

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

## 1 LEGAL STATUS AND PRINCIPAL ACTIVITIES

Bank Nizwa SAOG ("the Bank") was registered in the Sultanate of Oman as a public joint stock company under registration number 1152878 on 15 August 2012. The Bank's shares are listed on the Muscat Securities Market "MSM" and its principle place of business is in Muscat, Sultanate of Oman.

The Bank commenced its operations on 23 December 2012 and currently operates through twelve branches in the Sultanate under the banking license issued by the Central Bank of Oman on 19 December 2012.

The principal activities of the Bank are opening current, saving and investment accounts, providing Murabaha finance, Ijara financing and other Sharia compliant forms of financing as well as managing investors' money on the basis of Mudaraba in exchange for a profit share or agency in exchange for a fee, and excess profit as incentive providing commercial banking services and other investment activities.

The Bank's activities are regulated by the Central Bank of Oman ("CBO") and supervised by a Sharia Supervisory Board ("SSB") whose role is defined in Bank's Memorandum and Articles of Association.

At 31 December 2017, the Bank had 336 employees (2016: 330 employees) and its address is: P O Box 1423, Postal Code 133, Muscat, Sultanate of Oman.

## 2 BASIS OF PREPARATION

### 2.1 Statement of compliance

In accordance with the requirements of Section 1.2 of Title 3 of the Islamic Banking Regulatory Framework ("IBRF") issued by CBO, the financial statements have been prepared in accordance with Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank and the Financial Accounting Standards ("FAS") issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI") and other applicable regulations of CBO. In accordance with requirements of AAOIFI, matters that are not covered by FAS, the Bank uses guidance from the relevant International Financial Reporting Standards ("IFRS"). Thus subject to preparation of the financial statements in accordance with FAS issued by AAOIFI, the financial statements comply with the relevant disclosure requirements of the Commercial Companies Law of 1974, as amended and Capital Market Authority of the Sultanate of Oman. The significant accounting policies are set out in note 3 to the financial statements.

Statement of restricted investment accountholders, statement of Qard fund and Zakat are not presented as these are not applicable.

### 2.2 Basis of measurement

The financial statements are prepared on historical cost basis, except for the measurement at fair value of certain investments carried at fair value.

### 2.3 Functional and presentation currency

The financial statements have been presented in Rial Omani (RO) which is the functional currency of the Bank. Except as otherwise indicated, financial information presented in RO has been rounded off to the nearest Omani Rial.

### 2.4 Use of estimates and judgements

The preparation of financial information 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 assumptions are based on historical experience and various other factors including expectation of future events that are believed by the Bank to be reasonable under the circumstances. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 3 SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of the financial statements are set out below.

#### 3.1 Cash and cash equivalents

For the purposes of the statement of cash flows cash and cash equivalents comprise cash in hand, non-restricted balance with the CBO, amounts due to / from banks and financial institutions, inter-bank Wakala, with remaining maturity of three months. Cash and cash equivalents are carried at amortised cost at the reporting date.

#### 3.2 Sales receivables and other receivables

- Sales receivables consist mainly of sales transaction agreements (Murabaha) stated net of deferred profits and provision for impairment. The Bank considers the promise made in the Murabaha to the purchase orderer as obligatory.
- Istisna receivables is a sale agreement between the Bank as the seller and the customer as the ultimate purchaser whereby the Bank undertakes to have manufactured (or acquire) goods and sell it to the customer for an agreed upon price on completion at future date. Istisna receivables are stated net of deferred profits and provision for impairment.
- Ijara income receivables represent outstanding rentals at the end of the year less any provision for doubtful amount.

#### 3.3 Ijara Muntahia Bittamleek and Ijara income receivables

Assets acquired for leasing (Ijara) are stated at cost, less accumulated depreciation. Leased assets are depreciated over the life of the lease in a systematic manner.

#### 3.4 Wakala Bil Istethmar

Wakala Bil Istithmar is used as a short to medium and long term working capital financing tool. The Bank, in its capacity as the Principal (hereinafter referred to as the "Muwakkil") appoints the Client as its Agent (hereinafter referred to as the "Wakil") to manage the investment amount (hereinafter referred to as the "Investment Amount") in Sharia-compliant activities that may be entered into, as agreed, by the Wakil on behalf of the Muwakkil. The prime objective of making such an investment is to generate profit from the business activities and get the Investment Amount paid back along with the profit amount, if any, on the investment maturity date based on the anticipated profit rate Investments.

#### 3.5 Musharaka financing

Diminishing Musharaka is a contract, based on Shirkat-ul-Mulk, between the Bank and a customer for joint ownership of a fixed asset (e.g. house, land, plant or machinery). The Bank divides its share in the fixed asset into units and gradually transfers the ownership of these units to a customer (at carrying value). It is a contract in which the Bank contributes capital. These are stated at the fair value of consideration given less impairment.

#### 3.6 Investments

##### Investment in Ijarah asset

##### Operating Ijarah of the Bank as lessee:

Ijarah instalments are allocated over the financial periods of the lease term and recognised in the financial period in which these instalments are due. Ijarah instalments are presented in the lessee's statement of income as Ijarah expenses. Initial direct cost incurred by lessee for arranging for the lease agreement is, if material, allocated to periods in the lease term in a pattern consistent with that used for allocating Ijarah expenses. If immaterial they are charged directly as an expense to the financial period in which the lease agreement is made.

##### Operating Ijarah of the Bank as lessor:

When the Bank rents out to a client asset that was previously rented by the Bank; the leased asset is presented in the lessor's statement of financial position under Investment in Ijarah assets.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 3 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 3.6 Investments (continued)

##### **Equity and debt type instruments at fair value through equity**

This includes all equity and debt type instruments that are not fair valued through statement of income. Subsequent to acquisition, investments designated at fair value through equity are re-measured at fair value with unrealised gains or losses recognised proportionately in owners' equity and equity of unrestricted investment accountholders until the investment is derecognised or determined to be impaired at which time the cumulative gain or loss previously recorded in owners' equity or equity of investment accountholders is recognised in statement of income.

##### **Debt type instruments at amortised cost**

Debt type instruments which are managed on a contractual yield basis and are not held for trading and have been designated at fair value through statement of income are classified as debt type instrument at amortised cost, such investment are carried at amortised cost less provisions for impairment in value. Amortisation cost is calculated by taking into account any premium or discount on acquisition. Any gain or loss on such investment is recognised in statement of income when the investment is derecognised or impaired.

##### **Investment in real estate**

Investment in real estate is classified as held-for-use and is measured at fair value under the fair value model of Financial Accounting Standard No. 26 issued by AAOIFI. These are initially recognised at cost including transaction cost and subsequently measured at fair value. Unrealised gains arising from a change in the fair value of investment in real estate are recognised directly in equity under "Property fair value reserve" for the period in which it arises taking into consideration the split between the portions related to owners' equity and equity of investment accountholders. Unrealised losses resulting from re-measurement at fair value of investment in real estate carried at fair value are adjusted in equity against the property fair value reserve, taking into consideration the split between the portion related to owners' equity and equity of investment accountholders, to the extent of the available credit balance of this reserve. In case such losses exceed the available balance, the unrealised losses are recognised in the statement of income. In case there are unrealised losses relating to investment in real estate that have been recognised in the statement of income in a previous financial period, the unrealised gains relating to the current financial period are recognised to the extent of crediting back such previous losses in the statement of income.

The realised profits or losses resulting from the sale of any investment in real estate are measured as the difference between the book value (or carrying amount) and the net cash or cash equivalent proceeds from the sale for each investment separately. The resulting profit or loss together with the available balance on the property fair value reserve account are recognised in the statement of income for the current financial period, taking into consideration the split between the portion related to owners' equity and the portion related to investment accountholders.

#### 3.7 Derecognition of financial assets and liabilities

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

- the right to receive cash flows from the asset has expired;
- the Bank has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 3 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 3.8 Jointly and self-financed

Investments, financing and receivables that are jointly owned by the Bank and equity of unrestricted investment accountholders are classified under the caption "jointly financed" in the financial statements. Investments, financing and receivables that are financed solely by the Bank are classified under "self-financed".

#### 3.9 Fair value for financial assets

For investments quoted in an active market, fair value is determined by reference to quoted market prices. For financial instruments where there is no active market, fair value is normally based on comparison with the current market value of highly similar financial instruments.

Where the fair value of an investment cannot be reliably measured, it is stated at the fair value of consideration given or amortised cost and any impairment in the value are recorded in statement of income.

For Sales (Murabaha) receivables the fair value is determined at the end of the financial period at their cash equivalent value.

#### 3.10 Fair value for non-financial assets

Market prices represent the fair value for non-financial assets. In case market prices are not available, they are assessed by taking average value of three assessments from experienced and certified parties.

#### 3.11 Property and equipment

Property and equipment are measured at cost less accumulated depreciation and accumulated impairment in value. Depreciation is calculated using the straight-line method to write down the cost of property and equipment to their residual values over their estimated useful lives from the date the assets is brought in to use as follows:

	Years
Furniture	5
Fixtures	10
Equipment	7
Motor vehicle	7
Computer hardware	5

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying values may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amounts, the assets are written down to their recoverable amount, and the impairment is recorded in the statement of income.

#### 3.12 Intangible assets

Intangible assets are classified according to their useful life for a specified or unspecified period of time. Intangible assets with definite useful life are amortised over 10 years (2016: 10 years), and amortisation is recorded in statement of income. For intangible assets with indefinite useful life, impairment in value is reviewed at the reporting date and any impairment in their value is recorded in statement of income.

Any indications of impairment of intangible assets are reviewed at the reporting date; in addition, the useful lives of these assets are reviewed annually. If expected useful lives vary from the estimated ones the change in estimate is adjusted prospectively.

