***

A number of new standards and amendments became effective for the year ended 31 December 2016. These are listed out below.

New standards and significant amendments to standards applicable to the Group	Effective for annual periods beginning on or after:
<p><b>Amendments to IAS 1 Presentation of financial statements (disclosure initiative)</b> The amendments clarify that it may be necessary to disaggregate some of the line items specified in IAS 1 paragraphs 54 (statement of financial position) and 82 (profit or loss). That disaggregation is required where it is relevant to an understanding of the entity’s financial position or performance.</p>	1 January 2016
<p><b>Amendment to IAS 16, ‘Property, plant and equipment’ and IAS 38, ‘Intangible assets’ regarding depreciation and amortisation.</b> This amendment clarifies that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. The presumption may only be rebutted in certain limited circumstances.</p>	1 January 2016

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

3 Significant accounting policies (continued)

**New and revised International Financial Reporting Standards (continued)**

*Standards, amendments and interpretations that are effective for the Group's accounting period beginning on 1 January 2016 (continued)*

New standards and significant amendments to standards applicable to the Group	Effective for annual periods beginning on or after:
<p><b>Annual improvements 2014</b>                      These annual improvements amend standards from the 2012 - 2014 reporting cycle. It includes changes to:</p> <ul style="list-style-type: none"> <li>• IFRS 7, 'Financial instruments: Disclosures' – The amendment related to servicing contracts requires that if an entity transfers a financial asset to a third party under conditions which allow the transferor to derecognise the asset, IFRS 7 requires disclosure of all types of continuing involvement that the entity might still have in the transferred assets.</li> <li>• IAS 19, 'Employee benefits' – The amendment clarifies, when determining the discount rate for post-employment benefit obligations, that it is the currency that the liabilities are denominated in that is important, not the country where they arise.</li> <li>• IAS 34, 'Interim financial reporting', regarding information disclosed elsewhere in the interim financial report. The amendment clarifies what is meant by the reference in the standard to 'information disclosed elsewhere in the interim financial report'. The amendment further amends IAS 34 to require a cross-reference from the interim financial statements to the location of that information. The amendment is retrospective.</li> </ul>	<p>1 January 2016</p>

There is no material impact of the above amendments and revised standards on the consolidated financial statements of the Group.

There are no other IFRSs or IFRIC interpretations that were effective for the first time for the financial year beginning on 1 January 2016 that have had a material impact on the Group's consolidated financial statements.

*Standards, amendments and interpretations issued but not yet effective for the Group's accounting period beginning on 1 January 2016 and not early adopted*

New standards and significant amendments to standards issued and not yet effective and not early adopted	Effective for annual periods beginning on or after:
<p><b>IFRS 9, 'Financial instruments'</b>                      The complete version of IFRS 9 replaces most of the guidance in IAS 39. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through OCI and fair value through P&amp;L. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities, there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value, through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually uses for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39.</p>	<p>1 January 2018</p>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

## 3 Significant accounting policies (continued)

## New and revised International Financial Reporting Standards (continued)

*Standards, amendments and interpretations issued but are not yet effective for the Group's accounting period beginning on 1 January 2016 and not early adopted (continued)*

New standards and significant amendments to standards issued and not yet effective and not early adopted	Effective for annual periods beginning on or after:
<p><b>Amendments to IAS 7, Statement of cash flows on disclosure initiative</b> These amendments to IAS 7 introduce an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities including those from cash flows and other non-cash changes. The new requirement typically entails a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities.</p>	1 January 2017
<p><b>IFRS 15, 'Revenue from contracts with customers'</b> This standard replaces IAS 11, 'Construction contracts', IAS 18, 'Revenue' and related interpretations. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use of and obtain the benefits from the good or service. The core principle of IFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. IFRS 15 also includes a cohesive set of disclosure requirements that will result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts with customers.</p>	1 January 2018
<p><b>IFRS 16 'Leases'</b> This standard replaces the current guidance in IAS 17. Under IAS 17, lessees were required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). IFRS 16 now requires lessees to recognise a lease liability reflecting future lease payments and a 'right-of-use asset' for virtually all lease contracts. The IASB has included an optional exemption for certain short-term leases and leases of low-value assets; however, this exemption can only be applied by lessees. For lessors, the accounting stays almost the same. However, as the IASB has updated the guidance on the definition of a lease (as well as the guidance on the combination and separation of contracts), lessors will also be affected by the new standard. At the very least, the new accounting model for lessees is expected to impact negotiations between lessors and lessees. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. IFRS 16 is not expected to have material impact on the consolidated financial statements.</p>	1 January 2019
<p><b>Amendments to IFRS 10, 'Consolidated financial statements' and IAS 28, 'Investments in associates and joint ventures' regarding the sale or contribution of assets between an investor and its associate or joint venture</b> These amendments address an inconsistency between IFRS 10 and IAS 28 in the sale or contribution of assets between an investor and its associate or joint venture. A full gain or loss is recognised when a transaction involves a business. A partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if those assets are in a subsidiary. These amendments are not expected to have material impact on the consolidated financial statements.</p>	Date to be determined

The Group has plans in place for adhering to the above new standards and amendments to published standards or IFRIC interpretations issued but not yet effective for the Group's financial year beginning on 1 January 2016. The Group is currently assessing the impact of these standards and interpretations on the consolidated financial statements.

There are no other applicable new standards and amendments to published standards or IFRIC interpretations that have been issued but are not effective for the first time for the Group's financial year beginning on 1 January 2016 that would be expected to have a material impact on the consolidated interim financial information of the Group.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**3 Significant accounting policies (continued)**

**Basis of measurement**

The consolidated financial statements are prepared under the historical cost convention except for the following financial assets and liabilities that are measured at fair value:

- derivative financial instruments;
- available-for-sale financial assets; and
- investment properties

**Functional and presentation currency**

The consolidated financial statements have been presented in UAE Dirhams which is the presentation currency of the Group and the functional currency of the Bank and its subsidiary and all values are rounded to the nearest thousand (AED'000) except when otherwise indicated.

**Basis of consolidation**

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary as at 31 December 2016 (collectively referred to as the "Group"). The following subsidiary has been consolidated within these consolidated financial statements:

<i>Name</i>	<i>Legal Status</i>	<i>Beneficial ownership</i>	<i>Country of incorporation</i>	<i>Principal activities</i>
Al Sadarah Investment Company	Limited Liability Company	100%	Sharjah, UAE	Investments and investment advisory services

Subsidiaries are investees controlled by the Group. The Group controls an investee when it is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect these returns through its power over the investee.

Subsidiaries are fully consolidated from the date of acquisition or establishment, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the parent entity, using consistent accounting policies. Where necessary, the accounting policies of subsidiaries are aligned to ensure consistency with the policies adopted by the Group. All intra-group balances, transactions, unrealised gains and losses and dividends resulting from intra-group transactions are eliminated in full.

**Financial instruments**

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument for another entity. All assets and liabilities in the consolidated statement of financial position are financial instruments except property and equipment, capital work-in-progress, prepayments, provision for employee service benefits and shareholders' equity.

**Classification**

The Group classified its financial assets at initial recognition in the following categories:

- Financial assets at fair value through profit or loss: A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they were designated as hedges.
- Loans and advances: This category comprised of non-derivative financial assets with fixed and determinable payments that were not quoted in an active market. Loans and advances arise when the Group provides money directly to the borrower with no intention of trading the receivable.
- Available-for-sale: Investments classified as Available-for-sale are those non-derivative financial assets that are designated as available-for-sale or not classified as (a) loans and advances; (b) held-to-maturity investments; or (c) financial assets at fair value through profit or loss.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**3 Significant accounting policies (continued)**

**Financial instruments (continued)**

***Recognition and initial measurement***

The Group initially recognises loans and advances and deposits on the date at which they are originated. All other financial assets and liabilities are initially recognised on the trade date which is the date on which the Group 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 fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

***Amortised cost measurement principles***

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal re-payments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment. Premiums and discounts including initial transaction costs are included in the carrying amount of the related instrument.

***Subsequent measurement***

Subsequent to initial recognition, all financial instruments to be fair valued are measured at fair value using the fair value measurement principles below.

All other assets are measured at amortised cost using the effective interest method less impairment losses, if any.

***Gains and losses on subsequent measurement***

**Debt Investments**

Gains and losses arising from changes in the fair value of available-for-sale investments are recognised directly in equity through other comprehensive income, until the financial assets are derecognised or impaired, at which time the cumulative gain or loss previously recognised in equity is recognised in the consolidated statement of income.

**Equity Investments**

Gains and losses arising from changes in the fair value on equity investments are recognized in other comprehensive income, until the financial assets are derecognised or impaired, at which time the cumulative gain or loss previously recognised in equity is recognised in the consolidated statement of income. Dividends from such investments continue to be recognised in profit or loss as other income when the right to receive payments is established.

***De-recognition***

Financial assets are derecognised when the contractual rights to receive cash flows from the asset expire or where the Group has transferred substantially all the risks and rewards of ownership. A financial liability is derecognised when its contractual obligations are discharged, cancelled or expire.

***Fair value measurement***

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 in the principal, or in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk.

When applicable, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

When there is no quoted price in an active market, the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would take into account in pricing a transaction.

**3 Significant accounting policies (continued)**

**Financial instruments (continued)**

*Fair value measurement (continued)*

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price i.e. the fair value of the consideration given or received. If the Group determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability, nor based on a valuation technique that uses only data from observable markets, the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is supported wholly by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, the Group measures assets and long positions at a bid price and liabilities and short positions at an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Group on the basis of the net exposure to either market or credit risk, are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

The Group recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

*Due from banks*

Due from banks and financial institutions are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest rate less allowance for impairment, if any.

*Cash and cash equivalents*

Cash and cash equivalents as referred to in the consolidated statement of cash flows comprise cash on hand, non-restricted current accounts with the Central Bank, deposits with the Central Bank with an original maturity of three months or less, and amounts due from (to) banks on demand or with an original maturity of three months or less.

*Financial guarantees*

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the consolidated financial statements at fair value, with premium received included in 'Other liabilities'. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the consolidated statement of income in 'Provision for credit losses'. The premium received is recognised in the consolidated statement of income in 'Net fees and commission income' on a straight line basis over the life of the guarantee.

*Derivatives*

The Group enters into derivative instruments including forwards, futures, forward rate agreements, swaps and options in foreign exchange, interest rate and capital markets. In the normal course of business, the fair value of a derivative on initial recognition is the transaction price. Subsequent to their initial recognition, derivative financial instruments are stated at fair values. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the statement of financial position. Changes in the fair values of derivatives held for trading or to offset other trading positions are included in other operating income (expenses) in the consolidated statement of income.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**3 Significant accounting policies (continued)**

**Financial instruments (continued)**

*Derivatives (continued)*

On initial designation of the hedge, the Group formally documents the relationship between the hedging instrument(s) and hedged item(s), including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instrument(s) is / are expected to be 'highly effective' in offsetting the changes in the fair value or cash flows of the respective hedged item(s) during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80-125 percent.

Changes in the fair value of derivatives that are designated, and qualify, as fair value hedges and that prove to be highly effective in relation to the hedged risk are included in other operating income / (expenses) along with the corresponding changes in the fair value of the hedged assets or liabilities which are attributable to the risk being hedged.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. Upon such discontinuance, in the case of fair value hedges of interest-bearing financial instruments any adjustment to the carrying amount relating to the hedged risk is amortised in the consolidated statement of income over the remaining term to maturity.

Certain derivative transactions, while providing effective economic hedges under the Group's asset and liability management and risk management positions, do not qualify for hedge accounting under the specific rules in IAS 39 and are therefore accounted for as derivatives held for trading and the related fair value gains and losses reported in other operating income (expenses).

Derivatives may be embedded in another contractual agreement (host contract). Derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through the consolidated statement of income. These embedded derivatives are measured at fair value with the changes in fair value recognised in the consolidated statement of income.

