bank muscat SAOG

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017

Registered office

P.O Box 134
Ruwi 112
Sultanate of Oman

Principal place of business

Building No.120/4, Block No.311
Street No.62, Airport Heights
Seeb,
Sultanate of Oman

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Chartered Accountants Licence No. APC/17/2015, Management Consultants Licence No. OPC/11/2015, Commercial Register No. 1230865

Independent auditor's report to the shareholders of bank muscat SAOG

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 financial position of bank muscat SAOG ("the Bank") and its subsidiaries (together "the Group") as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2017;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows 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 consolidated financial statements in the Sultanate of Oman. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Our audit approach

Overview

Key Audit Matters	• Impairment of Loans and Advances • Impact assessment of IFRS 9 and related disclosures

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 the directors 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.

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Independent auditor's report to the shareholders of bank muscat SAOG (continued)

Our audit approach (continued)

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated 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 are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	*How our audit addressed the key audit matter*
Impairment of loans and advances	
Impairment allowances represent the directors' best estimate of the losses incurred within the loan portfolios at the balance sheet date. They are calculated on a collective basis for portfolios of loans of a similar nature and on an individual basis for significant loans. The calculation of both collective and individual impairment allowances is inherently judgemental for any bank. Collective impairment allowances are used to recognise unidentified impairment. Collective impairment allowances are calculated using statistical models, which approximate the impact of current economic and credit conditions on portfolios of similar loans. The inputs to these models are subject to 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. We focused on this area because the directors make complex and subjective judgements over both timing of recognition of impairment and the estimation of the size of any impairment. Information on credit risk and the Group's credit risk management is provided in note 42.2. The use of estimates and judgements in respect of impairment of loans and advances is disclosed in note 4(a). Disclosure of the impairment allowance and net impairment charge is provided in notes 7 and 42.2.	We assessed and tested the design and operating effectiveness of the controls over the identification of which loans and advances were impaired. In addition, we performed detailed testing on the models used to calculate both identified and unidentified impairment. This testing typically included testing of the extraction of data used in the model, assessing the appropriateness of the assumptions used and re-performance of the impairment calculation. We also have reviewed the methodology applied in certain models. Where the models were designed to meet the Central Bank of Oman requirements in respect of impairment allowances, we reconciled the output of these models to the provisioning requirement under IFRS. We also tested a sample of loans and advances to ascertain whether the loss event (the point at which impairment is recognised) had been identified in a timely manner. Where impairment had been identified, we examined the forecasts of future cash flows prepared by management to support the calculation of the impairment, challenging the assumptions and comparing estimates to external evidence where available. We examined a sample of loans and advances which had not been identified by management as potentially impaired and formed our own judgement as to whether that was appropriate including using external evidence in respect of the relevant counterparties.

Independent auditor's report to the shareholders of bank muscat SAOG (continued)

Key audit matters (continued)

Key audit matter	*How our audit addressed the key audit matter*
Impact assessment of IFRS 9 and related disclosures The Group will adopt IFRS 9 on 1 January 2018 and has computed its impact in accordance with IFRS 9 and Central Bank of Oman guidelines. IFRS 9 will replace IAS 39 Financial Instruments: Recognition and Measurement and introduces new requirements for the classification and measurement of financial assets and financial liabilities, a new model based on expected credit losses (ECL) for recognising loan loss provisions and provides for simplified hedge accounting by aligning hedge accounting more closely with an entity's risk management methodology. The Group will apply the new rules retrospectively from 1 January 2018. The Group considers the implementation of IFRS 9 as a significant project and, therefore, has set up a multidisciplinary implementation team with members from its Credit Risk and Modeling, Finance, IT, Operations, and business teams to manage the implementation. The Group has also engaged with external consultants to provide support in relevant areas. The project is managed by the Chief Financial Officer and Chief Risk Officer. IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which financial assets are managed and the underlying cash flow characteristics. IFRS 9 contains three principal classification categories for financial assets measured at: (a) Amortised Cost (AC); (b) Fair Value through Other Comprehensive Income (FVOCI); and (c) Fair Value through Profit or Loss (FVPL). Under IFRS 9, derivatives embedded in contracts where the host is a financial asset are never bifurcated. Instead, the hybrid financial instrument as a whole is assessed for classification.	We have obtained the disclosures and accounting policies prepared by the directors along with the work performed by the Group's consultants pertaining to the following: ● classification and measurement of financial instruments ● ECL methodology and models PwC experts were engaged to perform procedures on the initial application of IFRS 9. We have used the work performed by our experts to form our assessment on the appropriateness of the methodology and disclosures. The work performed included the following: ● Review of business models driving classification and measurement of financial instruments; ● Review of mapping financial assets to business models; ● Performing the 'Solely Payment of Principal and Interest' (SPPI) test on an agreed number of samples that is representative of the asset portfolio of the Group; ● Review of IFRS 9 compliant classification and measurement accounting policy notes; ● Review of the ECL and Probability of Default (PD)/Loss Given Default (LGD)/Exposure At Default (EAD) methodology documents; ● Performing phased testing on a sample basis of the PD/LGD/EAD models, reviewing key assumptions and key areas where significant judgment is exercised; ● Recalculation of expected credit loss numbers as of 30 September 2017 and 31 December 2017 to gain assurance over the ECL provisions calculated by the Group; and ● Review of the financial statement disclosure to assess that it is consistent with the work performed above.

Independent auditor's report to the shareholders of bank muscat SAOG (continued)

Key audit matters (continued)

Key audit matter	*How our audit addressed the key audit matter*
Impact assessment of IFRS 9 and related disclosures (continued) In addition IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. The new impairment model will apply to financial assets measured at amortised cost and FVOCI, except for investments in equity instruments. A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as: ● Determining criteria for significant increase in credit risk (SICR); ● Choosing appropriate models and assumptions for the measurement of ECL including PD/LGD/EAD; ● Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and ● Establishing portfolios of similar financial assets for the purposes of measuring ECL. We focused on this area because of the significance of this change in accounting standard on the determination of impairment losses and the classification and measurement of financial instruments. The Group has disclosed the impact of the new classification and measurement approach, impairment and its overall assessment, based on the significant judgements, in note 2.4 (b) of the consolidated financial statements.	

Other information

The directors are responsible for the other information. The other information which we obtained prior to the date of our auditor's report comprises of Chairman's report, Basel II – Pillar III Disclosures, Basel III Disclosures, Financial review, Corporate Governance Report, and Management Discussion and Analysis but does not include the financial statements and our auditor's report thereon. The complete annual report, which is not yet received, is expected to be made available to us after that date.

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

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

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

When we read the complete annual report which is not yet received, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Independent auditor's report to the shareholders of bank muscat SAOG (continued)

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

The directors are 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 relevant requirements of the Capital Market Authority ("the CMA") of the Sultanate of Oman and the Commercial Companies Law of 1974, as amended, and for such internal control as the directors determine are 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, the directors are 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 the directors either intend to liquidate the Group or to cease operations, or have 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.

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 the directors.
- Conclude on the appropriateness of the directors' 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.

Independent auditor's report to the shareholders of bank muscat SAOG (continued)

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

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.

Report on other legal and regulatory requirements

Further, we report that these consolidated financial statements have been prepared and comply, in all material respects, with the relevant requirements of the CMA of the Sultanate of Oman and the Commercial Companies Law of 1974, as amended.

Kenneth Macfarlane
Muscat, Sultanate of Oman

28 February 2018

bank muscat SAOG

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2017

2016 US$ 000's	2017 US$ 000's		Notes	2017 RO 000's	2016 RO 000's
		ASSETS			
2,705,382	2,427,909	Cash and balances with Central Banks	5	934,745	1,041,572
1,367,831	1,537,730	Due from banks	6	592,026	526,615
18,447,593	19,113,255	Loans and advances	7	7,358,603	7,102,323
2,220,797	2,519,775	Islamic financing receivables	7	970,113	855,007
		Investment securities:			
1,026,824	956,431	- Available-for-sale	9	368,226	395,327
1,463,898	1,579,104	- Held to maturity	9	607,955	563,601
132,457	132,455	- Fair value through profit or loss	9	50,995	50,996
124,868	-	Investment in an associate	11	-	48,074
421,618	505,039	Other assets	8	194,440	162,323
192,810	187,322	Property, equipment and software	12	72,119	74,232
28,104,078	28,959,020	**Total assets**		11,149,222	10,820,070
		LIABILITIES AND EQUITY			
		LIABILITIES			
2,160,499	2,363,961	Deposits from banks	14	910,125	831,792
17,389,112	16,777,688	Customers' deposits	15	6,459,410	6,694,808
1,981,608	2,493,253	Islamic customers' deposits	15	959,902	762,919
-	115,865	Sukuk	16	44,608	-
996,351	998,722	Euro medium term notes	17	384,508	383,595
167,221	84,198	Mandatory convertible bonds	18	32,416	64,380
876,248	975,704	Other liabilities	19	375,646	337,356
85,792	111,465	Taxation	20	42,914	33,030
429,740	315,221	Subordinated liabilities	21	121,360	165,450
24,086,571	24,236,077	**Total liabilities**		9,330,889	9,273,330
		EQUITY			
		Equity attributable to equity holders of parent			
648,377	703,730	Share capital	22	270,936	249,625
1,262,966	1,323,057	Share premium	23	509,377	486,242
635,865	750,384	General reserve	24	288,898	244,808
216,125	234,577	Legal reserve	24	90,312	83,208
13,779	14,987	Revaluation reserve	12	5,770	5,305
251,143	213,221	Subordinated loan reserve	24	82,090	96,690
(782)	(483)	Cash flow hedge reserve	38	(186)	(301)
49,958	43,670	Cumulative changes in fair value		16,813	19,234
(5,106)	(3,436)	Foreign currency translation reserve		(1,323)	(1,966)
-	13,247	Reserve for restructured accounts	24	5,100	-
945,182	1,092,327	Retained profit		420,546	363,895
4,017,507	4,385,281	**Total equity attributable to the equity holders**		1,688,333	1,546,740
-	337,662	Perpetual Tier 1 capital	25	130,000	-
4,017,507	4,722,943	**Total equity**		1,818,333	1,546,740
28,104,078	28,959,020	**Total liabilities and equity**		11,149,222	10,820,070
US$ 1.61	US$ 1.62	**Net assets per share**	27	RO 0.623	RO 0.620
7,762,310	7,428,754	**Contingent liabilities and commitments**	28	2,860,070	2,988,489

These consolidated financial statements along with notes and other explanatory information on pages 12 to 96 were authorised for issue on 28/FEB/2018 in accordance with the resolution of the Board of Directors.

Chairman **Director** **Chief Executive**

The notes and other explanatory information on pages 12 to 96 form an integral part of these consolidated financial statements

Independent auditor's report - pages 1 - 6.

bank muscat SAOG

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2017

2016 US$ 000's	2017 US$ 000's		Notes	2017 RO 000's	2016 RO 000's
925,139	**982,593**	Interest income	29	**378,298**	356,178
(274,317)	**(315,884)**	Interest expense	30	**(121,615)**	(105,612)
650,822	**666,709**	**Net interest income**		**256,683**	250,566
96,114	**119,732**	Income from Islamic financing/investments	29	**46,097**	37,004
(34,863)	**(55,673)**	Distribution to depositors	30	**(21,434)**	(13,422)
61,251	**64,059**	**Net income from Islamic financing**		**24,663**	23,582
712,073	**730,768**	**Net interest income and Income from Islamic financing**		**281,346**	274,148
247,507	**241,730**	Commission and fee income (net)	31	**93,066**	95,290
121,394	**159,880**	Other operating income	32	**61,554**	46,737
1,080,974	**1,132,378**	**OPERATING INCOME**		**435,966**	416,175
		OPERATING EXPENSES			
(419,110)	**(443,785)**	Other operating expenses	33	**(170,857)**	(161,357)
(33,042)	**(34,343)**	Depreciation	12	**(13,222)**	(12,721)
(452,152)	**(478,128)**			**(184,079)**	(174,078)
(1,558)	**9,351**	Reversal of impairment/(impairment) for due from banks	6	**3,600**	(600)
(182,566)	**(164,016)**	Impairment for credit losses	7	**(63,146)**	(70,288)
-	**(45,545)**	Loss on reclassification of investment in an associate	11	**(17,535)**	-
94,130	**106,945**	Recoveries from provision for credit losses	7	**41,174**	36,240
(12,475)	**(19,148)**	Impairment for investments available for sale	9	**(7,372)**	(4,803)
4,486	**6,332**	Share of results from an associate	11	**2,438**	1,727
(550,135)	**(584,209)**			**(224,920)**	(211,802)
530,839	**548,169**	**PROFIT BEFORE TAXATION**		**211,046**	204,373
(72,242)	**(88,904)**	Tax expense	20	**(34,228)**	(27,813)
458,597	**459,265**	**PROFIT FOR THE YEAR**		**176,818**	176,560
		OTHER COMPREHENSIVE (EXPENSE) INCOME			
		Net other comprehensive (expense) income to be reclassified to profit or loss in subsequent periods			
-	**860**	Transfer from foreign currency translation reserve on reclassification of investment in an associate	11	**331**	-
-	**81**	Transfer from cumulative changes in fair value on reclassification of an associate	11	**31**	-
(16)	-	Foreign currency translation of investment in associate	11	-	(6)
564	-	Share of other comprehensive income of an associate	11	-	217
(364)	**810**	Translation of net investments in foreign operations		**312**	(140)
(642)	**(6,369)**	Change in fair value of investments available for sale	20	**(2,452)**	(247)
1,083	**299**	Change in fair value of cash flow hedge	38	**115**	417
625	**(4,319)**			**(1,663)**	241
		Net other comprehensive (expense) income not to be reclassified to profit or loss in subsequent periods			
-	**(416)**	Transfer from revaluation of land and building on reclassification of an associate	11	**(160)**	-
-	**1,623**	Surplus on revaluation of land and building	12	**625**	-
625	**(3,112)**	**OTHER COMPREHENSIVE (EXPENSE) INCOME FOR THE YEAR**		**(1,198)**	241
459,222	**456,153**	**TOTAL COMPREHENSIVE INCOME FOR THE YEAR**		**175,620**	176,801
		Total comprehensive income attributable to:			
459,222	**456,153**	Equity holders of Parent Company		**175,620**	176,801
		Profit attributable to:			
458,597	**459,265**	Equity holders of Parent Company		**176,818**	176,560
		Earnings per share:			
US$ 0.17	**US$ 0.17**	- Basic and diluted	35	**RO 0.064**	RO 0.064

Items in the other comprehensive income are disclosed net of tax. The income tax relating to each component of other comprehensive income is disclosed in note 20.
The notes and other explanatory information on pages 12 to 96 form an integral part of these consolidated financial statements.

Independent auditor's report - pages 1 - 6.

CONSOLIDATED STATEMENT CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017

		Attributable to equity holders of parent													
2017	**Notes**	**Share capital RO 000's**	**Share premium RO 000's**	**General reserve RO 000's**	**Legal reserve RO 000's**	**Revaluation reserve RO 000's**	**Subordinated loan reserve RO 000's**	**Cash flow hedge reserve RO 000's**	**Cumulative changes in fair value RO 000's**	**Foreign currency translation reserve RO 000's**	**Reserve for restructured loans RO 000's**	**Retained profit RO 000's**	**Total RO 000's**	**Perpetual Tier I capital RO 000's**	**Total RO 000's**
Balance at 1 January 2017		**249,625**	**486,242**	**244,808**	**83,208**	**5,305**	**96,690**	**(301)**	**19,234**	**(1,966)**	**-**	**363,895**	**1,546,740**	**-**	**1,546,740**
Profit for the year		**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**176,818**	**176,818**	**-**	**176,818**
Transfer of share of other comprehensive income (expense) on reclassification of an associate		**-**	**-**	**-**	**-**	**(160)**	**-**	**-**	**31**	**331**	**-**	**-**	**202**	**-**	**202**
Transfer from retained profits to restructured accounts reserve		**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**5,100**	**(5,100)**	**-**	**-**	**-**
Other comprenhensive (expense) income		**-**	**-**	**-**	**-**	**625**	**-**	**115**	**(2,452)**	**312**	**-**	**-**	**(1,400)**	**-**	**(1,400)**
Total comprehensive income		**-**	**-**	**-**	**-**	**465**	**-**	**115**	**(2,421)**	**643**	**5,100**	**171,718**	**175,620**	**-**	**175,620**
Dividends paid	26	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(62,406)**	**(62,406)**	**-**	**(62,406)**
Issue of bonus shares during the year	26	**12,482**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(12,482)**	**-**	**-**	**-**
Transfer to legal reserve	24	**-**	**-**	**-**	**7,104**	**-**	**-**	**-**	**-**	**-**	**-**	**(7,104)**	**-**	**-**	**-**
Conversion of mandatory convertible Bonds	18	**8,829**	**23,135**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**31,964**	**-**	**31,964**
Transfer from subordinated loan reserve	24	**-**	**-**	**44,090**	**-**	**-**	**(44,090)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Transfer to subordinated loan reserve	24	**-**	**-**	**-**	**-**	**-**	**29,490**	**-**	**-**	**-**	**-**	**(29,490)**	**-**	**-**	**-**
Issue of Perpetual Tier I capital	25	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**130,000**	**130,000**
Interest on Perpetual Tier I capital	25	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(3,585)**	**(3,585)**	**-**	**(3,585)**
Balance at 31 December 2017		**270,936**	**509,377**	**288,898**	**90,312**	**5,770**	**82,090**	**(186)**	**16,813**	**(1,323)**	**5,100**	**420,546**	**1,688,333**	**130,000**	**1,818,333**
Balance at 31 December 2017 (US $)		**703,730**	**1,323,057**	**750,384**	**234,577**	**14,987**	**213,221**	**(483)**	**43,670**	**(3,436)**	**13,247**	**1,092,327**	**4,385,281**	**337,662**	**4,722,943**

(Continued on page 10)

The notes and other explanatory information on pages 12 to 96 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

		Attributable to equity holders of Parent Company										
	Notes	Share capital RO 000's	Share premium RO 000's	General reserve RO 000's	Legal reserve RO 000's	Revaluation reserve RO 000's	Subordinated loan reserve RO 000's	Cash flow hedge reserve RO 000's	Cumulative changes in fair value RO 000's	Foreign currency translation reserve RO 000's	Retained profit RO 000's	Total RO 000's
At 1 January 2016		229,183	464,951	169,808	76,394	5,305	138,600	(718)	19,264	(1,820)	295,992	1,396,959
Profit for the year		-	-	-	-	-	-	-	-	-	176,560	176,560
Share of other comprehensive income/ (expense) of an associate		-	-	-	-	-	-	-	217	(6)	-	211
Other comprehensive income\ (expense)		-	-	-	-	-	-	417	(247)	(140)	-	30
Total comprehensive income for the year		-	-	-	-	-	-	417	(30)	(146)	176,560	176,801
Dividends paid	26	-	-	-	-	-	-	-	-	-	(57,295)	(57,295)
Issue of bonus shares during the year		11,458	-	-	-	-	-	-	-	-	(11,458)	-
Transfer to legal reserve	24	-	-	-	6,814	-	-	-	-	-	(6,814)	-
Conversion of mandatory convertible bonds	18	8,984	21,291	-	-	-	-	-	-	-	-	30,275
Transfer from subordinated loan reserve	24	-	-	75,000	-	-	(75,000)	-	-	-	-	-
Transfer to subordinated loan reserve	24	-	-	-	-	-	33,090	-	-	-	(33,090)	-
At 31 December 2016 (RO 000's)		249,625	486,242	244,808	83,208	5,305	96,690	(301)	19,234	(1,966)	363,895	1,546,740
At 31 December 2016 (US$ 000's)		648,377	1,262,966	635,865	216,125	13,779	251,143	(782)	49,958	(5,106)	945,182	4,017,507

The notes and other explanatory information on pages 12 to 96 form an integral part of these consolidated financial statements.

Independent auditor's report - pages 1 - 6.

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2017

2016 US$ 000's	2017 US$ 000's		Note	2017 RO 000's	2016 RO 000's
		CASH FLOWS FROM OPERATING ACTIVITIES			
530,839	**548,169**	**Profit for the year before taxation**		**211,046**	204,373
		Adjustments for :			
(4,486)	**(6,332)**	Share of results from an associate	11	**(2,438)**	(1,727)
33,042	**34,343**	Depreciation	12	**13,222**	12,721
12,475	**19,148**	Impairment for investments available for sale	9	**7,372**	4,803
-	**45,545**	Loss on reclassification of investment in an associate	11	**17,535**	-
182,566	**164,016**	Impairment for credit losses	7	**63,146**	70,288
1,558	**(9,351)**	(Reversal of impairment)/ impairment on due from banks		**(3,600)**	600
(94,130)	**(106,945)**	Recoveries from impairment for credit losses	7	**(41,174)**	(36,240)
(7)	**(20)**	Profit on sale of property and equipment		**(8)**	(3)
-	**730**	Loss on revaluation of property		**281**	-
(9,366)	**(47,057)**	Profit on sale of investments	9	**(18,117)**	(3,606)
(12,244)	**(10,018)**	Dividends income		**(3,857)**	(4,714)
640,247	**632,228**	**Operating profit before working capital changes**		**243,408**	246,495
862,678	**(248,384)**	Due from banks		**(95,628)**	332,131
(1,135,826)	**(714,855)**	Loans and advances		**(275,219)**	(437,293)
(581,481)	**(306,855)**	Islamic financing receivables		**(118,139)**	(223,870)
13,922	**(69,009)**	Other assets		**(26,568)**	5,360
15,774	**207,873**	Deposits from banks		**80,031**	6,073
(113,005)	**(611,423)**	Customers' deposits		**(235,398)**	(43,507)
357,886	**511,644**	Islamic Customer deposits		**196,983**	137,786
500,000	**-**	Euro Medium term notes		**-**	192,500
-	**115,865**	Sukuk		**44,608**	-
(82,720)	**103,680**	Other liabilities		**39,917**	(31,847)
477,475	**(379,236)**	Cash (used in)/from operations		**(146,005)**	183,828
(60,335)	**(62,265)**	Income taxes paid		**(23,972)**	(23,229)
417,140	**(441,501)**	**Net cash (used in) from operating activities**		**(169,977)**	160,599
		CASH FLOWS FROM INVESTING ACTIVITIES			
4,182	**4,184**	Dividend received from an associate	11	**1,611**	1,610
12,244	**10,018**	Dividend received from investment securities		**3,857**	4,714
(308,210)	**(398,214)**	Purchase of investments	9	**(153,313)**	(118,661)
237,535	**281,062**	Proceeds from sale of investments		**108,209**	91,451
(27,158)	**(27,958)**	Purchase of property and equipment	12	**(10,764)**	(10,456)
319	**26**	Proceeds from sale of property and equipment		**10**	123
(81,088)	**(130,882)**	**Net cash used in investing activities**		**(50,390)**	(31,219)
		CASH FLOWS FROM FINANCING ACTIVITIES			
(148,818)	**(162,091)**	Dividends paid		**(62,406)**	(57,295)
-	**337,662**	Perpetual Tier I capital issued		**130,000**	-
-	**(9,314)**	Interest on Perpetual Tier I capital		**(3,585)**	-
(194,805)	**(114,519)**	Subordinated loan paid		**(44,090)**	(75,000)
(343,623)	**51,738**	**Net cash from (used in) financing activities**		**19,919**	(132,295)
(7,571)	**(520,645)**	**NET CHANGE IN CASH AND CASH EQUIVALENTS**		**(200,448)**	(2,915)
3,563,436	**3,555,865**	Cash and cash equivalents at 1 January		**1,369,008**	1,371,923
3,555,865	**3,035,220**	**CASH AND CASH EQUIVALENTS AT 31 DECEMBER**	34	**1,168,560**	1,369,008

The notes and other explanatory information on pages 12 to 96 form an integral part of these consolidated financial statements.