#### 3.13 Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and able to be measured reliably.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 3 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 3.13 Provisions (continued)

According to the regulations of the CBO; Banks are required to record general credit loss provisions as set below:

- 1% of performing corporate financing
- 2% of performing personal financing, 1% home financing
- 0.5% of inter-bank and SMEs

CBO regulations are followed for non-performing assets based on days past due and any profit accrual on these non-performing assets is suspended as per the regulations.

#### 3.14 Equity of unrestricted investment accountholders

Equity of unrestricted investment accountholders are recognised when received by the Bank and measured by the amount received during the time of contracting. At the end of the financial period the equity investment accountholders are measured at the book value.

#### 3.15 Profit equalisation reserve

Profit equalisation reserve, this is the amount appropriated by the Bank out of Mudaraba income before allocating the Bank's share as investment manager (Mudarib), in order to maintain a certain level of return on investment for unrestricted investment accountholders and increase owners' equity.

#### 3.16 Investment risk reserve

Investment risk reserve is the amount appropriated by the Bank out of profit share of the unrestricted investment accountholders after allocating the Mudarib share, in order to cushion the effects of the risk of future investment losses.

The terms and conditions whereby investment risk reserve can be set aside and utilised are determined and approved by the Sharia Supervisory Board of the Bank.

#### 3.17 Foreign currencies

Transactions in foreign currencies are recorded at the exchange rate on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into Omani Riyal at the mid-rate of exchange at the reporting date. All differences are taken into the statement of income.

Translation gains or losses on non-monetary items carried at fair value are included in equity as part of the fair value adjustment.

#### 3.18 Offsetting

Financial assets and financial liabilities are only offset and the net amount is reported when there is a Sharia or legally enforceable right to set off the recognized amounts and the Bank intends to either settle on a net basis, or to realize the asset and settle the liability simultaneously.

#### 3.19 Revenue recognition

##### Sales receivables and other receivables

Murabaha profit from sales transactions is recognised when the income is both contractually determinable and quantifiable at the commencement of the transaction. Such income is recognised on a time-apportioned basis over the period of the transaction. Where the income from a contract is not contractually determinable or quantifiable, it is recognised when the realisation is reasonably certain or when actually realised.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 3 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 3.19 Revenue recognition (continued)

Istisna profit from Istisna is recognised using proportionate allocation over the future financial period of credit whereby each financial period shall carry its portion of profits irrespective of whether or not cash received.

**Ijara Muntahia Bittamleek** Ijara income is recognised on a time apportioned basis over the Ijara term.

##### **Wakala Bil Istethmar**

Income from Wakala Bil Istethmar is recognised on a time apportioned basis so as to yield a constant periodic rate of return based on the balance outstanding.

##### **Investment in Ijarah asset**

Ijarah revenue is allocated proportionately to the financial periods in the lease term. Ijarah revenue is presented in the lessor's statement of income as Ijarah revenue. Initial direct cost incurred by lessee for arranging for the lease agreement is, if material, be allocated to periods in the lease term in a pattern consistent with that used for allocating Ijarah expenses. If immaterial they are charged directly as an expense to the financial period in which the lease agreement is made. Ijarah receivables are measured at their cash equivalent value.

##### **Musharaka**

Profit is shared as per the agreement set between both parties while the loss is shared in proportion to their shares of capital or the enterprise.

##### **Bank's share as Mudarib of income from equity of unrestricted investment accountholders**

The Bank's share as a Mudarib for managing equity of unrestricted investment accountholders is accrued based on the terms and conditions of the related Mudarib agreements.

##### **Fee and commission**

Fees and commission income is recognised upon rendering the services.

##### **Dividends**

Dividends are recognised when the right to receive payment is established.

##### **Income from investments**

Income from investments is recognised when earned.

##### **Rental income from investment in real estate**

Rental income is accounted for on a straight line basis over the term of the lease.

#### 3.20 Return on equity of unrestricted investment accountholders

Investors' share of income is calculated based on income generated from joint investment accounts after deducting profit equalisation reserve, Bank's share as Mudarib, fund provider and investment risk reserve. The investors' share of income is distributed to the investors based on average participation balance in the Mudaraba pool.

#### 3.21 Employee benefits

Obligations for contributions to an unfunded defined benefit retirement plan, for Omani employees, in accordance with the Oman Social Insurance Scheme, are recognised as an expense in statement of income as incurred. The Bank's obligation in respect of non-Omani terminal benefits, under an unfunded defined benefits retirement plan, is the amount of future benefit that such employees have earned in return for their service in the current and prior periods.

#### 3.22 Directors' remuneration

Director's remuneration is calculated in accordance with the requirements of Commercial Companies Law of 1974, as amended and Capital Market Authority of the Sultanate of Oman.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 3 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 3.23 Segment reporting

An operating segment is the component of the Bank that engages in business activities from which it may earn revenues and incur expenses including revenue and expenses that relate to transactions with any of the Bank's other components whose operating results are reviewed regularly by the management to make decisions about the resources allocated to each segment and assesses its performance and for which discrete financial information is available. The Bank's primary format for reporting segmental information is business segment, based upon management internal reporting structure. The Bank's main business segments are comprised of retail, corporate and treasury and investment banking.

#### 3.24 Taxation

Taxation is provided for based on the tax laws of Sultanate of Oman. Income tax comprises current and deferred tax. Income tax expense is recognised in statement of income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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 adjustment to tax payable in respect of previous years.

Deferred tax is calculated using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary difference when they reverse, based on the laws that have been enacted or substantively enacted at the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

#### 3.25 Earnings prohibited by Sharia

The Bank is committed to avoid recognising any income generated from Sharia non-compliant sources. Accordingly, all Sharia non-complaint income is credited to a charity fund and the Bank disburses these funds according to the Sharia Supervisory Board supervision and instructions.

#### 3.26 Zakah

Calculation and payment of Zakah is the responsibility of individual Shareholders' and accountholders.

#### 3.27 Sharia supervisory board

All business activities, products, transactions, agreements, contracts and other relevant documents are subject to the supervision of the Sharia Supervisory Board of the Bank which meets quarterly and consists of three prominent Sharia scholars appointed by the General Assembly of Shareholders.

- Dr. Abdul-Sattar Abu Ghuddah Chairman
- Sheikh Dr. Mohammed Al-Gharbi Member
- Sheikh Ibrahim Al-Sawwafi Member

#### 3.28 Trade date accounting

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

#### 3.29 Dividend on ordinary shares

Dividend on ordinary shares is recognised as liability and deducted from equity in the period when it is approved by the Bank's shareholders. Interim dividend is deducted from equity when they are paid.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 3 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 3.19 Revenue recognition (continued)

#### 3.30 Dividend on ordinary shares

Dividend on ordinary shares is recognised as liability and deducted from equity in the period when it is approved by the Bank's shareholders. Interim dividend is deducted from equity when they are paid.

#### 3.31 Earnings per share (EPS)

The Bank presents basic and diluted earnings per share data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to owners of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to owners and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares.

#### 3.32 New standards, amendments and interpretations

There are no new standards issued by AAOIFI during the year which may impact the financial statements of the Bank.

##### Standard issued but not yet effective

##### FAS 30 Impairment, Credit losses and onerous commitments

In November 2017, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) issued Financial Accounting Standard (FAS) 30 - Impairment, credit losses and onerous commitments, the standard supersedes the earlier FAS 11 "Provisions and Reserves" effective from the financial periods beginning on or after 1 January 2020, with early adoption permitted.

However, during the year, the CBO has issued a circular BM 1149 dated 13 April 2017 governing implementation of IFRS 9 Financial Instruments (IFRS 9) for all the banks, which also apply to Islamic banks/windows subject to any specific instructions by the Central Bank for Islamic Banking entities on IFRS 9 if, as and when instructions are issued.

In accordance with the requirement of the CBO, the Bank will implement IFRS 9 Financial instruments with effect from 1 January 2018. The further details and impact analysis is stated below:

The Bank will adopt IFRS 9 on 1 January 2018 and will not restate the comparative information in accordance with relevant requirements of IFRS 9. 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 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 Bank has assessed the estimated impact of the initial application of IFRS 9 and its initial estimate is expected to positively impact total owner's equity by (20) – (15) % as of 1 January 2018.

The above assessment is preliminary because not all transition work has been finalised. The actual impact of adopting IFRS 9 on 1 January 2018 may change because:

- IFRS 9 will require the Bank to revise its accounting processes and internal controls and these changes are not yet complete;
- Although parallel runs were carried out in the second half of 2017, the associated controls in place have not been operational for a more extended period;
- The Bank is refining and finalizing its models for ECL calculations; and
- The new accounting policies, assumptions, judgements and estimation techniques employed are subject to re-assessment and changes upon instructions of the regulatory authority.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 3 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 3.32 New standards, amendments and interpretations (continued)

##### (i) Classification and measurement

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: (a) measured at Amortised Cost (AC), Fair Value through Other Comprehensive Income (FVOCI) and 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.

Based on the Bank's assessment, the new IFRS 9 classification requirements is expected to have a material impact on its investments in equity securities as follows:

At 31 December 2017, the Bank had equity investments classified as available-for-sale with a fair value of RO 262 thousands that are held for long-term strategic purposes. Under IFRS 9, the Bank has designated these investments as measured at FVOCI. Due to this reclassification, an increase of RO 70 K is estimated in the retained earnings along with a corresponding increase in fair value reserve due to reclassification of impairment on equity investments measured at fair value through other comprehensive income to the reserves.

##### (ii) Expected credit losses

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 or 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;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Establishing groups of similar financial assets for the purposes of measuring ECL.

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

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

##### (iii) Financial liabilities

Most of the requirements in IAS 39 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.

##### (iv) Hedge accounting

Hedge accounting requirements of IFRS 9 are designed to align the accounting more closely to the 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

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 3 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 3.32 New standards, amendments and interpretations (continued)

As IFRS 9 does not change the general principles of how an entity accounts for effective hedges, the Bank does not expect a significant impact as a result of applying IFRS 9.