***Impairment of financial assets***

The Group assesses at each statement of financial position date whether there was any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) had an impact on the estimated future cash flows of the financial asset or the group of financial assets that could be reliably estimated.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower;
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower's competitive position;
- Deterioration in the value of collateral;
- Downgrading below investment grade level; and
- Skipping / non-existence of borrowers

**(i) Financial assets carried at amortised cost**

For financial assets carried at amortised cost (such as amounts due from banks, loans and advances to customers as well as held-to-maturity investments), the Group first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, 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.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**3 Significant accounting policies (continued)**

**Financial instruments (continued)**

*Impairment of financial assets (continued)*

**(i) Financial assets carried at amortised cost (continued)**

If there is objective evidence that an impairment loss 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 expected credit losses that have not yet been incurred). 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 consolidated statement of income. Interest income continues to be accrued on the reduced carrying amount and is accrued using the revised / renegotiated rate of interest. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to 'Provision for credit losses'.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate ("EIR"). If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR. 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.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal credit grading system, that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

**(ii) Available-for-sale financial investments**

For available-for-sale financial investments, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. 'Significant' is evaluated against the original cost of the investment and 'prolonged' against the period in which the fair value has been below its original cost. When there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated statement of income – is removed from other comprehensive income and recognised in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income; increases in their fair value after impairment are recognised directly in other comprehensive income.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated statement of income.

Future interest income continues to be accrued based on the reduced carrying amount of the asset, applying the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of finance income. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**3 Significant accounting policies (continued)**

**Financial instruments (continued)**

***Renegotiated loans***

Where possible, the Group 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 continually 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.

***Write-off***

The Group writes off a loan or other Financial asset (and any other related allowances for impairment losses) when the Group Credit determines that the loans or other financial assets are uncollectible in whole or in part. This is determined after considering information such as the occurrence of significant changes in the borrower or issuer's financial position such that the borrower or issuer can no longer pay its obligation in full, or that proceeds from collateral will not be sufficient to pay back the entire exposure. Assets are written-off against provisions up to the extent of amount considered un-collectible.

However the Group retains its full legal claim on, and may continue with its recovery effort including litigation, on written-off accounts.

**Assets acquired in settlement of debts**

In certain cases, the Group may close out transactions by acquiring assets in settlement of debts. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan (net of impairment losses) at the date of exchange. These assets are recorded in "Other assets". It is the Group's policy to dispose of such repossessed properties in an orderly manner. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for business use.

**Revenue recognition**

For all financial instruments measured at amortised cost and debt financial instruments classified as available for sale, interest income or expense is recorded at the effective interest rate, which is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Fees earned for provision of services over a period of time are accrued over that period. These fees include commission income, custody and other management advisory fees.

Other fee income and expense are recognised when earned or incurred. Dividend income is recognised when the right to receive payment is established.

**Investment properties**

Investment properties are measured initially at cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met and excludes the costs of day to day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the reporting date. Gains or losses arising from changes in the fair values of investment properties are included in the consolidated statement of income in the period in which they arise. Fair values are evaluated, at least annually, by an accredited external, independent valuer, applying a valuation model recommended by the International Valuation Standards Committee.

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**3 Significant accounting policies (continued)**

**Property and equipment**

Property and equipment are stated at cost excluding the costs of day to day servicing, less accumulated depreciation and any impairment in value. Freehold land is not depreciated as it is deemed to have an indefinite life.

Depreciation is calculated on a straight line basis over the estimated useful lives of property and equipment as follows:

Buildings	Over 25 years
Motor vehicles	Over 5 years
Furniture, fixtures and equipment	Over 3 to 8 years
Leasehold improvements	Over 12 years

Depreciation methods, useful lives and residual values are reassessed at each reporting date and adjusted if appropriate.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount, being the higher of their fair value less costs to sell and their value in use.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in 'Other operating income' in the consolidated statement of income in the year the asset is derecognised.

**Provisions**

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event and the costs to settle the obligation are both probable and can be reliably measured. The expense relating to any provision is presented in the consolidated statement of income net of any reimbursement.

**Employees' end of service benefits**

Provision is made, in accordance with the provisions of IAS 19, for the end of service benefits due to employees in accordance with the UAE labor law for their period of service up to the financial position date and the provision arising is disclosed as 'provision for employees' end of service benefits' in the statement of financial position. The Group pays its contributions in respect of UAE citizens under the UAE pension and social security law and no further liability exists.

**Foreign currencies**

Foreign currency transactions are recorded at rates of exchange ruling at the value dates of the transactions. Monetary assets and liabilities in foreign currencies are translated into United Arab Emirates Dirhams at mid-market rates of exchange ruling at the balance sheet date. Any resultant gains and losses are taken to the consolidated statement of income.

**Segment reporting**

The Group's segmental reporting is based on the following operating segments: Retail banking, Corporate banking and Others.

**Impairment of non-financial assets**

The Group 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 Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or Cash-Generating Unit's (CGU) fair value less costs to sell and its value in use. Where the carrying amount of an asset or CGU 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 discount rates that reflect 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. These calculations are corroborated by valuation multiples or other available fair value indicators.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**3 Significant accounting policies (continued)**

**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 Group estimates the asset's or CGU'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 consolidated statement of income.

**Trade and settlement date accounting**

All "regular way" purchases and sales of financial assets are recognised on the settlement date, i.e. the date that the asset is delivered to the counter party. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the timeframe generally established by regulation or convention in the market place.

**Fiduciary assets**

Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and accordingly are not included in these financial statements.

**Offsetting**

Financial assets and financial liabilities are only offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

**Dividends on ordinary shares**

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Bank. Dividends for the year that are approved after the statement of financial position date are disclosed as an event after the statement of financial position date.

**Acceptances**

Acceptances arise when the Bank is under an obligation to make payments against documents drawn under letters of credit. After acceptance, the instrument becomes an unconditional liability of the bank and is therefore recognized as a financial liability in the consolidated statement of financial position. However every acceptance has a corresponding contractual right of reimbursement from the customer which is recognised as a financial asset.

**Islamic financing and investment products**

In addition to conventional banking products, the Group offers its customers certain non-interest based banking products, which are approved by its Sharia'a Supervisory Board.

The various Islamic instruments described below are accounted for, disclosed and presented in accordance with the requirements of the underlying substance of the instruments and IFRS / IAS / IFRIC.

*Murabaha:*

Murabaha receivables are non-derivative financial assets with fixed payments that are not quoted in an active market. Murabaha is a sale transaction in which the seller (Group) expressly mentions the actual cost of the asset to be sold to the customer, and sells it to the customer on a cost plus mark-up (profit) basis. It is in fact the sale of an asset for a profit, usually on deferred payment basis.

Income on Murabaha financing is recognised on a time apportioned basis over the period of the Murabaha contract, using the effective profit rate method.



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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**3 Significant accounting policies (continued)**

**Islamic financing and investment products (continued)**

*Ijara:*

Ijara involves a contract where the Group buys and then leases an item to a customer for a specified rental over a specific period. The duration of lease, as well as the basis for rental, are set and agreed in advance. The Group acquires the beneficial ownership of the property to lease the usufruct to the customer.

Income on Ijara financing is recognised on a time apportioned basis over the lease term, using the effective profit rate method.

*Qard*

A Qard is the transfer of ownership in tangible wealth (money), from the customer to the Group, and it is binding on the Group to return equal wealth (money) to the customer on demand or as per the agreed terms, which means that the principal is to be repaid on demand. The Islamic current account offered to customers is based on the concept of Qard, a profit free amount received from the customer to the Group, on which no profit or other form of return is payable.

*Wakala*

Wakala involves an agreement, based on the concept of Wakala Bil Istithmar, where the Group becomes the investment agent (Wakil) for its customers (Muwakkil) for deposit of their funds in the Wakala investment account to be invested in Shariah-compliant investment instruments. The funds are used to generate profit for the customer by investing in Islamic financing facilities to the Group's other customers or investing in other Shariah-compliant investment instruments.

Income generated from the financing and investment activities are paid to the customers and the Group recognises income in the form of a fixed Wakala fee. Where the income generated exceeds the anticipated profit rate, the Group recognises income in the form of a performance fee.

**4 Significant management judgements and estimates**

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

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

Information about significant areas of estimation and uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements are described below:

**Impairment losses on financial assets**

The Group reviewed its individually significant loans and advances at each statement of financial position date to assess whether a provision for impairment should be recorded in the consolidated statement of income. In particular, judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about the probability of default and probable losses in the event of default, the value of the underlying security and realisation costs. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the provisions.

Loans and advances that were assessed individually and found not to be impaired and all individually insignificant loans and advances were then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provisions should be made due to incurred loss events for which there is objective evidence but whose effects were not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratio etc.), concentrations of risks and economic data (including levels of unemployment, real estate prices indices, country risk and the performance of different individual groups).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**4 Significant management judgements and estimates (continued)**

**Impairment of investments**

The Group treats its equity and debt investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where 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 the loss event (or events) has an impact on the estimated future cash flows that can be reliably estimated. The determination of what is “significant” or “prolonged” requires considerable judgment. The Group evaluates a number of factors, including the amount of decline and the length of period of the decline, the normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities and debt securities. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

**Going concern**

The Group’s management has made an assessment of the Group’s ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future, at least beyond 12 months from the balance sheet date. Furthermore, the management is not aware of any material uncertainties that may cast significant doubt upon the Group’s ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

**5 Cash and balances with UAE Central Bank**

	<i>2016</i> <i>AED’000</i>	<i>2015</i> <i>AED’000</i>
Cash on hand	<b>107,616</b>	138,719
Balances with the UAE Central Bank:		
Clearing accounts	<b>690,345</b>	1,115,301
Certificate of deposits	<b>1,200,000</b>	800,000
Reserve requirements	<b>768,567</b>	1,021,332
	<b><u>2,766,528</u></b>	<b><u>3,075,352</u></b>

The reserve requirements, kept with the UAE Central Bank in AED and USD, are not available for use in the Group’s day to day operations and cannot be withdrawn without its approval. However, the Central Bank in its Circular 4310/2008 dated 24 September 2008, has temporarily permitted banks to overdraw their current accounts (a) up to the amount of reserves at interest of 3% above the prevailing Central Bank Repo rate; and (b) in excess of reserves at interest of 5% above the prevailing Central Bank Repo rate. The level of reserve required changes every month in accordance with the UAE Central Bank directives.

**6 Due from other banks**

	<i>2016</i> <i>AED’000</i>	<i>2015</i> <i>AED’000</i>
Demand deposits	<b>174,422</b>	177,687
Term deposits	<b>190,654</b>	686,699
	<b><u>365,076</u></b>	<b><u>864,386</u></b>

Due from other banks includes AED 208,279,000 (2015: AED 554,091,000) placed with foreign banks outside the UAE. AED 24,068,000 (2015: AED 64,910,000) is held by other banks as margin for derivative transactions.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**7 Loans and advances**

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
The composition of the loans and advances portfolio is as follows:		
<b>(a) By type:</b>		
Overdrafts	<b>1,369,166</b>	1,548,208
Loans (medium and short term)*	<b>11,155,680</b>	12,286,125
Loans against trust receipts	<b>1,340,716</b>	1,640,225
Bills discounted	<b>304,153</b>	763,734
Other cash advances	<b>78,707</b>	95,681
Bills drawn under letters of credit	<b>86,132</b>	156,683
	<hr/>	<hr/>
Gross amount of loans and advances	<b>14,334,554</b>	16,490,656
Less: Provision for impairment on loans and advances	<b>(988,992)</b>	(819,025)
	<hr/>	<hr/>
Net loans and advances	<b>13,345,562</b>	15,671,631
	<hr/> <hr/>	<hr/> <hr/>

\* Includes retail loans of AED 3,658,144,000 (2015: AED 4,814,577,000)

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
<b>(b) By economic sector:</b>		
Government and public sector	<b>600,868</b>	693,431
Trade	<b>2,402,202</b>	2,887,297
Personal loans (retail and business)	<b>5,646,201</b>	6,682,272
Manufacturing	<b>1,822,292</b>	2,194,723
Construction	<b>771,602</b>	783,641
Services	<b>1,451,163</b>	1,471,434
Financial institutions	<b>1,224,798</b>	1,293,692
Transport and communication	<b>396,103</b>	481,895
Others	<b>19,325</b>	2,271
	<hr/>	<hr/>
Gross amount of loans and advances	<b>14,334,554</b>	16,490,656
	<hr/> <hr/>	<hr/> <hr/>

Loans and advances are stated net of provision for impairment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**7 Loans and advances (continued)**

Loans and advances are stated net of provision for impairment of loans and advances. The movement in provision is as follows:

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Balance at 1 January	<b>819,025</b>	525,531
Provided during the year	<b>1,205,295</b>	934,861
Released during the year	<b>(175,734)</b>	(32,212)
Amounts written off (net) during the year	<b>1,029,561</b> <b>(859,594)</b>	902,649 (609,155)
Balance at 31 December	<b>988,992</b>	819,025

At 31 December 2016, the gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance amounted to AED 825,302,000 (2015: AED 661,150,000).