Independent auditor's report - pages 1 - 6.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017

1. Legal status and principal activities

bank muscat SAOG (the Bank or the Parent Company) is a joint stock company incorporated in the Sultanate of Oman and is engaged in commercial and investment banking activities through a network of 166 branches within the Sultanate of Oman and one branch each in Riyadh, Kingdom of Saudi Arabia and Kuwait. The Bank has representative offices in Dubai, United Arab Emirates, Singapore and Iran. The Bank has a subsidiary in Riyadh, Kingdom of Saudi Arabia. The Bank operates in Oman under a banking license issued by the Central Bank of Oman (CBO) and is covered by its deposit insurance scheme. The Bank has its primary listing on the Muscat Securities Market.

The Bank and its subsidiary (together, the Group) operate in six countries (2016 - six countries) and employed 3,712 employees as of 31 December 2017 (2016: 3,747).

During 2013, the Parent Company inaugurated "Meethaq Islamic banking window" ("Meethaq") in the Sultanate of Oman to carry out banking and other financial activities in accordance with Islamic Shari'a rules and regulations. Meethaq operates under an Islamic banking license granted by the CBO on 13 January 2013. Meethaq's Shari'a Supervisory Board is entrusted to ensure Meethaq's adherence to Shari'a rules and principles in its transactions and activities. The principal activities of Meethaq include: accepting customer deposits; providing Shari'a compliant financing based on various Shari'a compliant modes; undertaking Shari'a compliant investment activities permitted under the CBO's Regulated Islamic Banking Services as defined in the licensing framework. As of 31 December 2017, Meethaq has 19 branches (2016 - 17 branches) in the Sultanate of Oman.

2. Basis of preparation

2.1 Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), the applicable regulations of the CBO, the requirements of the Commercial Companies Law of 1974, as amended and disclosure requirements of the Capital Market Authority of the Sultanate of Oman.

The Islamic window operation of the Parent Company; "Meethaq" uses Financial Accounting Standards ("FAS"), issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"), for preparation and reporting of its financial information. Meethaq's financial information is included in the results of the Bank, after adjusting for financial reporting differences, if any, between AAOIFI and IFRS.

2.2 Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis, modified to include the revaluation of freehold land and buildings and the measurement at fair value of derivative financial instruments, available-for-sale investment securities and investments recorded at fair value through profit or loss. The carrying values of recognised assets and liabilities that are designated as hedged items in fair value hedges that would otherwise be carried at amortised cost are adjusted to record changes in the fair values attributable to the risks that are being hedged in effective hedge relationships.

The consolidated statement of financial position is presented in descending order of liquidity as this presentation is more appropriate to the Group's operations.

For the ease of users, relevant balances of Meethaq are separately presented in these consolidated financial statements wherever applicable. A complete set of carve out financial statements of Meethaq, prepared under AAOIFI, is included in the Bank's annual report.

2.3 Functional and presentation currency

These consolidated financial statements are presented in Rial Omani, which is the entity's functional currency and also in US Dollars, for the convenience of the readers. The US Dollar amounts, which are presented in these consolidated financial statements have been translated from the Rial Omani amounts at an exchange rate of US Dollar 1 = RO 0.385. All financial information presented in Rial Omani and US Dollars has been rounded to the nearest thousand, unless otherwise stated.

2. Basis of preparation (continued)

2.4 New Standards, implementations and amendments in existing standards

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

For the year ended 31 December 2017, the Group has adopted all of the new and revised standards and interpretations issued by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for periods beginning on 1 January 2017.

The following new standards and amendments became effective as of 1 January 2017:

- Amendments to IAS 12 Income Taxes
- Annual Improvements 2014-2016 Cycle
- Amendments to IAS 7, Statement of cash flows on disclosure initiative

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

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

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2017 reporting periods and have not been early adopted by the Group. The Bank's assessment of the impact of these new standards and interpretations is set out below:

IFRS 9 Financial Instruments:

In July 2014, the International Accounting Standards Board (IASB) issued the final version of 'IFRS 9 - Financial Instruments', which will replace 'IAS 39 – Financial Instruments: Recognition and Measurement'. This new standard includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting. The group will adopt IFRS 9 on its mandatory application date that is from 1 January 2018. The Group is now in the final phase of implementation, whereby a parallel run exercise is currently under process together with various levels of validation. As permitted by the transitional provisions of IFRS 9, the group is not planning to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at 31 December 2017 will be recognised in the opening retained earnings and other reserves at 1 January 2018.

The significant areas impacted by application of IFRS 9 are as follows:

i. Classification and measurement:

IFRS 9 contains a classification and measurement approach for financial assets that is based on the business model in which the assets are managed and their contractual cash flow characteristics.. These factors determine whether the financial assets are measured at (a) Amortised Cost (AC), Fair Value through Other Comprehensive Income (FVOCI) or Fair Value Profit or Loss (FVPL). Under IFRS 9, derivatives embedded in contracts where the host is a financial asset are not bifurcated. Instead, the hybrid financial instrument as a whole is assessed for classification.

Based on the Group's assessment, the IFRS 9 requirements are expected to have the following impact on the classification and measurement of its financial assets:

At 31 December 2017, the Group had equity investments classified as available-for-sale with a carrying value of RO 95.536 million. Under IFRS 9, the Group will measure these investments as follows:

a) Equity investments amounting to RO 86.976 million would be classified as FVOCI resulting in an increase in retained profits by RO 7.835 million and a corresponding decrease in cumulative changes in fair value of an equal amount.
b) Equity investments amounting to RO 8.56 million would be classified as FVPL resulting in an increase in retained profits by RO 0.609 million and a corresponding decrease in cumulative changes in fair value of an equal amount.

2. Basis of preparation (continued)

2.4 New Standards, implementations and amendments in existing standards (continued)

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

i. Classification and measurement (continued):

As at 31 December 2017, the Group had investments in funds classified as available-for-sale with a fair value of RO 19.288 million. Under IFRS 9, the Group will measure these investments as FVPL, resulting into an increase in retained profits by RO 1.786 million and a corresponding decrease in cumulative changes in fair value of an equal amount.

At 31 December 2017, the Group had debt investments classified as available-for-sale with a fair value of RO 253.402 million. Under IFRS 9, the Group will measure these investments as follows :

a) Debt investment amounting to RO 208.733 million would be classified as Held at amortized cost as they qualify for held to collect business model and have contractual cash flows that are solely payments of principal and interest resulting into decrease in cumulative changes in fair value by RO 1.259 million and a corresponding decrease in the carrying value of investments of the same amount.
b) Debt investments amounting to RO 44.670 million would be classified as FVOCI. An impairment allowance of RO 0.264 million would be created through retained profits. Cumulative changes in fair value would increase by RO 0.264 million with a corresponding increase in the carrying value of investment.

As at 31 December 2017, the Group had debt investments classified as held to maturity with a carrying value of RO 607.955 million. Under IFRS 9, the Group will measure these investments as Held at amortized cost. An impairment allowance of RO 0.619 million would be created through retained profits.

As at 31 December 2017, the Group had debt investments classified as fair value profit and loss with a carrying value of RO 50.995 million. Under IFRS 9, the Group will measure these investments as follows:

a) Debt investment amounting to RO 1.0 million would be classified as FVOCI resulting in a decrease in retained profits by RO 0.038 million and a corresponding increase in cumulative changes in fair value by the same amount.
b) Debt investment amounting to RO 49.995 million would be classified as Held at amortized cost with no impact.

Most of the requirements in IAS39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

No significant changes are expected for the classification and measurement of the Bank's financial liabilities.

ii. Expected credit losses

IFRS 9 replaces the 'incurred loss' model under IAS 39 with a forward-looking 'expected credit loss' (ECL) model. The new impairment model will apply to financial assets measured at Amortised cost or FVOCI which mainly include, loans and advances / financing, investments (other than equity investments), interbank placements, financial guarantees and credit commitments. No impairment loss will be recognised on equity investments. A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining quantitative and qualitative criteria for significant increase in credit risk (SICR);
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL.
- Establishing group of financial assets based on similar risk characteristics for the purposes of measuring ECL.

2. Basis of preparation (continued)

2.4 New Standards, implementations and amendments in existing standards (continued)

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

Financial assets will be categorized into the following three stages in accordance with the IFRS 9 methodology:

Stage 1 Performing assets: Financial asset(s) that are not significantly deteriorated in credit quality since origination for which a 12 month ECL will be recorded.
Stage 2 Underperforming assets: Financial asset(s) that has significantly deteriorated in credit quality since origination for which a lifetime ECL will be recorded.
Stage 3 Impaired assets: For Financial asset(s) that are impaired, the group will recognize life time ECL.

The Group assessed the impact of impairment under IFRS 9 as at 30 September 2017 and 31 December 2017. Based on the assessment, the Group expects that the ECL as per IFRS 9 would be well within the cumulative provision for impairment as per the regulatory requirements. With regards to the impairment requirements of IFRS 9, the Group estimates the transition impact on shareholders' equity will be an increase in a range of 1% to 2% of equity. The adjustments would be taken in shareholders' equity in Q1 2018 and would not affect the income statement.

iii. Hedge accounting

IFRS 9's hedge accounting requirements are designed to align the accounting more closely to the entity's risk management framework; permit a greater variety of hedging instruments; and remove or simplify some of the rule-based requirements in IAS 39. The elements of hedge accounting: fair value, cash flow and net investment hedges are retained.

When initially applying IFRS 9, the Group has the option to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements in IFRS 9. However, The Group determined that all existing hedge relationships that are currently designated in effective hedging relationships would continue to qualify for hedge accounting under IFRS 9. The new hedge accounting requirements under IFRS 9 will not have a material impact on hedge accounting applied by the Group.

iv. Disclosure

IFRS 9 also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of Group's disclosures about its financial instruments particularly in the year of the adoption of IFRS 9.

v. Central Bank of Oman (CBO) circular BM 1149 dated 13th April 2017

CBO circular BM 1149 sets out Management's responsibilities both on and post implementation of IFRS 9, aims to promote consistency, comparability in reporting across Omani banks, provides a robust alternate while replacing existing prudential norms of the Central Bank, sets out requirements for board approved IFRS 9 policies, policy deviation reporting, norms for creating regulatory impairment reserve, enhanced disclosures etc.

In the year of adoption, if IFRS 9 based provision for impairment is lower than the provision for impairment as per regulatory guidelines, the excess, net of tax, shall be transferred as an appropriation from net profit after taxes to a regulatory reserve "Impairment reserve" under Parent Company's equity. In subsequent years, if IFRS 9 based provision for impairment (i.e. charge to the profit and loss) is lower than provision for impairment as per regulatory guidelines, the excess, net of tax, shall be transferred as an appropriation from net profit after taxes to aforementioned Impairment reserve.

The regulatory impairment reserve cannot be used by the Parent Company for capital adequacy calculation and for declaration of any dividends. Utilization of the Impairment reserve created above would require prior approval of the Central Bank of Oman.

2. Basis of preparation (continued)

2.4 New Standards, implementations and amendments in existing standards (continued)

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

IFRS 15 Revenue from Contracts with Customers :

IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognising revenue. Specifically, the standard introduces a 5-step approach to revenue recognition:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2018.

The Group has planned to adopt the new standard on the required effective date. The Group does not expect that IFRS 15 will have significant impact on the consolidated financial statements.

IFRS 16 Leases:

The IASB issued IFRS 16 Leases which requires lessees to recognise assets and liabilities for most leases. For lessors there is little change to the existing accounting in IAS 17 Leases. The new standard will be effective for the annual periods beginning on or after 1 January 2019. Early application is permitted, provided the new revenue standard, IFRS 15 Revenue from Contracts with customers, has been applied, or is applied at the same date as IFRS 16. The Group plans to adopt the new standard on the required effective date.

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

2.5 Consolidation

(a) Basis of consolidation

The consolidated financial statements comprise the financial statements of the Group and its subsidiary as at 31 December 2017. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee that significantly affect their returns)
- Exposure, or rights, to variable returns from its involvement with the investee, and
- The ability to use its power over the investee to affect its returns

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement with the other vote holders of the investee.
- Rights arising from other contractual arrangements.
- The Group's voting rights and potential voting rights.

2 Basis of preparation and accounting policies (continued)

2.5 Consolidation (continued)

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the statement of comprehensive income from the date the Group gains control until the date the Group ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income are attributed to the equity holders of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies. All intra-Group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

- derecognizes the assets (including goodwill) and liabilities of the subsidiary
- derecognizes the carrying amount of any non-controlling interests
- derecognizes the cumulative translation differences recorded in equity
- recognizes the fair value of the consideration received
- recognizes the fair value of any investment retained
- recognizes any surplus or deficit in profit or loss
- reclassifies the parent's share of components previously recognized in other comprehensive
- income to profit or loss or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities

(b) Transactions and non-controlling

The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. The acquisition of an additional ownership interest in a subsidiary without a change of control is accounted for as an equity transaction in accordance with IFRS 10. Any excess or deficit of consideration paid over the carrying amount of the non-controlling interests is recognised in equity of the Group in transactions where the non-controlling interests are acquired or sold without loss of control.

When the Group ceases to have control or significant influence, any retained interest in the entity is measured to its fair value, with the change in carrying amount recognized in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognized in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognized in other comprehensive income are reclassified to profit or loss.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognized in other comprehensive income are reclassified to profit or loss where appropriate.

(c) Investment in an associate

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control.

The considerations made in determining significant influence or joint control is similar to those necessary to determine control over subsidiaries. The Group's investments in its associates are accounted for using the equity method.

2 Basis of preparation and accounting policies (continued)

2.5 Consolidation (continued)

Under the equity method, the investment in an associate is initially recognized at cost. The carrying amount of the investment is adjusted to recognize changes in the Group's share of net assets of the associate since the acquisition date. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortized nor individually tested for impairment.

The statement of profit or loss reflects the Group's share of the results of operations of the associate. Any change in other comprehensive income of those investees is presented as part of the Group's other comprehensive income. In addition, when there has been a change recognized directly in the equity of the associate, the Group recognizes its share of any changes, when applicable, in the statement of changes in equity. Unrealized gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

The aggregate of the Group's share of profit or loss of an associate is shown on the face of the statement of comprehensive income.

The financial statements of the associate are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

After application of the equity method, the Group determines whether it is necessary to recognize an impairment loss on its investment in its associate. At each reporting date, the Group determines whether there is objective evidence that the investment in the associate is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value.

Upon loss of significant influence over the associate, the Group measures and recognizes any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment is recognised in the profit or loss.

When the Group's share of losses in an equity-accounted investment equals or exceeds its interest in the entity, including any other unsecured long-term receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the other entity.

Dividends received or receivable from associates are recognised as a reduction in the carrying amount of the investment.

3. Significant accounting policies

The accounting policies set out below have been applied consistently by the Group to all periods presented in these consolidated financial statements, unless otherwise stated.

3.1 Foreign currency translation

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

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

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

3. Significant accounting policies (continued)

3.1 Foreign currency translation (continued)

(iv) On consolidation, the assets and liabilities of foreign operations are translated into Rial Omani at the rate of exchange prevailing at the reporting date and their income statements are translated at exchange rates prevailing at the dates of the transactions. The exchange differences arising on translation for consolidation are recognised in other comprehensive income. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the profit or loss in other operating expenses or other operating income. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations and translated at closing rate.

3.2 Revenue and expense recognition

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

3.2.1 Interest

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

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

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

3.2.2 Fees and commission

Fees integral to the effective interest rate (EIR) are included in the EIR calculation, and are recognised over the life of the financial instrument. This include fees integral to the origination of a financial instrument (fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability) and commitment fees (if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination). The Group does not designate loan commitments as financial liabilities at fair value through profit or loss.

All other fees, commissions and other income and expense items are generally recorded on an accrual basis by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided. Loan syndication fees are recognised as income when the syndication has been completed and the Group retains no part of the loan package for itself, or retains a part at the same effective interest rate as for the other participants.

Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, and which are earned on execution of the underlying transaction, are recorded on its completion. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-proportion basis or based on a right to receive. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria. Asset management fees relating to investment funds are recorded rateably over the period that the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continually provided over an extended period of time.

3. Significant accounting policies (continued)

3.2.3 Dividends

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

3.2.4 Provisions

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

3.3 Financial assets and liabilities

3.3.1 Classification

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, held to maturity and available-for-sale. The classification depends on the purpose for which the financial assets were acquired, intention of the management and the contractual terms. Management determines the classification of its financial assets at initial recognition. The Group measures all financial liabilities at amortised cost, except for financial liabilities at fair value through profit or loss.

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

Financial assets and financial liabilities classified in this category are those that have been designated by management upon initial recognition. The Group classifies financial assets at fair value through profit or loss if they are acquired principally for the purpose of trading i.e. are held for trading. Management may also only designate an instrument at fair value through profit or loss upon initial recognition when the following criteria are met, and designation is determined on an instrument-by-instrument basis:

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

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

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

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

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables in the statement of financial position includes 'cash and balances with central banks', 'due from banks', 'Loans and advances', Islamic financing receivables' and 'other assets except prepayments' and instruments for which the entity may not recover all of its initial investment other than because of credit deterioration.

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

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

3. Significant accounting policies (continued)

3.3 Financial assets and liabilities (continued)

3.3.1 Classification (continued)

(c) Held to maturity

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

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

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

(d) Available-for-sale financial assets

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

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

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

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

(e) 'Day 1' profit or loss

When the transaction price differs from the fair value of other observable current market transactions in the same instrument, or based on a valuation technique whose variables include only data from observable markets, the Group immediately recognises the difference between the transaction price and fair value (a Day 1 profit or loss) in other operating income. In cases where fair value is determined using data which is not observable, the difference between the transaction price and model value is only recognised in the statement of comprehensive income when the inputs become observable.

3.3.2 Derivative financial instruments and hedging activities

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

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

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

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

3 Significant accounting policies (continued)

3.3 Financial assets and liabilities (continued)

3.3.2 Derivative financial instruments and hedging activities (continued)

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

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

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

(i) Fair value hedges

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

(ii) Cash flow hedges

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

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

3 Significant accounting policies (continued)

3.3 Financial assets and liabilities (continued)

3.3.2 Derivative financial instruments and hedging activities (continued)

(ii) Cash flow hedges (continued)

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

3.3.3 Recognition

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

3.3.4 Derecognition

(i) Financial assets

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

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

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

(ii) Financial liabilities

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

3 Significant accounting policies (continued)

3.3 Financial assets and liabilities (continued)

3.3.5 Offsetting

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

3.3.6 Amortised cost measurement

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

3.3.7 Fair value measurement

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on a number of accounting policies and methods. Where applicable, information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability. Details are set out in note 43.

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

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

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

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

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

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

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

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

3 Significant accounting policies (continued)

3.3 Financial assets and liabilities (continued)

3.3.7 Fair value measurement (continued)

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

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

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

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

3.3.8 Investment in equity and debt securities

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

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

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

3.3.9 Fair value measurement of derivatives

The fair value of forward contracts/options and others are estimated based on observable market inputs for such contracts as on the reporting date.

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

The fair value of options is determined based on its intrinsic values, term to maturity and implied volatility.

3.4 Identification and measurement of impairment of financial assets

(a) Assets carried at amortised cost

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

3 Significant accounting policies (continued)

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

(a) Assets carried at amortised cost (continued)

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

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

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

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

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

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

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

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

If in a subsequent period, the amount of impairment loss decreases and decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the consolidated statement of comprehensive income. Also refer to notes 3.3.1. (b) loans and receivables and 3.3.1. (c) held to maturity investments.

3 Significant accounting policies (continued)

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

(b) Assets classified as available-for-sale

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

(c) Renegotiated loans

Where possible, the 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. The restructured or rescheduled loans are upgraded only after satisfactory performance of a minimum period defined in the Bank's policy from the date of the first payment of interest or principal, whichever is earlier, under the rescheduled/ renegotiated terms and regulatory guidelines. Management continuously reviews renegotiated loans to ensure that all renegotiation criteria such as cash flows, collateral and tenor are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

3.5 Cash and cash equivalents

Cash and cash equivalents consist of cash in hand and bank balances, treasury bills and money market placements and deposits maturing within three months of the date of acquisition. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

3.6 Due from banks

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

3.7 Property, equipment and software

Items of property and equipment are measured at cost less accumulated depreciation and impairment loss. Cost includes expenditures that are directly attributable to the acquisition of the asset. When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

Computer software costs that are directly associated with identifiable and unique software products controlled by the Group and have probable economic benefit exceeding the costs beyond one year are recognised as an intangible asset. Computer software costs recognised as an asset are amortised using the straight-line method over the estimated useful life of 5-10 years.

Revaluations of freehold land and buildings are carried out every five years on an open market value for existing use basis, by an independent valuer. Increases in the carrying amount arising on revaluation are credited to other comprehensive income and shown as revaluation reserve in shareholders' equity. Decreases that offset previous increases of the same asset are charged in other comprehensive income and debited against other reserves directly in equity; all other decreases are charged to the statement of comprehensive income. On disposal the related revaluation surplus is transferred directly to retained earnings. Transfers from revaluation surplus to retained earnings are not made through statement of comprehensive income. Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

3 Significant accounting policies (continued)

3.7 Property and equipment (continued)

	Years
Freehold and leasehold buildings	20 - 50
Leased hold improvements	5 - 10
Furniture, fixtures and equipment	5 - 10
Motor vehicles	3 - 5

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

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

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

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

3.8 Collateral pending sale

The Group occasionally acquires real estate in settlement of certain loans and advances. Real estate is stated at the lower of the outstanding amount of the related loans and advances or the fair value of the collateral held. Gains or losses on disposal and unrealised losses on revaluation are recognised in the statement of comprehensive income.

3.9 Business combinations and Goodwill

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred measured at acquisition date fair value and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, any previously held equity interest is re-measured at its acquisition date at fair value and any resulting gain or loss is recognised in profit or loss.

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*, is measured at fair value with changes in fair value recognised either in either profit or loss or as a change to OCI. If the contingent consideration is not within the scope of IAS 39, it is measured in accordance with the appropriate IFRS. Contingent consideration that is classified as equity is not re-measured and subsequent settlement is accounted for within equity.

3.10 Deposits

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

3 Significant accounting policies (continued)

3.11 Income tax

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

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

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

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

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

3.12 Fiduciary assets

The Group provides trustee, corporate administration, investment management and advisory services to third parties, which involve the Group making allocation and purchase and sale decisions in relation to a wide range of financial instruments. Those assets that are held in a fiduciary capacity are not included in these consolidated financial statements.

3.13 Acceptances

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

3.14 Repurchase and resale agreements

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

3.15 Trade and settlement date accounting

All regular way purchases and sales of financial assets are recognised on the trade date, i.e. the date that the entity commits to purchase the asset. Regular way purchase 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.

3.16 Leases

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

3 Significant accounting policies (continued)

3.16 Leases (continued)

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

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

3.17 Employee end of service benefits

Contributions to a defined contribution retirement plan, for Omani employees, in accordance with the Oman Social Insurance Scheme, are recognised as expense in the statement of comprehensive income when accrued.

The Group's obligation in respect of non-Omani end of service benefits, which is an unfunded defined benefit retirement plan, is the amount of future benefit that such employees have earned in return for their service in current and prior periods.

3.18 Earnings per share

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

3.19 Financial guarantees contracts

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

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

3.20 Borrowings

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

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

3.21 Dividend on ordinary shares

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

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

3 Significant accounting policies (continued)

3.22 Directors' remuneration

The board of directors' remuneration is accrued within the limits specified by the Capital Market Authority and the requirements of the Commercial Companies Law of the Sultanate of Oman. These costs are recorded as expenses in the period in which they are incurred.

3.23 Share Capital

Ordinary shares with discretionary dividends and other eligible shares / instruments are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

4 Critical accounting estimates and judgements

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in this note. Specific fair value estimates are disclosed in note 43.