(v) Disclosure

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

#### 4 Cash and balances with Central Bank of Oman

	2017	2016
	RO	RO
Cash in hand	5,267,318	4,783,329
Balances with Central Bank of Oman	37,046,649	11,470,234
Capital deposit with Central Bank of Oman	500,001	346,095
	<u>42,813,968</u>	<u>16,599,658</u>

4.1 The capital deposit with the Central Bank of Oman cannot be withdrawn without the prior approval of the Central Bank of Oman.

4.2 During the year, average minimum balance to be kept with Central Bank of Oman as statutory reserves is RO 15.978 million (2016: RO 10.532 million).

#### 5 Due from banks and financial institutions

	2017	2016
	RO	RO
Local banks – local currency	610,220	495,362
Foreign banks – foreign currency	2,854,275	4,424,211
	<u>3,464,495</u>	<u>4,919,573</u>

#### 6 Inter-bank Wakala investments

	2017	2016
	RO	RO
Local banks – local currency	15,000,000	34,000,065
Foreign banks – foreign currency – less than one year	1,397,550	7,397,840
	<u>16,397,550</u>	<u>41,397,905</u>

## NOTES TO THE FINANCIAL STATEMENTS

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### 7 Sales receivables and other receivables - net

	Jointly-financed 2017	Self-financed 2017	Total 2017
	RO	RO	RO
Sales receivables (Murabaha)- retail	96,932,261	1,961,567	98,893,828
Sales receivables (Murabaha)- corporate	80,533,398	-	80,533,398
Istisna receivables - corporate	5,603,116	-	5,603,116
Ijara rent receivables - retail	2,097,522	-	2,097,522
Ijara rent receivables - corporate	1,299,272	-	1,299,272
Credit card receivables - Ijarah service (Ujrah)	926,001	-	926,001
<b>Gross sales receivables and other receivables</b>	<b>187,391,570</b>	<b>1,961,567</b>	<b>189,353,137</b>
Less:			
Deferred profit	(25,168,312)	(206,751)	(25,375,063)
General provision	(2,404,317)	(35,096)	(2,439,413)
Specific provision	(98,927)	(27,670)	(126,597)
Reserved profit	(12,929)	(807)	(13,736)
<b>Net sales receivables and other receivables</b>	<b>159,707,085</b>	<b>1,691,243</b>	<b>161,398,328</b>

	Jointly-financed 2016	Self-financed 2016	Total 2016
	RO	RO	RO
Sales receivables (Murabaha)- retail	90,115,840	1,929,908	92,045,748
Sales receivables (Murabaha)- corporate	23,195,099	-	23,195,099
Istisna receivables - corporate	3,496,460	-	3,496,460
Ijara rent receivables - retail	2,693	-	2,693
Ijara rent receivables - corporate	155,224	-	155,224
Credit card receivables - Ijarah service (Ujrah)	236,762	-	236,762
Gross sales receivables and other receivables	117,202,078	1,929,908	119,131,986
Less:			
Deferred profit	(16,970,169)	(203,797)	(17,173,966)
General provision	(1,772,395)	(22,055)	(1,794,450)
Specific provision	(51,652)	-	(51,652)
Reserved profit	(8,197)	(388)	(8,585)
<b>Net sales receivables and other receivables</b>	<b>98,399,665</b>	<b>1,703,668</b>	<b>100,103,333</b>

The general provision movement against sales receivables and other receivables is as follow:

	2017	2016
	RO	RO
Balance at 1 January	1,794,450	1,435,943
General provision during the year (note 14)	644,963	358,507
Balance at 31 December	<b>2,439,413</b>	<b>1,794,450</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 7 Sales receivables and other receivables - net (continued)

The specific provision movement against sales receivables and other receivables is as follow:

	2017	2016
	RO	RO
Balance at 1 January	51,652	32,632
Specific provision during the year (note 14)	74,945	19,020
Balance at 31 December	126,597	51,652

The reserved profit movement against sales receivables other receivables is as follow:

	2017	2016
	RO	RO
Balance at 1 January	8,585	2,055
Profit reserved during the year	5,151	6,530
Balance at 31 December	13,736	8,585

Non-performing assets of sales receivables and other receivables, amounted to RO 347,389 representing 0.22% of sales receivables and other receivables-net, as of 31 December 2017 (31 December 2016: 0.13%).

### 8 Financial assets at fair value through equity – Jointly financed

	Cost	Fair value
	2017	2017
	RO	RO
International un-listed Sukuk	4,908,750	4,908,766
International listed Sukuk	713,196	704,858
Regional listed Sukuk	6,420,938	6,362,504
Regional un-listed funds	5,054,035	5,134,912
Regional un-listed shares	334,100	334,100
Local listed Sukuk	23,252,015	23,254,734
Local listed shares	56,378	93,024
Impairment loss provision regional un-listed shares	(71,761)	(71,761)
<b>Total</b>	<b>40,667,651</b>	<b>40,721,137</b>

	Cost	Fair value
	2016	2016
	RO	RO
International un-listed Sukuk	1,912,663	1,959,573
International listed Sukuk	1,536,915	1,536,379
Regional listed Sukuk	2,165,860	2,105,013
Regional un-listed funds	5,053,564	5,276,734
Regional un-listed shares	334,035	268,385
Local listed Sukuk	7,363,600	7,363,600
Local Un-listed Sukuk	3,750,000	3,750,000
Local listed shares	58,378	99,826
<b>Total</b>	<b>22,175,015</b>	<b>22,359,510</b>

### 9 Financial assets at amortised cost

	Self-financed	
	2017	2016
	RO	RO
Local listed Sukuk	7,000,000	7,000,000

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 10 Musharaka financing - net

	Jointly-financed	
	2017	2016
	RO	RO
Musharaka financing	25,986,532	807,517
General provision (note 14)	(259,866)	(8,076)
Net investment in Musharaka financing	<u>25,726,666</u>	<u>799,441</u>

The general provision movement against Musharaka as follow:

	Jointly-financed	
	2017	2016
	RO	RO
Balance at 1 January	8,076	-
Provision during the year (note 14)	251,790	8,076
Balance at 31 December	<u>259,866</u>	<u>8,076</u>

### 11 Investment in real estate

This represents investment in income generating industrial real estate; where 70% of the beneficial ownership is held by the Bank for a consideration of RO 14.175 million. Subsequently, the property has been leased under a master lease agreement for a period of ten years with a fixed rental amount.

Investment in real estate has been financed from Shareholders' funds and classified as self-finance investment and not included in the Mudaraba pool 'commingled pool'. All profits generated and costs in relation to the investment will be for the account of the Bank only and not subject to income distribution for the unrestricted investment accountholders.

The Bank follows sales comparison and investment approach based valuation methodology and believes that the fair value of investment in real estate is not materially different from its carrying value as at 31 December 2017. Further, the Bank has a plan for disinvestment by end of December 2018.

### 12 Ijara Muntahia Bittamleek - net

	2017		
	Jointly-financed	Self-financed	Total
	RO	RO	RO
<b>Real estate</b>			
Cost	282,151,238	11,396,978	293,548,216
Accumulated depreciation	(22,895,312)	(856,981)	(23,752,293)
Net book value	<u>259,255,926</u>	<u>10,539,997</u>	<u>269,795,923</u>
<b>Equipment</b>			
Cost	26,424,806	-	26,424,806
Accumulated depreciation	(10,589,859)	-	(10,589,859)
Net book value	<u>15,834,947</u>	<u>-</u>	<u>15,834,947</u>
<b>Total cost</b>	<b>308,576,044</b>	<b>11,396,978</b>	<b>319,973,022</b>
<b>Accumulated depreciation</b>	<b>(33,485,171)</b>	<b>(856,981)</b>	<b>(34,342,152)</b>
<b>Net book value before general provision</b>	<b>275,090,873</b>	<b>10,539,997</b>	<b>285,630,870</b>
<b>General provision</b>	<b>(3,415,909)</b>	<b>(105,400)</b>	<b>(3,521,309)</b>
<b>Net book value after general provision</b>	<b>271,674,964</b>	<b>10,434,597</b>	<b>282,109,561</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 12 Ijara Muntahia Bittamleek - net (continued)

	2016		Total RO
	Jointly-financed	Self-financed	
	RO	RO	
Real estate			
Cost	224,079,806	8,975,680	233,055,486
Accumulated depreciation	(13,453,312)	(522,977)	(13,976,289)
Net book value	<u>210,626,494</u>	<u>8,452,703</u>	<u>219,079,197</u>
Equipment			
Cost	23,687,126	-	23,687,126
Accumulated depreciation	(5,858,133)	-	(5,858,133)
Net book value	<u>17,828,993</u>	<u>-</u>	<u>17,828,993</u>
Total cost	247,766,932	8,975,680	256,742,612
Accumulated depreciation	(19,311,445)	(522,977)	(19,834,422)
Net book value before general provision	<u>228,455,487</u>	<u>8,452,703</u>	<u>236,908,190</u>
General provision	(2,769,898)	(84,527)	(2,854,425)
Net book value after general provision	<u>225,685,589</u>	<u>8,368,176</u>	<u>234,053,765</u>

The general provision movement against Ijara Muntahia Bittamleek is as follow:

	2017	2016
	RO	RO
Balance at 1 January	2,854,425	2,079,135
Provision during the year (note 14)	666,884	775,290
Balance at 31 December	<u>3,521,309</u>	<u>2,854,425</u>

### 13 Wakala Bil Istethmar - net

	2017	2016
	RO	RO
Wakala Bil Istethmar	92,233,136	63,485,673
General provision (note 14)	(922,331)	(634,856)
Wakala Bil Istethmar - net	<u>91,310,805</u>	<u>62,850,817</u>

The general provision movement against Wakala Bil Istethmar as follow:

	2017	2016
	RO	RO
Balance at 1 January	634,856	380,278
Provision during the year (note 14)	287,475	254,578
Balance at 31 December	<u>922,331</u>	<u>634,856</u>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 14 General provision and specific provision movement

	2017	2016
	RO	RO
Balance at 1 January	5,343,459	3,927,988
General provision made during the year on sales and other receivables (note 7)	644,963	358,507
General provision made during the year on Ijara Muntahia Bittamleek (note 12)	666,884	775,290
General provision made during the year on Wakala Bil Istethmar (note 13)	287,475	254,578
General provision made during the year on Musharaka financing (note 10)	251,790	8,076
Specific provision made during the year on sales and other receivables (note 7)	74,945	19,020
General and specific provision expense	1,926,057	1,415,471
Balance at 31 December	7,269,516	5,343,459

### 15 Property and equipment - net

2017	Furniture & fixture	Equipment	Motor vehicle	Computer hardware	Capital work in progress	Total
	RO	RO	RO	RO	RO	RO
Balance at 1 January	4,268,624	870,987	167,590	1,858,041	12,792	7,178,034
Additions	72,559	54,672	-	88,345	-	215,576
Transfers	-	12,792	-	-	(12,792)	-
Disposal	-	(375)	(36,500)	(470)	-	(37,345)
Balance at 31 December	4,341,183	938,076	131,090	1,945,916	-	7,356,265
Accumulated depreciation at 1 January	(2,438,208)	(362,626)	(68,361)	(1,203,516)	-	(4,072,711)
Depreciation expense	(370,912)	(134,261)	(22,843)	(355,363)	-	(883,379)
Disposal	-	70	27,820	41	-	27,931
Accumulated depreciation at 31 December	(2,809,120)	(496,817)	(63,384)	(1,558,838)	-	(4,928,159)
Carrying value at 31 December	1,532,063	441,259	67,706	387,078	-	2,428,106

2016	Furniture & fixture	Equipment	Motor vehicle	Computer hardware	Capital work in progress	Total
	RO	RO	RO	RO	RO	RO
Balance at 1 January	4,246,621	818,816	162,101	1,677,824	223,114	7,128,476
Additions	20,936	24,818	5,489	69,471	-	120,714
Transfers	1,067	27,353	-	110,746	(210,322)	(71,156)
Balance at 31 December	4,268,624	870,987	167,590	1,858,041	12,792	7,178,034
Accumulated Depreciation at 1 January	(2,055,275)	(236,358)	(43,448)	(854,895)	-	(3,189,976)
Depreciation expense	(382,933)	(126,268)	(24,913)	(348,621)	-	(882,735)
Accumulated Depreciation at 31 December	(2,438,208)	(362,626)	(68,361)	(1,203,516)	-	(4,072,711)
Carrying value at 31 December	1,830,416	508,361	99,229	654,525	12,792	3,105,323

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 16 Intangible assets

	Software	Capital work in progress	Total
2017	RO	RO	RO
Carrying value at 1 January	1,827,211	294,119	2,121,330
Additions	104,446	250,426	354,872
Transfers	149,399	(149,399)	-
Amortisation	(272,750)	-	(272,750)
Carrying value at 31 December	<u>1,808,306</u>	<u>395,146</u>	<u>2,203,452</u>

	Software	Capital work in progress	Total
2016	RO	RO	RO
Carrying value at 1 January	1,649,914	206,903	1,856,817
Additions	158,145	437,264	595,409
Transfers	338,942	(350,048)	(11,106)
Written off	(112,928)	-	(112,928)
Amortisation	(206,862)	-	(206,862)
Carrying value at 31 December	<u>1,827,211</u>	<u>294,119</u>	<u>2,121,330</u>

### 17 Other assets

	2017	2016
	RO	RO
Deferred tax asset (note 35.3)	2,677,703	2,937,242
Profit receivable	3,560,366	2,243,460
Advance payment	99,824	862,280
Prepaid expense	386,614	279,003
Refundable deposits	83,388	83,388
Inventory	49,335	42,502
Others	31,673	61,847
	<u>6,888,903</u>	<u>6,509,722</u>

### 18 Inter-bank Wakala

Wakala	2017	2016
	RO	RO
Local banks – foreign currency	11,550,000	8,937,840
Foreign banks – foreign currency maturing > 1 year	-	13,475,000
Foreign banks – foreign currency maturing < 1 year	7,788,529	820,032
	<u>19,338,529</u>	<u>23,232,872</u>

### 19 Customers' Wakala

Under Wakala arrangement, Bank accepts funds from investors as Wakeel and invests in Sharia compliant assets. Wakeel is entitled to a fixed fee as a lump sum or percentage of fund provided. Expected profit payout is mentioned to investors upfront while any return generated in excess of expected profit is retained by the Bank as Wakeel. Wakeel should bear the loss in case of Wakeel's default, negligence or violation of any terms and conditions of the Wakala agreement, otherwise the loss would be borne by the investor or Muwakkil.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 20 Customers' accounts

	2017	2016
	RO	RO
Current accounts	67,702,458	68,940,499
Margin accounts	607,761	177,315
	<u>68,310,219</u>	<u>69,117,814</u>

### 21 Other liabilities

	2017	2016
	RO	RO
Payment orders	3,925,700	3,569,662
Creditors and accruals	11,755,939	7,976,235
Profit payable	4,532,723	1,669,044
Others	185,713	217,645
	<u>20,400,075</u>	<u>13,432,586</u>

### 22 Equity of unrestricted investment accountholders

	2017	2016
	RO	RO
Unrestricted investment accountholders	227,777,182	157,984,717
Investment fair value reserve	17,740	50,181
Profit equalisation reserve	-	779,239
Investment risk reserve	280,708	160,124
	<u>228,075,630</u>	<u>158,974,261</u>

Unrestricted investment accounts comprise Mudaraba deposits accepted by the Bank. The funds received from equity of unrestricted investment accountholders have been commingled and jointly invested by the Bank. The Bank has utilised full amount of profit equalisation reserve during the current year.

#### 22.1 Basis of distribution of profit between owners' equity and unrestricted investment accountholders

The investment profits have been distributed between owners' equity and unrestricted investment accountholders for the year 2017 and 2016 as follows:

	2017	2016
	Percentage	Percentage
Unrestricted investment accountholders share	50%	50%
Mudarib share	50%	50%

The investment risk reserve at 2 percent is deducted from customers' share after allocating the Mudarib share of profit as per the approved policy in order to cater against future losses of equity of unrestricted investment accountholders. Investment risk reserve will revert to the investment accountholders as per terms and conditions of Mudaraba contract.

The profit equalisation reserve is the amount the Bank appropriates in excess of the profit to be distributed to equity of unrestricted accountholders before allocating the Mudarib share of income to maintain a certain level of return. Profit equalisation reserve will revert to owner equity and unrestricted investment accountholders.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 22.1 Basis of distribution of profit between owners' equity and unrestricted investment accountholders (continued)

The percentages of the profit allocation between owners' equity and unrestricted investment accountholders are as follows:

Account type	Participation factor		2017 average rate of return	2016 average rate of return
	RO	USD	RO	RO
<b>2017</b>				
Saving account	20% - 40%	15%	1.40%	0.74%
One month tenure	46% - 50%	23%-25%	1.35%	1.39%
Three months tenure	51% - 55%	25.5% - 27.5%	1.53%	1.55%
Six months tenure	61% - 68%	30.5% - 34%	1.89%	1.90%
Nine months tenure	66% - 73%	33% - 36.5%	2.05%	2.07%
One year tenure	71% - 78%	35.5% - 39%	2.42%	2.45%
One year and a half tenure	78.5% - 85%	-	3.21%	3.28%
Two years tenure	79.5% - 87%	-	3.79%	3.79%

Unrestricted investment accountholders are commingled with Bank funds for investment, no priority is granted to any party for the purpose of investments and distribution of profits. The administration expenses are only charged on the Bank expenses.

#### a. Equity of unrestricted investment accountholders details

Account type	2017	2016
	RO	RO
<b>Saving account</b>	<b>137,475,222</b>	<b>82,915,579</b>
<b>Investment accounts:</b>		
One month	15,000	93,000
Three months	649,418	783,007
Six months	2,178,665	1,453,674
Nine months	181,100	92,000
One year	18,277,655	15,263,134
One year and a half	2,092,223	1,122,223
Two years	66,546,681	56,262,100
Three years	37,486	-
Four years	13,039	-
Five years	59,543	-
More than five years	251,150	-
	<b>227,777,182</b>	<b>157,984,717</b>

### 23 Paid-up capital

The authorised share capital of the Bank is OMR 300,000,000 and the issued and paid up capital is OMR 150,000,000, divided into 1,500,000,000 shares of a nominal value of OMR 0.100 each.

At 31 December 2017, no shareholders' of the Bank owned 10% or more of the Bank's paid up capital.

### 24 Share premium

This represent share premium of RO 2,091,192 on issue of the shares of the Bank through IPO. Expenses incurred on issuance were netted off.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 25 Reserves

#### 25.1 Investment fair value reserve

The fair value reserve includes the cumulative net change in fair value of the investment at fair value through equity.

#### 25.2 Legal reserve

	2017	2016
	RO	RO
1 January	10,972	-
Appropriation for the year	378,650	10,972
31 December	389,622	10,972

accordance with the Commercial Company Law of 1974, as amended annual appropriation of 10% of the profit for the year is required to be made to legal reserve until such time that accumulated reserve equals to one third of the Bank paid up capital. This reserve is not available for distribution.

#### 25.3 Special reserve

In accordance of Central bank of Oman circular BSD/2017/BKUP/Banks and FLCs/467 dated 20 June 2017 in which banks are required to create Special Reserve of 10% for all restructured financing. The amount is computed as an appropriation from net profit and is not eligible to be considered for the purpose regulatory capital and dividend distribution.