Provision for credit losses recognised in the consolidated statement of income is as follows:

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Net impairment of loans and advances	<b>1,029,561</b>	902,649
Recovery of bad debt written off	<b>(18,127)</b>	(14,858)
Provision for credit losses	<b>1,011,434</b>	887,791

Sector wise analysis of impaired loans and advances and related provisions is as follows:

	<i>2016</i>		<i>2015</i>	
	<i>Gross exposure</i> <i>AED'000</i>	<i>Specific provision</i> <i>AED'000</i>	<i>Gross exposure</i> <i>AED'000</i>	<i>Specific provision</i> <i>AED'000</i>
<b>By economic sector</b>				
Trade	<b>256,572</b>	<b>186,635</b>	211,675	177,307
Personal loans (retail and business)	<b>117,860</b>	<b>55,524</b>	208,692	71,803
Manufacturing	<b>66,499</b>	<b>42,230</b>	61,865	41,740
Construction	<b>23,613</b>	<b>23,165</b>	85,338	84,609
Services	<b>343,850</b>	<b>264,529</b>	91,367	46,360
Financial institutions	-	-	-	-
Transport and communication	<b>1,983</b>	<b>1,880</b>	2,137	570
Others	<b>14,925</b>	<b>3,627</b>	76	2
Total	<b>825,302</b>	<b>577,590</b>	661,150	422,391

The fair value of collateral that the Group holds relating to loans to corporate and retail customers individually determined to be impaired at 31 December 2016 amounts to AED 255,353,000 (2015: AED 166,956,000). The collateral consists of cash, securities, first and floating charges over real estate properties, vehicles, plant and machinery, inventory, trade receivables and guarantees from parent companies for loans to their subsidiaries or other group companies. During the year, the Group did not repossess any material amounts of collateral.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**8 Investments**

	2016			2015		
	<i>Quoted AED'000</i>	<i>Unquoted AED'000</i>	<i>Total AED'000</i>	<i>Quoted AED'000</i>	<i>Unquoted AED'000</i>	<i>Total AED'000</i>
<b>Debt:</b>						
<i>Held for trading</i>						
Local	18,572	-	18,572	-	-	-
Overseas	201,095	-	201,095	-	-	-
<i>Available for sale</i>						
Local	2,553,409	-	2,553,409	2,253,806	-	2,253,806
Overseas	531,520	-	531,520	295,854	-	295,854
<b>Total debt securities</b>	<b>3,304,596</b>	<b>-</b>	<b>3,304,596</b>	<b>2,549,660</b>	<b>-</b>	<b>2,549,660</b>
<b>Equity:</b>						
<i>Available for sale</i>						
Overseas	9,081	76	9,157	9,614	76	9,690
<b>Total equities</b>	<b>9,081</b>	<b>76</b>	<b>9,157</b>	<b>9,614</b>	<b>76</b>	<b>9,690</b>
<b>Total investments</b>	<b>3,313,677</b>	<b>76</b>	<b>3,313,753</b>	<b>2,559,274</b>	<b>76</b>	<b>2,559,350</b>

Included in the above are investment securities amounting to AED 554,968,000 (2015: AED 774,420,000) held under repurchase agreement with the lenders.

The Group has not purchased or invested in shares of companies in 2016 (2015: AED Nil)

**9 Investment property**

Investment property represents a building in the UAE, which has been possessed through foreclosure of a loan. During the year ended 31 December 2016, the Group did not acquire any new investment property (31 December 2015: AED Nil). During the year ended 31 December 2016, the Group disposed of its remaining investment property at a value of AED 75,000,000 (31 December 2015: two properties at a combined value of AED 14,794,000) resulting in a net loss on sale of AED 3,000,000 (31 December 2015: gain of AED 1,089,000) and is included in the consolidated statement of income.

During the review of investment property, an error in the valuation of an investment property included in the financial statements of the Group for the year ended 31 December 2014 has been rectified in the current year. Please see note 31 for further details.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**10 Property, equipment and capital work-in-progress**

	<i>Freehold land and buildings AED'000</i>	<i>Motor vehicles, leasehold improvements, furniture, fixtures and equipment AED'000</i>	<i>Capital work-in- progress AED'000</i>	<i>Total AED'000</i>
Cost:				
At 1 January 2016	436,030	241,588	44,594	722,212
Additions	-	7,936	34,599	42,535
Transfers	-	31,882	(31,882)	-
Write-offs	-	(16,300)	-	(16,300)
Disposals	-	(865)	-	(865)
At 31 December 2016	<u>436,030</u>	<u>264,241</u>	<u>47,311</u>	<u>747,582</u>
Depreciation:				
At 1 January 2016	9,119	125,375	-	134,494
Charge for the year	3,891	30,459	-	34,350
Transfer	-	-	-	-
Write-offs	-	(4,722)	-	(4,722)
Disposals	-	(865)	-	(865)
At 31 December 2016	<u>13,010</u>	<u>150,247</u>	<u>-</u>	<u>163,257</u>
Net Carrying Value:				
<b>At 31 December 2016</b>	<u><b>423,020</b></u>	<u><b>113,994</b></u>	<u><b>47,311</b></u>	<u><b>584,325</b></u>
		<i>Motor Vehicles, leasehold improvements, furniture, fixtures and equipment AED'000</i>	<i>Capital work-in- progress AED'000</i>	<i>Total AED'000</i>
Cost:				
At 1 January 2015	281,826	217,046	14,443	513,315
Additions	154,204	17,756	39,264	211,224
Transfers	-	9,113	(9,113)	-
Disposals	-	(2,327)	-	(2,327)
At 31 December 2015	<u>436,030</u>	<u>241,588</u>	<u>44,594</u>	<u>722,212</u>
Depreciation:				
At 1 January 2015	5,253	98,947	-	104,200
Charge for the year	3,866	27,599	-	31,465
Transfer	-	-	-	-
Disposals	-	(1,171)	-	(1,171)
At 31 December 2015	<u>9,119</u>	<u>125,375</u>	<u>-</u>	<u>134,494</u>
Net Carrying Value:				
At 31 December 2015	<u>426,911</u>	<u>116,213</u>	<u>44,594</u>	<u>587,718</u>

The cost of freehold land included above is AED 338,368,000 (2015: AED 338,368,000).

During 2016, additions to capital work-in-progress relate to expenditure incurred in connection with the purchase of leasehold improvements, furniture, fixtures and equipment amounting to AED 34,599,000 (2015: AED 39,264,000). Upon completion of associated projects, AED 31,882,000 (2015: AED 9,113,000) was transferred to 'motor vehicles, leasehold improvements, furniture, fixtures and equipment'.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**10 Property, equipment and capital work-in-progress (continued)**

During 2016, the Group undertook a review of its branch network and wrote off furniture and equipment with a net carrying value of AED 11,578,000 (2015: AED Nil) resulting from closure of certain branches.

Intangible assets relating to computer software are included within equipment and capital work-in-progress with a net carrying value of AED 32,029,000 (2015: AED 21,576,000).

**11 Other assets**

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Interest receivable	79,597	91,850
Positive fair value of derivatives (Note 24)	109,963	29,343
Acceptances	616,410	639,742
Prepayments and other assets	70,330	66,251
	<u>876,300</u>	<u>827,186</u>

**12 Due to banks**

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Demand deposits	12,491	6,458
Term deposits	1,082,991	1,031,488
	<u>1,095,482</u>	<u>1,037,946</u>

Term deposits include borrowings through repurchase agreements of AED 440,676,000 (31 December 2015: AED 682,613,000).

**13 Customers' deposits**

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Term and call deposits	11,054,363	11,548,820
Current accounts	4,108,846	4,701,183
Saving accounts	374,806	525,040
	<u>15,538,015</u>	<u>16,775,043</u>

**14 Medium term borrowings**

Movement in medium term borrowings during the year is as follows:

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Balance as at 1 January	2,313,549	2,019,655
New borrowings	550,845	1,028,344
Repayments	(1,340,389)	(734,450)
	<u>1,524,005</u>	<u>2,313,549</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**14 Medium term borrowings (continued)**

The table below details the maturity, currency and interest rate details of the medium term borrowings:

Maturity	Currency	Fixed / Floating	Interest Rate	2016 AED'000	2015 AED '000
2016	USD	Floating	LIBOR + Margin	91,808	319,332
2017	USD	Floating	LIBOR + Margin	1,432,197	1,057,780
2018	USD	Floating	LIBOR + Margin	-	936,437
				<u>1,524,005</u>	<u>2,313,549</u>

**15 Other liabilities**

	2016 AED'000	2015 AED'000
Interest payable	101,862	76,904
Staff related provisions	34,662	39,570
Negative fair value of derivatives (Note 24)	82,807	69,462
Acceptances	616,410	639,742
Un-presented cheques	76,926	48,258
Others	94,658	93,194
	<u>1,007,325</u>	<u>967,130</u>

	2016 AED'000	2015 AED'000
<b>Staff related provisions</b>		
The aggregate employee entitlement liability comprises:		
Employees' end of service benefits	30,115	29,115
Other liabilities	4,547	10,455
	<u>34,662</u>	<u>39,570</u>

In accordance with UAE labour law, the Group provides for end of service benefit for its expatriate employees. Movements in the liability recognised in the consolidated statement of financial position in respect of end of service benefits are as follows:

	2016 AED'000	2015 AED'000
Liability as at 1 January	29,115	34,732
Expense recognised in the consolidated statement of income	6,970	6,384
End of service benefits paid	(5,970)	(12,001)
Liability as at 31 December	<u>30,115</u>	<u>29,115</u>

**16 Share capital and reserves**

**a) Share capital**

The authorised, issued and fully paid up share capital of the Bank comprises 1,375,033,766 (2015: 1,375,033,766) shares of AED 1 each.

**b) Special reserve**

Article 82 of Federal Law No. 10 of 1980 concerning the Central Bank, the Monetary System and Organisation of Banking requires that 10% of the net profit is transferred to a non-distributable special reserve until this reserve equals 50% of the paid up share capital.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**16 Share capital and reserves (continued)**

**c) Statutory reserve**

Article 192 of the UAE Commercial Companies Law No.(8) of 1984 (as amended) and the Articles of Association of the Bank, require that 10% of the net profit is transferred to a non-distributable statutory reserve until this reserve equals 50% of the paid up share capital.

**d) General reserve**

The general reserve may be utilised for any purpose to be determined by a resolution of the shareholders of the bank at an ordinary general meeting, on the recommendation of the Board of Directors.

**e) Revaluation reserve**

The revaluation reserve was used to record increases in the fair value of freehold land and buildings and decreases to the extent that such decreases relate to an increase on the same asset previously recognised in other comprehensive income. The revaluation reserve balance pertains to revaluations done in 2007.

**f) Dividends**

The directors do not propose any cash dividend for the year ended 31 December 2016 (2015: Nil). For the year ended 31 December 2014, a cash dividend of AED 114,586,147 at AED 0.10 per share of AED 1 each and a scrip dividend of AED 229,172,994 at AED 0.20 per share of AED 1 each was approved which was paid in 2015.