The Group's significant accounting estimates were on:

(a) Impairment losses on loans and advances

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

The table below shows the sensitivity analysis and its impact of increase or decrease in the net credit loss percentages of loans and advances and Islamic financing receivables by 10 bps and 20 bps compared to the loss estimates on the impairment losses as follows:

Sensitivity of impairment estimates	**At 31 December 2017**		At 31 December 2016	
	% of change in net credit losses (+/-)	**Change in impairment for credit losses (+\-) RO 000's**	% of change in net credit losses (+/-)	Change in impairment for credit losses (+\-) RO 000's
Carrying of loans and advances	10 bps	8,657	10 bps	8,271
Carrying of loans and advances	20 bps	17,313	20 bps	16,542

4 Critical accounting estimates and judgements (continued)

(b) Impairment on due from banks

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

Sensitivity of impairment estimates	**At 31 December 2017**		At 31 December 2016	
	% of change in net cash flows (+/-)	**Change in impairment for credit losses (+\-) RO 000's**	% of change in net cash flows (+/-)	Change in impairment for credit losses (+\-) RO 000's
Due from banks	**5 bps**	**297**	5 bps	265
Due from banks	**10 bps**	**595**	10 bps	529

(c) Fair value of derivatives and other financial instruments

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The Group uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period. The Group uses expected cash flow analysis for various available-for-sale financial assets that are not traded in active markets.

The sensitivity analysis of the fair value of derivatives and other financial instruments is shown in note 43, fair value information.

(d) Impairment of available-for-sale equity investments

The Group determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost or objective evidence of impairment exists. This determination of what is considered to be significant or prolonged requires judgement. In applying judgement, the Group evaluates among other factors, the volatility in share price. Objective evidence of impairment may be due to deterioration in the financial health of the investee, industry and sector performance. A decline in value of security below its cost over twenty percent is considered as significant. Further, a decline in value of any security below its cost for a continuous period of twelve months is considered prolonged.

The sensitivity analysis and its impact of impairment of available-for-sale equity investments is shown in note 43, fair value information.

(e) Impairment loss on investment in associate

The Group reviews its investment in associate periodically and evaluates the objective evidence of impairment. Objective evidence includes the performance of associate, the future business model, local economic conditions and other relevant factors. Based on the objective evidence, the Group determines the need for impairment loss on investment in associate using the higher of the value in use and fair value.

(f) Taxes

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

4 Critical accounting estimates and judgements (continued)

(f) Taxes (continued)

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

A table showing the impact of change in tax is as follows:

	At 31 December 2017		At 31 December 2016	
	% of change (+/-)	**Change (+\-) RO 000's**	% of change (+/-)	Change (+\-) RO 000's
Deferred tax asset/ liability (net)	5%	238	5%	72
Tax expense	5%	1,711	5%	1,391

5. Cash and balances with Central Banks

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
430,735	**476,597**	Cash	**183,490**	165,833
1,136,325	**1,483,010**	Other balances with Central Banks	**570,959**	437,485
1,137,023	**467,003**	Certificate of deposits with Central Banks	**179,796**	437,754
1,299	**1,299**	Capital deposit with Central Banks	**500**	500
2,705,382	**2,427,909**		**934,745**	1,041,572

The capital deposit with the Central Banks cannot be withdrawn without the approval of the respective Central Bank. During the year, the average minimum balance to be kept with Central Banks as statutory reserves is RO 251.9 million (2016: RO 299.4 million).

6. Due from banks

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
370,020	**365,157**	Nostro balances	**140,586**	142,458
652,384	**764,652**	Inter-bank placements	**294,391**	251,168
361,400	**414,543**	Loans to banks	**159,599**	139,139
1,383,804	**1,544,352**		**594,576**	532,765
(15,973)	**(6,622)**	Provision for impairment	**(2,550)**	(6,150)
1,367,831	**1,537,730**		**592,026**	526,615

The movement in provision for impairment is analysed below:

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
14,415	**15,973**	1 January	**6,150**	5,550
1,558	**(9,351)**	(Released)/ provided during the year	**(3,600)**	600
15,973	**6,622**	31 December	**2,550**	6,150

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FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

7. Loans and advances/ Islamic financing receivables

Loans and advances - conventional

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
17,150,944	**17,610,152**	Loans	**6,779,908**	6,603,113
569,003	**700,914**	Overdrafts and credit cards	**269,852**	219,066
566,236	**594,914**	Loans against trust receipts	**229,042**	218,001
57,353	**137,470**	Bills purchased and discounted	**52,926**	22,081
881,335	**874,930**	Other advances	**336,848**	339,314
19,224,871	**19,918,380**		**7,668,576**	7,401,575
(777,278)	**(805,125)**	Provision for impairment	**(309,973)**	(299,252)
18,447,593	**19,113,255**		**7,358,603**	7,102,323

Islamic financing receivables

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
1,011,727	**1,185,943**	Housing finance	**456,588**	389,515
112,052	**116,777**	Consumer finance	**44,959**	43,140
1,135,039	**1,263,317**	Corporate finance	**486,377**	436,990
2,258,818	**2,566,037**		**987,924**	869,645
(38,021)	**(46,262)**	Provision for impairment	**(17,811)**	(14,638)
2,220,797	**2,519,775**		**970,113**	855,007

The movement in provision for impairment is analysed below:

Impairment for credit losses

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
713,721	**759,059**	At 1 January	**292,237**	274,782
182,566	**164,016**	Provided during the year	**63,146**	70,288
(74,540)	**(100,400)**	Released during the year	**(38,654)**	(28,698)
(5,925)	**(8,473)**	Written off during the year	**(3,262)**	(2,281)
(59,795)	**(27,899)**	Transfer to memorandum portfolio	**(10,741)**	(23,021)
3,164	**2,047**	Transfer from memorandum portfolio	**788**	1,218
(132)	**203**	Foreign currency translation difference	**78**	(51)
-	**(442)**	Transfer to collateral pending sale	**(170)**	-
759,059	**788,111**	**At 31 December (a)**	**303,422**	292,237

Contractual interest/profit not recognised

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
59,544	**56,240**	At 1 January	**21,653**	22,925
36,257	**33,252**	Contractual interest not recognised	**12,802**	13,959
(12,374)	**(15,491)**	Contractual interest recovered	**(5,964)**	(4,764)
(2,499)	**(1,881)**	Written off during the year	**(724)**	(962)
260	**291**	Transfer from memorandum portfolio	**112**	100
(24,948)	**(9,138)**	Transfer to memorandum portfolio	**(3,518)**	(9,605)
-	**3**	Foreign currency translation difference	**1**	-
56,240	**63,276**	**At 31 December (b)**	**24,362**	21,653
815,299	**851,387**	Total impairment (a) + (b)	**327,784**	313,890

7. Loans and advances/ Islamic financing receivables (continued)

Recoveries during the year of RO 41.174 million (2016: RO 36.240 million) include RO 2.520 million (2016: RO 7.542 million) recovered from loans written off earlier. The loans transferred to memorandum portfolio, during the year of RO 14.259 million (2016: RO 32.626 million) were fully provided by the Group.

As of 31 December 2017, loans and advances on which contractual interest is not being accrued or has not been recognised amounted to RO 254.2 million (2016: RO 240.3 million).

During the year, written off loans amounting to RO 0.9 million (2016: RO 1.32 million) were upgraded from classified portfolio. Accordingly these loans were reclassified from memorandum account to loans and advances. These accounts were fully provided.

8. Other assets

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
186,912	**228,210**	Acceptances (Note 19)	**87,861**	71,961
64,645	**102,219**	Other debtors and prepaid expenses	**39,354**	24,888
56,384	**71,031**	Positive fair value of derivatives (Note 38)	**27,347**	21,708
76,727	**62,330**	Accrued interest	**23,997**	29,540
1,309	**15,865**	Deferred tax asset (Note 20)	**6,108**	504
15,922	**6,106**	Others	**2,351**	6,130
19,719	**19,278**	Collateral pending sale (net of provisions)	**7,422**	7,592
421,618	**505,039**		**194,440**	162,323

In accordance with the CBO requirements, the bank has retained the existing impairment provision of RO 4.82 million (2016: RO 4.65 million) till all the properties are disposed

9. Investment securities

	Fair value through profit or loss RO 000's	**Available-for-sale RO 000's**	**Held to maturity RO 000's**	**2017 Total RO 000's**	2016 Total RO 000's
Quoted investments					
Bonds	**50,995**	**241,182**	**219,374**	**511,551**	89,798
Equities	**-**	**102,499**	**-**	**102,499**	432,004
Total quoted	**50,995**	**343,681**	**219,374**	**614,050**	521,802
Unquoted investments:					
Treasury bills	**-**	**-**	**372,012**	**372,012**	433,514
Bonds/equities	**-**	**39,518**	**16,569**	**56,087**	68,028
Total unquoted	**-**	**39,518**	**388,581**	**428,099**	501,542
Total investments	**50,995**	**383,199**	**607,955**	**1,042,149**	1,023,344
Impairment losses on investments	**-**	**(14,973)**	**-**	**(14,973)**	(13,420)
Net investments	**50,995**	**368,226**	**607,955**	**1,027,176**	1,009,924
2016	50,996	395,327	563,601	1,009,924	

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9. Investment securities (continued)

	Fair value through profit or loss US$ 000's	Available-for-sale US$ 000's	Held to maturity US$ 000's	2017 Total US$ 000's	2016 Total US$ 000's
Quoted investments					
Bonds	**132,455**	**626,447**	**569,803**	**1,328,705**	233,242
Equities	**-**	**266,231**	**-**	**266,231**	1,122,088
Total quoted	**132,455**	**892,678**	**569,803**	**1,594,936**	1,355,330
Unquoted investments:					
Treasury bills	**-**	**-**	**966,265**	**966,265**	1,126,010
Bonds/equities	**-**	**102,644**	**43,036**	**145,680**	176,696
Total unquoted	**-**	**102,644**	**1,009,301**	**1,111,945**	1,302,706
Total investments	**132,455**	**995,322**	**1,579,104**	**2,706,881**	2,658,036
Impairment losses on investments	**-**	**(38,891)**	**-**	**(38,891)**	(34,857)
Net investments	**132,455**	**956,431**	**1,579,104**	**2,667,990**	2,623,179
2016	132,457	1,026,824	1,463,898	2,623,179	

An analysis of available-for-sale investments is set out below:

2016 US$ 000's	2017 US$ 000's		2017 RO 000's	2016 RO 000's
		Quoted investments		
		Equity		
126,561	**169,326**	Foreign securities	**65,190**	48,726
54,825	**45,318**	Other services sector	**17,448**	21,108
27,127	**28,122**	Unit funds	**10,827**	10,444
15,358	**15,112**	Financial services sector	**5,818**	5,913
9,369	**8,353**	Industrial sector	**3,216**	3,607
		Debt		
632,678	**537,161**	Government bonds	**206,807**	243,581
60,938	**85,244**	Foreign bonds	**32,819**	23,461
564	**4,042**	Local bonds	**1,556**	217
927,420	**892,678**	**Total quoted investments**	**343,681**	357,057
		Unquoted investments		
		Equity		
28,782	**16,766**	Foreign securities	**6,455**	11,081
50,774	**50,007**	Local securities	**19,253**	19,548
2,049	**1,974**	Unit funds	**760**	789
		Debt		
52,656	**33,897**	Local bonds	**13,050**	20,272
134,261	**102,644**	**Total unquoted investments**	**39,518**	51,690
1,061,681	**995,322**	**Total available-for-sale investments**	**383,199**	408,747
(34,857)	**(38,891)**	Impairment losses on investments	**(14,973)**	(13,420)
1,026,824	**956,431**	**Available-for-sale investments (net)**	**368,226**	395,327

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

9. Investments securities (continued)

The movement in impairment of investment securities is summarised as follows:

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
28,234	**34,857**	At 1 January	**13,420**	10,870
12,475	**19,148**	Provided during the year	**7,372**	4,803
(5,852)	**(15,114)**	Released during the year on disposal	**(5,819)**	(2,253)
34,857	**38,891**	At 31 December	**14,973**	13,420

The movement in investment securities may be summarised as follows:

	Available-for -sale RO 000's	**Held to maturity RO 000's**	**Fair value through profit or loss RO 000's**	**Total RO 000's**
At 1 January 2017	**395,327**	**563,601**	**50,996**	**1,009,924**
Exchange differences on monetary assets	**(178)**	**569**	**-**	**391**
Additions	**49,165**	**3,585,365**	**-**	**3,634,530**
Transfer from investment in associate	**49,103**	**-**	**-**	**49,103**
Disposals and redemption	**(108,209)**	**(3,542,187)**	**-**	**(3,650,396)**
Loss from change in fair value	**(8,650)**	**-**	**(1)**	**(8,651)**
Impairment losses	**(7,372)**	**-**	**-**	**(7,372)**
Loss on reclassification of investment in an associate	**(17,535)**	**-**	**-**	**(17,535)**
Amortisation of discount / premium	**(1,542)**	**607**	**-**	**(935)**
Realised gains on sale	**18,117**	**-**	**-**	**18,117**
At 31 December 2017	**368,226**	**607,955**	**50,995**	**1,027,176**
US$'000	**956,431**	**1,579,104**	**132,455**	**2,667,990**

	Available-for-sale RO 000's	Held to maturity RO 000's	Fair value through profit or loss RO 000's	Total RO 000's
At 1 January 2016	444,973	1,022,184	51,227	1,518,384
Exchange differences on monetary assets	(30)	(130)	-	(160)
Additions	45,440	1,887,986	-	1,933,426
Disposals and redemption	(91,443)	(2,347,556)	(8)	(2,439,007)
Loss from change in fair value	(316)	-	-	(316)
Impairment losses	(4,803)	-	-	(4,803)
Amortisation of discount / premium	(2,323)	1,117	-	(1,206)
Realised/unrealised gains/(losses)	3,829	-	(223)	3,606
At 31 December 2016	395,327	563,601	50,996	1,009,924
US$ 000's	1,026,824	1,463,898	132,457	2,623,179

10. Investment in a subsidiary

Details regarding the Parent company's investment in a significant subsidiary are set out below:

Company name	Country of incorporation	Proportion held	
		2017	2016
Muscat Capital LLC	Kingdom of Saudi Arabia (KSA)	100%	100%

As at 31 December 2017, the authorised and issued share capital of Muscat Capital LLC was SAR 60 million (2016: SAR 60 million).

11. Investment in an associate

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
124,868	**-**	Al Salam Bank ('ASB'), Kingdom of Bahrain	**-**	48,074

During 2017, share of results from an associate amounted to RO 2.438 million (2016: RO 1.727 million) and share of other comprehensive income from associate investments amounted to gain of RO 0.20 million (2016: gain of RO 0.21 million).

On January 1, 2005, the Parent Company acquired 26,681,345 shares representing 49 percent of the issued and paid up share capital of BMI Bank ("BMI"), a closely held company engaged in banking services in Bahrain. It was a strategic investment and was accounted as an equity associate under IAS 28. In March 2014, BMI was acquired by Al Salam Bank ("ASB"), Bahrain under a share swap agreement. As per the agreement, ASB issued 11 shares to the Parent Company for every 1 share held in BMI. The Parent Company thus received 315,494,795 shares in ASB resulting into a 14.74 percent stake in the merged entity. The Parent Company held two directorship positions and exercised significant influence on the financial and operating policies of ASB and thus continued to account for it as an equity associate under IAS 28.

As at 31 December 2017, the Parent Company held 14.74 percent (2016: 14.74 percent) shareholding in ASB. The carrying value of the investment in ASB as on 31 December 2017 was as follows:

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
124,016	**124,868**	Carrying value of the investment	**48,074**	47,746
4,486	**6,332**	Share of results for the period	**2,438**	1,727
548	**524**	Share of other comprehensive income	**202**	211
(4,182)	**(4,184)**	Dividends received	**(1,611)**	(1,610)
-	**(127,540)**	Transfer to available-for-sale investment	**(49,103)**	-
124,868	**-**	At 31 December	**-**	48,074

The Parent Company's share of the total recognized profits of associate are reflected on the basis of reviewed results of ASB for the period 1 January 2017 to 30 September 2017. The financial statements of ASB for the quarter ended 31 December 2017 were not available at the time of the preparation of these financial statements. The impact from 1 October 2017 till the date of reclassification is not considered material.

11. Investments in an associate (continued)

The stake of the Parent Company in the merged entity had a lock in period of three years from March 2014 till March 2017.

During the year 2017, the three year lock in period of the investment has expired. Further, on 19 December 2017, one of the two directors representing the Parent Company on the board of ASB resigned from his directorship position, thereby substantially reducing the influence of the Parent Company on ASB from that date. The Parent Company does not have significant influence in ASB through policy making processes, material transactions between the entities or any other means. Given the change in the board composition and the parent company's inability to appoint two directors in ASB, the Parent Company reassessed its previous classification of the investment under IAS 28 as an 'Equity associate' and concluded that the change in the circumstances results in the investment in ASB being reclassified to 'Available-for-sale' investment under IAS 39 and carry the same at its fair market value.

The fair market value of the investment on the date of change in the significant influence was RO 31.568 million. The difference of RO 17.535 million between the fair value of RO 31.568 million and the carrying value of the former associate of RO 49.103 million is recognized in the income statement in December 2017. All amounts previously recognized and held in other comprehensive income are appropriately reclassified and derecognized by the Parent company.

Summarised statement of financial position as at 30 September is as follows :

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
404,114	**273,421**	Cash and balances with banks	**105,267**	155,584
241,558	**412,603**	Due from banks	**158,852**	93,000
1,849,997	**1,973,556**	Loans and receivables	**759,819**	712,249
1,651,829	**1,508,203**	Investments	**580,658**	635,954
137,169	**254,057**	Other assets	**97,812**	52,810
4,284,667	**4,421,840**	Total assets	**1,702,408**	1,649,597
231,397	**385,678**	Due from banks	**148,486**	89,088
2,823,200	**2,763,548**	Customer deposits	**1,063,966**	1,086,932
373,613	**408,904**	Other liabilities	**157,428**	143,841
3,428,210	**3,558,130**	**Total liabilities**	**1,369,880**	1,319,861
856,457	**863,710**	**Net assets**	**332,528**	329,736
852,756	**861,875**	Equity attributable to the shareholders of the bank	**331,822**	328,311
3,701	**1,835**	Non-controlling interest	**706**	1,425

Summarised statement of comprehensive income for the period ended 30 September is as follows :

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
107,148	**119,860**	Financing income	**46,146**	41,252
32,803	**42,044**	Fees and other income	**16,187**	12,629
(43,990)	**(39,174)**	Profit sharing expense	**(15,082)**	(16,936)
(49,600)	**(45,813)**	Operating expenses	**(17,638)**	(19,096)
(12,756)	**(43,249)**	Net provisions and others	**(16,651)**	(4,911)
33,605	**33,668**	**Net profit for the period**	**12,962**	12,938
34,291	**34,034**	Net profit attributable to the shareholders of the bank	**13,103**	13,202
(686)	**(366)**	Non-controlling interest	**(141)**	(264)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

11. Investments in an associate (continued)

Reconciliation of the summarized financial information presented to the carrying amount of its interest in the associate is as follows:

2016 US$ 000's	2017 US$ 000's		2017 RO 000's	2016 RO 000's
848,629	**861,616**	**Opening net assets at 1 January**	**331,722**	326,722
33,605	**33,668**	Profit for the period	**12,962**	12,938
2,613	**(3,392)**	Other comprehensive (expense)/ income	**(1,306)**	1,006
(28,390)	**(28,182)**	Dividend paid during the year	**(10,850)**	(10,930)
856,457	**863,710**	**Closing net assets attributable to shareholders as at 30 September**	**332,528**	329,736
852,756	**861,875**	Net assets attributable to the shareholders of the bank (a)	**331,822**	328,311
3,701	**1,835**	Non-controlling interest	**706**	1,425
14.736%	**14.736%**	Investment in associate (b)	**14.736%**	14.736%
125,663	**127,007**	a x b	**48,897**	48,380
(795)	**534**	Other adjustments	**206**	(306)
124,868	**127,541**	**Carrying value at 30 September**	**49,103**	48,074

12. Property, equipment and software

	Land and buildings RO 000's	Furniture, fixtures and equipment RO 000's	Motor vehicles RO 000's	Total RO 000's
Cost or valuation:				
At 1 January 2017	**50,082**	**128,152**	**1,120**	**179,354**
Additions during the year	**23**	**10,651**	**90**	**10,764**
Disposals	**-**	**(15)**	**(37)**	**(52)**
Surplus on revaluation	**625**	**-**	**-**	**625**
Loss on revaluation	**(281)**	**-**	**-**	**(281)**
Translation Adjustment	**3**	**14**	**-**	**17**
At 31 December 2017	**50,452**	**138,802**	**1,173**	**190,427**
Depreciation:				
At 1 January 2017	**10,967**	**93,438**	**717**	**105,122**
Charge for the year	**1,023**	**12,061**	**138**	**13,222**
Relating to disposals	**-**	**(13)**	**(37)**	**(50)**
Translation Adjustment	**2**	**12**	**-**	**14**
At 31 December 2017	**11,992**	**105,498**	**818**	**118,308**
Net book value:				
At 31 December 2017	**38,460**	**33,304**	**355**	**72,119**
At 31 December 2017 (US$)	**99,896**	**86,504**	**922**	**187,322**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

12. Property and equipment (continued)

	Land and buildings RO 000's	Furniture, fixtures and equipment RO 000's	Motor vehicles RO 000's	Total RO 000's
Cost or valuation:				
At 1 January 2016	49,882	118,189	1,039	169,110
Additions during the year	201	10,100	155	10,456
Disposals	-	(128)	(74)	(202)
Translation adjustment	(1)	(9)	-	(10)
At 31 December 2016	50,082	128,152	1,120	179,354
Accumulated depreciation:				
At 1 January 2016	9,943	81,897	649	92,489
Charge for the year	1,025	11,554	142	12,721
Relating to disposals	-	(8)	(74)	(82)
Translation adjustment	(1)	(5)	-	(6)
At 31 December 2016	10,967	93,438	717	105,122
Net book value:				
At 31 December 2016	39,115	34,714	403	74,232
At 31 December 2016 (US$ 000's)	101,597	90,166	1,047	192,810

Cost of furniture, fixtures and equipment above includes acquired software of RO 49.987million (2016: RO 44.240 million). Accumulated depreciation of the same is RO 31.488 million (2016: RO 25.915 million).

Land and buildings above includes leasehold land and buildings of RO 32.670 million (2016: RO 33.415 million). The Bank has a policy to revalue its owned land and buildings at the end of every five years. In accordance with the bank's policy, the owned land and buildings were revalued during 2017 by independent professional valuers on an open market basis.

Had the freehold land and buildings been carried at cost less depreciation, the carrying amount would have been RO 2.921 million (2016: 2.950 million)

The revaluation reserve is not available for distribution until the related asset is disposed.

13. Finance lease liabilities

The Group had entered into a lease agreement with a third party (a quasi government entity) to lease a purpose built head office which was constructed for exclusive use of the Group. The construction of building was completed in 2009. The lease is for a period of 50 years. The annual lease payment of building for the initial 25 years is RO 2.7 million. Subsequently, for the next 10 years, the annual rent will increase by 25% to RO 3.4 million. From 36th year onwards, the annual rent will further increase by 10% to RO 3.7 million. Due to this the minimum lease payments in the first 25 years of the lease period are less than the finance charges payable every year.