### 26 Contingent liabilities and commitments

#### a) Contingent liabilities

	2017	2016
	RO	RO
Letters of guarantee	53,881,017	33,556,090
Letters of credit	20,071,723	9,696,018
Acceptances	7,328,535	12,513,402
Bills for collection	104,113	-
<b>Total contingent liabilities (a)</b>	<b>81,385,388</b>	<b>55,765,510</b>

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

	2017	2016
	RO	RO
Construction	31,494,686	17,168,304
Manufacturing	17,219,733	17,076,156
Service	3,830,941	3,606,942
Others	28,840,028	17,914,108
<b>Total contingent liabilities (a)</b>	<b>81,385,388</b>	<b>55,765,510</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 26 Contingent liabilities and commitments (continued) b) Commitments

	2017		2016	
	RO		RO	
Unutilised limits		144,059,426		105,411,154
<b>Total commitments (b)</b>		<b>144,059,426</b>		<b>105,411,154</b>
<b>Total contingent liabilities and commitments (a+b)</b>		<b>225,444,814</b>		<b>161,176,664</b>

### 27 Sales receivables and other receivables revenue

	Jointly-financed	
	2017	2016
	RO	RO
Retail	4,549,407	3,998,019
Corporate	2,877,491	770,306
	<b>7,426,898</b>	<b>4,768,325</b>

### 28 Ijara Muntahia Bittamleek revenue and Ijara assets revenue

	Jointly-financed	
	2017	2016
	RO	RO
Ijara Muntahia Bittamleek – real estate	29,625,508	27,933,429
Ijara Muntahia Bittamleek – equipment	5,580,627	4,660,358
Depreciation on Ijara Muntahia Bittamleek assets	(21,948,316)	(23,166,639)
	<b>13,257,819</b>	<b>9,427,148</b>

### 29 Profit from inter-bank Wakala investments

	Jointly-financed	
	2017	2016
	RO	RO
Inter-bank Wakala local	29,115	18,466
Inter-bank Wakala foreign	12,790	16,050
	<b>41,905</b>	<b>34,516</b>

### 30 Profit from financial assets at fair value through equity

	Jointly-financed	
	2017	2016
	RO	RO
Profit on sukuk	1,214,786	116,464
Profit on funds investment	320,672	-
Gains on sale of sukuk	95,340	751,011
Gain on sale of shares	1,383	219,765
Impairment loss provision on FVTE	(71,761)	-
	<b>1,560,420</b>	<b>1,087,240</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 31 Return on unrestricted investment accountholders before the Bank's share as a Mudarib

	2017	2016
	RO	RO
Saving accounts	3,915,592	1,384,870
Investment accounts	5,566,761	840,269
Investment risk reserve	120,584	118,818
Profit equalisation reserve	(779,239)	51,354
	<u>8,823,698</u>	<u>2,395,311</u>

### 32 Bank's income from its own investments and financing

	2017	2016
	RO	RO
Rental income from investment in real estate	1,134,000	1,134,000
Profit from financial assets at amortised cost	355,832	354,861
Sales receivables revenue	59,247	51,774
Ijara Muntahia Bittamleek revenue - net of depreciation	253,670	203,160
Gain from selling fixed assets	3,711	-
	<u>1,806,460</u>	<u>1,743,795</u>

### 33 Revenue from banking services

	2017	2016
	RO	RO
Commissions income	763,231	568,594
Processing fees	1,912,849	767,907
Service charges	826,104	585,435
	<u>3,502,184</u>	<u>1,921,936</u>

### 34 Operating expenses

	2017	2016
	RO	RO
Staff cost	10,291,130	9,576,856
Rent expense	889,129	873,658
Advertisement	601,058	656,167
Operational leasing	132,522	201,665
Maintenance expense	749,920	756,925
Security and cleaning	258,712	265,679
Professional and consulting charges	167,366	130,149
Boards expenses	123,673	126,948
Government fee	204,865	205,683
Printing and stationery	79,382	140,364
Telephone, electricity and water	469,949	481,935
Traveling expense	50,070	41,999
Subscription expense	124,529	111,465
Cards expense	724,051	687,878
Others	397,131	506,877
	<u>15,263,487</u>	<u>14,764,249</u>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 35 Income tax

#### 35.1 Recognised in the statement of income

	2017	2016
	RO	RO
Deferred income tax	259,539	-

The Bank is subject to income tax at the rate of 15% of taxable profits (2016 - 12%). The tax losses are available to carry forward for a period of 5 years and will be utilised against the future taxable profits.

#### 35.2 Reconciliation

The following is a reconciliation of income taxes calculated at the applicable tax rate with the income tax expense:

	31 December 2017	31 December 2016
	RO	RO
Profit (loss) as per financial statements	4,046,039	109,722
Tax asset at the rate mentioned above	606,906	13,167
Non-deductible expenses and other permanent differences	(8,428)	20,420
Deferred tax Recognized from previous years	(338,939)	(33,587)
Total	259,539	-

#### 35.3 Net deferred tax asset routed through statement of income are attributable to the following items:

Deferred tax asset are attributable to the following items:

	As at 1 Jan 2017	Recognized in income	Unrecognized in income	As at 31 Dec 2017
	RO	RO	RO	RO
Property, plant and equipment	(370,503)	(11,255)	-	(381,758)
General provision	221,303	(76,588)	-	144,715
Other provision	7,057	96,271	-	103,328
Losses carried forward	3,418,324	(606,906)	-	2,811,418
Deferred tax recognized from previous years	-	338,939	(338,939)	-
Net deferred tax asset	3,276,181	(259,539)	(338,939)	2,677,703

	As at 1 Jan 2016	Recognized in income	Unrecognized in income	As at 31 Dec 2016
	RO	RO	RO	RO
Property, plant and equipment	(263,285)	-	(107,218)	(370,503)
General provision	240,545	-	(19,242)	221,303
Other provision	5,990	-	1,067	7,057
Losses carried forward	3,326,518	-	91,806	3,418,324
Net deferred tax asset	3,309,768	-	(33,587)	3,276,181

Deferred tax asset and liabilities recognized as at the reporting date are in the amount of RO 2,677,703.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 36 Net assets per share

Net assets per share is calculated by dividing the net assets at the year-end by number of shares outstanding at the end of reporting period

	2017	2016
	RO	RO
Net assets (RO)	130,749,377	127,061,445
Number of shares outstanding	1,500,000,000	1,500,000,000
<b>Net assets per share</b>	<b>0.087</b>	<b>0.085</b>

### 37 Earnings per share- basic and diluted

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

	2017	2016
	RO	RO
Profit for the year (RO)	3,786,500	109,722
Weighted average number of shares outstanding during the year	1,500,000,000	1,500,000,000
<b>Earnings per share- basic and diluted (RO)</b>	<b>0.003</b>	<b>0.000</b>

Earnings per share- basic and diluted has been derived by dividing profit for the year attributable to the shareholders' by weighted average number of shares outstanding. As there are no dilutive potential shares, the diluted earnings per share is same as the basic earnings per share.

### 38 Segment reporting

For management purposes, the Bank is organised into three operating segments based on business units and are as follows:

**Retail banking** offers various products and facilities to individual customers to meet everyday banking needs.

**Corporate banking** delivers a variety of products and services to corporate and SMEs customers that includes financing, accepting deposits, trade finance and foreign exchange.

**Treasury and investment banking** provides a full range of treasury products and services including money market and foreign exchange to the clients in addition to managing liquidity and market risk, in addition to asset management corporate advisory and investment products high net worth individuals and institutional clients.

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

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 38 Segment reporting (continued)

Segment information is as follows:

	Retail banking	Corporate banking	Treasury & investment	Others	Total
31 December 2017	RO	RO	RO	RO	RO
Total revenue (joint)	14,155,802	12,197,829	1,602,386	-	27,956,017
Return on unrestricted investment accountholders	(1,090,069)	(3,106,951)	-	-	(4,197,020)
Profit paid on Wakala	(698,052)	(5,813,686)	(576,246)	-	(7,087,984)
Bank's share in income from investment as a Mudarib and Rabul Maal	12,367,681	3,277,192	1,026,140	-	16,671,013
Bank's income from its own investments and financing	316,628	-	1,489,832	-	1,806,460
Other operating income	889,262	2,613,008	411,969	-	3,914,239
Total revenue	13,573,571	5,890,200	2,927,941	-	22,391,712
Staff cost	6,827,280	1,861,510	1,602,340	-	10,291,130
Other operating expense	3,333,058	744,846	894,453	-	4,972,357
Depreciation and amortisation	850,429	181,228	124,472	-	1,156,129
General and specific provision	605,162	1,155,895	165,000	-	1,926,057
Total expense	11,615,929	3,943,479	2,786,265	-	18,345,673
Profit before tax	1,957,642	1,946,721	141,676	-	4,046,039
Income tax	-	-	-	(259,539)	(259,539)
Profit after tax	1,957,642	1,946,721	141,676	(259,539)	3,786,500
Total assets	296,927,626	263,617,734	124,572,150	11,520,461	696,637,971
Total liabilities and equity of unrestricted investment accountholders	201,643,602	324,506,389	19,338,529	20,400,075	565,888,595

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 38 Segment reporting (continued)

	Retail banking	Corporate banking	Treasury & investment	Others	Total
31 December 2016	RO	RO	RO	RO	RO
Total revenue (joint)	10,494,026	6,365,990	1,121,755	-	17,981,771
Return on unrestricted investment accountholders	(822,599)	(372,874)	-	-	(1,195,473)
Profit paid on Wakala	(357,227)	(2,371,391)	(555,611)	-	(3,284,229)
Bank's share in income from investment as a Mudarib and Rabul Maal	9,314,200	3,621,725	566,144	-	13,502,069
Bank's income from its own investments and financing	254,934	-	1,488,861	-	1,743,795
Other operating income	710,252	1,191,598	231,325	-	2,133,175
Total revenue	10,279,386	4,813,323	2,286,330	-	17,379,039
Staff cost	5,796,241	2,135,286	1,645,329	-	9,576,856
Other operating expense	3,280,805	1,041,525	865,063	-	5,187,393
Depreciation and amortisation	697,853	168,717	223,027	-	1,089,597
General provision	959,943	455,528	-	-	1,415,471
Total expense	10,734,842	3,801,056	2,733,419	-	17,269,317
Net (loss)/profit before tax	(455,456)	1,012,267	(447,089)	-	109,722
Income tax	-	-	-	-	-
Net (loss)/profit after tax	(455,456)	1,012,267	(447,089)	-	109,722
Total assets	247,971,712	149,835,644	106,451,646	11,736,375	515,995,377
Total liabilities and equity of unrestricted investment accountholders	318,419,114	33,849,361	23,232,872	13,432,585	388,933,932

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 39 Financial instruments

#### (a) Fair values of financial instruments

Fair value is an amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Consequently, differences can arise between carrying value and fair value estimates. As at the reporting date the fair values of the Bank's financial instruments are not significantly different from their carrying values.