**g) Cumulative changes in fair value**

Cumulative changes in fair value reserve includes the net change in fair value of available-for-sale financial assets and the net effective portion of changes in fair value of cash flow hedges (if any).

**17 Interest income**

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Interest on loans and advances to customers	<b>827,848</b>	1,108,150
Interest on money market and inter bank transactions	<b>15,738</b>	13,478
Interest on debt investments securities	<b>100,402</b>	95,205
	<b>943,988</b>	1,216,833

**18 Interest expense**

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Interest on customer deposits	<b>226,894</b>	160,246
Interest on interbank transactions	<b>83,484</b>	69,367
	<b>310,378</b>	229,613

**19 Net fees and commission income**

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Fees on letters of credit and acceptances	<b>20,590</b>	26,034
Fees on guarantees	<b>25,172</b>	34,655
Fees on loans and advances	<b>58,140</b>	72,640
Commission expense	<b>(20,032)</b>	(30,082)
	<b>83,870</b>	103,247

**20 Foreign exchange income**

Foreign exchange income comprises mainly of gains and losses of AED 57,493,000 (2015: AED 54,159,000) arising from trading of foreign currencies.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**21 Other operating income**

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Charges recovered from customers	<b>37,037</b>	29,702
Income from collections	<b>5,419</b>	5,850
Others	<b>33,158</b>	(5,869)
	<b>75,614</b>	29,683

Other income primarily includes realized gains of AED 38,487,000 (2015: AED 9,057,000) on sale of available-for-sale investments including related hedge accounting adjustments. Other income for the year ending 31 December 2015 has been restated to account for the ineffectiveness on fair value hedges amounting to a loss of AED 16,949,000 (Note 32).

**22 Other operating expenses**

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Occupancy and maintenance costs	<b>54,347</b>	53,054
Legal and professional fees	<b>27,891</b>	79,620
Other administrative expenses	<b>19,056</b>	45,138
Write-off of property and equipment	<b>11,578</b>	1,156
	<b>112,872</b>	178,968

**23 Earnings per share**

Basic earnings per share is based on the profit attributable to ordinary shareholders and a weighted average number of ordinary shares outstanding calculated as follows:

	<i>2016</i> <i>AED</i>	<i>2015</i> <i>AED</i>
Net loss for the year	<b>(522,691,000)</b>	<b>(183,096,000)</b>
<i>Weighted average number of ordinary shares:</i>		
Ordinary shares of AED 1 each at the beginning of the year	<b>1,375,033,766</b>	1,145,861,472
Effect of scrip dividend of AED 0.20 per share of AED 1 each issued during 2015	-	229,172,294
Weighted average number of shares of AED 1 each outstanding for the year	<b>1,375,033,766</b>	1,375,033,766
Basic earnings per share	<b>(0.38)</b>	(0.13)

Weighted average number of shares outstanding for the year has been adjusted to include the effect of a scrip dividend issued during 2015.

The figures for diluted earnings per share are the same as basic earnings per share as the Bank has not issued any instruments which would have an impact on earnings per share if or when exercised.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**24 Related party transactions**

The Group carries out transactions in the ordinary course of business with related parties, defined as shareholders who have a significant influence on the Group, directors of the Group, key management personnel of the group and companies over which such shareholders and directors exercise control or significant influence either directly or indirectly.

The significant balances outstanding at 31 December are as follows:

	<b>2016</b>	<b>2015</b>
	<b>AED'000</b>	<b>AED'000</b>
<i><u>Shareholders:</u></i>		
Due from banks	<b>2,022</b>	3,182
Due to banks	<b>1,752</b>	1,752
Medium term borrowings	<b>165,254</b>	141,703
<i><u>Directors:</u></i>		
Loans and advances	<b>501</b>	3,241
Customers' deposits	<b>36,033</b>	37,065
Commitments and contingencies	<b>45</b>	45
<i><u>Other related entities of shareholders and directors:</u></i>		
Loans and advances	<b>299,677</b>	248,611
Investments	<b>85,560</b>	9,336
Due from banks	<b>72</b>	111,965
Due to banks	<b>50</b>	12
Customers' deposits	<b>256,711</b>	308,659
Commitments and contingencies	<b>287,205</b>	297,791
<i><u>Key management personnel of the Group:</u></i>		
Loans and advances	<b>14,803</b>	15,893
Customers' deposits	<b>6,169</b>	28,035
<i><u>Shareholders, directors, their related entities and key management personnel</u></i>		
Accrued interest income	<b>5,687</b>	4,231
Accrued interest expense	<b>2,646</b>	1,066

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**24 Related party transactions (continued)**

The income and expenses and purchase and sale of investments in respect of related parties during the year included in the consolidated statement of income are as follows:

	<b>2016</b> <i>AED'000</i>	<b>2015</b> <i>AED'000</i>
<i>Shareholders, directors and their related entities</i>		
Interest income	<b>22,465</b>	12,744
Interest expense	<b>9,330</b>	4,236
Other Income	-	644
Management fee	-	2,645
Loss from sale of investments	<b>104</b>	-
Purchase of investments	<b>5,586</b>	-
Sale of investments	<b>39,236</b>	-
<i>Key management personnel</i>		
Short term benefits	<b>28,398</b>	31,588
Employees' end of service benefits	<b>740</b>	2,804
Total compensation to key management personnel as at 31 December	<b>29,138</b>	34,392
Interest income	<b>243</b>	236
Interest expense	<b>18</b>	17

*Terms and conditions of transactions with related parties*

The above mentioned outstanding balances and transactions arose from the ordinary course of business and have been conducted on arm's length basis. The interest charged to and by, related parties is at normal commercial rates. Outstanding balances at year end are unsecured. There have been no guarantees provided or received for any related party receivables or payables. For the year ended 31 December 2016, the Group has not made any provision for doubtful debts relating to amounts owed by related parties (2015: AED Nil).

	<b>2016</b>	<b>2015</b>
Number of key management personnel	<b>22</b>	26

The Group has leased office space in various premises owned by a related party. The property rental and associated expenses for the year amounted to AED 2,332,000 (2015: AED 2,355,000). The property rentals are negotiated each year at market rates.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**25 Derivatives**

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

***Derivative product types***

*Forward Contracts*

Forward contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. The Group has credit exposure to the counterparties of forward contracts.

*Options*

Options are contractual agreements that convey the right, but not the obligation, for the purchaser either to buy or sell a specific amount of a financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

*Swaps*

Swaps are contractual agreements between two parties to exchange streams of payments over time based on specified notional amounts, in relation to movements in a specified underlying index such as an interest rate, foreign currency rate or equity index.

Interest rate swaps relate to contracts taken out by the Group with other financial institutions in which the Group either receives or pays a floating rate of interest in return for paying or receiving, respectively, a fixed rate of interest. The payment flows are usually netted against each other, with the difference being paid by one party to the other.

In a currency swap, the Group pays a specified amount in one currency and receives a specified amount in another currency. Currency swaps are mostly gross-settled.

***Purpose of derivatives***

The Group is a party to derivative instruments in the normal course of meeting the needs of the Group's customers. In addition, The Group also uses derivatives for trading purposes and, as part of its risk management activity, the Group uses derivative instruments for hedging purposes in order to reduce its own exposure to current and expected risks. This is achieved by hedging specific transactions as well as strategic hedging against overall balance sheet exposures.

Derivatives often involve at their inception only a mutual exchange of promises with little or no transfer of consideration. However, these instruments frequently involve a high degree of leverage and are very volatile. A relatively small movement in the value of the asset, rate or index underlying a derivative contract may have a significant impact on the profit or loss of the Group.

Over-the-counter derivatives may expose the Group to the risks associated with the absence of an exchange market on which to close out an open position.

The derivatives are recorded at fair value by using the published price quotations in an active market or counterparty prices or valuation techniques using a valuation model that has been tested against the prices of actual market transactions and the Group's best estimate of the most appropriate model inputs (Note 28).

The tables below show the fair values of derivative financial instruments for risk management and hedging purposes, recorded as assets and liabilities, together with their notional amounts. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are neither indicative of the market risk nor credit risk.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**25 Derivatives (continued)**
*Purpose of derivatives (continued)*

## A. Derivatives held for risk management

31 December 2016

	<i>Positive fair value AED'000</i>	<i>Negative fair value AED'000</i>	<i>Notional amount AED'000</i>	<i>Notional amounts by term to maturity</i>			
				<i>Within 3 months AED'000</i>	<i>3-12 months AED'000</i>	<i>1-5 years AED'000</i>	<i>Over 5 years AED'000</i>
Forward contracts	100,963	(52,820)	15,550,449	8,066,054	3,791,977	3,692,418	-
Foreign currency options	867	(867)	168,017	22,034	145,983	-	-
Interest rate swaps	3,314	(3,314)	411,815	-	-	192,636	219,179
	<u>105,144</u>	<u>(57,001)</u>	<u>16,130,281</u>	<u>8,088,088</u>	<u>3,937,960</u>	<u>3,885,054</u>	<u>219,179</u>

31 December 2015

	<i>Positive fair value AED'000</i>	<i>Negative fair value AED'000</i>	<i>Notional amount AED'000</i>	<i>Notional amounts by term to maturity</i>			
				<i>Within 3 months AED'000</i>	<i>3-12 months AED'000</i>	<i>1-5 years AED'000</i>	<i>Over 5 years AED'000</i>
Forward contracts	27,092	(25,171)	7,649,890	2,621,474	4,147,821	880,595	-
Foreign currency options	1,109	(1,109)	734,460	205,648	264,406	264,406	-
Interest rate swaps	1,142	(1,564)	397,507	-	-	397,507	-
	<u>29,343</u>	<u>(27,844)</u>	<u>8,781,857</u>	<u>2,827,122</u>	<u>4,412,227</u>	<u>1,542,508</u>	<u>-</u>

## B. Derivatives held for Hedging purposes

*Fair value hedges of interest rate risk*

The Group uses interest rate swaps to hedge its exposure to changes in fair values of fixed-rate investments in respect of a benchmark interest rate. Interest rate swaps are matched to specific purchases of investments.

The Group hedges interest rate risk only to the extent of benchmark interest rates. The benchmark rate is a component of interest rate risk that is observable in relevant environments. Hedge accounting is applied where economic hedge relationships meet the hedge accounting criteria.

When fair value hedge accounting is applied by the Group, the Group assesses whether the derivative designated in each hedging relationship is expected to be and has been highly effective in offsetting changes in fair value of the hedged item using regression analysis. The assessment is based on an evaluation of the quantitative measures of the regression results.

The fair value of the swaps is disclosed in other assets (liabilities) and the carrying amount of the hedged items included in the line item 'Investments' in the consolidated statement of financial position. Fair value gains on derivatives held in qualifying fair value hedging relationships and the hedging gain or loss on the hedged items are included in other operating income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

25 Derivatives (continued)

B. Derivatives held for hedging purposes (continued)

*Fair value hedges of interest rate risk*

At 31 December 2016, the Group held the following interest rate swaps as hedging instruments in fair value hedges of interest risk, along with amounts relating to hedged items.

31 December 2016

	<i>Positive fair value AED'000</i>	<i>Negative fair value AED'000</i>	<i>Notional amount AED'000</i>	<i>Notional amounts by term to maturity</i>			
				<i>Within 3 months AED'000</i>	<i>3-12 months AED'000</i>	<i>1-5 years AED'000</i>	<i>Over 5 years AED'000</i>
Hedge of investments	4,819	(25,806)	1,063,964	-	-	157,909	906,055
	<u>4,819</u>	<u>(25,806)</u>	<u>1,063,964</u>	<u>-</u>	<u>-</u>	<u>157,909</u>	<u>906,055</u>

31 December 2015

	<i>Positive fair value AED'000</i>	<i>Negative fair value AED'000</i>	<i>Notional amount AED'000</i>	<i>Notional amounts by term to maturity</i>			
				<i>Within 3 months AED'000</i>	<i>3-12 months AED'000</i>	<i>1-5 years AED'000</i>	<i>Over 5 years AED'000</i>
Hedge of investments	-	(41,618)	1,026,813	-	-	36,723	990,090
	<u>-</u>	<u>(41,618)</u>	<u>1,026,813</u>	<u>-</u>	<u>-</u>	<u>36,723</u>	<u>990,090</u>

The fair value of the swaps are disclosed in other assets / (liabilities) on the consolidated statement of financial position.