The minimum lease payments and total liability in respect of these leases relating to future periods are as follows:

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
(130)	**(140)**	Current	**(54)**	(50)
99,920	**100,062**	Non-current	**38,524**	38,469
99,790	**99,922**	Total (note 19)	**38,470**	38,419
		Represented by:		
363,974	**356,969**	Gross finance lease payment due	**137,433**	140,130
(264,184)	**(257,047)**	Less: future finance charges	**(98,963)**	(101,711)
99,790	**99,922**	Net lease liability/ present value recognised as property	**38,470**	38,419

The following tables show the maturity analysis of finance lease payable:

RO 000's	**Less than 1 year**	**Between 1 and 2 years**	**Between 2 and 5 years**	**More than 5 years**	**Total**
As at 31 December 2017					
Total minimum lease payments	**2,697**	**2,697**	**8,091**	**123,948**	**137,433**
Less: Amounts representing finance charges	**(2,751)**	**(2,754)**	**(8,289)**	**(85,169)**	**(98,963)**
Net finance lease liability	**(54)**	**(57)**	**(198)**	**38,779**	**38,470**

US$ 000's	**Less than 1 year**	**Between 1 and 2 years**	**Between 2 and 5 years**	**More than 5 years**	**Total**
As at 31 December 2017					
Total minimum lease payments	**7,005**	**7,005**	**21,016**	**321,943**	**356,969**
Less: Amounts representing finance charges	**(7,145)**	**(7,153)**	**(21,530)**	**(221,219)**	**(257,047)**
Net finance lease liability	**(140)**	**(148)**	**(514)**	**100,724**	**99,922**

13. Finance lease liabilities (continued)

The following table shows the maturity analysis of finance lease payable:

RO 000's	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	More than 5 years	Total
As at 31 December 2016					
Total minimum lease payments	2,697	2,697	8,091	126,645	140,130
Less: Amounts representing finance charges	(2,747)	(2,751)	(8,276)	(87,937)	(101,711)
Net finance lease liability	(50)	(54)	(185)	38,708	38,419

US$ 000's	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	More than 5 years	Total
As at 31 December 2016					
Total minimum lease payments	7,005	7,005	21,016	328,948	363,974
Less: Amounts representing finance charges	(7,135)	(7,145)	(21,496)	(228,408)	(264,184)
Net finance lease liability	(130)	(140)	(480)	100,540	99,790

14. Deposits from banks

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
1,058,442	**1,501,774**	Inter bank borrowings	**578,183**	407,500
187,057	**137,187**	Vostro balances	**52,817**	72,017
915,000	**725,000**	Other money market deposits	**279,125**	352,275
2,160,499	**2,363,961**		**910,125**	831,792

15. Conventional/ Islamic customers' deposits

Conventional customers' deposits

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
5,624,626	**4,915,265**	Deposit accounts	**1,892,377**	2,165,481
6,137,195	**6,241,852**	Savings accounts	**2,403,113**	2,362,820
4,640,935	**4,676,117**	Current accounts	**1,800,305**	1,786,760
870,018	**797,158**	Call accounts	**306,906**	334,957
116,338	**147,296**	Margin accounts	**56,709**	44,790
17,389,112	**16,777,688**		**6,459,410**	6,694,808

15. Conventional/ Islamic customers' deposits (continued)

Islamic customers' deposits

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
1,173,346	**1,553,591**	Deposit accounts	**598,132**	451,738
242,745	**294,234**	Savings accounts	**113,280**	93,457
241,743	**324,231**	Current accounts	**124,829**	93,071
323,774	**321,197**	Margin accounts	**123,661**	124,653
1,981,608	**2,493,253**		**959,902**	762,919

16. Sukuk

In June 2017, the Parent Company issued Sukuk Al Musharaka Certificates. A special purpose vehicle (SPV) was formed for this purpose (Meethaq Sukuk Company LLC) which is the issuer and trustee of Sukuk program.

As part of the program, the first series of certificates was issued amounting to RO 44.6 million (face value RO 1.000/ per certificate) through a Shari'a compliant financing arrangement and approved by the Board of Directors of the bank.

The Sukuk has an indicative profit rate of 5 percent per annum, has a tenor of five years and is to be redeemed at face value subject to the terms and conditions given in the issuing documents. The profit on Sukuk is payable semi-annually in arrears in the month of June and December. The Sukuk is listed in Muscat Security Market ("MSM").

17. Euro medium term notes

Euro medium term notes are issued by the Parent Company under its Euro Medium Term Note Programme and are denominated in US Dollars. These are non-convertible and unsecured. The Notes of RO 192.5 million due March 2018 are listed on the Luxemburg Stock Exchange and the Notes of RO 192.5 million due May 2021 are listed on the Irish Stock Exchange. During 2017, notes amounting to nil (2016: RO 192.5 million) were issued. The Parent Company has entered into interest rate swaps, which is designated as fair value hedge, for hedging the interest rate risk on Euro medium term notes. The cumulative change in the fair value of the Euro medium term notes (hedged item) attributable to the risk hedged is recorded as part of the carrying value of the Euro medium term notes and accordingly presented in statement of financial position. The maturity profile and interest rates of floating rate notes are disclosed in notes 42.3.2 and 42.4.4 respectively.

18. Mandatory convertible bonds

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
245,857	**167,221**	At 1 January	**64,380**	94,655
(78,636)	**(83,023)**	Conversion during the year	**(31,964)**	(30,275)
167,221	**84,198**	At 31 December	**32,416**	64,380

The maturity profile and interest rate of mandatory convertible bonds are disclosed in notes 42.3.2 and 42.4.4 respectively. Mandatory convertible bonds were issued by the Parent Company as part of its dividend distribution. On maturity, the bonds will be converted to ordinary shares of the Parent Company by using a "conversion price" which will be calculated by applying 20 percent discount to 3 month average share price of the Parent Company on the Muscat Securities Market prior to the conversion.

During March 2017, the Parent Company converted a portion of its mandatory convertible bonds issued in 2014 into share capital. The conversion amounting to RO 31.964 million was credited to the share capital and share premium amounting to RO 8.829 million and RO 23.135 million, respectively.

Based on the terms of prospectus, the conversion price was calculated at RO 0.362 which represented a 20 percent discount to average closing market price over the preceding 90 calendar day period prior to the conversion date after adjusting for the impact of bonus shares issued in Q1-2017. The Parent Company issued 88,299,081 shares on account of conversion.

19. Other liabilities

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
339,513	**354,705**	Other liabilities and accrued expenses	**136,561**	130,713
186,912	**228,210**	Acceptances (note 8)	**87,861**	71,961
154,956	**185,727**	Accrued interest	**71,505**	59,658
99,790	**99,922**	Finance lease (note 13)	**38,470**	38,419
49,665	**67,106**	Negative fair value of derivatives (note 38)	**25,836**	19,121
22,634	**20,982**	Unearned discount and interest	**8,078**	8,714
17,729	**15,558**	Employees' end of service benefits	**5,990**	6,826
5,049	**3,494**	Deferred tax liability (note 20)	**1,345**	1,944
876,248	**975,704**		**375,646**	337,356

The charge for the year and amounts paid in respect of employee end of service benefits were RO 1,232 thousand (2016: RO 1,002 thousand) and RO 2,072 thousand (2016: RO 576 thousand), respectively.

20. Taxation

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
		Current liability:		
66,244	**92,399**	Current year	**35,573**	25,504
19,548	**19,066**	Prior years	**7,341**	7,526
85,792	**111,465**		**42,914**	33,030

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
		Consolidated statement of comprehensive income:		
66,244	**92,399**	Current year	**35,573**	25,504
5,561	**(3,495)**	Prior years	**(1,345)**	2,141
71,805	**88,904**		**34,228**	27,645
437	**-**	Relating to origination and reversal of temporary differences	**-**	168
72,242	**88,904**		**34,228**	27,813

(i) The tax rate applicable to the Parent Company is 15% (2016: 12%). For the purpose of determining the tax expense for the year, the accounting profit has been adjusted for tax purposes. Adjustments for tax purposes include items relating to both income and expense. After giving effect to these adjustments, the average effective tax rate is estimated to be 16.22% (2016: 13.61 %).

The difference between the applicable tax rate of 15% (2016: 12%) and effective tax rate of 16.22% (2016: 13.61%) arises due to tax effect of income not considered to be taxable and expenses not considered to be deductible. The adjustments are based on the current understanding of the existing tax laws, regulations and practices.

20. Taxation (continued)

(ii) The reconciliation of taxation on the accounting profit before tax for the year at RO 211.0 million (2016: RO 204.4 million) after the taxation charge in the consolidated financial statements is as follows:

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
63,691	**82,226**	Tax charge at 15% (2016:12%) on accounting profit before tax	**31,657**	24,521
		Add/(less) tax effect of:		
(1,717)	**(2,538)**	Income not taxable	**(977)**	(661)
3,336	**11,494**	Expenses not deductible or deferred	**4,425**	1,284
816	**1,029**	Foreign taxes on foreign-sourced income	**396**	314
119	**187**	Tax relating to subsidiary	**72**	46
436	**-**	Relating to origination and reversal of temporary differences	**-**	168
5,561	**(3,495)**	(Reversal)/ Charge of provision for prior years	**(1,345)**	2,141
72,242	**88,904**	Tax charge as per consolidated statement of comprehensive income	**34,228**	27,813

(iii) The deferred tax asset/liability has been recognised at the effective tax rate of 15% (2016 - 12%).

Deferred tax asset/(liability) in the statement of financial position and the deferred tax credit/ (charge) in the statement of comprehensive income relates to the tax effect of provisions, change in fair value of investment available for sale, accelerated depreciation and changes in fair value hedge.

	At 1 January 2017 RO 000's	**Reversal/ (charged) to consolidated statement of comprehensive income RO 000's**	**Reversal/ (charged) to consolidated statement of other comprehensive income RO 000's**	**At 31 December 2017 RO 000's**
Asset:				
Tax effect of provisions	**1,713**	**-**	**-**	**1,713**
Change in fair value of hedge	**41**	**-**	**(9)**	**32**
Change in fair value of investment available for sale	**-**	**-**	**5,613**	**5,613**
Liability:				
Tax effect of accelerated tax depreciation	**(1,250)**	**-**	**-**	**(1,250)**
	504	**-**	**5,604**	**6,108**

During the year, the Group charged deferred tax asset of RO 5.604 million (2016: nil) relating to fair value changes of investments available-for-sale and changes in fair value of hedge. The deferred tax charge/ (reversal) is disclosed under other comprehensive income.

20. Taxation (continued)

	At 1 January 2016 RO 000's	Reversal/ (charged) to consolidated statement of comprehensive income RO 000's	Reversal/ (charged) to consolidated statement of other comprehensive income RO 000's	At 31 December 2016 RO 000's
Asset				
Tax effect of provisions	1,616	97	-	1,713
Change in fair value of hedge	98	(57)	-	41
Liability:				
Tax effect of accelerated tax depreciation	(1,042)	(208)	-	(1,250)
	672	(168)	-	504

	1 January 2017 RO 000's	**Tax (charge)/ credit RO 000's**	**31 December 2017 RO 000's**	1 January 2016 RO 000's	Tax (charge)/ credit RO 000's	31 December 2016 RO 000's
Deferred tax liability	**1,944**	**(599)**	**1,345**	2,043	(99)	1,944

	1 January 2017 US$ 000's	**Tax charge/ (credit) US$ 000's**	**31 December 2017 US$ 000's**	1 January 2016 US$ 000's	Tax charge/ (credit) US$ 000's	31 December 2016 US$ 000's
Deferred tax liability	**5,049**	**(1,555)**	**3,494**	5,306	(257)	5,049

During the year, the Group credited deferred tax liability of RO 0.599 million (2016: RO 0.099 million tax credit) relating to fair value changes of investments available for sale, which may be taxable in the future. The deferred tax credit is disclosed under other comprehensive income.

The tax (charge)/credit relating to components of other comprehensive income is as follows:

	31 December 2017			31 December 2016		
	Before Tax RO 000's	**Tax (charge)/ credit RO 000's**	**After Tax RO 000's**	Before tax RO 000's	Tax (charge)/ credit RO 000's	After tax RO 000's
Transfer from foreign currency translation reserve on reclassification of investment in an associate	**331**	**-**	**331**	(6)	-	(6)
Translation of net investments in foreign operations	**312**	**-**	**312**	(140)	-	(140)
Transfer from cumulative changes in fair value on reclassification of an associate	**31**	**-**	**31**	217	-	217
Change in fair value of investments available for sale	**2,562**	**(5,014)**	**(2,452)**	(346)	99	(247)
Change in fair value of cash flow hedge	**106**	**9**	**115**	417	-	417
Transfer from revaluation of land and building on reclassification of an associate	**(160)**	**-**	**(160)**	-	-	-
Surplus on revaluation of land and building	**625**	**-**	**625**	-	-	-
Total	**3,807**	**(5,005)**	**(1,198)**	142	99	241

20. Taxation (continued)

	31 December 2017			31 December 2016		
	Before tax US$ 000's	**Tax (charge)/ credit US$ 000's**	**After tax US$ 000's**	Before Tax US$ 000's	Tax (charge)/ credit US$ 000's	After tax US$ 000's
Transfer from foreign currency translation reserve on reclassification of investment in an associate	**860**	**-**	**860**	(16)	-	(16)
Translation of net investments in foreign operations	**810**	-	**810**	(364)	-	(364)
Transfer from cumulative changes in fair value on reclassification of an associate	**81**	**-**	**81**	564	-	564
Change in fair value of investments available for sale	**6,655**	**(13,023)**	**(6,368)**	(899)	257	(642)
Change in fair value of cash flow hedge	**275**	**23**	**298**	1,083		1,083
Transfer from revaluation of land and building on reclassification of an associate	**(416)**		**(416)**	-	-	-
Surplus on revaluation of land and building	**1,623**	**-**	**1,623**	-	-	-
Total	**9,888**	**(13,000)**	**(3,112)**	368	257	625

The Bank's tax assessments have been completed by the tax authorities up to tax year 2011.

21. Subordinated liabilities

In accordance with the Central Bank of Oman's regulations, subordinated loans are included in the calculation of supplementary capital as defined by the Bank for International Settlements (BIS) for capital adequacy purposes.

During the year the Parent Company repaid RO 44.090 million (2016: RO 75 million).

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
259,740	**179,221**	Fixed rate Rial Omani subordinated loans	**69,000**	100,000
170,000	**136,000**	Floating rate US$ subordinated loans	**52,360**	65,450
429,740	**315,221**		**121,360**	165,450

Subordinated loans are repayable at par on maturity. The maturity profile and interest rate of subordinated liabilities are disclosed in notes 42.3.2 and 42.4.4 respectively.

22. Share capital

Share capital

The authorised share capital of the Parent Company is 3,500,000,000 shares of RO 0.100 each (2016: 3,500,000,000 of RO 0.100 each). At 31 December 2017, 2,709,361,854 shares of RO 0.100 each (2016: 2,496,250,258 shares of RO 0.100 each) have been issued and fully paid. The Bank's shares are listed in Muscat Securities Market, Bahrain stock exchange and London stock exchange. Listing in London stock exchange is through Global Depository Receipts issued by the Bank.

During March 2017, the Bank converted a portion of its mandatory convertible bonds issued in 2014 into shares (refer note 18).

Significant shareholders

The following shareholders held 10 percent or more of the Parent Company's capital, either individually or together with other Group companies:

2016			**2017**	
No.of shares	% holding		**No.of shares**	**% holding**
589,844,518	23.63%	Royal Court Affairs	**640,144,235**	**23.63%**
308,669,563	12.37%	Dubai Financial Group	**335,147,759**	**12.37%**

23. Share Premium

During March 2017, the Bank converted a portion of its mandatory convertible bonds issued in 2014 into shares. (refer note 18). The conversion amounting to RO 31.964 million was credited to the share capital and share premium amounting to RO 8.829 million and RO 23.135 million, respectively.

24. Legal and general reserves

(i) Legal reserve

In accordance with the Omani Commercial Companies Law of 1974, the Parent Company is required to transfer 10 percent of its profit for the year to legal reserve until the accumulated balance of the reserve equals one third of the Parent Company's paid up share capital. During the year RO 7.104 million (2016: RO 6.814 million) was transferred from profits to legal reserve. After this transfer the Parent Company's legal reserve is equal to one third of its share capital.

(ii) General reserve

The general reserve is established to support the operations and the capital structure of the Group.

(iii) Reserve for restructured accounts

The Parent Company has created a reserve for restructured accounts in accordance with the regulations of the Central Bank of Oman (CBO). This reserve represents provisions on performing but restructured accounts at the rate prescribed by CBO. This reserve is not available for regulatory capital or distribution of dividends. The reserve will be released to retained earnings on satisfactory performance of these accounts as per regulatory guidelines.

(iv) Subordinated loan reserve

The subordinated loan reserve is created in accordance with the guidelines given by the Bank of International Settlement and the Central Bank of Oman. During the year, the Parent Company transferred RO 29.49 million (2016: RO 33.09 million) to subordinated loan reserve from retained profit.

A subordinated loan of RO 44.09 million was repaid during the year (2016: RO 75 million). On maturity, the reserve of RO 44.09 million (2016: RO 75 million) related to this loan was transferred to the general reserve.

25. Perpetual Tier I Capital

In April 2017, the Bank issued Additional Equity Tier 1 (AET1) capital deposit amounting to RO 130 million. The AET1 capital constitute direct, unconditional, subordinated and unsecured obligations of the Bank and are classified as equity in accordance with IAS 32: Financial Instruments – Classification. The AET 1 capital do not have a fixed or final redemption date. They are first callable by the Bank after a minimum of 5 years from the instrument date and thereafter in accordance with the terms of the agreement and subject to prior approval of Central Bank of Oman.

The AET1 capital bear interest on their nominal amount from the issue date to the first call date at a fixed annual rate of 5.5 percent. Thereafter the interest rate will be reset as per the terms of the agreement. Interest will be payable semi-annually in arrears and treated as deduction from equity. Interest will be paid exclusively out of the distributable items of the Bank, and shall not be cumulative, and any interest which is not paid will not accumulate or compound. The depositor will have no right to receive such unpaid interest in the future, even if interest is paid in respect of any subsequent period. The Instrument meets all the requirements of AET 1 issuance as mandated by Basel and Central Bank of Oman norms.

26. Proposed dividends

For 2017, the Board of Directors has proposed a dividend of 35 percent of paid up share capital, 30 percent in the form of cash and 5 percent in the form of bonus shares. Thus shareholders would receive cash dividend of RO 0.030 per ordinary share of RO 0.100 each aggregating to RO 81.281 million on Bank's existing share capital. In addition, they would receive bonus shares in the proportion of 1 share for every 20 ordinary shares aggregating to 135,468,092 shares of RO 0.100 each amounting to RO 13.547 million. The proposed cash dividend and issuance of bonus shares are subject to formal approval of the Annual General Meeting of the shareholders and regulatory authorities.

For 2016, the Board of Directors had proposed a dividend of 30 percent, 25 percent in the form of cash and 5 percent in the form of bonus shareswhich was approved by the Parent Company shareholders in its Annual General Meeting held on 19 March 2017. Thus shareholders received cash dividend of RO 0.025 per ordinary share of RO 0.100 each aggregating to RO 62.406 million on Bank's existing share capital. In addition, they received bonus shares in the proportion of one share for every twenty ordinary shares aggregating to 124,812,512 shares of RO 0.100 each amounting to RO 12.481 million.

27. Net assets per share

The calculation of net assets per share is based on net assets as at 31 December 2017 attributable to ordinary shareholders of RO 1,688.333 million (2016: RO 1,546.740 million) and on 2,709,361,854 ordinary shares (2016: 2,496,250,258 ordinary shares) being the number of shares outstanding as at 31 December 2017.

28. Contingent liabilities and commitments

(a) Legal proceedings

There were a number of legal proceedings outstanding against the Parent Company at 31 December 2017. No provision has been made, as professional advice indicates that it is unlikely that any significant loss will arise.

(b) Credit related commitments

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

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed expiration dates or other termination clauses and require the payment of a fee. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash obligations.

Standby letters of credit and guarantees commit the Parent Company to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

Irrevocable commitments to extend credit at the reporting date amounted to RO 564.7 million (2016: RO 616.0 million).

28. Contingent liabilities and commitments (continued)

(b) Credit related commitments (continued)

As of the reporting date, commitments on behalf of customers, for which there were corresponding customer liabilities consisted of the following:

2016 US $ 000's	**2017 US $ 000's**		**2017 RO 000's**	2016 RO 000's
1,858,622	**1,330,053**	Letters of credit	**512,070**	715,569
5,903,688	**6,098,701**	Guarantees	**2,348,000**	2,272,920
7,762,310	**7,428,754**		**2,860,070**	2,988,489

(c) Capital commitments

As of the reporting date, capital commitments were as follows:

2016 US $ 000's	**2017 US $ 000's**		**2017 RO 000's**	2016 RO 000's
1,776	**2,352**	Purchase of property and equipment	**905**	684

(d) As of the reporting date, the Bank has not pledged any of its assets as security (2016: no assets were pledged).

(e) As of the reporting date, the amount payable on partly paid investments in shares held by the Bank was RO 2.1 million (2016: RO 2.4 million).

28.1 Concentration of credit related commitments

The table below analyses the concentration of credit related commitments by economic sector:

2016 US $ 000's	**2017 US $ 000's**		**2017 RO 000's**	2016 RO 000's
32,727	**38,631**	Agriculture/allied activity	**14,873**	12,600
1,744,019	**1,599,858**	Construction	**615,945**	671,447
2,722	**4,842**	Export trade	**1,864**	1,048
2,903,295	**2,932,691**	Financial institutions	**1,129,086**	1,117,768
819,423	**324,317**	Government	**124,862**	315,478
307,756	**394,361**	Import trade	**151,829**	118,486
213,584	**245,244**	Manufacturing	**94,419**	82,230
156,026	**252,758**	Mining and quarrying	**97,312**	60,070
21,036	**20,901**	Real estate	**8,047**	8,099
1,133,283	**1,170,008**	Services	**450,453**	436,314
90,813	**119,213**	Transport	**45,897**	34,963
109,057	**95,192**	Utilities	**36,649**	41,987
152,756	**110,644**	Wholesale and retail trade	**42,598**	58,811
75,813	**120,094**	Others	**46,236**	29,188
7,762,310	**7,428,754**		**2,860,070**	2,988,489

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29. Interest income / income from Islamic financing/ investments

2016 US $ 000's	2017 US $ 000's		2017 RO 000's	2016 RO 000's
832,183	**895,515**	Loans and advances	**344,773**	320,390
34,974	**31,816**	Due from banks	**12,249**	13,465
57,982	**55,262**	Investments	**21,276**	22,323
925,139	**982,593**		**378,298**	356,178
90,166	**113,075**	Islamic financing receivable	**43,534**	34,714
351	**792**	Islamic due from banks	**305**	135
5,597	**5,865**	Islamic investment	**2,258**	2,155
96,114	**119,732**		**46,097**	37,004
1,021,253	**1,102,325**		**424,395**	393,182

Effective annual rates on yielding assets are provided in note 42.4.4.

30. Interest expense / distribution to depositors

2016 US $ 000's	2017 US $ 000's		2017 RO 000's	2016 RO 000's
185,954	**216,541**	Customers' deposits	**83,368**	71,592
37,948	**24,042**	Subordinated liabilities / mandatory convertible bonds	**9,256**	14,610
23,888	**36,766**	Bank borrowings	**14,155**	9,197
26,527	**38,535**	Euro medium term notes	**14,836**	10,213
274,317	**315,884**		**121,615**	105,612
31,086	**45,766**	Islamic customers' deposits	**17,620**	11,968
-	**3,304**	Sukuk	**1,272**	-
3,777	**6,603**	Islamic bank borrowings	**2,542**	1,454
34,863	**55,673**		**21,434**	13,422
309,180	**371,557**		**143,049**	119,034

Interest expense on customers deposits include accruals towards prize schemes of RO 10 million (2016: RO 10 million) offered by the Bank to its saving deposit holders.

Effective annual rate of interest bearing liabilities are provided in note 42.4.4.

31. Commission and fee income (net)

The commission and fee income shown in the statement of consolidated comprehensive income is net of commission and fee paid of RO 1,702 thousand (2016: RO 1,035 thousand).