#### (b) Fair values of financial instruments valuation hierarchy

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements. This fair value disclosure is divided into three levels as follows:

##### Level 1 portfolio

Level 1 assets and liabilities are typically exchange -traded positions and some government bonds traded in active markets. These positions are valued using unadjusted quoted prices in active markets.

##### Level 2 portfolio

Fair value is determined using valuation techniques based on valuation models with directly or indirectly market observable inputs. These valuation techniques include discounted cash flow analysis models, option pricing models, simulation models and other standard models commonly used by market participants. Valuation techniques incorporate assumptions that other market participants would use in their valuations, such as discount rates, default rates, credit spreads and option volatilities. These inputs need to be directly or indirectly observable in order to be classified as level 2.

##### Level 3 portfolio

Level 3 assets are valued using techniques similar to those outlined for level 2, except that if the instrument has one or more inputs that are unobservable and significant to the fair value measurement of the instrument in its entirety, it will be classified as level 3.

If the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The Bank recognizes transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

#### Transfer between Level 1 and 2

There were no transfers between level 1, level 2 and level 3 of the fair value hierarchy of investment securities during the year.

	Level 1	Level 2	Level 3	Total
	RO	RO	RO	RO
Financial assets at fair value through equity	35,323,886	5,397,251	-	40,721,137
Investment in real estate	-	-	14,175,000	14,175,000
<b>Total financial assets at 31 December 2017</b>	<b>35,323,886</b>	<b>5,397,251</b>	<b>14,175,000</b>	<b>54,896,137</b>

	Level 1	Level 2	Level 3	Total
	RO	RO	RO	RO
Financial assets at fair value through equity	16,814,391	5,545,119	-	22,359,510
Investment in real estate	-	-	14,175,000	14,175,000
<b>Total financial assets at 31 December 2016</b>	<b>16,814,391</b>	<b>5,545,119</b>	<b>14,175,000</b>	<b>36,534,510</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 40 Related party transactions

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

No specific provisions has been established in respect of the financing given to related parties

	Principal shareholders	Sharia'a Board	Senior management	Total
<b>31 December 2017</b>	RO	RO	RO	RO
Sales receivables & other receivables	311,095	15,731	90,085	416,911
Ijara Muntahia Bittamleek	1,598,966	80,977	552,635	2,232,578
Wakala Bil Istethmar	1,200,000	-	-	1,200,000
Customers' accounts	1,110,079	167	401,042	1,511,288
Unrestricted investment accountholders	9,303,444	10	237	9,303,691

	Principal shareholders	Sharia'a Board	Senior management	Total
<b>31 December 2016</b>	RO	RO	RO	RO
Sales receivables & other receivables	419,453	19,361	120,133	558,947
Ijara Muntahia Bittamleek	1,837,778	83,835	610,529	2,532,142
Customers' accounts	612,990	1,799	200,508	815,297
Unrestricted investment accountholders	3,354,000	13	-	3,354,013

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

	Principal shareholders	Sharia'a Board	Senior management	Total
<b>31 December 2017</b>	RO	RO	RO	RO
Profit account	66,543	4,895	18,941	90,379
Commission income	160	-	6	166
Operating expenses				
Staff expense	-	-	1,111,957	1,111,957
Other expenses	64,050	59,623	-	123,673

	Principal shareholders	Sharia'a Board	Senior management	Total
<b>31 December 2016</b>	RO	RO	RO	RO
Profit account	114,517	3,061	18,832	136,410
Commission income	209	-	1	210
Operating expenses				
Staff expense	-	-	1,112,459	1,112,459
Other expenses	72,350	54,598	-	126,948

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management

The Bank's activities expose it to a variety of financial risks. The management's aim is to achieve an appropriate balance between risk and return, and minimize potential adverse effects on its financial performance. The Bank's risk management program is designed to set out the overarching philosophy, principles, requirements and responsibilities for a sound approach to risk oversight, management and on-going internal control assurance required within the Bank. All risk management policies and systems are regularly reviewed to reflect changes in markets, products and emerging best practice. Risk management is carried out by the Bank under policies approved by the Board of Directors. Risk policies explain the Bank's underlying approach to risk management, roles and responsibilities of the key players in risk management process as well as outlines tools and techniques for management of risks. The principal risks associated with the banking business are: credit risk, market risk, liquidity risk and operational risk.

The high-level risk framework mainly addresses the following:

- The oversight of board and senior management
- Overall policy approach of the Bank to establish risk appetite/tolerance, procedures and limits
- Identification, measurement, mitigation, controlling and reporting of risks
- Risk MIS at the Bank wide level

The risk management processes have been effective throughout the year and members of Senior Management and Board of Directors have remained active and involved in maintaining risk profile of the Bank at acceptable level and adequate capital is held as per the regulatory requirements.

#### Credit risk

Credit risk is the risk that a customer or counterparty may not settle an obligation for full value, either when due or at any time thereafter. This risk arises from potential that a customer or counterparty's willingness to meet an obligation or its ability to meet such an obligation is impaired, resulting in an economic loss to the Bank. Credit risk management, administration and control are carried out by risk management teams, which report to the Board Governance, Risk and Compliance Committee. The Bank has well defined credit structures under which credit committees, comprising of senior officers with requisite banking background, critically scrutinize and sanction financing up to the delegated authority. The Bank's exposure to credit is managed on an individual counterparty basis, as well as by groups of counterparties that share similar attributes. To reduce the potential of risk concentration, counterparty limits, group exposure limits, and industry limits are monitored in light of changing counterparty and market conditions. All credit decisions are taken as per the Bank's credit risk policies and CBO regulations and are monitored accordingly. For purpose of capital charge, the Bank uses Basel II Standardized approach.

#### Types of credit risk

Credit risk arises mainly on sales receivables and other receivables, Ijara Muntahia Bittamleek, Wakala Bil Istethmar, Musharaka financing, due from banks, investment in Sukuk and securities, investments in real-estate and interbank wakala.

#### Sales receivable and other receivables

The Bank finances these transactions based on two structures:

- 1) Murabaha: In this structure, the Bank buys an asset which represents the object of the Murabaha and the Bank resells this asset to the customer (beneficiary) at a profit. The sale price (cost plus the profit margin) is repaid in instalments by the customer over the agreed period. The transactions are secured at all times by the object of the Murabaha (in case of real estate and auto finance) and other times by a total collateral package securing the facilities given to the client.
- 2) Istisna: This is a sale agreement between the Bank as the seller and the customer as the ultimate purchaser whereby the Bank undertakes to have manufactured (or acquire) goods and sell it to the customer for an agreed upon price on completion at future date. Istisna is stated net of deferred profits and provision for impairment.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued) Credit risk (continued)

#### Ijara Muntahia Bittamleek

This is a lease whereby the legal title of the leased asset passes to the lessee at the end of the Ijara (lease) term, provided that all Ijara Instalments are settled.

#### Wakala Investments

This is an investment in which the Bank, in its capacity as the “Muwakkil” (Principal) appoints the customer as “Wakeel” (Agent) to manage the invested fund amount in Sharia-compliant activities that may be entered into, as agreed, by the Wakeel on behalf of the Muwakkil. The investment amount is not guaranteed while the profit rate is anticipated and cannot be fixed. Therefore, the utmost care is taken before taking any exposure.

#### Musharaka financing

Musharaka means relationship established under a contract by a mutual consent of parties for profits and losses arising from a joint enterprise or venture. Investments come from all partners/shareholders and profits are distributed in the proportion mutually agreed in the contract. If one or more partners choose to become non-working or silent partners, the ratio of their profit cannot exceed the ratio which their capital investment bears to the total capital investment in Musharaka. Under the arrangement, both partners mutually agree to contribute capital for the Musharaka business activity and share any profit arising from the Asset or business activities according to a pre-agreed ratio, while loss is borne proportionate to their respective capital contribution. Capital from the Bank (finance amount) can either be disbursed as a lump-sum amount or staggered through progressive payments, as mutually agreed by both parties in the agreement. The Musharaka Asset is co-owned by the Bank and the client proportionate to their respective capital contribution. In such a transaction, the Bank takes a risk in the Musharaka Asset to an extent of its share / capital contribution in it. The Bank’s exposure (and hence the associated risk) continues to reduce over the life of the transaction, as the customer buys back units of the Bank’s ownership share in the Musharaka Asset.

In case of a loss, the Bank bears the loss equivalent to its share / capital contribution in the Musharaka Asset. However, this is applicable subject to the fact that the loss has not occurred due to the gross negligence or wilful misconduct of the customer, as the Musharaka Manager, in which case, the customer shall solely be responsible for the entire loss.