The carrying amount of the hedged items are included in the line item 'Investments' on the consolidated statement of financial position with the notional amount totalling to AED 1,063,964,000 (2015: AED 1,026,813,000). These hedged item comprises of debt instruments which are held as available-for-sale.

During 2016, the Group has recognised a loss of AED 3,369,000 relating to hedge ineffectiveness calculated as changes in value of hedging instrument and hedged item as follows:

	<i>Change in value AED'000</i>	<i>Ineffectiveness recognised in profit and loss AED'000</i>
On hedging instruments	20,723	(3,369)
On hedged items	(24,092)	

*Derivative related credit risk*

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Group. Approximately 95% (2015: 95%) of the Group's derivative contracts are entered into with other financial institutions.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**26 Contingent liabilities and commitments***Credit related commitments*

The Group's contractual amounts in respect of letters of credit and guarantees commit the Group to make payments on behalf of customers contingent upon the customer satisfying the terms of the contract. The contractual amounts represent the credit risk, assuming that the amounts are fully advanced, guarantees are called for full amount following performance failure, and that any collateral or other security is of no value. However, the total contractual amount of commitments does not necessarily represent future cash requirements since many of such commitments will expire or terminate without being funded.

The loan commitments represent the contractual commitments to make the loan. These commitments are revocable and generally have fixed expiry dates or other termination clauses. Since commitments are revocable, may expire without being drawn down and as conditions precedent to draw down have to be fulfilled, the total contract amounts do not necessarily represent future cash requirements.

The Group has the following credit related commitments:

	<b>2016</b> <i>AED'000</i>	<b>2015</b> <i>AED'000</i>
<i>Contingent liabilities</i>		
Letters of credit	<b>420,563</b>	461,358
Guarantees	<b>3,218,243</b>	3,023,975
	<b>3,638,806</b>	3,485,333
<i>Commitments</i>		
Undrawn loan commitments	<b>2,716,966</b>	2,784,629



**27 Risk management**

**Introduction**

Risk is inherent in all of the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to their responsibilities.

Risk Management covers all risks including credit, liquidity, market and operational risk, and processes from origination to approval and ongoing control, review, maintenance and reporting of exposures. It also covers the high level organisation, roles and responsibilities of Board and management level committees, and authorities and processes relating to risk management, internal controls, compliance and internal audit functions.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. These are monitored through the Group's strategic planning process.

*Risk Management Structure*

The Board of Directors are ultimately responsible for identifying and controlling risks; however, there are separate board sub-committees responsible for managing and monitoring risks.

*Board Credit Committee*

The Board Credit Committee (BCC) has the responsibility to establish credit risk strategy and monitor the overall credit process within the Group for maintaining a diversified portfolio, avoiding undesired risk concentrations, improving the overall asset quality of the portfolio, and complying with Credit Policy and regulatory guidelines.

*Board Audit Committee*

The Board Audit Committee (BAC) is responsible for monitoring, reviewing and reporting to the Board on the formal arrangements relating to the financial and narrative reporting of the Group, internal controls, compliance and internal / external audit processes.

*Board Risk Committee*

The Board Risk Committee (BRC) has the overall responsibility for the development of the risk strategy and implementing principles, frameworks and policies for enhancing the Group's risk management framework to best practices standards. This includes, but is not limited to, ensuring effective control structures and the monitoring of aggregate risk exposures (including but not limited to credit, market, liquidity, operational and legal).

*Group Remuneration Committee*

The Group Remuneration Committee (GRC) acts on behalf of the Board on all matters related to governance, remuneration, nomination and strategic plans, except for those powers and actions that are restricted to the Board on the basis of legal provisions or the Articles. The GRC is responsible for supporting the Board in overseeing the remuneration scheme, in order to ensure that the subject remuneration is appropriate and consistent with the Bank's culture, long-term business and risk appetite, performance and control environment as well as with any legal or regulatory requirements.

*Risk Management Group*

The Risk Management Group is responsible for implementing and maintaining risk related procedures to ensure an independent control process. It works closely with the commercial organisation to support their activities, while safeguarding the risk profile of the Group. It institutes prudent risk monitoring and control mechanisms (processes and systems) to ensure compliance of individual risk assets and portfolios to agreed terms and policy parameters. It reviews and presents all credit submissions, risk policy and portfolio management reports to the BCC and BRC.

*General Management Risk Committee*

The General Management Risk Committee (GMRC) is the highest approving authority at the management level on all aspects of enterprise risk management including, but not restricted to: credit risk; market risk; operational risk; legal risk; regulatory risk; liquidity risk; financial risks; corporate governance; and audit matters of the Bank (and any subsidiaries and affiliates in which it has strategic investments). The GMRC provides recommendation on all risks and investment policies and portfolio issues to the BRC, and to other Board Committees.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**27 Risk management (continued)**

**Introduction (continued)**

*Group Treasury*

Group Treasury is responsible for managing the Group's assets and liabilities and the overall financial structure. It is also primarily responsible for managing the funding and liquidity risks of the Group.

*Internal Audit*

Risk management processes throughout the Group are audited annually by the internal audit function that examines both the adequacy of, and the Group's compliance with, its procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Board Audit Committee.

*Risk Measurement and Reporting Systems*

Monitoring and controlling risks is primarily performed based on limits established by the Group. These limits reflect both the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept, with additional emphasis on selected industries. In addition, the Group monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information compiled from all the businesses is examined and processed in order to identify, analyse and control at an early stage. This information is presented and explained to the Board of Directors, the BRC and the head of each business division. The report includes aggregate credit exposure, hold limit exceptions, liquidity ratios and risk profile changes. Senior management assess the appropriateness of the allowance for credit losses on a quarterly basis. The Board receives a comprehensive credit risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the credit related risks of the Group.

For all levels throughout the Group, specifically tailored risk reports are prepared and distributed in order to ensure all business divisions have access to extensive, necessary and up-to-date information.

Regular briefings are given to the Chief Executive Officer, GMRC and all other relevant members of management on all aspects of risk taken by the Group including the utilisation of limits, proprietary investments and liquidity, plus any other risk developments.

*Risk Mitigation*

As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates and foreign currencies.

The Group actively uses collateral to reduce its credit risks.

*Risk concentration*

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

## 27 Risk management (continued)

**Credit Risk**

Credit risk is the risk that a customer or counterparty will fail to meet a commitment / contractual obligation, resulting in a financial loss to the Group. Such risk arises from lending, trade finance, treasury and other activities undertaken by the Group. Credit risk is actively monitored in accordance with the credit policies which clearly define delegated lending authorities, policies and procedures. The management of credit risk also involves the monitoring of risk concentrations by industrial sector as well as by geographic location.

The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process allows the Group to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

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

	<i>Notes</i>	<b>2016</b> <i>AED'000</i>	<b>2015</b> <i>AED'000</i>
Cash and balances with the UAE Central Bank (excluding cash on hand)	5	<b>2,658,912</b>	2,936,633
Due from other banks	6	<b>365,076</b>	864,386
Loans and advances (net of provisions)	7	<b>13,345,562</b>	15,671,631
Investments	8	<b>3,304,596</b>	2,549,660
Other assets*	11	<b>824,489</b>	785,743
<i>*excluding prepayments and assets acquired in settlement of debt</i>			
Total		<b>20,498,635</b>	22,808,053
Letters of credit	26	<b>420,563</b>	461,358
Guarantees	26	<b>3,218,243</b>	3,023,975
Undrawn loan commitments	26	<b>2,716,966</b>	2,784,629
Total		<b>6,355,772</b>	6,269,962
Total credit risk exposure		<b>26,854,407</b>	29,078,015

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

27 Risk management (continued)

Credit Risk (continued)

*Risk concentrations of the maximum exposure to credit risk*

Concentration of risk is managed by client / counterparty, by geographical region and by industry sector. The maximum credit exposure to any client or counterparty as of 31 December 2016 was AED 600,868,000 (2015: AED 665,097,000) before taking account of collateral or other credit enhancements and AED 600,868,000 (2015: AED 665,097,000) net of such protection.

The Group's maximum exposure to credit risk, after provisions but before taking into account any collateral held or other credit enhancements can be analysed by the following geographical regions:

	2016		2015	
	Assets AED'000	Contingent Liabilities and commitments AED'000	Assets AED'000	Contingent liabilities and commitments AED'000
United Arab Emirates	18,668,773	5,928,546	21,062,184	5,742,320
Other Middle East countries	1,312,349	168,983	1,391,515	174,474
Europe	128,133	59,248	157,652	78,868
USA	262,302	-	10,586	500
Rest of World	127,078	198,995	186,116	273,800
Total	<u>20,498,635</u>	<u>6,355,772</u>	<u>22,808,053</u>	<u>6,269,962</u>

An industry sector analysis of the Group's maximum exposure to credit risk (excluding cash on hand) after provisions but before taking into account collateral held or other credit enhancements, is as follows:

	2016 AED'000	2015 AED'000
Financial Services	4,866,970	5,632,177
Trade	2,766,359	3,290,291
Manufacturing	1,992,628	2,380,650
Government and public sector	3,491,050	2,851,626
Construction	831,466	794,099
Other services	1,872,852	1,993,692
Other	5,666,302	6,684,543
	<u>21,487,627</u>	<u>23,627,078</u>
Less: Provision for impairment on loans and advances	(988,992)	(819,025)
	<u>20,498,635</u>	<u>22,808,053</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

27 Risk management (continued)

Credit Risk (continued)

*Credit quality per class of financial assets*

The credit quality of financial assets is managed by the Group using internal credit ratings. The table below shows the credit quality by class of financial assets based on the Group's credit rating system.

31 December 2016

*Neither past due nor impaired*

	<i>High grade AED'000</i>	<i>Standard grade AED'000</i>	<i>Sub-standard grade AED'000</i>	<i>Past due but not impaired AED'000</i>	<i>Individually impaired AED'000</i>	<i>Total AED'000</i>
Balances with the UAE Central Bank	2,658,912	-	-		-	2,658,912
Due from banks	104,117	260,959	-		-	365,076
Loans and advances (Gross)						
- Corporate	424,538	7,517,836	1,702,293	328,452	703,291	10,676,410
- Retail	-	3,515,836	-	20,297	122,011	3,658,144
Investments	2,469,548	835,048	-	-	-	3,304,596
Other assets	166,083	567,718	90,688	-	-	824,489
	<u>5,823,198</u>	<u>12,697,397</u>	<u>1,792,981</u>	<u>348,749</u>	<u>825,302</u>	<u>21,487,627</u>

31 December 2015

*Neither past due nor impaired*

	<i>High grade AED'000</i>	<i>Standard grade AED'000</i>	<i>Sub-standard grade AED'000</i>	<i>Past due but not impaired AED'000</i>	<i>Individually impaired AED'000</i>	<i>Total AED'000</i>
Balances with UAE Central Bank	2,936,633	-	-	-	-	2,936,633
Due from banks	190,876	673,510	-	-	-	864,386
Loans and advances (Gross)						
- Corporate	3,455,925	6,422,666	668,283	648,364	480,841	11,676,079
- Retail	-	4,599,212	-	35,056	180,309	4,814,577
Investments	2,176,815	372,845	-	-	-	2,549,660
Other assets	205,765	547,426	32,552	-	-	785,743
	<u>8,966,014</u>	<u>12,615,659</u>	<u>700,835</u>	<u>683,420</u>	<u>661,150</u>	<u>23,627,078</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

27 Risk management (continued)

Credit Risk (continued)

*Past due but not impaired*

Past due loans and advances include those that are past due on their repayment schedule. The majority of the past due loans are not considered to be impaired. Aging analysis of past due but not impaired loans and advances is as follows:

<i>31 December 2016</i>	<i>Less than 30 days</i> <i>AED'000</i>	<i>31 to 60 days</i> <i>AED'000</i>	<i>61 to 90 days</i> <i>AED'000</i>	<i>More than 91 days</i> <i>AED'000</i>	<i>Total</i> <i>AED'000</i>
Loans and advances	<u>91,439</u>	<u>15,619</u>	<u>26,450</u>	<u>215,241</u>	<u>348,749</u>
<i>31 December 2015</i>	<i>Less than 30 days</i> <i>AED'000</i>	<i>31 to 60 days</i> <i>AED'000</i>	<i>61 to 90 days</i> <i>AED'000</i>	<i>More than 91 days</i> <i>AED'000</i>	<i>Total</i> <i>AED'000</i>
Loans and advances	<u>226,676</u>	<u>165,130</u>	<u>136,024</u>	<u>155,590</u>	<u>683,420</u>

Approximately 93% (2015: 95 %) of the above loans are advanced to the corporate sector.