32. Other operating income

2016 US $ 000's	2017 US $ 000's		2017 RO 000's	2016 RO 000's
84,335	**83,623**	Foreign exchange	**32,195**	32,469
9,366	**47,057**	Profit on sale of non-trading investments	**18,117**	3,606
12,244	**10,018**	Dividend income	**3,857**	4,714
15,449	**19,182**	Other income	**7,385**	5,948
121,394	**159,880**		**61,554**	46,737

33. Other operating expenses

2016 US $ 000's	2017 US $ 000's		2017 RO 000's	2016 RO 000's
169,822	**174,562**	Employees' salaries	**67,206**	65,381
61,562	**68,045**	Other staff costs	**26,197**	23,701
13,156	**13,694**	Contribution to social insurance schemes	**5,272**	5,065
2,603	**3,200**	Employees' end of service benefits	**1,232**	1,002
247,143	**259,501**		**99,907**	95,149
132,464	**143,061**	Administrative expenses	**55,079**	50,999
38,984	**40,704**	Occupancy costs	**15,671**	15,009
519	**519**	Directors' remuneration	**200**	200
419,110	**443,785**		**170,857**	161,357

34. Cash and cash equivalents

Cash and cash equivalents included in the statement of cash flows comprise the following amounts:

2016 US $ 000's	2017 US $ 000's		2017 RO 000's	2016 RO 000's
1,096,829	**1,008,992**	Due from banks	**388,462**	422,279
2,704,083	**2,426,610**	Cash and balances with Central Banks	**934,245**	1,041,072
1,126,010	**966,265**	Treasury bills	**372,012**	433,514
(1,371,057)	**(1,366,647)**	Deposits from banks	**(526,159)**	(527,857)
3,555,865	**3,035,220**		**1,168,560**	1,369,008

35. Earnings per share

Basic earnings per share are calculated by dividing the profit for the year by the weighted average number of shares outstanding during the year as follows:

	2017	2016
Profit attributable to ordinary shareholders of parent company for basic earnings per share (RO 000's)	**176,818**	176,560
Interest on convertible bonds, net of taxation (RO 000's)	**1,229**	2,526
	178,047	179,086
Weighted average number of ordinary shares adjusted for effect of dilution (in 000's)	**2,792,574**	2,790,336
Basic earnings per share (RO)	**0.064**	0.064
Basic earnings per share (US$)	**0.17**	0.17

There are no instruments that are dilutive in nature, hence the basic and diluted earnings per share are same for both the years.

The weighted number of ordinary shares (in 000's) have been calculated as follows:

	2017	2016
At 1 January	**2,496,250**	2,291,823
Effect of shares issued in conversion of convertible bonds	**69,188**	70,200
Effect of bonus shares issued in 2017	**124,813**	124,813
Effect of bonus shares issued in 2016	**-**	114,591
Estimated effect of dilution from convertible bonds on conversion	**102,323**	188,909
Weighted average number of ordinary shares	**2,792,574**	2,790,336

36. Related party transactions

In the ordinary course of business, the Group conducts transactions with certain of its directors, shareholders, senior management and companies in which they have a significant interest. The terms of these transactions are approved by the Bank's Board and Management. The balances in respect of related parties included in the consolidated statement of financial position as at the reporting date are as follows:

2016 US $ 000's	**2017 US $ 000's**		**2017 RO 000's**	2016 RO 000's
		a) Directors and senior management		
11,545	**11,847**	Loans and advances (gross)	**4,561**	4,445
-	**-**	Provision and reserve interest	**-**	-
11,545	**11,847**	**Loans and advances (net)**	**4,561**	4,445
1,678	**2,532**	**Current, deposit and other accounts**	**975**	646
		b) Major shareholders and others		
88,110	**141,782**	Loans and advances (gross)	**54,586**	33,922
(22,260)	**(22,629)**	Provision and reserve interest	**(8,712)**	(8,570)
65,850	**119,153**	**Loans and advances (net)**	**45,874**	25,352
158,190	**130,013**	**Current, deposit and other accounts**	**50,055**	60,903
23,811	**17,545**	**Customers' liabilities under documentary credits, guarantees and other commitments**	**6,755**	9,167

The income and expenses in respect of related parties included in the consolidated financial statements are as follows:

2016 US $ 000's	**2017 US $ 000's**		**2017 RO 000's**	2016 RO 000's
		a) Directors and senior management		
509	**366**	Interest income	**141**	196
47	**39**	Interest expenditure	**15**	18
319	**319**	Directors' remuneration	**123**	123
200	**200**	Directors' sitting fees	**77**	77
		b) Major shareholders and others		
3,447	**3,753**	Interest income	**1,445**	1,327
2,746	**4,787**	Interest expenditure	**1,843**	1,057

Loans, advances or receivables and non-funded exposure due from related parties or holders of 10 percent or more of Banks shares, or their family members, less all provisions and write-offs, are further analysed as follows:

2016 US $ 000's	**2017 US $ 000's**		**2017 RO 000's**	2016 RO 000's
41,442	**87,623**	Royal Court Affairs	**33,735**	15,955
22,260	**22,629**	Dubai Group (Ex. Dubai Financial Group) Gross	**8,712**	8,570
(22,260)	**(22,629)**	Less: provisions	**(8,712)**	(8,570)
48,281	**49,140**	H.E.Sheikh Mustahail Ahmed Al Mashani Group companies	**18,919**	18,588
11,483	**11,782**	Others	**4,536**	4,421
101,206	**148,545**		**57,190**	38,964

36. Related party transactions (continued)

During 2017, the Group has entered into a settlement agreement with its related party Dubai Group LLC ('the borrower') on their exposure of RO 8.712 million. As on 31 December 2017, the Group carries 100% provision towards this exposure. Under the agreement, the Group has agreed to receive RO 2.508 million as full and final settlement from the borrower on or before 31 March 2018 and write-off the balance exposure. The settlement and the balance write-off is approved by the Board of directors and has necessary regulatory approval.

Interest expense incurred on deposits:

Items of expense which were paid to related parties or holders of 10 percent or more of the Bank's shares, or their family members, during the year can be further analysed as follows:

2016 US $ 000's	**2017 US $ 000's**		**2017 RO 000's**	2016 RO 000's
1,987	**2,548**	Royal Court Affairs	**981**	765
		H.E. Sheikh Mustahail Ahmed Al Mashani Group companies:		
725	**2,255**	Al Mashani Group Companies	**868**	279
81	**23**	Others	**9**	31
2,793	**4,826**		**1,858**	1,075

Key management compensation

Key management comprises of 5 members (2016 : 5 member) of the management executive committee in the year 2017. The Bank considers the members of Management Executive Committee to be key management personnel for the purposes of IAS 24 Related Party Disclosures.

In the ordinary course of business, the Group conducts transactions with certain of its key management personnel and companies in which they have a significant interest. The balances in respect of these related parties included in the consolidated statement of financial position as at the reporting date are as follows:

2016 US $ 000's	**2017 US $ 000's**		**2017 RO 000's**	2016 RO 000's
10,070	**7,686**	Loans and advances	**2,959**	3,877
657	**784**	Current, deposit and other accounts	**302**	253

The income and expenses in respect of these related parties included in the consolidated financial statements are as follows:

2016 US $ 000's	**2017 US $ 000's**		**2017 RO 000's**	2016 RO 000's
416	**286**	Interest income	**110**	160
36	**16**	Interest expenditure	**6**	14
8,545	**9,722**	Salaries and other short-term benefits	**3,743**	3,290
135	**143**	Post-employment benefits	**55**	52
8,680	**9,865**		**3,798**	3,342

The amounts disclosed in the table are the amounts accrued / paid recognised as an expense during the reporting period related to key management personnel. Certain components of key management compensation are on deferral basis and are disclosed accordingly. The previous year figures are revised considering the actual payment wherever applicable.

37. Fiduciary activities

The Bank's fiduciary activities consist of investment management activities conducted as trustee and manager for a number of investment funds and individuals. The aggregate amounts of funds managed, which are not included in the Group's statement of financial position, are as follows:

2016 US $ 000's	**2017 US $ 000's**		**2017 RO 000's**	2016 RO 000's
2,171,616	**2,586,434**	Funds under management	**995,777**	836,072

38. 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. These derivatives are stated at fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Unrealised gains or losses on derivatives classified as held for trading and fair value hedges are included in the statement of comprehensive income. The Group uses the following derivative financial instruments:

Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Forward rate agreements are effectively tailor-made interest rate futures which fix a forward rate of interest on a notional loan, for an agreed period of time starting on a specified future date.

Interest rate swaps are contractual agreements between two parties to exchange interest differentials based on a specific notional amount. Counter parties generally exchange fixed and floating rate interest payments based on a notional value in a single currency.

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

Derivatives held or issued for hedging purposes

As part of its asset and liability management, the Group uses derivatives for hedging purposes in order to reduce its exposure to currency and interest rate risks. This is achieved by hedging specific financial instruments and forecasted transactions as well as strategic hedging against overall financial position exposures.

The Group uses forward foreign exchange contracts, currency options and currency swaps to hedge against specifically identified currency risks. In addition, the Group uses interest rate swaps to hedge against the changes in the cash flow arising from certain fixed interest rate loans and deposits.

For interest rate risks strategic hedging is carried out by monitoring the repricing of financial assets and liabilities and entering into interest rate swaps to hedge a proportion of the interest rate exposure. As strategic hedging does not qualify for special hedge accounting, the related derivatives are accounted for as trading instruments.

The Parent Company has entered into interest rate swaps that are designated as fair value hedges, for hedging the interest rate risk movement on Euro medium term notes and certain of its customer deposits and as cash flow hedges for hedging the cash flow volatility risk on its subordinated liabilities. The cumulative change in the fair value of the hedged liabilities attributable to the risk hedged is recorded as part of their respective carrying values and are accordingly presented in statement of financial position.

The table on the following page shows the positive and negative fair values of derivative financial instruments, which are equivalent to the market values, together with the notional amounts analysed by the term to maturity. 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.

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38. Derivatives (continued)

31 December 2017	**Positive fair value**	**Negative Fair value**	**Notional amount total**	**Notional amounts by term to maturity**		
				within 3 months	**4-12 months**	**> 12 months**
Derivatives:	*(Note 8)*	*(Note 19)*				
Fair value hedge	**-**	**1,353**	**312,309**	**192,500**	**-**	**119,809**
Cash flow hedge	**-**	**214**	**52,360**	**-**	**-**	**52,360**
Interest rate swaps	**9,398**	**9,398**	**458,154**	**7,700**	**11,534**	**438,920**
Currency options bought	**157**	**-**	**48,214**	**35,472**	**12,742**	**-**
Currency options sold	**-**	**157**	**48,214**	**35,472**	**12,742**	**-**
Commodity options bought	**5**	**-**	**2,562**	**854**	**1,708**	**-**
Commodity options sold	**-**	**5**	**2,562**	**854**	**1,708**	**-**
Commodities purchase contracts	**8,775**	**158**	**106,350**	**82,373**	**15,499**	**8,478**
Commodities sale contracts	**2**	**8,687**	**106,350**	**82,373**	**15,499**	**8,478**
Forward purchase contracts	**2,903**	**1,857**	**1,307,672**	**802,705**	**398,321**	**106,646**
Forward sales contracts	**6,107**	**4,007**	**1,301,071**	**797,094**	**399,928**	**104,049**
Total	**27,347**	**25,836**	**3,745,818**	**2,037,397**	**869,681**	**838,740**
Total US$	**71,031**	**67,106**	**9,729,397**	**5,291,940**	**2,258,912**	**2,178,545**

31 December 2016	Positive fair value RO 000's (Note 8)	Negative fair value RO 000's (Note 19)	Notional amount total RO 000's	Notional amounts by term to maturity RO 000's		
				Within 3 months	4-12 months	>12 months
Derivatives:						
Fair value hedge	-	2,162	494,391	-	-	494,391
Cash flow hedge	-	341	65,450	-	-	65,450
Interest rate swaps	8,726	8,726	257,809	-	5,812	251,997
Cross currency swap	-	988	115,500	38,500	77,000	-
Currency options bought	824	-	47,201	24,292	22,909	-
Currency options sold	-	826	47,299	24,330	22,969	-
Commodities purchase contracts	3,366	1,185	74,625	57,206	16,685	734
Commodities sale contracts	1,247	3,364	72,237	62,572	8,931	734
Forward purchase contracts	839	736	823,902	485,967	298,311	39,624
Forward sales contracts	6,706	793	815,888	475,556	301,633	38,699
	21,708	19,121	2,814,302	1,168,423	754,250	891,629
US$ 000's	56,384	49,665	7,309,875	3,034,865	1,959,091	2,315,919

39. Repurchase agreements

The Group did not have any repurchase transactions outstanding as of the reporting date (2016: nil).

40. Geographical distribution of assets and liabilities

The geographical distribution of assets and liabilities was as follows:

At 31 December 2017	Sultanate of Oman RO 000's	Other GCC countries RO 000's	Europe RO 000's	United States of America RO 000's	Others RO 000's	Total RO 000's
Cash and balances with Central Banks	778,704	156,041	-	-	-	934,745
Due from banks	25,632	175,314	96,331	10,446	284,303	592,026
Loans and advances	7,926,163	361,549	10,138	14	30,852	8,328,716
Property and equipment and other assets	259,658	6,901	-	-	-	266,559
Investments	740,632	131,219	133,207	29	22,089	1,027,176
Total assets	9,730,789	831,024	239,676	10,489	337,244	11,149,222
Deposits from banks	650	466,866	51,403	554	390,652	910,125
Customers' deposits	6,978,822	414,398	3,115	365	22,612	7,419,312
Euro medium term notes/ Sukuk	44,608	-	384,508	-	-	429,116
Other liabilities and taxation	399,128	19,317	-	-	115	418,560
Subordinated liabilities / mandatory convertible bonds	101,416	-	-	52,360	-	153,776
Shareholders' funds	1,818,333	-	-	-	-	1,818,333
Total liabilities and equity	9,342,957	900,581	439,026	53,279	413,379	11,149,222

At 31 December 2017	Sultanate of Oman US$ 000's	Other GCC countries US$ 000's	Europe US$ 000's	United States of America US$ 000's	Others US$ 000's	Total US$ 000's
Cash and balances with Central Banks	2,022,608	405,301	-	-	-	2,427,909
Placements with banks	66,578	455,361	250,210	27,132	738,449	1,537,730
Loans and advances	20,587,437	939,089	26,333	36	80,135	21,633,030
Investments	1,923,720	340,829	345,992	75	57,374	2,667,990
Property and equipment and other assets	674,436	17,925	-	-	-	692,361
Total assets	25,274,779	2,158,505	622,535	27,243	875,958	28,959,020
Deposits from banks	1,688	1,212,639	133,514	1,439	1,014,681	2,363,961
Customers' deposits	18,126,811	1,076,359	8,091	948	58,732	19,270,941
Euro medium term notes/ Sukuk	115,865	-	998,722	-	-	1,114,587
Other liabilities and taxation	1,036,696	50,174	-	-	299	1,087,169
Subordinated liabilities / mandatory convertible bonds	263,419	-	-	136,000	-	399,419
Shareholders' funds	4,722,943	-	-	-	-	4,722,943
Total liabilities and equity	24,267,422	2,339,172	1,140,327	138,387	1,073,712	28,959,020

40. Geographical distribution of assets and liabilities (continued)

At 31 December 2016	Sultanate of Oman RO 000's	Other GCC countries RO 000's	Europe RO 000's	United States of America RO 000's	Others RO 000's	Total RO 000's
Cash and balances with Central Banks	890,417	151,155	-	-	-	1,041,572
Due from banks	11,576	187,375	191,760	42,843	93,061	526,615
Loans and advances	7,506,468	434,014	151	15	16,682	7,957,330
Investments	883,595	134,461	11,215	10,198	18,529	1,057,998
Property and equipment and other assets	226,287	10,268	-	-	-	236,555
Total assets	9,518,343	917,273	203,126	53,056	128,272	10,820,070
Deposits from banks	42,646	406,585	59,245	686	322,630	831,792
Customers' deposits and certificates of deposit	6,957,177	477,863	2,889	294	19,504	7,457,727
Euro medium term notes	-	-	383,595	-	-	383,595
Other liabilities and taxation	354,136	16,102	-	-	148	370,386
Subordinated liabilities / mandatory convertible bonds	164,380	-	-	65,450	-	229,830
Shareholders' funds	1,546,740	-	-	-	-	1,546,740
Total liabilities and equity	9,065,079	900,550	445,729	66,430	342,282	10,820,070

At 31 December 2016	Sultanate of Oman US$ 000's	Other GCC countries US$ 000's	Europe US$ 000's	United States of America US$ 000's	Others US$ 000's	Total US$ 000's
Cash and balances with Central Banks	2,312,772	392,610	-	-	-	2,705,382
Due from banks	30,067	486,688	498,078	111,281	241,717	1,367,831
Loans and advances	19,497,320	1,127,309	392	39	43,330	20,668,390
Investments	2,295,053	349,249	29,130	26,488	48,127	2,748,047
Property and equipment and other assets	587,758	26,670	-	-	-	614,428
Total assets	24,722,970	2,382,526	527,600	137,808	333,174	28,104,078
Deposits from banks	110,769	1,056,065	153,883	1,782	838,000	2,160,499
Customers' deposits and certificates of deposit	18,070,589	1,241,203	7,504	764	50,660	19,370,720
Euro medium term notes	-	-	996,351	-	-	996,351
Other liabilities and taxation	919,833	41,823	-	-	384	962,040
Subordinated liabilities / mandatory convertible bonds	426,961	-	-	170,000	-	596,961
Shareholders' funds	4,017,507	-	-	-	-	4,017,507
Total liabilities and equity	23,545,659	2,339,091	1,157,738	172,546	889,044	28,104,078

41. Segmental information

Management has determined the operating segments based on the reports reviewed by the executive committee that are used to make strategic decisions. The committee considers the business from both a geographic and product perspective. Geographically, management considers the performance of whole bank in Oman and International markets. The Oman market is further segregated into corporate, consumer, wholesale and Islamic banking, as all of these business lines are located in Oman. Segment information in respect of geographical locations is as follows:

For the year ended 31 December 2017:

Total US$ 000's	International US$ 000's	Oman US$ 000's	Segment revenue	Oman RO 000's	International RO 000's	Total RO 000's
982,593	57,161	925,432	Interest income	356,291	22,007	378,298
(315,884)	(30,761)	(285,123)	Interest expense	(109,772)	(11,843)	(121,615)
119,732	-	119,732	Income from Islamic financing	46,097	-	46,097
(55,673)	-	(55,673)	Distribution to depositors	(21,434)	-	(21,434)
241,730	16,784	224,946	Commission and fee income (net)	86,604	6,462	93,066
159,880	2,158	157,722	Other operating income	60,723	831	61,554
1,132,378	**45,342**	**1,087,036**		**418,509**	**17,457**	**435,966**
			Segment costs			
(443,785)	(22,967)	(420,818)	Other operating expenses	(162,015)	(8,842)	(170,857)
(34,343)	(685)	(33,658)	Depreciation	(12,958)	(264)	(13,222)
9,351	-	9,351	Reversal of impairment for due from banks	3,600	-	3,600
(164,016)	(29,600)	(134,416)	Impairment for credit losses	(51,750)	(11,396)	(63,146)
(45,545)	(45,545)	-	Loss on reclassification of investment in an associate	-	(17,535)	(17,535)
106,945	17,296	89,649	Recoveries from impairment for credit losses	34,515	6,659	41,174
(19,148)	-	(19,148)	Impairment for investments	(7,372)	-	(7,372)
6,332	6,332	-	Share of profit from an associate	-	2,438	2,438
(88,904)	(1,217)	(87,687)	Tax expense	(33,760)	(468)	(34,228)
(673,113)	(76,386)	(596,727)		(229,740)	(29,408)	(259,148)
459,265	**(31,044)**	**490,309**	**Segment profit/ (loss) for the year**	**188,769**	**(11,951)**	**176,818**
			Other information			
28,959,020	1,605,818	27,353,202	Segment assets	10,530,982	618,240	11,149,222
27,959	208	27,751	Segment capital expenses	10,684	80	10,764

41. Segmental information (continued)

For the year ended 31 December 2016:

Total US$ 000's	International US$ 000's	Oman US$ 000's		Oman RO 000's	International RO 000's	Total RO 000's
			Segment revenue			
925,139	53,956	871,183	Interest income	335,405	20,773	356,178
(274,317)	(30,286)	(244,031)	Interest expense	(93,952)	(11,660)	(105,612)
96,114	-	96,114	Income from Islamic financing	37,004	-	37,004
(34,863)	-	(34,863)	Distribution to depositors	(13,422)	-	(13,422)
247,507	15,356	232,151	Commission and fee income (net)	89,378	5,912	95,290
121,394	2,512	118,882	Other operating income	45,770	967	46,737
1,080,974	41,538	1,039,436		400,183	15,992	416,175
			Segment costs			
(419,110)	(21,463)	(397,647)	Other operating expenses	(153,094)	(8,263)	(161,357)
(33,042)	(711)	(32,331)	Depreciation	(12,447)	(274)	(12,721)
(1,558)	-	(1,558)	Impairment for placements	(600)	-	(600)
(182,566)	(31,319)	(151,247)	Impairment for credit losses	(58,230)	(12,058)	(70,288)
94,130	21,829	72,301	Recoveries from impairment for credit losses	27,836	8,404	36,240
(12,475)	-	(12,475)	Impairment for investments	(4,803)	-	(4,803)
4,486	4,486	-	Share of profit from an associate	-	1,727	1,727
(72,242)	(1,009)	(71,233)	Tax expense	(27,425)	(388)	(27,813)
(622,377)	(28,187)	(594,190)		(228,763)	(10,852)	(239,615)
458,597	13,351	445,246	Segment profit for the year	171,420	5,140	176,560
			Other information			
28,104,078	1,997,055	26,107,023	Segment assets	10,051,204	768,866	10,820,070
27,158	288	26,870	Segment capital expenses	10,345	111	10,456

41. Segmental information (continued)

The Group reports the segment information by the following business segments: Corporate, Consumer, Wholesale, International and Islamic Banking. The following table shows the distribution of the Group's operating income, profit and total assets by business segments

As at 31 December 2017	Corporate banking RO 000's	Consumer banking RO 000's	Wholesale banking RO 000's	International banking * RO 000's	Subtotal RO 000's	Islamic banking RO 000's	Total RO 000's
Segment revenue							
Net interest income	106,653	122,242	17,372	10,416	256,683	-	256,683
Net income from Islamic financing	-	-	-	-	-	24,663	24,663
Commission, fees and other income (net)	25,643	74,023	45,105	7,548	152,319	2,301	154,620
Operating income	132,296	196,265	62,477	17,964	409,002	26,964	435,966
Segment costs							
Operating expenses (including depreciation)	(29,011)	(113,394)	(17,404)	(11,347)	(171,156)	(12,923)	(184,079)
Impairment for credit losses (net)	(9,813)	(5,588)	1,195	(4,733)	(18,939)	(3,033)	(21,972)
Impairment on due from banks / for investments	-	-	(2,588)	-	(2,588)	(1,184)	(3,772)
Loss on reclassification of investment in an associate	-	-	-	(17,535)	(17,535)	-	(17,535)
Share of results from an associate	-	-	-	2,438	2,438	-	2,438
Tax expense	(13,998)	(11,550)	(6,640)	(468)	(32,656)	(1,572)	(34,228)
	(52,822)	(130,532)	(25,437)	(31,645)	(240,436)	(18,712)	(259,148)
Segment profit/ (loss) for the year	79,474	65,733	37,040	(13,681)	168,566	8,252	176,818
Segment assets	4,175,628	3,137,442	1,990,085	648,400	9,951,555	1,197,667	11,149,222
Operating income (US $ 000's)	343,625	509,779	162,278	46,660	1,062,342	70,036	1,132,378
Segment profit/ (loss) for the year (US $ 000's)	206,425	170,734	96,207	(35,535)	437,831	21,434	459,265
Segment assets (US $ 000's)	10,845,788	8,149,201	5,169,052	1,684,156	25,848,197	3,110,823	28,959,020

* International banking includes overseas operations and cost allocations from Oman operations.