The analysis of credit portfolio is given below:

#### (a) Geographical concentrations

	Assets			Liabilities		
	Due from banks and Interbank Wakala investment	Gross financing	Investments in Sukuk and securities	Customer account, unrestricted IAH and customer Wakala	Interbank Wakala	Contingent liabilities and commitments
31 December 2017	RO	RO	RO	RO	RO	RO
Sultanate of Oman	15,610,219	591,310,758	30,347,758	525,851,542	11,550,000	214,478,975
Other GCC countries	2,707,746	1,892,917	11,759,755	-	7,700,000	2,772,990
Europe and North America	1,471,414	-	-	-	-	4,270,267
Africa and Asia	72,665	-	5,613,624	-	88,529	3,922,582
<b>Total</b>	<b>19,862,045</b>	<b>593,203,675</b>	<b>47,721,137</b>	<b>525,851,542</b>	<b>19,338,529</b>	<b>225,444,814</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued) Credit risk (continued)

#### (a) Geographical concentrations (continued)

	Assets			Liabilities		
	Due from banks and Interbank Wakala investment	Gross financing	Investments in Sukuk and securities	Customer account, unrestricted IAH and customer Wakala	Interbank Wakala	Contingent liabilities and commitments
31 December 2016	RO	RO	RO	RO	RO	RO
Sultanate of Oman	34,495,427	418,183,783	18,213,426	351,278,930	8,937,840	156,742,432
Other GCC countries	8,895,030	2,149,583	7,647,548	-	13,745,000	560,221
Europe and North America	2,872,324	-	1,342,854	-	-	2,786,916
Africa and Asia	54,697	-	2,155,682	-	550,032	1,087,095
<b>Total</b>	<b>46,317,478</b>	<b>420,333,366</b>	<b>29,359,510</b>	<b>351,278,930</b>	<b>23,232,872</b>	<b>161,176,664</b>

#### (b) Customer concentrations

	Assets			Liabilities		
	Due from banks and Interbank Wakala investment	Gross financing	Investments in Sukuk and securities	Customer account, unrestricted IAH and customer Wakala	Interbank Wakala	Contingent liabilities and commitments
2017	RO	RO	RO	RO	RO	RO
Personal	-	316,307,269	-	201,467,257	-	35,712
Corporate	19,862,045	276,896,406	22,680,255	40,855,418	19,338,529	206,409,102
Government	-	-	25,040,882	283,528,867	-	19,000,000
<b>Total</b>	<b>19,862,045</b>	<b>593,203,675</b>	<b>47,721,137</b>	<b>525,851,542</b>	<b>19,338,529</b>	<b>225,444,814</b>

	Assets			Liabilities		
	Due from banks and Interbank Wakala investment	Gross financing	Investments in Sukuk and securities	Customer account, unrestricted IAH and customer Wakala	Interbank Wakala	Contingent liabilities and commitments
2016	RO	RO	RO	RO	RO	RO
Personal	-	265,334,557	-	157,703,285	-	31,436
Corporate	46,317,478	154,998,809	19,380,253	33,849,361	23,232,872	142,145,228
Government	-	-	9,979,257	159,726,284	-	19,000,000
<b>Total</b>	<b>46,317,478</b>	<b>420,333,366</b>	<b>29,359,510</b>	<b>351,278,930</b>	<b>23,232,872</b>	<b>161,176,664</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued) Credit risk (continued)

#### (c) Economic sector concentrations

	Assets			Liabilities		
	Due from banks and Interbank Wakala investment	Gross financing	Investments in Sukuk and securities	Customer account, unrestricted IAH and customer Wakala	Interbank Wakala	Contingent liabilities and commitments
31 December 2017	RO	RO	RO	RO	RO	RO
Personal	-	316,307,269	-	201,467,257	-	35,712
Construction	-	55,268,843	-	2,532,312	-	65,606,155
Manufacturing	-	52,141,605	-	3,361,125	-	33,847,672
Financial services	19,862,045	-	704,858	-	19,338,529	-
Government	-	-	25,040,882	283,528,867	-	19,000,000
Other services	-	37,172,759	-	1,424,800	-	12,826,432
Others	-	132,313,199	21,975,397	33,537,181	-	94,128,843
	<u>19,862,045</u>	<u>593,203,675</u>	<u>47,721,137</u>	<u>525,851,542</u>	<u>19,338,529</u>	<u>225,444,814</u>

	Assets			Liabilities		
	Due from banks and Interbank Wakala investment	Gross financing	Investments in Sukuk and securities	Customer account, unrestricted IAH and customer Wakala	Interbank Wakala	Contingent liabilities and commitments
31 December 2016	RO	RO	RO	RO	RO	RO
Personal	-	265,334,557	-	163,525,970	-	31,436
Construction	-	33,727,662	-	2,440,460	-	34,445,522
Manufacturing	-	1,499,956	-	994,558	-	31,925,044
Financial services	46,317,478	-	707,515	1,250,000	23,232,872	-
Government	-	-	9,979,257	152,706,569	-	19,000,000
Other services	-	10,444,266	-	2,182,241	-	8,889,103
Others	-	109,326,925	18,672,738	28,179,132	-	66,885,559
	<u>46,317,478</u>	<u>420,333,366</u>	<u>29,359,510</u>	<u>351,278,930</u>	<u>23,232,872</u>	<u>161,176,664</u>

#### (d) Gross credit exposure

	2017	2016
	RO	RO
Gross financing	593,203,675	420,333,366
Due from banks and interbank Wakala	19,862,045	46,317,478
Investments in Sukuk and securities	47,721,137	29,359,510
Total	<u>660,786,857</u>	<u>496,010,354</u>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued) Credit risk (continued)

#### (e) Geographical distribution of exposures:

	Sultanate of Oman	Other Countries	Total
31 December 2017	RO	RO	RO
Gross Sales receivables and other receivables	189,353,137	-	189,353,137
Gross Ijarah Muntahia Bittamleek	283,737,953	1,892,917	285,630,870
Gross Musharaka financing	25,986,532	-	25,986,532
Gross Wakala Bil Istethmar	92,233,136	-	92,233,136
Investments in Sukuk and securities	30,347,758	17,373,380	47,721,137
Due from banks and interbank Wakala	15,610,219	4,251,826	19,862,045
Total	637,268,735	23,518,122	660,786,857

	Sultanate of Oman	Other Countries	Total
31 December 2016	RO	RO	RO
Gross Sales receivables and other receivables	119,131,986	-	119,131,986
Gross Ijarah Muntahia Bittamleek	234,758,607	2,149,583	236,908,190
Gross Musharaka financing	807,517	-	807,517
Gross Wakala Bil Istethmar	63,485,673	-	63,485,673
Investments in Sukuk and securities	18,213,426	11,146,084	29,359,510
Due from banks and interbank Wakala	34,495,427	11,822,051	46,317,478
Total	470,892,636	25,117,718	496,010,354

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

	Due from banks and interbank Wakala	Gross Sales receivables and other receivables	Gross Ijarah Muntahia Bittamleek	Gross Musharaka financing	Gross Wakala Bil Istethmar	Investment in Sukuk & securities	Total	Off balance sheet exposures
2017	RO	RO	RO	RO	RO	RO	RO	RO
Construction	-	8,424,567	10,634,998	1,033,914	35,175,364	-	55,268,843	65,606,155
Electricity, gas and water	-	24,047,289	1,206,534	-	27,558,249	-	52,812,072	34,430,842
Financial institutions	19,862,045	-	-	-	-	704,858	20,566,903	-
Services	-	13,403,343	2,249,690	17,645,290	3,874,436	-	37,172,759	12,826,432
Personal financing	-	101,917,352	214,389,917	-	-	-	316,307,269	-
Government	-	-	-	-	-	25,040,882	25,040,882	19,000,000
Non-resident financing	-	-	1,892,917	-	-	-	1,892,917	-
Others	-	41,560,586	55,256,814	7,307,328	25,625,087	21,975,397	151,725,212	93,581,385
Total	19,862,045	189,353,137	285,630,870	25,986,532	92,233,136	47,721,137	660,786,857	225,444,814

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued) Credit risk (continued)

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

	Due from banks and interbank Wakala	Gross Sales receivables and other receivables	Gross Ijarah Muntahia Bittamleek	Gross Musharaka financing	Gross Wakala Bil Istethmar	Investment in Sukuk & securities	Total	Off balance sheet exposures
2016	RO	RO	RO	RO	RO	RO	RO	RO
Construction	-	1,924,597	7,299,555	-	24,503,510	-	33,727,662	34,445,522
Electricity, gas and water	-	1,010,905	133,182	-	31,873,134	-	33,017,221	33,582,778
Financial institutions	46,317,478	-	-	-	-	707,515	47,024,993	-
Services	-	295,191	135,205	-	3,290,310	-	3,720,706	8,889,103
Personal financing	-	92,047,398	173,287,159	-	-	-	265,334,557	-
Government	-	-	-	-	-	9,979,257	9,979,257	19,000,000
Non-resident financing	-	-	2,149,583	-	-	-	2,149,583	-
Others	-	23,853,895	53,903,506	807,517	3,818,719	18,672,738	101,056,375	65,259,261
<b>Total</b>	<b>46,317,478</b>	<b>119,131,986</b>	<b>236,908,190</b>	<b>807,517</b>	<b>63,485,673</b>	<b>29,359,510</b>	<b>496,010,354</b>	<b>161,176,664</b>