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

	<i>2016</i> <i>AED'000</i>	<i>2015</i> <i>AED'000</i>
Loans and advances	<u>1,414,555</u>	<u>708,554</u>

*Collateral held and other credit enhancements*

The Group holds collateral and other credit enhancements against certain of its credit exposures. The main types of collateral obtained are cash, securities, first and floating charges over real estate properties, vehicles, plant and machinery, inventory and trade receivables. The Group also obtains guarantees from parent companies for loans to their subsidiaries or other group companies. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters. Collateral is generally not held against non trading investment and due from banks and financial institutions. Management monitors the market value of collateral and wherever necessary the Group requests collateral in accordance with the underlying agreement and considers collateral value during its periodic review of credit facilities and adequacy of provision for impairment on loans and advances.

The percentage of collateralized exposure and the principal types of collateral held against loans and advances are as follows:

	<i>Percentage of collateralized exposure</i>		<i>Principal type of collateral held</i>
	<i>2016</i>	<i>2015</i>	
Retail Mortgage loans	<b>100%</b>	100%	Residential property
Corporate customers	<b>51%</b>	39%	Property and equipment, commercial property, floating charges over corporate assets

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

27 Risk management (continued)

Credit risk (continued)

*Collateral held and other credit enhancements (continued)*

**Retail Mortgage loans**

Credit exposures on retail mortgage loans by range of loans to value (LTV) ratio are as follows:

	<b>2016</b>	2015
	<b>AED'000</b>	AED'000
LTV ratio		
Less than 50%	<b>331,068</b>	447,201
51- 70%	<b>889,410</b>	1,001,549
71- 90%	<b>642,716</b>	617,192
91- 100%	<b>7,343</b>	-
More than 100%	<b>517</b>	-
Total	<b>1,871,054</b>	2,065,942

LTV is calculated as the ratio of the gross amount of the loan to the value of the collateral. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for residential mortgage loans is based on the collateral value at origination updated based on changes in house price indices.

Impaired loans:

For impaired loans the value of collateral is based on the most recent appraisals. Credit exposure on impaired retail mortgage loans by range of LTV ratio are as follows:

	<b>2016</b>	2015
	<b>AED'000</b>	AED'000
LTV ratio		
Less than 50%	<b>4,009</b>	10,096
51- 70%	<b>14,074</b>	41,371
More than 70%	<b>25,088</b>	7,282
Total	<b>43,171</b>	58,749

At 31 December 2016, the net carrying amount of impaired loans and advances to retail customers (including mortgages) amounted to AED 122,011,000 (2015: AED 180,309,000) and the value of identifiable collateral held against those loans and advances amounted to AED 76,401,000 (2015: AED 68,435,000).

**Corporate customers**

At 31 December 2016, the net carrying amount of impaired loans and advances to corporate customers amounted to AED 687,657,000 (2015: AED 480,841,000) and the value of identifiable collateral (mainly commercial properties) held against those loans and advances amounted to AED 178,952,000 (2015: AED 98,521,000). For each loan, the value of disclosed collateral is capped to the nominal amount of the loan that is held against.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**27 Risk management (continued)****Liquidity risk**

Liquidity risk is defined as the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk arises because of the possibility that the Group might be unable to meet its payment obligations when they fall due under both normal and stressed circumstances. To limit this risk, management have arranged diversified funding sources in addition to its core deposit base, and adopted a policy of managing assets with liquidity in mind and of monitoring future cash flows and liquidity on a daily basis. The Group has developed internal control processes and contingency plans for managing liquidity risk. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Group maintains a portfolio of marketable and diverse assets that are assumed to be easily liquidated in the event of an unforeseen interruption of cash flow. The Group also has committed lines of credit that it can access to meet liquidity needs. In addition, the Group maintains a statutory deposit with the Central Bank of UAE equal to 14% of current deposits and 1% of time deposits. In accordance with the Group's policy, the liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Group. The most important of these is to maintain the regulatory limits for Lending to Stable Resources and Eligible Liquid Assets to total liabilities ratios. Eligible Liquid Assets ratio was introduced by Central Bank of the UAE in 2015 and replaced the Liquid Assets ratio. Eligible liquid assets consist of cash, balances with the Central Bank of UAE, short term bank deposits and eligible debt securities. The ratios as at the year end were as follows:

	<b>2016</b>	2015
Lending to Stable Resources Ratio	<b>77.5%</b>	81.0%
Eligible Liquid Assets Ratio	<b>19.2%</b>	18.7%

The Group stresses the importance of current accounts, time deposits and savings accounts as a source of funds to finance its lending to customers. They are monitored using the lending to stable resources ratio, which compares loans and advances to customers as a percentage of core customer current and savings accounts, together with term funding.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

27 Risk management (continued)

Liquidity risk (continued)

Maturities of assets and liabilities based on the remaining period at the statement of financial position date to the contractual maturity date not taking account of the effective maturities as indicated by the Group's deposit retention history and the availability of liquid funds, as at 31 December 2016 is as follows:

	<i>Less than 3 months AED '000</i>	<i>From 3 months to 6 months AED '000</i>	<i>From 6 months to 12 months AED '000</i>	<i>Sub total less than 12 months AED '000</i>	<i>1 to 5 years AED '000</i>	<i>Over 5 years AED '000</i>	<i>Subtotal over 12 months AED '000</i>	<i>Undated AED '000</i>	<i>Total AED '000</i>
<b>Assets</b>									
Cash and balances with the UAE									
Central Bank	2,466,528	150,000	150,000	2,766,528	-	-	-	-	2,766,528
Due from other banks	240,076	125,000	-	365,076	-	-	-	-	365,076
Loans and advances (Gross)	3,492,042	537,042	696,615	4,725,699	5,093,160	4,515,695	9,608,855	-	14,334,554
Investments	239,007	55,904	-	294,911	1,080,933	1,928,752	3,009,685	9,157	3,313,753
Investment property	-	-	-	-	-	-	-	-	-
Property, equipment and capital work-in-progress	-	-	-	-	-	-	-	584,325	584,325
Other assets	538,105	118,080	137,712	793,897	75,094	7,309	82,403	-	876,300
Provision for impairment on loans and advances	(988,992)	-	-	(988,992)	-	-	-	-	(988,992)
<b>Total assets</b>	<b>5,986,766</b>	<b>986,026</b>	<b>984,327</b>	<b>7,957,119</b>	<b>6,249,187</b>	<b>6,451,756</b>	<b>12,700,943</b>	<b>593,482</b>	<b>21,251,544</b>
<b>Liabilities and shareholders' equity</b>									
Due to banks	434,468	-	220,338	654,806	440,676	-	440,676	-	1,095,482
Customers' deposits	11,154,900	2,011,526	1,604,571	14,770,997	767,018	-	767,018	-	15,538,015
Medium term borrowings	-	-	91,808	91,808	1,432,197	-	1,432,197	-	1,524,005
Other liabilities	686,642	104,764	118,392	909,798	43,889	23,523	67,412	30,115	1,007,325
Shareholders' equity	-	-	-	-	-	-	-	2,086,717	2,086,717
<b>Total liabilities and shareholders' equity</b>	<b>12,276,010</b>	<b>2,116,290</b>	<b>2,035,109</b>	<b>16,427,409</b>	<b>2,683,780</b>	<b>23,523</b>	<b>2,707,303</b>	<b>2,116,832</b>	<b>21,251,544</b>
<b>Net liquidity gap</b>	<b>(6,289,244)</b>	<b>(1,130,264)</b>	<b>(1,050,782)</b>	<b>(8,470,290)</b>	<b>3,565,407</b>	<b>6,428,233</b>	<b>9,993,640</b>	<b>(1,523,350)</b>	<b>-</b>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

27 Risk management (continued)

Liquidity risk (continued)

The maturity profile of assets and liabilities at 31 December 2015 was as follows:

	<i>Less than 3 months AED'000</i>	<i>From 3 months to 6 months AED'000</i>	<i>From 6 months to 12 months AED'000</i>	<i>Sub total less than 12 months AED'000</i>	<i>1 to 5 years AED'000</i>	<i>Over 5 years AED'000</i>	<i>Subtotal over 12 months AED'000</i>	<i>Undated AED'000</i>	<i>Total AED'000</i>
<b>Assets</b>									
Cash and balances with the UAE									
Central Bank	3,075,352	-	-	3,075,352	-	-	-	-	3,075,352
Due from other banks	772,578	91,808	-	864,386	-	-	-	-	864,386
Loans and advances (Gross)	3,952,252	799,015	534,784	5,286,051	6,661,758	4,542,847	11,204,605	-	16,490,656
Investments	36,905	55,570	57,296	149,771	967,543	1,432,346	2,399,889	9,690	2,559,350
Investment property	-	-	-	-	-	-	-	78,000	78,000
Property, equipment and capital work-in-progress	-	-	-	-	-	-	-	587,718	587,718
Other assets	629,909	122,324	34,208	786,441	40,745	-	40,745	-	827,186
Provision for impairment on loans and advances	(819,025)	-	-	(819,025)	-	-	-	-	(819,025)
<b>Total assets</b>	<b>7,647,971</b>	<b>1,068,717</b>	<b>626,288</b>	<b>9,342,976</b>	<b>7,670,046</b>	<b>5,975,193</b>	<b>13,645,239</b>	<b>675,408</b>	<b>23,663,623</b>
<b>Liabilities and shareholders' funds</b>									
Due to banks	151,543	-	519,173	670,716	367,230	-	367,230	-	1,037,946
Customers' deposits	12,332,706	1,998,830	1,715,242	16,046,778	728,265	-	728,265	-	16,775,043
Medium term borrowings	319,330	-	-	319,330	1,994,219	-	1,994,219	-	2,313,549
Other liabilities	701,322	121,674	32,715	855,711	42,144	40,160	82,304	29,115	967,130
Shareholders' equity	-	-	-	-	-	-	-	2,569,955	2,569,955
<b>Total liabilities and shareholders' equity</b>	<b>13,504,901</b>	<b>2,120,504</b>	<b>2,267,130</b>	<b>17,892,535</b>	<b>3,131,858</b>	<b>40,160</b>	<b>3,172,018</b>	<b>2,599,070</b>	<b>23,663,623</b>
<b>Net liquidity gap</b>	<b>(5,856,930)</b>	<b>(1,051,787)</b>	<b>(1,640,842)</b>	<b>(8,549,559)</b>	<b>4,538,188</b>	<b>5,935,033</b>	<b>10,473,221</b>	<b>(1,923,662)</b>	<b>-</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

## 27 Risk management (continued)

## Liquidity risk (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2016 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