41. Segmental information (continued)

As at 31 December 2016	Corporate banking RO 000's	Consumer banking RO 000's	Wholesale banking RO 000's	International banking * RO 000's	Subtotal RO 000's	Islamic banking RO 000's	Total RO 000's
Segment revenue							
Net interest income	99,360	128,127	13,740	9,339	250,566	-	250,566
Net income from Islamic financing	-	-	-	-	-	23,582	23,582
Commission, fees and other income (net)	23,684	63,152	46,238	7,030	140,104	1,923	142,027
Operating income	123,044	191,279	59,978	16,369	390,670	25,505	416,175
Segment costs							
Operating expenses (including depreciation)	(26,804)	(108,513)	(16,537)	(10,680)	(162,534)	(11,544)	(174,078)
Impairment for credit losses (net)	(15,518)	(9,881)	(600)	(4,457)	(30,456)	(3,592)	(34,048)
Impairment on due from banks / for investments	-	-	(5,202)	-	(5,202)	(201)	(5,403)
Share of results from an associate	-	-	-	1,727	1,727	-	1,727
Tax expense	(11,109)	(10,043)	(5,185)	(256)	(26,593)	(1,220)	(27,813)
	(53,431)	(128,437)	(27,524)	(13,666)	(223,058)	(16,557)	(239,615)
Segment profit for the year	69,613	62,842	32,454	2,703	167,612	8,948	176,560
Segment assets	4,090,094	2,893,473	2,028,480	768,323	9,780,370	1,039,700	10,820,070
Operating income (US $ 000's)	319,594	496,829	155,787	42,517	1,014,727	66,247	1,080,974
Segment profit/ (loss) for the year (US $ 000's)	180,812	163,226	84,296	7,021	435,355	23,242	458,597
Segment assets (US $ 000's)	10,623,622	7,515,514	5,268,779	1,995,644	25,403,559	2,700,519	28,104,078

42. Financial risk management

42.1 Introduction and overview

Risk Management is a process by which bank muscat SAOG (the Group) identifies key risks, applies consistent, understandable risk measures, and chooses which risks to reduce and which to hold and by what means and establishes procedures to monitor and report the resulting risk position for necessary action. The objective of risk management is to ensure that the Group operates within the risk appetite levels set by its Board of Directors while various business functions pursue their objective of maximizing the risk adjusted returns. The Group has exposure to the following core risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk
- Operational risk

Risk management is the overall responsibility of the Group's Board of Directors and managed through the Board Risk Committee (BRC). BRC provides recommendations to the Board of Directors on the risk-reward strategy, risk appetite and policies and framework for managing different types of risks. The Board reviews and approves the risk management strategy of the Group and defines the risk appetite of the Group. The Board approved strategy is implemented at management level through management committees. For the purpose of day-to-day management of risks, the Group has created an independent Risk Management department (RMD). Risk Management department objectively reviews and ensures that the various functions of the Group operate in compliance with the risk parameters set by the Board of Directors. Risk Management department has a direct reporting line to the Board of Directors of the Group. The risk appetite, approved by the Board of Directors, in various business areas is defined and communicated through an enterprise-wide risk policy. The Group's risk policy, approved by the Board of Directors, analyses and sets risk limits for core risks - Credit risk, Liquidity risk, Market risk and Operational risk. The risk levels of each of these categories is measured and monitored on a continuous basis and compliance to prescribed risk levels reported on a quarterly basis. This ensures prudent management of the risks assumed by the Group in its normal course of business. The risk policy is updated regularly, based on an analysis of the economic trends and the operating environment in the countries where the Group operates.

Group's Board of Directors have remained closely involved with key risk management initiatives, in ensuring the Group's risks are effectively managed, appropriate levels of liquidity are maintained and adequate capital is held in line with the requirements.

The Group recognises that an effective risk management process is key to its objective of enhancing shareholder value and is committed to developing risk management as an area of core competence. It continues in investing in its risk management capabilities so as to ensure that it is able to deliver on its growth plans while managing the underlying risks in an effective manner.

42.2 Credit risk

42.2.1Management of credit risk

Credit risk is the potential loss resulting from the failure of a borrower or counter party to honour its financial or contractual obligations in accordance with the agreed terms. It includes the below sub types:

- Cross border risk
- Counterparty Risk
- Settlement risk

42. Financial risk management (continued)

42.2 Credit risk (continued)

42.2.1Management of credit risk (continued)

The function of credit risk management is to maximise the Group's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Credit risk makes up the largest part of the Group's risk exposure. Credit risk management process of the Group begins with the risk policy, updated regularly, which clearly defines parameters for each type of risks assumed by the Group.

Risk limit control and mitigation policies

The Group has set for itself clear and well defined limits to address different dimensions of credit risk including concentration risk. Compliance with the various parameters set in the risk policy, is reviewed on a regular basis and exceptions are reported to enable remedial actions.

- All credit processes – Approval, disbursal, administration, classification, recoveries and write-off, all are governed by the Group's credit manual which is reviewed by Risk Management department and approved by appropriate approval authorities. The credit policy stipulates clear guidelines for each of these functions and the lending authority at various levels as stipulated in appropriate 'Lending Authority Limits'.

- All Corporate lending proposals, where the proposed credit limit for a borrower or related Group exceeds a threshold, are submitted for approval/renewal to the appropriate authority after an independent review by the Risk Management Department whose comments are incorporated into the proposal.

- All Corporate relationships are reviewed at least once a year. Retail portfolio, including credit cards and mortgage portfolio, is reviewed on a portfolio basis at a product level at least once a year.

- Concentration of exposure to counterparties, geographies and sector are governed and monitored according to regulatory norms and limits prescribed in the Group's risk policy.

- Credit exposures are risk rated to provide support for credit decisions. The portfolio is analysed based on risk grades and risk grade migration to focus on management of prevalent credit risk.

- Retail portfolio is rated using an application score card.

A robust collateral management system is in place to mitigate any credit risk. The Group has a strong credit administration process that ensures compliance with terms of approval, documentation and continuous review to ensure quality of credit and collateral. While securities such as listed equities are valued regularly, credit policy mandates securities obtained by way of legal mortgage over real estate to be valued at least once in 3 years or more frequently if situation warrants.

The Group executes Credit Support annex to the International Swaps and Derivatives Association (ISDA) document with major counterparty banks to mitigate credit risk arising out of change in the value of underlying for the derivative exposures. The Treasury Middle office undertakes daily valuation of all the derivative deals and raises appropriate margin calls.

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured. In addition, in order to minimise the credit loss, the Group will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances. Collateral held as security for financial assets other than loans and advances, is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

42. Financial risk management (continued)

42.2 Credit risk (continued)

42.2.1 Management of credit risk (continued)

All loans and advances of the Group are regularly monitored to ensure compliance with the stipulated repayment terms. Those loans and advances are classified into one of the 5 risk classification categories: Standard, Special Mention, Substandard, Doubtful, and Loss – as stipulated by Central Bank of Oman regulations and guidelines. The responsibility for identifying problem accounts and classifying them rests with business line function.

42.2.2 Exposure to credit risk – Statement of financial position items

	Loans and advances and Islamic financing to customers		**Due from banks**	
	2017 RO 000's	2016 RO 000's	**2017 RO 000's**	2016 RO 000's
Individually impaired				
Sub-Standard	**38,019**	32,211	-	-
Doubtful	**15,896**	38,700	-	-
Loss	**131,957**	97,259	-	-
Gross amount	**185,872**	168,170	-	-
Allowance for impairment	**(131,310)**	(115,889)	-	-
Carrying amount	**54,562**	52,281	-	-
Collectively impaired				
Sub-Standard	**11,210**	8,962	-	-
Doubtful	**14,487**	11,977	-	-
Loss	**42,601**	51,221	-	-
Gross amount	**68,298**	72,160	-	-
Allowance for impairment	**(51,652)**	(65,902)	-	-
Carrying amount	**16,646**	6,258	-	-
Past due but not impaired				
Standard	**116,289**	85,485	-	-
Carrying amount	**116,289**	85,485	-	-
Past due but not impaired			-	
1-30 days	**53,343**	28,470	-	-
30-60 days	**47,712**	45,799	-	-
60-90 days	**15,234**	11,216	-	-
	116,289	85,485	-	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

42. Financial risk management (continued)

42.2 Credit risk (continued)

42.2.2 Exposure to credit risk – Statement of financial position items (continued)

	Loans and advances and Islamic financing to customers		Due from banks	
	2017 RO 000's	2016 RO 000's	**2017 RO 000's**	2016 RO 000's
Neither past due nor impaired				
Standard	**7,572,592**	7,408,990	**594,576**	532,765
Special mention	**713,449**	536,415	**-**	-
Gross amount	**8,286,041**	7,945,405	**594,576**	532,765
Allowance for impairment	**(144,822)**	(132,099)	**(2,550)**	(6,150)
Carrying amount	**8,141,219**	7,813,306	**592,026**	526,615
Total carrying amount	**8,328,716**	7,957,330	**592,026**	526,615
Carrying amount in USD'000	**21,633,029**	20,668,390	**1,537,730**	1,367,831
Total allowances for impairment	**(327,784)**	(313,890)	**(2,550)**	(6,150)
US$ 000's	**(851,387)**	(815,299)	**(6,623)**	(15,974)

Total impairment above includes impairment for off-balance sheet exposures as well.

Restructured loans on standard and special mentioned portfolio as at 31 December 2017 : RO '000 71,649 (2016 - RO'000 35,881). Restructured loans on classified portfolio as at 31 December 2017: RO '000 89,107 (2016 - RO '000 76,826).

Other assets is outlined in note 8 includes elements of credit risk for which the Group does not hold any impairment provision.

Maximum exposure to credit risk before collateral held or other credit enhancements for all on-balance sheet assets are based on net carrying amounts as reported in the statement of financial position.

The maximum credit risk equivalents relating to off-balance sheet items calculated as per Basel II guidelines are as follows:

2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
743,265	**854,351**	Financial guarantees	**328,925**	286,157
2,386,779	**2,415,914**	Other credit related liabilities	**930,127**	918,910
530,512	**487,294**	Loan commitments	**187,608**	204,247
3,660,556	**3,757,559**		**1,446,660**	1,409,314

The above table represents a worst case scenario of credit risk exposure as of 31 December 2017 and 2016, without taking into account of any collateral held or other credit enhancements attached.

42. Financial risk management (continued)

42.2 Credit risk (continued)

42.2.2 Exposure to credit risk – Statement of financial position items (continued)

Management is confident in its ability to continue to control and sustain minimal exposure of credit risk resulting from the Group's loans and advances portfolio based on the following:

- Regular review of the loans and advances portfolio to identify any potential risk;
- 95.7 percent of the loans and advances portfolio are considered to be neither past due nor impaired (2016: 96.0 percent);
- Of the RO 5,090 million (2016: RO 4,974 million) loans and advances assessed on an individual basis, less than 3.7 percent is impaired (2016: 3.5 percent);
- Personal and housing loans represent 41.20 percent (2016: 39.87 percent) of total loans and advances which are backed by salary assignment and/or by collateral;
- Well diversified loans and advances portfolio to avoid concentration risk in segment, sector, geographies and counterparty.

42.2.3 Impaired loans and securities

Impaired loans and securities are loans and securities for which the Group determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan and security agreements. Those loans are categorised either as Sub-standard, Doubtful or Loss in the internal credit risk system.

42.2.4 Past due but not impaired loans

Loans and securities where contractual interest or principal payments are past due but the Group believes that impairment is not appropriate on the basis of the stage of collection of amounts owed to the Group.

42.2.5 Allowances for impairment

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures. A collective loan loss allowance is established for Groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment. The Group makes provision for bad and doubtful debts promptly when required in line with the conservative provisioning norms it has set for itself.

42.2.6 Write-off policy

The Group writes off a loan or security and any related allowances for impairment when the Group determines that the loan or security is uncollectible. This determination is reached after considering factors such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation or that proceeds from collateral will not be sufficient to pay back the entire exposure or legal measures to recover the dues. For smaller balance standardized loans, charge off decisions generally based on a product specific past due status and borrower's capacity to repay the loan.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

42. Financial risk management (continued)

42.2 Credit risk (continued)

42.2.7 Analysis of impairment and collateral

(a) An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below:

Loans and advances and Islamic financing to customers			Loans and advances and Islamic financing to customers	
2016 US$ 000's	**2017 US$ 000's**		**2017 RO 000's**	2016 RO 000's
		Against individually impaired		
264,400	**660,662**	Property	**254,355**	101,794
18	**16,156**	Equities	**6,220**	7
2,603	**22,795**	Others	**8,776**	1,002
267,021	**699,613**		**269,351**	102,803
		Against past due but not impaired		
267,927	**921,055**	Property	**354,606**	103,152
28,384	**37,590**	Equities	**14,472**	10,952
65,229	**96,966**	Others	**37,332**	25,113
361,540	**1,055,611**		**406,410**	139,193
		Against neither past due nor impaired		
10,094,922	**10,103,075**	Property	**3,889,684**	3,886,545
1,895,319	**2,101,894**	Equities	**809,229**	729,698
1,019,249	**523,509**	Others	**201,551**	392,411
13,009,490	**12,728,478**		**4,900,464**	5,008,654
13,638,051	**14,483,702**		**5,576,225**	5,250,650

(b) Repossessed collateral

The Group obtains assets by taking possession of collateral held as security. The carrying value of collateral held for sale as at 31 December 2017 is as follows:

	Carrying Amount	
	2017 RO 000's	2016 RO 000's
Nature of assets		
Residential/commercial property	**7,422**	7,592
US$ 000's	**19,278**	19,719

Repossessed properties are sold as soon as practicable, with the proceeds used to reduce the outstanding indebtedness. Repossessed property is classified in the statement of financial position within other assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

42. Financial risk management (continued)

42.2 Credit risk (continued)

42.2.8 Credit rating analysis

The table below presents an analysis of debt securities, treasury bills and other eligible bills by rating agency designation, based on Moody's ratings or their equivalent:

At 31 December 2017

Debt and T Bills **Rated:**	**2017** **RO 000's**	2016 RO 000's
Aaa to Aa3	**174,598**	43,816
A1 to A3	**64,957**	58,015
Baa1 to Baa3	**634,350**	756,679
Ba1 to Ba3	**3,813**	4,968
Unrated	**8,487**	6,478
	886,205	869,956
Equity Securities	**155,944**	153,388
Total investment securities	**1,042,149**	1,023,344
Total investment securities (US$ 000's)	**2,706,881**	2,658,036

The debt securities, treasury bills and other eligible bills include element of credit risk for which the Group does not hold any impairment provision.

The following table shows the gross placements held with counterparties at the reporting date:

Banks rated:	**2017** **RO 000's**	2016 RO 000's
Aaa to Aa3	**90,268**	104,405
A1 to A3	**137,259**	145,478
Baa1 to Baa3	**194,123**	193,678
Ba1 to Ba3	**47,268**	57,687
B1 & Below	**174**	175
Banks unrated	**125,484**	31,342
Total	**594,576**	532,765
Total (US$ 000's)	**1,544,353**	1,383,805

The Group performs an independent assessment based on quantitative and qualitative factors where a counterparty is unrated.

The following table shows the gross off balance sheet exposures held with counterparties at the reporting date:

	2017 **RO'000**	2016 RO'000
Rated:		
Aaa to Aa3	**97,077**	163,107
A1 to A3	**544,063**	481,181
Baa1 to Baa3	**97,117**	148,234
Ba1 to Ba3	**179,513**	140,731
B1 & Below	**20,891**	2,463
Unrated	**1,921,409**	2,052,773
Total	**2,860,070**	2,988,489
Total (US$ 000's)	**7,428,754**	7,762,310

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

42. Financial risk management (continued)

42.2 Credit risk (continued)

42.2.9 Concentration of credit risk

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

The Group seeks to manage its credit risk exposure through diversification of lending activities to avoid undue concentrations of risks with individuals or Groups of customers in specific locations or businesses. It also obtains appropriate security concentration by location for loans and advances and is measured based on the location of the Group holding the asset, which has a high co-relation with the location of the borrower. Concentration by location for investment securities is measured based on the location of the issuer of the security.

An analysis of concentrations of credit risk as the reporting date is shown below.

	Gross loans and advances and Islamic financing to customers		**Due from banks**	
Carrying amount	**2017 RO 000's**	2016 RO 000's	**2017 RO 000's**	2016 RO 000's
Concentration by sector				
Corporate	**4,566,119**	4,516,940	-	-
Sovereign	**32,666**	9,994	-	-
Financial institution	**491,108**	446,727	**594,576**	532,765
Retail	**3,566,607**	3,297,559	-	-
Total	**8,656,500**	8,271,220	**594,576**	532,765
US$ 000's	**22,484,417**	21,483,689	**1,544,353**	1,383,805

The table below analyses the concentration of gross loans and advances to customers by various sectors.

2016 USD 000's	**2017 USD 000's**		**2017 RO 000's**	2016 RO 000's
		Corporate and other loans		
2,120,158	**2,274,174**	Services	**875,557**	816,261
1,109,626	**1,186,197**	Mining and quarrying	**456,686**	427,206
1,266,169	**1,323,286**	Manufacture	**509,465**	487,475
1,013,769	**991,252**	Real estate	**381,632**	390,301
534,717	**520,927**	Wholesale and retail trade	**200,557**	205,866
1,119,891	**1,152,683**	Import trade	**443,783**	431,158
1,160,330	**1,275,605**	Financial institutions	**491,108**	446,727
1,200,096	**1,208,873**	Utilities	**465,416**	462,037
2,201,106	**2,124,473**	Transport	**817,922**	847,426
890,868	**762,421**	Construction	**293,532**	342,984
25,958	**84,847**	Government	**32,666**	9,994
63,125	**74,577**	Agriculture and allied activities	**28,712**	24,303
25,239	**38,777**	Export trade	**14,929**	9,717
187,549	**202,411**	Others	**77,928**	72,206
12,918,601	**13,220,503**		**5,089,893**	4,973,661
8,565,088	**9,263,914**	Personal and housing loans	**3,566,607**	3,297,559
21,483,689	**22,484,417**		**8,656,500**	8,271,220

42. Financial risk management (continued)

42.2 Credit risk (continued)

42.2.9 Concentration of credit risk (continued)

The Group monitors concentrations of credit risk by sector and by geographic location.

An analysis of concentrations of credit risk by location at the reporting date is shown below.

	Gross loans and advances and Islamic financing to customers		Due from banks	
Carrying amount	**2017**	2016	**2017**	2016
	RO 000's	RO 000's	**RO 000's**	RO 000's
Concentration by location				
Sultanate of Oman	**8,192,755**	7,765,333	**28,182**	17,726
Other GCC countries	**430,246**	491,633	**175,314**	187,375
Europe	**-**	-	**96,331**	191,760
United States of America	**-**	-	**10,446**	42,843
Others	**33,499**	14,254	**284,303**	93,061
Total	**8,656,500**	8,271,220	**594,576**	532,765
US$ 000's	**22,484,417**	21,483,689	**1,544,353**	1,383,805

42.2.10 Settlement risk

The Group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of counterparty to honor its obligation to deliver cash, securities or other assets as contractually agreed.

The Group mitigates settlement risk by conducting settlements through a settlement / clearing agent or having bilateral payment netting agreements.

42.3 Liquidity risk

Liquidity risk is the potential inability of the Group to meet its maturing obligations to counterparty.

42.3.1 Management of liquidity risk

Liquidity risk arises when the Group is unable to generate sufficient cash resources to meet obligations as they fall due or can do so only at materially disadvantageous terms. Such liquidity risk may arise even when the institution is solvent. Liquidity stress may be caused by counterparties withdrawing credit lines or of not rolling over existing funding or as a result of general disruption in the markets or run on Group deposits etc.

Asset Liability Committee (ALCO) of the Group manages the liquidity position of the Group. In order to ensure that the Group meets its financial obligations as and when they fall due, cash flow positions are closely monitored. Liquidity risk management ensures that the Group has the ability, under varying levels of stress to efficiently and economically meet liquidity needs.

The Group consciously diversifies its funding base to include deposits raised from interGroup, issue of Certificate of deposits, retail customer deposits, bonds and medium term funds raised through Euro medium term notes and subordinated liabilities. These together with the strength of the Group's equity and asset quality ensure that funds are available at competitive rates at all times.

The sources and maturities of assets and liabilities are closely monitored to avoid any undue concentration and ensure a robust management of liquidity risks. The Group undertakes structural profiling based on the actual behavioral patterns of customers to study the structural liquidity position and initiate measures to fund these gaps.

42. Financial risk management (continued)

42.3 Liquidity risk (continued)

42.3.1 Management of liquidity risk (continued)

The Group undertakes liquidity management through both cash flow approach and stock approach. Under stock approach, Liquid assets to total deposits and Liquid assets to total assets ratios are closely monitored and managed. Under cash approach, assets and liabilities are bucketed based on their residual maturity to ascertain liquidity gaps. The ALCO reviews the liquidity position on a continuous basis.

The Group's statement on maturity of asset and liability is outlined in note 42.3.2 to the consolidated financial statements.

42.3.2. Exposure to liquidity risk

The key measures used by the Group for managing liquidity risk are the ratios of liquid assets to total deposits and liquid assets to total assets. For this purpose the liquid assets include cash and balances with Central Banks, government securities, treasury bills and due from banks. The table below provides the ratios of liquid assets to deposits from customers and liquid assets to total assets at the reporting date and during the reporting period.

	Liquid assets to total assets ratio		**Liquid assets to total deposits ratio**	
	2017	2016	**2017**	2016
As at 31 December	**17.46%**	16.28%	**23.85%**	21.03%
Average for the period	**18.05%**	20.89%	**24.58%**	28.30%
Maximum for the period	**21.40%**	25.63%	**28.43%**	34.69%
Minimum for the period	**15.52%**	16.28%	**21.58%**	21.03%

The table below analyses the Group's non-derivative financial liabilities and net-settled derivative financial liabilities into relevant maturity Groupings based on the remaining period at the reporting date using the contractual maturity date. Derivative financial liabilities are included in the analysis if their contractual maturities are essential for an understanding of the timing of the cash flows. The amounts disclosed in the table are the contractual undiscounted cash flows.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

42. Financial risk management (continued)

42.3 Liquidity risk (continued)

42.3.2 Exposure to liquidity risk (continued)

The Group's maturity position of on and off balance sheet assets and liabilities as follows:

	On demand or within one month RO 000's	Two to three months RO 000's	Four months to twelve months RO 000's	One to five years RO 000's	More than five years RO 000's	Total RO 000's
At 31 December 2017						
Cash and balances with Central Banks	712,346	25,338	57,210	95,139	44,712	934,745
Due from banks	191,168	197,294	167,122	36,442	-	592,026
Loans and advances	1,201,169	636,758	841,178	1,790,677	3,858,934	8,328,716
Investments	251,389	213,437	52,046	221,428	288,876	1,027,176
Property and equipment and other assets	87,732	48,627	48,636	2,647	78,917	266,559
Total on balance sheet assets	2,443,804	1,121,454	1,166,192	2,146,333	4,271,439	11,149,222
Irrevocable commitments to extend credit	-	-	-	402,527	162,190	564,717
Derivative products	420,865	440,051	420,379	115,479	-	1,396,774
Total off balance sheet assets	420,865	440,051	420,379	518,006	162,190	1,961,491
Total assets	2,864,669	1,561,505	1,586,571	2,664,339	4,433,629	13,110,713
Future interest cash inflows	29,147	64,559	262,535	959,077	783,391	2,098,709
Deposits from banks	397,539	128,620	71,879	312,087	-	910,125
Customers' deposits	737,623	771,839	1,714,829	2,870,375	1,324,646	7,419,312
Euro medium term notes	-	192,500	-	236,616	-	429,116
Other liabilities and taxation	115,979	114,684	183,395	3,704	798	418,560
Subordinated liabilities/ Mandatory convertible bonds	-	32,416	69,000	52,360	-	153,776
Shareholders' funds	-	-	-	-	1,818,333	1,818,333
Total liabilities and equity	1,251,141	1,240,059	2,039,103	3,475,142	3,143,777	11,149,222
Irrevocable commitments to extend credit	128,330	60,779	133,603	241,875	130	564,717
Derivative products	416,825	440,633	417,125	112,954	-	1,387,537
Total off balance sheet Liabilities	545,155	501,412	550,728	354,829	130	1,952,254
Total liabilities	1,796,296	1,741,471	2,589,831	3,829,971	3,143,907	13,101,476
Future interest cash outflows	9,645	17,516	47,201	130,965	3,662	208,989
Gap (total assets - total liabilities)	1,065,737	(179,966)	(1,003,260)	(1,165,632)	1,289,722	6,601
Cumulative gap	1,065,737	885,771	(117,489)	(1,283,121)	6,601	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

42.Financial risk management (continued)