	<i>On demand</i> <i>AED '000</i>	<i>Less than 3</i> <i>months</i> <i>AED'000</i>	<i>3 to 12</i> <i>months</i> <i>AED '000</i>	<i>1 to 5 years</i> <i>AED '000</i>	<i>Over</i> <i>5 years</i> <i>AED '000</i>	<i>Total</i> <i>AED '000</i>
<b>31 December 2016</b>						
Due to banks	12,491	423,560	224,111	456,399	-	1,116,561
Customers' deposits	4,538,475	6,684,980	3,686,877	800,888	-	15,711,220
Medium term borrowings	-	-	94,481	1,497,277	-	1,591,758
Other liabilities	171,586	393,462	209,443	18,052	-	792,543
Financial derivatives	-	6,524	19,571	102,118	57,590	185,803
<b>Total undiscounted financial liabilities</b>	<b>4,722,552</b>	<b>7,508,526</b>	<b>4,234,483</b>	<b>2,874,734</b>	<b>57,590</b>	<b>19,397,885</b>
	<i>On demand</i> <i>AED '000</i>	<i>Less than 3</i> <i>months</i> <i>AED'000</i>	<i>3 to 12</i> <i>months</i> <i>AED '000</i>	<i>1 to 5 years</i> <i>AED '000</i>	<i>Over</i> <i>5 years</i> <i>AED '000</i>	<i>Total</i> <i>AED '000</i>
<b>31 December 2015</b>						
Due to banks	6,458	145,230	522,613	369,442	-	1,043,743
Customers' deposits	5,126,022	7,257,186	3,770,944	749,481	-	16,903,633
Medium term borrowings	-	319,552	-	2,075,902	-	2,395,454
Other liabilities	141,452	478,706	140,796	30,695	-	791,649
Financial derivatives	-	6,682	20,045	101,236	74,227	202,190
<b>Total undiscounted financial liabilities</b>	<b>5,273,932</b>	<b>8,207,356</b>	<b>4,454,398</b>	<b>3,326,756</b>	<b>74,227</b>	<b>21,336,669</b>

The disclosed financial derivative instruments in the above table are the gross undiscounted outflows. However, these amounts may be settled gross or net. The following table shows the corresponding reconciliation of those amounts to their carrying amounts.

	<i>On demand</i> <i>AED '000</i>	<i>Less than 3</i> <i>months</i> <i>AED'000</i>	<i>3 to 12</i> <i>months</i> <i>AED '000</i>	<i>1 to 5 years</i> <i>AED '000</i>	<i>Over</i> <i>5 years</i> <i>AED '000</i>	<i>Total</i> <i>AED '000</i>
<b>31 December 2016</b>						
Inflows	-	2,528	8,577	70,514	51,947	133,566
Outflows	-	(6,524)	(19,571)	(102,118)	(57,590)	(185,803)
<b>Net</b>	<b>-</b>	<b>(3,996)</b>	<b>(10,994)</b>	<b>(31,604)</b>	<b>(5,643)</b>	<b>(52,237)</b>
<b>Discounted at applicable interbank rates</b>	<b>-</b>	<b>(3,956)</b>	<b>(10,872)</b>	<b>(31,063)</b>	<b>(5,522)</b>	<b>(51,413)</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**27 Risk management (continued)**
**Liquidity risk (continued)**
*Analysis of financial liabilities by remaining contractual maturities (continued)*

<i>31 December 2015</i>	<i>On demand AED '000</i>	<i>Less than 3 months AED'000</i>	<i>3 to 12 months AED '000</i>	<i>1 to 5 years AED '000</i>	<i>Over 5 years AED '000</i>	<i>Total AED '000</i>
Inflows	-	1,780	6,818	58,124	58,008	124,730
Outflows	-	(6,682)	(20,045)	(101,236)	(74,227)	(202,190)
Net	-	(4,902)	(13,227)	(43,112)	(16,219)	(77,460)
Discounted at applicable interbank rates	-	(4,872)	(13,124)	(42,500)	(15,904)	(76,400)

The table below shows the contractual maturity profile of the Group's contingent liabilities and commitments:

<i>31 December 2016</i>	<i>On demand AED '000</i>	<i>Less than 3 months AED'000</i>	<i>3 to 12 months AED '000</i>	<i>1 to 5 years AED '000</i>	<i>Over 5 years AED '000</i>	<i>Total AED '000</i>
Contingent Liabilities	-	2,345,876	1,059,837	233,093	-	3,638,806
Commitments	2,716,966	-	-	-	-	2,716,966
<b>Total</b>	<b>2,716,966</b>	<b>2,345,876</b>	<b>1,059,837</b>	<b>233,093</b>	<b>-</b>	<b>6,355,772</b>

  

<i>31 December 2015</i>	<i>On demand AED '000</i>	<i>Less than 3 months AED'000</i>	<i>3 to 12 months AED '000</i>	<i>1 to 5 years AED '000</i>	<i>Over 5 years AED '000</i>	<i>Total AED '000</i>
Contingent Liabilities	-	2,357,286	852,077	275,970	-	3,485,333
Commitments	2,784,629	-	-	-	-	2,784,629
Total	2,784,629	2,357,286	852,077	275,970	-	6,269,962

The Group expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments and therefore the actual cash flows are expected to be significantly lower than those reflected in the above table.

**Market risk**

Market risk arises from fluctuations in interest rates, foreign exchange rates and equity prices. The Board has set limits on the value of risk that may be accepted. This is monitored on a regular basis by the Group's Asset and Liability Committee (ALCO).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

## 27 Risk management (continued)

**Interest rate risk**

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or reprice in a given period. The Board has established limits on the interest rate gaps for stipulated periods. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits.

Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for re-pricing bands. ALCO is the monitoring body for compliance with these limits and is assisted by Treasury in its day-to-day monitoring activities.

The following table summarises interest rate sensitivity position at the year end. A summary of the Bank's interest rate gap position on non-trading portfolios is as follows:

<i>31 December 2016</i>	<i>Less than 3 months AED '000</i>	<i>3 to 12 months AED '000</i>	<i>1 to 5 years AED '000</i>	<i>Over 5 years AED '000</i>	<i>Non-Interest Sensitive AED '000</i>	<i>Carrying amount AED '000</i>
<b>Assets</b>						
Cash and balances with the UAE Central Bank	900,000	300,000	-	-	1,566,528	2,766,528
Due from other banks	65,654	125,000	-	-	174,422	365,076
Loans and advances	7,530,238	1,320,091	3,736,589	758,644	-	13,345,562
Investments	239,007	55,904	1,080,933	1,928,752	9,157	3,313,753
Investment property	-	-	-	-	-	-
Property, equipment and capital work-in-progress	-	-	-	-	584,325	584,325
Other assets	-	-	-	-	876,300	876,300
<b>Total assets</b>	<b>8,734,899</b>	<b>1,800,995</b>	<b>4,817,522</b>	<b>2,687,396</b>	<b>3,210,732</b>	<b>21,251,544</b>
<b>Liabilities and shareholders' equity</b>						
Due to banks	1,082,991	-	-	-	12,491	1,095,482
Customers' deposits	6,890,254	3,528,792	758,565	-	4,360,404	15,538,015
Medium term borrowings	1,524,005	-	-	-	-	1,524,005
Other liabilities	-	-	-	-	1,007,325	1,007,325
Shareholders' equity	-	-	-	-	2,086,717	2,086,717
<b>Total liabilities and shareholders' equity</b>	<b>9,497,250</b>	<b>3,528,792</b>	<b>758,565</b>	<b>-</b>	<b>7,466,937</b>	<b>21,251,544</b>
On-balance sheet	(762,351)	(1,727,797)	4,058,957	2,687,396	(4,256,205)	-
Off-balance sheet	1,063,964	-	-	-	16,130,281	17,194,245
<b>Cumulative interest rate sensitivity gap</b>	<b>301,613</b>	<b>(1,426,184)</b>	<b>2,632,773</b>	<b>5,320,169</b>	<b>17,194,245</b>	<b>-</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**27 Risk management (continued)**
**Interest rate risk (continued)**

31 December 2015	<i>Less than 3 months AED '000</i>	<i>3 to 12 months AED '000</i>	<i>1 to 5 years AED '000</i>	<i>Over 5 years AED '000</i>	<i>Non-Interest Sensitive AED '000</i>	<i>Carrying amount AED '000</i>
<b>Assets</b>						
Cash and balances with the UAE Central Bank	800,000	-	-	-	2,275,352	3,075,352
Due from other banks	594,892	91,808	-	-	177,686	864,386
Loans and advances	5,888,391	1,640,236	6,735,160	1,407,844	-	15,671,631
Investments	73,628	112,866	967,543	1,395,626	9,687	2,559,350
Investment property	-	-	-	-	78,000	78,000
Property, equipment and capital work-in-progress	-	-	-	-	587,718	587,718
Other assets	-	-	-	-	827,186	827,186
<b>Total assets</b>	<b>7,356,911</b>	<b>1,844,910</b>	<b>7,702,703</b>	<b>2,803,470</b>	<b>3,955,629</b>	<b>23,663,623</b>
<b>Liabilities &amp; shareholders' equity</b>						
Due to banks	861,183	170,305	-	-	6,458	1,037,946
Customers' deposits	7,620,236	3,632,426	708,387	-	4,813,994	16,775,043
Medium term borrowings	1,714,804	598,745	-	-	-	2,313,549
Other liabilities	-	-	-	-	967,130	967,130
Shareholders' funds	-	-	-	-	2,569,955	2,569,955
<b>Total liabilities and shareholders' equity</b>	<b>10,196,223</b>	<b>4,401,476</b>	<b>708,387</b>	<b>-</b>	<b>8,357,537</b>	<b>23,663,623</b>
Interest rate sensitivity	(2,839,312)	(2,556,566)	6,994,316	2,803,470	(4,401,908)	-
Cumulative interest rate sensitivity gap	(2,839,312)	(5,395,878)	1,598,438	4,401,908	-	-

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Group's income statement.

The sensitivity of the consolidated statement of income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2016, including the effect of hedging instruments.

	<b>2016</b>		<b>2015</b>		
	<i>Change in basis points</i>	<i>Sensitivity of net interest income and equity AED '000</i>	<i>Change in basis points</i>	<i>Sensitivity of interest income</i>	<i>and net equity AED '000</i>
Increase in rate	<b>+25</b>	<b>16,051</b>	+25		7,710
Decrease in rate	<b>-25</b>	<b>(16,051)</b>	-25		(7,710)

The interest rate sensitivity set out above relates primarily to the US Dollar as the Group does not have any significant net exposure for non-trading floating rate financial assets and financial liabilities denominated in other currencies.

The Bank is also exposed to fair value risk arising from its unhedged fixed rate bonds portfolio. A change in the fair value of these bonds by +/- 5% will result in a change in the fair value reserve in equity by AED 1,500,000 (2015: AED 3,000,000).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**27 Risk management (continued)****Currency risk**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group has set limits on positions by currency. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

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

The tables below indicates the currencies to which the Group had significant exposure at 31 December 2016 on its monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the AED, with all other variables held constant on the consolidated statement of income (due to the fair value of currency sensitive monetary assets and liabilities) and equity. A negative amount in the table reflects a potential net reduction in income statement, while a positive amount reflects a net potential increase.

<b>Currency</b>	<b>2016</b>		<b>2015</b>	
	<i>Change in currency rate in %</i>	<i>Effect on profit AED'000</i>	<i>Change in currency rate in %</i>	<i>Effect on profit AED'000</i>
EUR	+10	7	+10	(8)
GBP	+10	(1)	+10	1

**Operational risk**

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**28 Segmental analysis**

For the purposes of reporting to the chief operating decision makers, the Group is organised into four segments:

- Corporate banking - principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers;
- Retail banking - principally handling individual customers' deposits, and providing consumer type loans, overdrafts, credit card facilities and funds transfer facilities as well as Islamic banking services;
- Treasury - principally providing money market, trading and treasury services, as well as the management of the Group's funding operations including overseeing the operations of Al Sadarah Investment Company; and
- Others - includes the non-core lending portfolio of SME and Personal Loans to Self-Employed businesses as well as the Bank's head office functions.

Transactions between segments are conducted at estimated market rates on an arm's length basis. Interest is debited / credited to business segments based on a pool rate which approximates the marginal cost of funds.