42.3 Liquidity risk (continued)

42.3.2 Exposure to liquidity risk (continued)

	On demand or within one month US$ 000's	Two to three months US$ 000's	Four months to twelve months US$ 000's	One to five years US$ 000's	More than five years US$ 000's	Total US$ 000's
At 31 December 2017						
Cash and balances with Central Banks	1,850,250	65,813	148,597	247,114	116,135	2,427,909
Due from banks	496,540	512,452	434,083	94,655	-	1,537,730
Loans and advances	3,119,920	1,653,918	2,184,878	4,651,109	10,023,205	21,633,030
Investments	652,959	554,382	135,184	575,138	750,327	2,667,990
Property and equipment and other assets	227,876	126,304	126,327	6,875	204,979	692,361
Total on balance sheet assets	6,347,545	2,912,869	3,029,069	5,574,891	11,094,646	28,959,020
Irrevocable commitments to extend credit	-	-	-	1,045,525	421,273	1,466,798
Derivative products	1,093,156	1,142,990	1,091,894	299,945	-	3,627,985
Total off balance sheet assets	1,093,156	1,142,990	1,091,894	1,345,470	421,273	5,094,783
Total assets	7,440,701	4,055,859	4,120,963	6,920,361	11,515,919	34,053,803
Future interest cash inflows	75,706	167,686	681,909	2,491,109	2,034,782	5,451,192
Deposits from banks	1,032,568	334,078	186,699	810,616	-	2,363,961
Customers' deposits	1,915,905	2,004,777	4,454,101	7,455,519	3,440,639	19,270,941
Euro medium term notes	-	500,000	-	614,587	-	1,114,587
Other liabilities & taxation	301,243	297,881	476,351	9,621	2,073	1,087,169
Subordinated liabilities/ Mandatory Convertible Bonds	-	84,198	179,221	136,000	-	399,419
Shareholders' funds	-	-	-	-	4,722,943	4,722,943
Total liabilities and equity	3,249,716	3,220,934	5,296,372	9,026,343	8,165,655	28,959,020
Irrevocable commitments to extend credit	333,325	157,868	347,021	628,247	338	1,466,799
Derivative products	1,134,309	1,144,501	1,083,442	293,387	-	3,655,639
Total off balance sheet Liabilities	1,415,987	1,302,369	1,430,463	921,634	338	5,070,791
Total liabilities	4,665,703	4,523,303	6,726,835	9,947,977	8,165,993	34,029,811
Future interest cash outflows	25,052	45,496	122,600	340,169	9,512	542,829
Gap (total assets - total liabilities)	2,768,151	(467,444)	(2,605,872)	(3,027,616)	3,349,926	17,145
Cumulative gap	2,768,151	2,300,707	(305,165)	(3,332,781)	17,145	

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

42. Financial risk management (continued)

42.3. Liquidity risk (continued)

42.3.2 Exposure to liquidity risk (continued)

At 31 December 2016	On demand or within one month RO 000's	Two to three months RO 000's	Four months to 12 months RO 000's	One to five years RO 000's	More than five years RO 000's	Total RO 000's
Cash and balances with Central Banks	821,781	24,598	52,858	101,196	41,139	1,041,572
Due from banks	240,352	181,927	99,916	4,001	419	526,615
Loans and advances	1,213,137	764,072	736,340	1,679,150	3,564,631	7,957,330
Investments	479,635	82,148	73,620	210,608	211,987	1,057,998
Property and equipment and other assets	90,051	34,496	34,260	4,241	73,507	236,555
Total on balance sheet assets	2,844,956	1,087,241	996,994	1,999,196	3,891,683	10,820,070
Irrevocable commitments to extend credit	-	-	-	524,994	91,010	616,004
Derivative products	329,914	243,078	386,725	54,310	-	1,014,027
Total off balance sheet assets	329,914	243,078	386,725	579,304	91,010	1,630,031
Total assets	3,174,870	1,330,319	1,383,719	2,578,500	3,982,693	12,450,101
Future interest cash inflows	39,764	51,193	223,401	760,194	556,717	1,631,269
Deposits from banks	196,155	331,702	54,961	248,974	-	831,792
Customers' deposits	727,319	754,232	1,639,870	3,131,492	1,204,814	7,457,727
Euro medium term notes	-	-	-	383,595	-	383,595
Other liabilities and taxation	96,034	107,395	163,407	2,803	747	370,386
Subordinated liabilities/ Mandatory Convertible Bonds	18,000	31,964	-	179,866	-	229,830
Shareholders' funds	-	-	-	-	1,546,740	1,546,740
Total liabilities and equity	1,037,508	1,225,293	1,858,238	3,946,730	2,752,301	10,820,070
Irrevocable commitments to extend credit	208,445	81,827	187,766	137,966	-	616,004
Derivative products	328,615	243,887	377,734	53,389	-	1,003,625
Total off balance sheet Liabilities	537,060	325,714	565,500	191,355	-	1,619,629
Total liabilities	1,574,568	1,551,007	2,423,738	4,138,085	2,752,301	12,439,699
Future interest cash outflows	3,788	14,276	58,501	165,979	94,144	336,688
Gap (total assets - total liabilities)	1,600,302	(220,688)	(1,040,019)	(1,559,585)	1,230,392	10,402
Cumulative gap	1,600,302	1,379,614	339,595	(1,219,990)	10,402	

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017 (continued)

42. Financial risk management (continued)

42.3. Liquidity risk (continued)

42.3.2 Exposure to liquidity risk (continued)

At 31 December 2016	On demand or within one month US $ 000's	Two to three months US$ 000's	Four months to 12 months US $ 000's	One to five years US $ 000's	More than five years US $ 000's	Total US $ 000's
Cash and balances with Central Banks	2,134,495	63,891	137,294	262,847	106,855	2,705,382
Due from banks	624,291	472,538	259,522	10,392	1,088	1,367,831
Loans and advances	3,151,005	1,984,603	1,912,570	4,361,429	9,258,783	20,668,390
Investments	1,245,805	213,371	191,221	547,034	550,616	2,748,047
Property and equipment and other assets	233,898	89,600	88,987	11,016	190,927	614,428
Total assets	7,389,494	2,824,003	2,589,594	5,192,718	10,108,269	28,104,078
Irrevocable commitments to extend credit	-	-	-	1,363,621	236,390	1,600,011
Derivative products	856,919	631,371	1,004,481	141,065	-	2,633,836
Total off balance sheet assets	856,919	631,371	1,004,481	1,504,686	236,390	4,233,847
Total assets	8,246,413	3,455,374	3,594,075	6,697,404	10,344,659	32,337,925
Future interest cash outflows	103,283	132,969	580,262	1,974,530	1,446,018	4,237,062
Deposits from banks	509,493	861,564	142,756	646,686	-	2,160,499
Customers' deposits	1,889,141	1,959,044	4,259,403	8,133,745	3,129,387	19,370,720
Euro medium term notes	-	-	-	996,351	-	996,351
Other liabilities and taxation	249,438	278,948	424,433	7,281	1,940	962,040
Subordinated liabilities/ Mandatory Convertible Bonds	46,754	83,023	-	467,184	-	596,961
Shareholders' funds	-	-	-	-	4,017,507	4,017,507
Total liabilities and equity	2,694,826	3,182,579	4,826,592	10,251,247	7,148,834	28,104,078
Irrevocable commitments to extend credit	541,416	212,538	487,704	358,353	-	1,600,011
Derivative products	853,545	633,473	981,127	138,673	-	2,606,818
Total off balance sheet Liabilities	1,394,961	846,011	1,468,831	497,026	-	4,206,829
Total liabilities	4,089,787	4,028,590	6,295,423	10,748,273	7,148,834	32,310,907
Future interest cash flows	9,839	37,081	151,951	431,114	244,530	874,515
Gap (total assets - total liabilities)	3,299,707	(1,204,587)	(3,705,829)	(5,555,555)	2,959,435	(4,206,829)
Cumulative gap	3,299,707	2,095,120	(1,610,709)	(7,166,264)	(4,206,829)	

42. Financial risk management (continued)

42.3 Liquidity risk (continued)

42.3.2 Exposure to liquidity risk (continued)

Interest cash flows shown in the above tables represent inflows and outflows up to the contractual maturity of financial assets and liabilities. Mismatch in interest cash flows arise as contractual maturity of financial assets is longer than contractual maturity of financial liabilities. Historically, financial liabilities are rolled over on contractual maturity which is not considered in the future interest cash flow calculations. Furthermore, the interest cash flows do not factor in the stable nature of unambiguous maturity financial liabilities such as demand and savings accounts.

As on the reporting date, deposits from Ministries and other Government organisations represent 31.5 percent of the total customer deposits (2016: 35.9 percent).

42.4 Market risk

42.4.1 Management of market risks

The Group sets limits for each product and risk type in order to ensure that the Group's market risk is managed well within the overall regulatory requirements set by the Central Bank of Oman and internal regulations contained in the Risk Policy. The Group does not enter into trading positions in commodities and derivatives. Limits and all internal/external guidelines are strictly adhered to, deviations, if any, are immediately escalated and action taken wherever necessary.

The principal categories of market risk faced by the Group are set out below:

- Foreign exchange risk
- Investment price risk
- Interest rate risk
- Commodity price risk

42.4.2 Foreign exchange risk

Foreign exchange risk is the risk of loss due to volatility in the exchange rates. Foreign exchange risk management in the Group is ensured through regular measurement and monitoring of open foreign exchange positions against approved limits. Majority of the foreign exchange transactions carried out by the division are on behalf of corporate customers and are on a back-to-back basis. The treasury ensures that positions with customers are covered in the interbank market.

The Group conservatively restricts its open currency position at below 35 percent of its net worth as against the regulatory limit of 40 percent of net worth.

42. Financial risk management (continued)

42.4 Market risk (continued)

42.4.2 Foreign exchange risk (continued)

It also stipulates that exposure on any single non parity currency should be restricted to the extent of 3 percent of Parent Company's net worth and restricted to the extent of 10 percent of the Parent Company's net worth for all non-parity currencies taken together. As at the reporting date, the Group had the following net exposures denominated in foreign currencies:

2016 USD 000's	**2017 USD 000's**		**2017 RO 000's**	2016 RO 000's
19,758	**4,525**	UAE Dirhams	**1,742**	7,607
64,270	**280,442**	US Dollar	**107,970**	24,744
91,761	**60,787**	Saudi Riyal	**23,403**	35,328
11,023	**5,244**	Qatari Riyal	**2,019**	4,244
8,514	**8,223**	Pakistani Rupee	**3,166**	3,278
9,943	**6,816**	Indian Rupee	**2,624**	3,828
62,997	**71,358**	Kuwait Dinar	**27,473**	24,254
126,810	**96,330**	Bahraini Dinar	**37,087**	48,822
10,416	**11,558**	Others	**4,450**	4,010
405,492	**545,283**		**209,934**	156,115

Positions are monitored on a daily basis to ensure positions are maintained within the limits approved by the Central Bank of Oman.

The net exposure in foreign currencies includes foreign currency exposure on investment in overseas branches, subsidiary and significant investment in entity of equivalent to RO 87 million (2016: RO 95 million) which are exempted from regulatory limit on foreign exchange exposure.

The Group's significant portion of foreign exchange exposure is in USD and other GCC currencies which have (other than Kuwaiti Dinar) fixed parity with Omani Rial unless the peg is changed.

Exposure and sensitivity analysis:

The table below indicates the sensitivity analysis of foreign exchange exposure of the Group to changes in the non-parity foreign currency prices as at 31 December 2017 with all other variables held constant.

Non parity foreign currency net assets	**At 31 December 2017**		At 31 December 2016	
	% of change in the currency price(+/-)	**Change in Profit and equity (+/-) RO'000**	% of change in the currency price(+/-)	Change in profit and equity (+/-) RO'000
Indian Rupees	**10%**	**262**	10%	383
Pakistani Rupees	**10%**	**317**	10%	328
Kuwaiti Dinar	**10%**	**2,747**	10%	2,425
Others	**10%**	**445**	10%	401

42. Financial risk management (continued)

42.4 Market risk (continued)

42.4.3 Investment Price Risk

Investment price risk is the risk of decline in the market value of the Group's portfolio as a result of diminishment in the market value of individual investments. The Group's investments are governed by the Investment Policy and Risk Policy approved by the Board of Directors and are subject to rigorous due diligence. Investment limits such as position limits, exposure limits, stop loss limits, sectorial limits are defined in various policies enabling proper risk management of the Group's investments. The Group's Investment Committee monitors the investments. The rating and cost vis-a-vis the market price of the instruments are monitored on daily basis and necessary actions taken to reduce exposure, if needed. Traded portfolio is revalued on daily basis and the rest at regular intervals to ensure that unrealised losses, if any, on account of reduction in the market value of the investments below their cost remain within the acceptable parameters defined in the Group's Investment Policy.

Exposure and sensitivity analysis

The Group analyses price sensitivity of the equity portfolio as follows:

(a) For the local quoted equity portfolio, based on the beta factor of the portfolio performance to the MSM30 Index performance.

(b) For the international quoted equity portfolio, based on the individual security market price movement.

The Group's market risk is affected mainly by changes to the actual market price of financial assets. Actual performance of the Group's local equity portfolio has a correlation to the performance of MSM30 Index.

The beta of the Group's quoted local equity portfolio against the MSM30 Index for 2017 was 0.19. Thus, a +/- 5% change in the value of MSM30 index may result in 0.97% change in the value of Group's quoted local equity portfolio, amounting to RO 276 thousand change in the unrealised gain recognised in the statement of other comprehensive income for the year.

The beta of the Group's quoted local equity portfolio against the MSM30 Index for 2016 was 0.14. Thus, a +/- 5% change in the value of MSM30 index may result in 0.72% change in the value of Group's quoted local equity portfolio, amounting to RO 389 thousand change in the unrealised gain recognised in the statement of other comprehensive income for the year.

International quoted equity portfolio of the Group comprises of shares listed in GCC stock markets, Indian Stock markets and other international markets. A +/-5% change in the market price of the respective securities would result in change in value of the portfolio of +/- RO 3.87 million (2016: +/-RO 2.64 million) and corresponding increase or decrease in the unrealised gain recognised in the statement of other comprehensive income.

42.4.4 Interest rate risk management.

Interest rate risk is the risk of adverse impact on the Bank's financial position due to change in market interest rates. While the impact on the trading book is by way of change in the value of the portfolio, the banking book leads to impact on the net Interest Income (NII) and/or Economic Value of Equity (EVE). The short term impact of interest rate risk is measured by studying the impact on the NII of the Bank while the long term impact is measured through the study of the impact on the Economic Value of Equity. The responsibility for interest rate risk management rests with the Parent Company's Treasury under the supervision of the Asset Liability Management Committee (ALCO). The Group's interest rate sensitivity position of assets and liabilities, based on the contractual repricing or maturity dates, whichever dates are earlier, is as follows:

42. Financial risk management (continued)

42.4 Market risk (continued)

42.4.4 Interest rate risk management (continued)

	Effective annual interest rate %	Within one month RO 000's	Months 2 to 3 RO 000's	Months 4 to 12 RO 000's	Year 1 to 5 RO 000's	Over 5 years RO 000's	Non-interest sensitive RO 000's	Total RO 000's
As of 31 December 2017								
Cash and balances with Central Banks	0-0.5	188,067	-	1,899	-	-	744,779	934,745
Due from banks	1.53	182,211	197,294	167,122	36,442	-	8,957	592,026
Loans and advances	4.67	1,447,104	970,992	1,206,246	2,549,088	2,142,405	12,881	8,328,716
Investments	2.25	161,817	213,042	67,649	240,651	240,055	103,962	1,027,176
Property and equipment and other assets	None	-	-	944	11	-	265,604	266,559
Total on balance sheet assets		1,979,199	1,381,328	1,443,860	2,826,192	2,382,460	1,136,183	11,149,222
Derivatives		509,369	784,883	442,668	397,803	152,898	-	2,287,621
Total assets		2,488,568	2,166,211	1,886,528	3,223,995	2,535,358	1,136,183	13,436,843
Deposits from banks	2.26	394,872	128,620	71,879	312,087	-	2,667	910,125
Customers' deposits	1.46	302,715	419,180	4,167,685	324,131	843,804	1,361,797	7,419,312
Euro medium term notes / Sukuk	3.73	-	192,500	-	236,616		-	429,116
Other liabilities and taxation	None		-	-	-	-	418,560	418,560
Subordinated liabilities and Mandatory Convertible bonds	5.24	-	84,776	69,000	-	-	-	153,776
Perpetual Tier I capital	5.5	-	-	-	130,000	-	-	130,000
Shareholders' funds	None	-	-	-	-	-	1,688,333	1,688,333
Total on balance sheet liabilities and equity		697,587	825,076	4,308,564	1,002,834	843,804	3,471,357	11,149,222
Derivatives		627,774	785,466	387,670	346,904	133,206	-	2,281,020
Total liabilities		1,325,361	1,610,542	4,696,234	1,349,738	977,010	3,471,357	13,430,242
Total interest rate sensitivity gap		1,163,207	555,669	(2,809,706)	1,874,257	1,558,348	(2,335,174)	6,601
Cumulative interest rate sensitivity gap		1,163,207	1,718,876	(1,090,830)	783,427	2,341,775	6,601	
In US$ '000		3,021,317	4,464,613	(2,833,325)	2,034,875	6,082,532	17,145	

42. Financial risk management (continued)

42.4 Market risk (continued)

42.4.4 Interest rate risk management (continued)

	Effective annual interest rate %	Floating rate or within one month RO 000's	Months 2 to 3 RO 000's	Months 4 to 12 RO 000's	Year 1 to 5 RO 000's	Over 5 years RO 000's	Non-interest sensitive RO 000's	Total RO 000's
As of 31 December 2016								
Cash and balances with Central Banks	0-0.5	-	434,705	1,879	-	-	604,988	1,041,572
Due from banks	1.21	125,174	209,950	148,957	4,001	35,448	3,085	526,615
Loans and advances	4.56	1,477,816	1,000,098	987,830	2,389,752	2,089,519	12,315	7,957,330
Investments	2.15	350,686	85,687	84,599	214,858	164,922	157,246	1,057,998
Property and equipment and other assets	None	-	-	-	-	-	236,555	236,555
Total on balance sheet assets		1,953,676	1,730,440	1,223,265	2,608,611	2,289,889	1,014,189	10,820,070
Derivatives		378,699	303,681	485,548	657,331	53,619	-	1,878,878
Total assets		2,332,375	2,034,121	1,708,813	3,265,942	2,343,508	1,014,189	12,698,948
Deposits from banks	1.76	183,373	333,249	57,668	248,974	1,934	6,594	831,792
Customers' deposits	1.15	310,299	356,663	3,975,377	1,410,698	150,845	1,253,845	7,457,727
Euro medium term notes	3.29	-	-	-	383,595	-	-	383,595
Other liabilities and taxation	None	-	-	-	-	-	370,386	370,386
Subordinated liabilities/ Mandatory Convertible bonds	5.09	18,000	31,964	65,450	114,416	-	-	229,830
Shareholders' funds	None	-	-	-	-	-	1,546,740	1,546,740
Total on balance sheet liabilities and equity		511,672	721,876	4,098,495	2,157,683	152,779	3,177,565	10,820,070
Derivatives		757,220	496,159	338,552	223,024	53,619	-	1,868,574
Total liabilities		1,268,892	1,218,035	4,437,047	2,380,707	206,398	3,177,565	12,688,644
Total interest rate sensitivity gap		1,063,483	816,086	(2,728,234)	885,235	2,137,110	(2,163,376)	10,304
Cumulative interest rate sensitivity gap		1,063,483	1879,569	(848,665)	36,570	2,173,680	10,304	
In US$ '000		2,762,294	4,881,997	(2,204,325)	94,987	5,645,922	26,764	

42. Financial risk management (continued)

42.4 Market risk (continued)

42.4.4. Interest rate risk management (continued)

(i) The repricing profile is based on the remaining period to the next interest repricing date.

(ii) An asset (or positive) gap position exists when assets reprice more quickly or in greater proportion than liabilities during a given period and tends to benefit net interest income in a rising interest rate environment. A liability (or negative) gap position exists when liabilities reprice more quickly or in greater proportion than assets during a given period and tends to benefit net interest income in a declining interest rate environment.

Re-pricing gap is the difference between interest rate sensitive assets and liabilities spread over distinct maturity bands based on residual maturity or re-pricing dates. The Parent Company uses currency-wise and consolidated re-pricing gaps to quantify interest rate risk exposure over distinct maturities and analyse the magnitude of portfolio changes necessary to alter existing risk profile. The distribution of assets and liabilities over these time bands is done based on the actual repricing schedules. The schedules are used as a guideline to assess interest rate risk sensitivity and to focus the efforts towards reducing the mismatch in the repricing pattern of assets and liabilities.

The Parent Company uses simulation reports as an effective tool for understanding risk exposure under variety of interest rate scenarios. These reports help ALCO to understand the direction of interest rate risk in the Parent Company and decide on the appropriate strategy and hedging mechanism for managing it. The Parent Company's current on- and off-balance sheet exposures are evaluated under static environment to quantify potential effect of external interest rate shocks on the earnings and economic value of equity at risk, using assumptions about future course of interest rates and changes in Parent Company's business profile.

Economic Value of Equity (EVE) is the present value of all asset cash flows subtracted by the present value of all liability cash flows. By calculating the EVE the bank is able to show the effect of different interest rate changes on its total capital. This is a key tool that allows bank to prepare against constantly changing interest rate. The impact of interest rate changes on EVE is monitored by recognising the changes in the value of assets and liabilities for a given change in the market interest rate. The interest rate risk management is facilitated by limits of 5% NII impact and 20% impact on EVE for a 200 basis points shock.

An analysis of the Group's sensitivity to an increase or decrease in market interest rates is as follows:

Impact on Net Interest income	**+200 bps RO 000's**	**-200 bps RO 000's**	**+100 bps RO 000's**	**-100 bps RO 000's**	**+50 bps RO'000's**	**-50 bps RO 000's**
2017						
As at 31 December	**16,564**	**(13,115)**	**9,434**	**(4,247)**	**5,067**	**1,571**
Average for the period	**17,616**	**(12,819)**	**9,932**	**(4,588)**	**5,147**	**858**
Maximum for the period	**21,410**	**(10,752)**	**11,999**	**(3,296)**	**6,385**	**1,789**
Minimum for the period	**14,826**	**(15,241)**	**8,819**	**(6,390)**	**4,441**	**(808)**
2016						
As at 31 December	19,486	(18,246)	10,399	(9,129)	5,095	(4,022)
Average for the period	18,025	(12,027)	9,934	(5,038)	4,794	(415)
Maximum for the period	21,852	(18,246)	11,941	(9,129)	5,882	(4,022)
Minimum for the period	7,860	(1,815)	5,049	(1,275)	2,335	1,821

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42. Financial risk management (continued)

42.4 Market risk (continued)

42.4.4. Interest rate risk management (continued)

Impact on Economic Value	+200 bps RO 000's	-200 bps RO 000's	+100 bps RO 000's	-100 bps RO 000's	+50 bps RO 000's	-50 bps RO 000's
2017						
As at 31 December	**(210,917)**	**358,804**	**(87,430)**	**136,560**	**(90,983)**	**105,614**
Average for the period	**(205,111)**	**349,623**	**(78,597)**	**125,849**	**(86,487)**	**108,902**
Maximum for the period	**(187,243)**	**359,210**	**(68,265)**	**136,560**	**(81,217)**	**203,902**
Minimum for the period	**(221,349)**	**336,394**	**(88,191)**	**111,191**	**(91,375)**	**95,648**
2016						
As at 31 December	(317,089)	442,720	(167,287)	336,863	118,758	245,533
Average for the period	(258,341)	372,086	(138,321)	215,422	(3,478)	129,642
Maximum for the period	(210,901)	459,773	(117,698)	336,863	121,059	245,533
Minimum for the period	(317,089)	287,133	(167,287)	136,178	(75,782)	61,994

Impact on Net Interest income	+200 bps US$ '000	-200 bps US$ '000	+100 bps US$ '000	-100 bps US$ '000	+50 bps US$ '000	-50 bps US$ '000
2017						
As at 31 December	**43,023**	**(34,065)**	**24,504**	**(11,031)**	**13,161**	**4,081**
Average for the period	**45,756**	**(33,296)**	**25,797**	**(11,917)**	**13,369**	**2,229**
Maximum for the period	**55,610**	**(27,927)**	**31,166**	**(8,561)**	**16,584**	**4,647**
Minimum for the period	**38,509**	**(39,587)**	**22,906**	**(16,597)**	**11,535**	**(2,099)**
2016						
As at 31 December	50,613	(47,392)	27,010	(23,712)	13,234	(10,447)
Average for the period	46,818	(31,239)	25,803	(13,086)	12,452	(1,078)
Maximum for the period	56,758	(47,392)	31,016	(23,712)	15,278	(10,447)
Minimum for the period	20,416	(4,714)	13,114	(3,312)	6,065	4,730

Impact on Economic Value	+200 bps US$ 000's	-200 bps US$ 000's	+100 bps US$ 000's	-100 bps US$ 000's	+50 bps US$ 000's	-50 bps US$ 000's
2017						
As at 31 December	**(547,836)**	**931,958**	**(227,091)**	**354,701**	**(236,319)**	**274,322**
Average for the period	**(532,756)**	**908,112**	**(204,148)**	**326,881**	**(224,642)**	**282,862**
Maximum for the period	**(486,345)**	**933,013**	**(177,312)**	**354,701**	**(210,953)**	**529,616**
Minimum for the period	**(574,932)**	**873,751**	**(229,068)**	**288,808**	**(237,338)**	**248,436**
2016						
As at 31 December	(823,608)	1,149,922	(434,512)	874,969	308,462	637,748
Average for the period	(671,016)	966,457	(359,275)	559,538	(9,034)	336,732
Maximum for the period	(547,795)	1,194,216	(305,709)	874,969	314,439	637,748
Minimum for the period	(823,608)	745,800	(434,512)	353,709	(196,836)	161,023

42. Financial risk management (continued)

42.5 Commodity Price Risk

As part of its treasury operations, the Group offers commodities hedging facility to its clients. Customers of the Group who are exposed to commodities like Copper, Aluminium and also Jewellers with exposure to gold prices cover their commodity exposures through the Group. The Group covers all its commodity exposures back-to-back in the interbank market.