Segmental information for the year ended 31 December 2016 is as follows:

	<i>Corporate banking AED'000</i>	<i>Retail banking AED'000</i>	<i>Treasury AED'000</i>	<i>Others AED'000</i>	<i>Total AED'000</i>
Net interest income	323,748	125,341	38,089	146,432	633,610
Other operating income	107,791	33,673	82,126	4,169	227,759
Operating expenses	(173,402)	(137,688)	(40,863)	(20,673)	(372,626)
Net impairment losses	(504,625)	(66,390)	-	(440,419)	(1,011,434)
Profit / (Loss) for the year	<u>(246,488)</u>	<u>(45,064)</u>	<u>79,352</u>	<u>(310,491)</u>	<u>(522,691)</u>
Capital Expenditure - Property and equipment	<u>14,462</u>	<u>23,394</u>	<u>3,828</u>	<u>851</u>	<u>42,535</u>
At 31 December 2016					
Segment Assets	<u>10,688,533</u>	<u>3,367,086</u>	<u>6,555,320</u>	<u>640,605</u>	<u>21,251,544</u>
Segment Liabilities	<u>11,913,057</u>	<u>4,318,704</u>	<u>2,702,294</u>	<u>230,772</u>	<u>19,164,827</u>



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**28 Segmental analysis (continued)**

Segmental information for the year ended 31 December 2015 was as follows:

	<i>Corporate banking AED'000</i>	<i>Retail Banking AED'000</i>	<i>Treasury AED'000</i>	<i>Others AED'000</i>	<i>Total AED'000</i>
Net interest income	425,377	169,302	44,048	348,493	987,220
Other operating income	108,701	25,997	43,743	30,436	208,877
Operating expenses	(179,494)	(206,210)	(44,891)	(60,807)	(491,402)
Net impairment losses	(366,927)	(115,811)	-	(405,053)	(887,791)
Profit / (Loss) for the year	<u>(12,343)</u>	<u>(126,722)</u>	<u>42,900</u>	<u>(86,931)</u>	<u>(183,096)</u>
Capital Expenditure - Property and equipment	<u>111,950</u>	<u>73,928</u>	<u>16,898</u>	<u>8,448</u>	<u>211,224</u>
At 31 December 2015					
Segment Assets	<u>11,290,675</u>	<u>4,087,197</u>	<u>6,499,088</u>	<u>1,786,663</u>	<u>23,663,623</u>
Segment Liabilities	<u>12,455,048</u>	<u>4,514,272</u>	<u>3,351,495</u>	<u>772,853</u>	<u>21,093,668</u>

The Group operates in only one geographic area, the Middle East. Accordingly, no geographical analysis of operating income, net profit and net assets is given.

**29 Fair values of financial instruments****Determination of fair value and fair value hierarchy**

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1 - quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2 - other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3 - techniques that use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

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At 31 December 2016

29 Fair values of financial instruments (continued)

Financial instruments and assets recorded at fair value

The following table shows an analysis of financial instruments and assets recorded at fair value by level of the fair value hierarchy:

<b>31 December 2016</b>	<i>Level 1</i> <i>AED'000</i>	<i>Level 2</i> <i>AED'000</i>	<i>Level 3</i> <i>AED'000</i>	<i>Total</i> <i>AED'000</i>
<i>Available for sale investments</i>				
<i>Quoted</i>				
Government debt securities	1,329,806	-	-	1,329,806
Other debt securities	1,974,790	-	-	1,974,790
Equities	9,081	-	-	9,081
<i>Unquoted</i>				
Equities	-	-	76	76
Total	<u>3,313,677</u>	<u>-</u>	<u>76</u>	<u>3,313,753</u>
<i>Investment property</i>	-	-	-	-
<i>Derivative assets</i>				
Forward contracts	-	100,963	-	100,963
Interest rate swaps	-	8,133	-	8,133
Currency swaps	-	867	-	867
Total	<u>-</u>	<u>109,963</u>	<u>-</u>	<u>109,963</u>
Total financial assets	<u><u>3,313,677</u></u>	<u><u>109,963</u></u>	<u><u>76</u></u>	<u><u>3,423,716</u></u>
<i>Derivative liabilities</i>				
Forward contracts	-	52,820	-	52,820
Interest rate swaps	-	29,120	-	29,120
Currency options	-	867	-	867
Total financial liabilities	<u>-</u>	<u>82,807</u>	<u>-</u>	<u>82,807</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**29 Fair values of financial instruments (continued)****Financial instruments and assets recorded at fair value (continued)**

<i>31 December 2015</i>	<i>Level 1 AED'000</i>	<i>Level 2 AED'000</i>	<i>Level 3 AED'000</i>	<i>Total AED'000</i>
<i>Investments available-for-sale</i>				
<i>Quoted</i>				
Government debt securities	1,017,445	-	-	1,017,445
Other debt securities	1,532,215	-	-	1,532,215
Equities	9,614	-	-	9,614
<i>Unquoted Investments</i>				
Equities	-	-	76	76
<b>Total</b>	<b>2,559,274</b>	<b>-</b>	<b>76</b>	<b>2,559,350</b>
<i>Investment properties</i>	-	96,000	-	96,000
<i>Derivative assets</i>				
Forward contracts	-	27,092	-	27,092
Interest rate swaps	-	1,142	-	1,142
Currency swaps	-	1,109	-	1,109
<b>Total</b>	<b>-</b>	<b>29,343</b>	<b>-</b>	<b>29,343</b>
<b>Total financial assets</b>	<b>2,559,274</b>	<b>125,343</b>	<b>76</b>	<b>2,684,693</b>
<i>Derivative financial instruments</i>				
Forward contracts	-	25,171	-	25,171
Interest rate swaps	-	43,182	-	43,182
Currency options	-	1,109	-	1,109
<b>Total financial liabilities</b>	<b>-</b>	<b>69,462</b>	<b>-</b>	<b>69,462</b>

The following is a description of the determination of fair value for financial instruments and assets which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

***Derivatives***

Derivative products valued using a valuation technique with market observable inputs are mainly interest rate swaps, currency options and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

***Investments available-for-sale***

Financial investments valued using a valuation technique or pricing models primarily consist of unquoted equities. These assets are valued using models which sometimes only incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

***Investment property***

Investment properties are revalued based on fair value, which reflects market conditions at the reporting date. These valuation estimates are evaluated, at least annually, by an external, independent third party valuer based on a valuation model recommended by the International Valuation Standards Committee.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**29 Fair values of financial instruments (continued)**

**Financial instruments and assets recorded at fair value (continued)**

**Movements in level 3 financial instruments measured at fair value**

There was no movement between the levels of financial instruments during the year (2015: AED Nil).

**Gains or losses on level 3 financial instruments included in the profit or loss for the year:**

No gains or losses on level 3 financial instruments were included in the profit or loss for the year (2015: AED Nil).

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

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

**Financial instruments not recorded at fair value**

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

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

***Asset for which fair value approximates carrying value***

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

***Fixed rate financial instruments***

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

**30 Capital adequacy**

The Group actively manages the capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules / ratios") and adopted by the Central Bank of UAE in supervising the Bank.

***Capital management***

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and maximise shareholders' value.

The Group manages its capital base and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital base, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**30 Capital adequacy (continued)**

The risk asset ratio calculations, in accordance with the capital adequacy guidelines as per Basel II accord established for the global banking industry, are as follows:

<b>Risk Weighted Exposures</b>	<b>2016</b> <i>AED'000</i>	<b>2015</b> <i>AED'000</i> <i>(Restated)</i>
Credit Risk	<b>15,037,547</b>	16,626,508
Market Risk	<b>172,276</b>	80,023
Operational Risk	<b>2,185,685</b>	2,279,017
Total Risk Weighted Exposures	<b>17,395,508</b>	18,985,548
 <b>Tier I and II Capital</b>		
Tier I Capital	<b>2,124,361</b>	2,647,725
Tier II Capital	<b>150,325</b>	130,061
Capital Base	<b>2,274,686</b>	2,777,786
 <b>Capital Ratio:</b>		
Total regulatory capital as a percentage of total risk weighted assets	<b>13.1%</b>	14.6%
Total tier I regulatory capital as a percentage of total risk weighted assets	<b>12.2%</b>	13.9%

Regulatory capital consists mainly of Tier 1 capital, which comprises share capital, share premium, retained earnings including current year profit, foreign currency translation less accrued dividends. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the Central Bank of UAE. The other component of regulatory capital is Tier 2 capital, which includes general provisions and cumulative changes in fair values.

The Group has complied with all the requirements as set by the Central Bank of UAE in respect of capital adequacy.

**31 Social contribution**

Social contributions made during the year amount to AED Nil (2015: AED 555,000)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

**32 Prior period errors*****Investment property revaluation***

During the review of investment property, an error in the valuation of an investment property included in the financial statements of the Group for the year ended 31 December 2014 has been rectified in the current year. The result of the error was an overstatement of the carrying value of the investment property and the net profit for the year ended 31 December 2014 by AED 18,000,000. The impact of this error relating to the year ended 31 December 2014 has been adjusted against retained earnings as at 1 January 2015 and 1 January 2016.

***Hedge ineffectiveness***

The Bank invests in fixed rate bonds which are classified as available-for-sale and expose the Bank to fair value interest rate risk. In order to hedge this risk, the Bank enters into interest rate swaps (IRS) with various counterparties. The Bank has designated these interest rate swaps as hedging instruments and the bonds as hedged items.

During the current year, the Bank, with the assistance of an independent expert, performed hedge effectiveness tests for all its hedging relationships. Although these tests have met the hedge effectiveness criteria, under IAS 39, both retrospectively and prospectively, there was some ineffectiveness identified in respect of these relationships in previous years resulting in an overstatement of the Group's statement of income resulting in a cumulative loss of AED 32,096,000 as at 31 December 2015. This loss should have been reversed from the fair value reserve in equity and recognised in the income statement in prior years.

Therefore, as disclosed below, the loss pertaining to 2014 and amounting to AED 15,147,000 has been recognised in the retained earnings carried forward at 31 December 2014 which has been restated to rectify the error. Similarly, the loss of AED 16,949,000 relating to 2015 has been recognised in the comparative consolidated statement of income for the year ended 31 December 2015 which has, accordingly, been rectified and restated.

These effects of these prior period corrections on the Group's financial results are shown below:

<b><i>Consolidated statement of financial position</i></b>	<b><i>Investment Property</i></b>	<b><i>Retained Earnings</i></b>	<b><i>Cumulative Changes in Fair Value</i></b>
	<b><i>AED'000</i></b>	<b><i>AED'000</i></b>	<b><i>AED'000</i></b>
<b>As at 31 December 2014</b>			
As previously reported	110,794	914,759	(66,893)
Investment property revaluation	(18,000)	(18,000)	-
Hedge ineffectiveness	-	(15,147)	15,147
<b>As restated</b>	<b>92,794</b>	<b>881,612</b>	<b>(51,746)</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2016

## 32 Prior period errors (continued)

	<i>Statement of Income</i>	<i>Statement of Other Comprehensive Income</i>	<i>Investment Property</i>	<i>Retained Earnings</i>	<i>Cumulative Changes in Fair Value</i>
	<i>AED'000</i>	<i>AED'000</i>	<i>AED'000</i>	<i>AED'000</i>	<i>AED'000</i>
<b>As at 31 December 2015</b>					
As previously reported	(166,147)	(42,973)	96,000	404,890	(109,866)
<b>2014 error carried forward impact:</b>					
Investment property revaluation	-	-	(18,000)	(18,000)	-
Hedge ineffectiveness	-	-	-	(15,147)	15,147
<b>2015 error impact:</b>					
Hedge ineffectiveness	(16,949)	16,949	-	(16,949)	16,949
<b>As restated</b>	<b>(183,096)</b>	<b>(26,024)</b>	<b>78,000</b>	<b>354,794</b>	<b>(77,770)</b>

The balance sheet at 1<sup>st</sup> January 2015 has not been presented in these consolidated financial statements because the impact of the prior period errors relating to 2014 were not considered to be material in the context of the balance sheet as of that date.