The Group operates in the commodities market purely as a provider of hedging facilities and does not either trade in commodities or bullion or maintain positions in commodities. Customers of the Group are sanctioned a transaction volume limit based on their turn-over/ orders as well as a Variation Margin limit is applied to mitigate any mark-to-mark related credit exposures for the Group. The transaction volume limit is to restrict the total outstanding contracts value to the business requirement of the customer and the variation margin limit is to protect the Group from excessive credit risk due to adverse price movement in the underlying commodity prices. Margin calls for additional collateral or cash deposits is demanded from customers on the breach of the Variation Margin limit. The treasury middle-office monitors customers' positions and MTMs on daily basis.

42.6 Operational risks

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

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

The Group has developed its own Operational Risk Management Software to aid assessment of operational risks as well as the collection and analysis of operational losses.

The Group's risk policy provides the framework to identify, assess, monitor, control and report operational risks in a consistent and comprehensive manner across the Group. Operational Risk Management function independently supports business units in the management of operational risks. Operational risk management in the Group is driven by the objective to increase the efficiency and effectiveness of the available resources, minimise losses and utilise opportunities. The main objectives of Operational Risk Management are as follows:

- To achieve strong risk control by harnessing the latest risk management technologies and techniques, resulting in a distinctive risk management capability, enabling business units to meet their performance and growth objectives.
- To enable adequate capital allocation in respect of potential impact of operational risks
- To minimize the impact of operational risks through means such as a fully functional IT Disaster Recovery facility, Business Continuity Plans, up-to-date documentation and by developing general operational risk awareness within the Group.

Operational risk appetite is defined at a business unit and Group level. Business units have the primary responsibility for identifying, measuring and managing the operational risks that are inherent in their respective operations. Operational risk is controlled through a series of strong internal controls and audits, well-defined segregation of duties and reporting lines, detailed operational manuals and standards. The responsibility of overseeing the process lies with Operational Risk Unit in accordance with the Operational Risk Management Framework. Internal Audit independently reviews effectiveness of the Group's internal controls and its ability to minimise the impact of operational risks.

42. Financial risk management (continued)

42.6 Operational risks (continued)

The Operations committee is the primary oversight body for operational risk. The Operations committee is represented by business and control functions and is responsible for ensuring that the Group has an adequate risk management process that covers identification, evaluation and management of operational risks and the formulation of adequate policies pertaining to operational risk management.

Business Continuity Planning (BCP)

Business Continuity Management within the Group is the implementation and management of preventative measures, planning and preparation to ensure the Group can continue to operate following an incident, significant unplanned event or major operational disruption. The Group ensures that its systems and procedures are resilient to ensure business continuity through potential situations of failure. The Group has put in place Business Continuity Plans (BCP) to ensure that its business runs effectively in the event of most unforeseen disasters as required by the CBO Business Continuity Guidelines, the Basel Committee Joint Forum High-level principles for business continuity and international business continuity standards. The Group continuously strengthens and enhances its existing plans by implementing a robust business continuity framework to ensure that its systems and procedures are resilient and ready to meet 'emergency preparedness'. The BCM Committee is entrusted with the responsibility of formulating, adopting, implementing, testing and maintaining a robust BCP for the Group. The BCM Committee continuously review and agree the strategic Business Continuity assessment and planning information to ensure Business Continuity Management, planning and maintenance responsibilities are assigned, understood and implemented across the business areas.

The Group has made significant strides in enhancing its business continuity framework. Some of the major developments in line with the objective of the continuous evolution of the Group's BCM framework were:

- BCM Committee ensures business continuity is closely aligned and integrated with business initiatives and developments.
- Fire evacuation drills were conducted for each section of the Seeb Head Office and a collective, full-fledged surprise fire drill and evacuation was conducted in conjunction with the Royal Oman Police. Fire evacuation response leaders were appointed and trained.
- Comprehensive testing of the recovery of the Group's key systems and applications was conducted in conjunction with the Business.
- The Group's Business Recovery Centre of the Group has the capability to meet any unforeseen disaster and ensure continual operational capability in the event of a major operational disruption. To ensure the functionality of the Business Recovery Centre.

42.7 Capital management

42.7.1 Regulatory capital

The Parent Company's regulator, Central Bank of Oman (CBO), sets and monitors capital requirements for the Parent Company as a whole. In implementing Basel III's capital requirement, the CBO requires the Parent Company to maintain a minimum of 12.625% ratio of total capital to total risk-weighted assets. The Group's regulatory capital as per Basel III regulations is Grouped into:

- Tier I capital, which includes ordinary share capital, share premium, distributable and non-distributable reserves and retained earnings (net of proposed dividend) after deductions for goodwill and fifty percent of carrying value of investment in associates as per the regulatory adjustments that are included in equity but are treated differently for capital adequacy purposes;

42. Financial risk management (continued)

42.7 Capital management (continued)

42.7.1 Regulatory capital (continued)

- Tier II capital, which includes qualifying subordinated liabilities, collective impairment allowances and the element of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale after deductions for fifty percent of carrying value of investments in associates;

Various limits are applied to elements of the capital base. The qualifying Tier II and Tier III capital cannot exceed Tier I capital; qualifying subordinated liabilities may not exceed fifty percent of Tier I capital; and amount of collective impairment allowances that may be included as part of Tier II capital is limited to 1.25 percent of the total risk-weighted assets.

42.7.2 Capital adequacy

Capital adequacy indicates the ability of the Group in meeting any contingency without compromising the interest of the depositors and to provide credit across the business cycles. Sufficient capital in relation to the risk profile of the Group's assets helps promote financial stability and confidence of the stakeholders and creditors. The Group aims to maximise the shareholders' value through an optimal capital structure that protects the stakeholders' interests under most extreme stress situations, provides sufficient room for growth while meeting the regulatory requirements and at the same time gives a reasonable return to the shareholders. The Group has a forward looking capital policy which considers the current risk, planned growth and an assessment of the emerging risk for the forecasted period.

While risk coverage is the prime factor influencing capital retention, the Group is conscious of the fact that as a business entity, its capital needs to be serviced and a comfortable rate of return needs to be provided to the shareholders. Excessive capital will dilute the return on capital and this in turn can exert pressure for profitability, propelling business asset growth resulting in the Group assuming higher levels of risk. Hence, with regards to the retention of capital, the Group's policy is governed by the need for adequately providing for associated risks and the needs for servicing the capital retained. The Group makes good use of subordinated loans as Tier II Capital and raises share capital as and when the need arises. The Group's strong and diverse shareholder profile gives the Group the necessary confidence in its ability to raise capital when it is needed.

The Group desires to move to more advanced approaches for measuring credit risk, market risk and operational risk and has put in place a 'building block' approach. A road map has been laid down for each core area of risk viz. credit, market, operational. Progress has been made in line with the road map and is being monitored on a continuous basis and reported.

Basel III regulatory reporting

The Central Bank of Oman has issued final guidelines on the implementation of the new capital norms along with the phase-in arrangements and reporting norms. The Group remains strongly capitalised and is ahead of the transitional phase-in arrangements.

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42. Financial risk management (continued)

42.7 Capital management (continued)

42.7.2 Capital adequacy (continued)

The following table sets out the capital adequacy position of the Group:

2016	2017		2017	2016
USD 000's	**USD 000's**		**RO 000's**	RO 000's
		Common Equity Tier 1 (CET1) capital: Instruments and reserves		
648,377	**703,730**	Share capital	**270,936**	249,625
1,262,966	**1,323,057**	Share premium	**509,377**	486,242
216,125	**234,577**	Legal reserve	**90,312**	83,208
635,865	**750,384**	General reserve	**288,898**	244,808
251,143	**213,221**	Subordinated loan reserve	**82,090**	96,690
783,088	**881,208**	Retained profit (post proposed cash dividend)	**339,265**	301,489
3,797,564	**4,106,177**	**Total**	**1,580,878**	1,462,062
		Less:		
(813)	**(1,501)**	Cumulative loss on fair value	**(578)**	(313)
(782)	**(483)**	Cumulative loss on cash flow hedge	**(186)**	(301)
(1,309)	**(15,865)**	Deferred tax assets	**(6,108)**	(504)
(5,106)	**(3,436)**	Foreign currency translation reserve	**(1,323)**	(1,966)
(130,465)	**(99,888)**	Significant investments in the common stock of banking, financial and insurance entities	**(38,457)**	(50,229)
(138,475)	**(121,173)**	Total regulatory adjustments to CET1	**(46,652)**	(53,313)
3,659,089	**3,985,004**	Total Common Equity Tier 1 capital (CET1)	**1,534,226**	1,408,749
-	**337,662**	Additional Tier 1 capital (AT1)	**130,000**	-
3,659,089	**4,322,666**	Total Tier 1 capital (T1 = CET1 + AT1)	**1,664,226**	1,408,749
		Tier 2 capital: instruments and provisions		
22,847	**13,766**	Cumulative change in fair value (45%)	**5,300**	8,796
300,758	**289,870**	General Loan loss impairment	**111,600**	115,792
127,597	**102,000**	Subordinated liabilities (net of reserves)	**39,270**	49,125
83,026	**-**	Mandatory convertible Bonds	**-**	31,965
534,228	**405,636**		**156,170**	205,678
		Less: Regulatory adjustments		
-	**-**	Significant investments in the common stock of banking, financial and insurance entities	**-**	-
534,228	**405,636**	Tier 2 capital (T2)	**156,170**	205,678
4,193,317	**4,728,302**	Total Regulatory Capital (TC = T1 + T2)	**1,820,396**	1,614,427
24,814,928	**25,629,041**	Total risk weighted assets	**9,867,181**	9,553,347
22,373,951	**23,189,597**	Of which: Credit risk weighted assets	**8,927,995**	8,613,571
534,003	**451,361**	Of which: Market risk weighted assets	**173,774**	205,591
1,906,974	**1,988,083**	Of which: Operational risk weighted assets	**765,412**	734,185

42. Financial risk management (continued)

42.7 Capital management (continued)

42.7.2 Capital adequacy (continued)

2016	**2017**	Capital Ratios: (expressed as a % of total risk weighted assets)	**2017**	2016
14.75%	**15.55%**	Common Equity Tier 1	**15.55%**	14.75%
14.75%	**16.87%**	Tier 1	**16.87%**	14.75%
16.90%	**18.45%**	**Total capital**	**18.45%**	16.90%

* The total regulatory capital adequacy ratio of 18.45% (2016: 16.90%) is after considering the proposed dividend of 30% Cash and 5% Stock (2016: 25% Cash and 5% Stock). The total capital adequacy ratio pre consideration of dividend would be 19.27% (2016: 17.55%).

Capital Adequacy as per Basel II reporting for monitoring purposes:

The following table sets out the capital adequacy position as per Basel II guidelines issued by Central Bank of Oman of the Group for monitoring purposes:

2016 USD 000's	**2017 USD 000's**		**2017 RO 000's**	2016 RO 000's
3,724,319	**4,372,610**	Tier I Capital	**1,683,455**	1,433,863
519,997	**385,114**	Tier II Capital	**148,269**	200,199
4,244,316	**4,757,724**	**Total regulatory capital**	**1,831,724**	1,634,062
		Risk weighted assets		
22,373,951	**23,189,597**	Credit risk	**8,927,995**	8,613,571
534,003	**451,361**	Market risk	**173,774**	205,591
1,906,974	**1,988,083**	Operational risk	**765,412**	734,185
24,814,928	**25,629,041**	**Total risk weighted assets**	**9,867,181**	9,553,347
		Capital ratios		
17.10	**18.56%**	Total regulatory capital expressed as a % of total risk weighted assets	**18.56%**	17.10%
15.01%	**17.06%**	Total Tier I capital expressed as a % of total risk weighted assets	**17.06%**	15.01%

* The total regulatory capital adequacy ratio of 18.56% (2016: 17.10%) is after considering the proposed dividend of 30% Cash and 5% Stock (2016: 25% Cash and 5% Stock). The total capital adequacy ratio pre consideration of dividend would be 19.39% (2016: 17.76%).

42. Financial risk management (continued)

42.7 Capital management (continued)

42.7.3 Internal Capital Adequacy Assessment Process (ICAAP):

Apart from the regulatory capital which is based on the guidelines issued by Central Bank of Oman, the Group has in place Internal Capital Adequacy Assessment Process (ICAAP) which provides an assessment of the Group's actual capital adequacy based on advanced Economic Capital measure. ICAAP incorporates the impact of residual risk including business risk, concentration risk, correlation risk, interest rate risk on banking book along with the core risks. The purpose of the Group's ICAAP is not only to provide a detailed assessment of its current capital adequacy, but also to estimate future capital adequacy ratios in line with approved business plans in order to evaluate their validity from a risk perspective. The process covers a forward looking plan for the next 5 years. The overall framework has introduced a structured methodology for a comprehensive forward-looking assessment of capital based on the Group's risk profile. It will scrutinize the current business model of the Group and may lead to corresponding adjustments if the inherent risk goes beyond the Group's risk appetite. ICAAP is approved by the Board of Directors and submitted to Central Bank annually. On a quarterly basis, reporting is done to the Board of Directors on the adequacy of capital. The Group believes that its current and foreseen capital supply is suitable to support its business strategy. The present plan will be updated at least annually on a rolling basis for forward-looking planning period of 5 years.

The forward looking assessment of capital adequacy has helped the Group to plan ahead for capital management.

42.7.4 Capital allocation

The allocation of capital between specific business units and activities is, to large extent, driven by optimisation of the return on capital allocated. Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular business units or activities, it is not the sole basis used for decision making. Other factors such as synergies between the units or activities, the availability of management and other resources, and the fit of the activity with the Bank's longer term strategic objectives are taken in to account while allocating capital.

43. Fair value information

Based on the valuation methodology outlined below, the fair values of all on and off-balance sheet financial instruments at reporting dates are considered by the Board and Management not to be materially different to their book values:

	Notes	Loans and receivables RO 000's	Available-for-sale RO 000's	Held-to-maturity RO 000's	Fair value through profit or loss RO 000's	Other amortised cost RO 000's	Total carrying value RO 000's	Fair value RO 000's
At 31 December 2017								
Cash and balances with Central Banks	5	**934,745**	-	-	-	-	**934,745**	**934,745**
Due from banks	6	**592,026**	-	-	-	-	**592,026**	**595,217**
Loans and advances and Islamic financing receivables	7	**8,328,716**	-	-	-	-	**8,328,716**	**8,353,864**
Investment securities	9	-	**368,226**	**607,955**	**50,995**	-	**1,027,176**	**998,873**
Derivative assets	38	-	-	-	**27,347**		**27,347**	**27,347**
		9,855,487	**368,226**	**607,955**	**78,342**	-	**10,910,010**	**10,910,046**
Deposits from banks	14	-	-	-	-	**910,125**	**910,125**	**917,764**
Customers' deposits and Islamic customer deposits	15	-	-	-	-	**7,419,312**	**7,419,312**	**7,464,768**
Sukuk	17	-	-	-	-	**44,608**	**44,608**	**44,430**
Euro Medium Term Notes	17	-	-	-	-	**384,508**	**384,508**	**395,616**
Subordinated liabilities / mandatory convertible bonds	18,21	-	-	-	-	**153,776**	**153,776**	**155,721**
Derivative liabilities	38				**25,622**	-	**25,622**	**25,622**
		-	-	-	**25,622**	**8,912,329**	**8,937,951**	**9,003,921**

43. Fair value information (continued)

	Notes	Loans and receivables RO 000's	Available-for-sale RO 000's	Held-to-maturity RO 000's	Fair value through profit or loss RO 000's	Other amortised cost RO 000's	Total carrying value RO 000's	Fair value RO 000's
At 31 December 2016								
Cash and balances with Central Banks	5	1,041,572	-	-	-	-	1,041,572	1,041,572
Due from banks	6	526,615	-	-	-	-	526,615	526,949
Loans and advances	7	7,957,330	-	-	-	-	7,957,330	7,980,111
Investment securities	9	-	395,327	563,601	50,996	-	1,009,924	1,005,669
Derivative assets	38	-	-	-	21,708	-	21,708	21,708
		9,525,517	395,327	563,601	72,704	-	10,557,149	10,576,009
Deposits from banks	14	-	-	-	-	831,792	831,792	834,938
Customers' deposits	15	-	-	-	-	7,457,727	7,457,727	7,486,524
Euro medium term notes	17	-	-	-	-	383,595	383,595	403,651
Subordinated liabilities / mandatory convertible bonds	18,21	-	-	-	-	229,830	229,830	233,652
Derivative liabilities	38	-	-	-	18,780	-	18,780	18,780
		-	-	-	18,780	8,902,944	8,921,724	8,977,545

43. Fair value information (continued)

Effective 1 January 2010, the Group adopted the amendment to IFRS 7 for financial instruments that are measured in the statement of financial position at fair value; this requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs)
The following table presents the Group's assets and liabilities that are measured at fair value at 31 December:

2017	**Level 1 RO 000's**	**Level 2 RO 000's**	**Level 3 RO 000's**	**Total RO 000's**
Assets				
Derivatives	**-**	**27,347**	**-**	**27,347**
Fair value through profit or loss	**50,995**	**-**	**-**	**50,995**
Available-for-sale financial assets:				
- Equity securities	**87,526**	**-**	**26,468**	**113,994**
- Debt investments	**34,375**	**206,807**	**13,050**	**254,232**
Total assets	**172,896**	**234,154**	**39,518**	**446,568**
Liabilities				
Derivatives	**-**	**25,836**	**-**	**25,836**

2016	Level 1 RO 000's	Level 2 RO 000's	Level 3 RO 000's	Total RO 000's
Assets				
Derivatives	-	21,708	-	21,708
Fair Value through profit or loss	50,996	-	-	50,996
Available-for-sale financial assets:				
- Equity securities	76,378	-	31,418	107,796
- Debt investments	23,678	243,581	20,272	287,531
Total assets	151,052	265,289	51,690	468,031
Liabilities				
Derivatives	-	19,121	-	19,121

There are no transfers between levels of fair value measurement hierarchy during the years 2017 and 2016.

43. Fair value information (continued)

A table showing the impact of change in estimates by 5% on the Group's assets and liabilities that are measured at fair value at 31 December, on the other comprehensive income is as follows:

2017	**Level 1 RO 000's**	**Level 2 RO 000's**	**Level 3 RO 000's**	**Total RO 000's**
Assets				
Derivatives	**-**	**1,367**	**-**	**1,367**
Fair Value through profit or loss	**2,550**	**-**	**-**	**2,550**
Available-for-sale financial assets:				
- Equity securities	**4,376**	**-**	**1,323**	**5,699**
- Debt investments	**1,719**	**10,340**	**653**	**12,712**
Total assets	**8,645**	**11,707**	**1,976**	**22,328**
Liabilities				
Derivatives	**-**	**1,292**	**-**	**1,292**

2016	Level 1 RO 000's	Level 2 RO 000's	Level 3 RO 000's	Total RO 000's
Assets				
Derivatives	-	1,085	-	1,085
Fair Value through profit or loss	2,550	-	-	2,550
Available-for-sale financial assets:				
- Equity securities	3,819	-	1,571	5,390
- Debt investments	1,184	12,179	1,014	14,377
Total assets	7,553	13,264	2,585	23,402
Liabilities				
Derivatives	-	956	-	956

The impact of change in estimates used in measurement of fair value of level 3 securities is not material to the financial statements. The following table demonstrates the movement of the Group's level 3 investments:

	Equity securities RO 000's	**Debt investments RO 000's**	**Total RO 000's**
At 1 January 2017	**31,418**	**20,272**	**51,690**
Realised gain on sale	**(67)**	**9**	**(58)**
Loss from change in fair value	**(2,124)**	**(70)**	**(2,194)**
Additions	**1,354**	**3,300**	**4,654**
Disposals and redemption	**(4,103)**	**(10,461)**	**(14,564)**
Exchange differences	**(10)**	**-**	**(10)**
At 31 December 2017	**26,468**	**13,050**	**39,518**

	Equity securities RO 000's	Debt investments RO 000's	Total RO 000's
At 1 January 2016	36,863	25,538	62,401
Realised gain on sale	1,342	-	1,342
Loss from change in fair value	(2,621)	-	(2,621)
Additions	1,694	18,025	19,719
Disposals and redemption	(5,854)	(23,291)	(29,145)
Exchange differences	(6)	-	(6)
At 31 December 2016	31,418	20,272	51,690

43. Fair value information (continued)

As of 31 December 2017, 74% (2016: 64%) of the level 3 equity securities were valued on the basis of fair valuation carried out in accordance with appropriate valuation techniques based on income approach (discounting of cash flows), market approach (using prices or other relevant information generated by market transactions of identical or similar entities), cost approach or a combination thereof. Unobservable inputs are used to measure fair value to the extent that relevant observable inputs are not available, using the best information available in the circumstances. These might include banks own data and would consider all information about market participant assumptions that is reasonably available.

As of 31 December 2017, 26% (2016: 36%) of the level 3 equity securities were valued on the basis of latest available capital accounts statements of the investee companies received from independent fund managers as at 30 September 2017 or at a later date and adjusted for subsequent cash flows till 31 December 2017 or based on net asset values received from independent fund managers as at 30 September 2017 or at a later date.

The debt investments were valued on fair value basis. Valuation is based on Risk adjusted discount rate (yield) considering a reasonable range of estimates. A significant decrease in the credit quality would result in a lower fair value with significant increase in the spread above the risk-free rate and vice-versa. The Group holds adequate provisioning on the above investments as of the reporting date

43.1 Estimation of fair values

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

43.1.1 Loans and advances

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

43.1.2 Investments carried at cost and derivatives

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

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

43.1.3 Available for sale and fair value through profit or loss investments

Fair values for quoted investments are based on quoted bid prices as at the reporting date. Unquoted equity investments are carried at fair values, measured in accordance with appropriate valuation techniques based on income , market, cost approaches or a combination thereof or on the basis of latest available capital accounts statements or net asset values of the investee companies received from independent fund managers and adjusted for subsequent cash flows up to the reporting date.

43.1.4 Bank and customer deposits

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

43 Fair value information (continued)

43.1 Estimation of fair value (continued)

43.1.5 Off-balance sheet financial instruments

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

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

44 Comparative figures

No material corresponding figures for 2016 included for comparative purposes were reclassified.

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