#### (g) Residual contractual maturities of the portfolio by major types of credit exposures:

	Due from banks and interbank Wakala	Gross Sales receivables and other receivables	Gross Ijarah Muntahia Bittamleek	Gross Musharaka financing	Gross Wakala Bil Istethmar	Investment in Sukuk & securities	Total	Off balance sheet exposures
2017	RO	RO	RO	RO	RO	RO	RO	RO
Upto 1 month	19,862,045	5,449,979	1,766,917	39,691	16,499,319	10,431,751	54,049,703	49,521,661
1 to 3 months	-	12,383,038	6,186,156	707,821	15,187,640	3,850,154	38,314,809	22,235,199
3 to 6 months	-	14,284,252	5,129,593	231,021	11,962,594	-	31,607,460	12,308,442
6 to 9 months	-	16,388,337	5,432,637	641,537	13,183,375	-	35,645,886	15,981,073
9 to 12 months	-	13,273,026	5,759,645	287,827	9,363,108	-	28,683,606	73,707,913
1 to 3 years	-	56,185,513	50,824,625	4,344,826	9,829,222	1,325,080	122,509,266	32,397,295
3 to 5 years	-	40,377,760	46,360,271	4,136,122	13,917,003	8,469,318	113,260,474	8,313,201
Over 5 years	-	31,011,232	164,171,026	15,597,687	2,290,875	23,644,834	236,715,653	10,980,030
	<b>19,862,045</b>	<b>189,353,137</b>	<b>285,630,870</b>	<b>25,986,532</b>	<b>92,233,136</b>	<b>47,721,137</b>	<b>660,786,857</b>	<b>225,444,814</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued) Credit risk (continued)

#### (g) Residual contractual maturities of the portfolio by major types of credit exposures (continued):

	Due from banks and interbank Wakala	Gross Sales receivables and other receivables	Gross Ijarah Muntahia Bittamleek	Gross Musharaka financing	Gross Wakala Bil Istethmar	Investment in Sukuk & securities	Total	Off balance sheet exposures
2016	RO	RO	RO	RO	RO	RO	RO	RO
Upto 1 month	46,317,478	2,834,249	1,137,867	3,863	17,826,600	5,647,945	73,768,002	35,404,390
1 to 3 months	-	6,577,418	2,487,371	8,444	12,027,200	-	21,100,433	15,896,552
3 to 6 months	-	8,019,245	3,533,100	11,994	3,911,196	-	15,475,535	8,799,642
6 to 9 months	-	6,615,903	3,788,955	12,863	457,700	-	10,875,421	11,425,306
9 to 12 months	-	7,125,904	4,307,462	14,623	3,634,636	-	15,082,625	52,695,803
1 to 3 years	-	44,076,604	37,348,713	126,790	7,081,257	1,604,327	90,237,691	23,161,712
3 to 5 years	-	23,415,830	32,476,438	110,250	3,966,878	10,993,238	70,962,634	5,943,335
Over 5 years	-	20,466,833	151,828,284	518,690	14,580,206	11,114,000	198,508,013	7,849,924
	<u>46,317,478</u>	<u>119,131,986</u>	<u>236,980,190</u>	<u>807,517</u>	<u>63,485,673</u>	<u>29,359,510</u>	<u>496,010,354</u>	<u>161,176,664</u>

#### (h) Distribution of impaired financing, past due and not past due financing by type of industry:

	Performing financing	Non-performing financing	Specific provisions held	General provisions held
31 December 2017	RO	RO	RO	RO
Personal financing	316,307,269	159,027	73,632	4,510,067
Non-resident corporate financing	1,892,917	-	-	18,929
Resident corporate financing	275,003,489	188,362	52,965	2,613,923
	<u>593,203,675</u>	<u>347,389</u>	<u>126,597</u>	<u>7,142,919</u>

	Performing financing	Non-performing financing	Specific provisions held	General provisions held
31 December 2016	RO	RO	RO	RO
Personal financing	265,306,097	28,460	25,512	3,289,644
Non-resident corporate financing	2,149,583	-	-	21,496
Resident corporate financing	152,744,665	104,561	26,140	1,980,667
	<u>420,200,345</u>	<u>133,021</u>	<u>51,652</u>	<u>5,291,807</u>

#### (i) Distribution of impaired financing and past due financing by geographical distribution:

	Performing financing	Non-performing financing	Specific provisions held	General provisions held
31 December 2017	RO	RO	RO	RO
Sultanate of Oman	591,310,758	347,389	126,597	7,123,990
Other countries	1,892,917	-	-	18,929
Total	<u>593,203,675</u>	<u>347,389</u>	<u>126,597</u>	<u>7,142,919</u>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued) Credit risk (continued)

#### (i) Distribution of impaired financing and past due financing by geographical distribution (continued):

	Performing financing	Non-performing financing	Specific provisions held	General provisions held
31 December 2016	RO	RO	RO	RO
Personal financing	418,050,762	133,021	51,652	5,270,311
Non-resident corporate financing	2,149,583	-	-	21,496
Resident corporate financing	420,200,345	133,021	51,652	5,291,807

#### (j) Maximum exposure to credit risk without consideration of collateral held:

	2017	2016
	RO	RO
Due from banks and interbank Wakala investments	19,862,045	46,317,478
Investment in Sukuk and securities	47,721,137	29,359,510
Gross Financing	593,203,675	420,333,366
	660,786,857	496,010,354
Off-balance sheet items		
Financial guarantee	53,881,017	33,556,090
Financial letter of credits	20,071,723	9,696,018
Acceptances	7,328,535	12,513,402
Bills for collection	104,113	-
Commitments	144,059,426	105,411,154
	225,444,814	161,176,664

### Liquidity risk

Liquidity risk is the potential inability to meet the Bank's liabilities as they become due. It arises when the Bank is unable to generate cash to cope with a decline in deposits or increase in assets.

Bank's liquidity risk management is governed by the Liquidity Risk Management Policy document approved by the Board of Directors as well as the provisions of relevant CBO guidelines on liquidity risk management. The Liquidity risk policy also incorporates contingency plans and measures so as the Bank is always in a position to meet all maturing liabilities as well as to fund asset growth and business operations. The Contingency Funding Plan includes effective monitoring of the cash flows on a day to day basis, holding of tradable high quality liquid assets, which may be readily liquidated in sizeable amount etc. The Bank also has in place adequate lines of credit from both local and international Banks to meet any unforeseen liquidity requirements.

The Bank monitors its liquidity risk through cash flow approach and stock approach. Under cash flow approach Bank generates Maturity of Assets and Liabilities (MAL) report which captures all the maturing assets and liabilities into various pre-set time buckets ranging from one month to five years. The mismatches in various time buckets indicate liquidity gap and Bank strictly adheres to the limit set with respect to various time buckets as set out in Bank's Risk Appetite and Strategy Statement. Under stock approach, Bank monitors the liquidity risk through liquidity ratios, which portrays the liquidity available at the reporting date. In addition to this, the Bank also monitors and report liquidity in line with Basel III ratios that includes Liquidity Coverage Ratio (LCR) and Net-Stable Funding Ratio (NSFR).

The NSFR is defined as the amount of available stable funding relative to the amount of required stable funding. This ratio

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued) Liquidity risk (continued)

should be equal to at least 100% on an ongoing basis. "Available stable funding" is defined as the portion of capital and liabilities expected to be reliable over the time horizon considered by the NSFR, which extends to one year. The amount of such stable funding required ("Required stable funding") of a bank is a function of the liquidity characteristics and residual maturities of the various assets held by the Bank as well as those of its off-balance sheet (OBS) exposures.

Treasury department of the Bank and Asset Liability Committee (ALCO) controls and monitors the liquidity and ensures that the Bank is not exposed to undue liquidity risk and at the same time makes optimum use of its funds.

The Bank manages the liquidity risk based on estimated maturities using the guidelines provided by the Central Bank of Oman for the estimates. The table below represents cash flows receivable to and payable by the Bank under assets and liabilities by estimated remaining maturities at the balance sheet date.

#### Maturity profile of assets and liabilities

	Due on demand and up to 30 days	More than 1 month to 6 months	More than 6 months to 12 months	More than 1 year to 5 years	Over 5 years	Total
31 December 2017	RO	RO	RO	RO	RO	RO
Cash and balances with Central Bank of Oman	42,313,967	-	-	-	500,001	42,813,968
Inter-bank Wakala and Due from banks	19,862,045	-	-	-	-	19,862,045
Financing to customers - net	23,140,226	62,287,336	60,103,140	211,424,184	203,590,474	560,545,360
Financial assets at fair value through equity	10,431,751	3,850,154	-	2,794,398	23,644,834	40,721,137
Financial assets at amortized cost	-	-	-	7,000,000	-	7,000,000
Investment in real estate	-	-	14,175,000	-	-	14,175,000
Intangible asset	-	-	-	-	2,203,452	2,203,452
Property and equipment	-	-	-	-	2,428,106	2,428,106
Other assets	86,931	488,881	202,026	3,820,733	2,290,332	6,888,903
<b>Total assets</b>	<b>95,834,920</b>	<b>66,626,371</b>	<b>74,480,166</b>	<b>225,039,315</b>	<b>234,657,199</b>	<b>696,637,971</b>
Interbank Wakala	2,013,529	17,325,000	-	-	-	19,338,529
Customer accounts, Wakala and unrestricted accountholders	23,586,681	59,618,832	128,956,122	216,822,354	96,885,293	525,869,282
Other liabilities	5,544,238	3,925,700	10,683,982	246,155	-	20,400,075
Investment risk and profit equalization reserve	-	-	-	-	280,708	280,708
Owners' equity	-	-	-	-	130,749,377	130,749,377
<b>Total liabilities, equity of unrestricted investment accountholders and owners' equity</b>	<b>31,144,448</b>	<b>80,869,532</b>	<b>139,640,104</b>	<b>217,068,509</b>	<b>227,915,378</b>	<b>696,637,971</b>
Net gap	64,690,472	(14,243,161)	(65,159,938)	7,970,806	6,741,821	-
Cumulative net gap	64,690,472	50,447,311	(14,712,627)	(6,741,821)	-	-

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued) Liquidity risk (continued) Maturity profile of assets and liabilities (continued)

	Due on demand and up to 30 days	More than 1 month to 6 months	More than 6 months to 12 months	More than 1 year to 5 years	Over 5 years	Total
31 December 2016	RO	RO	RO	RO	RO	RO
Cash and balances with Central Bank of Oman	16,253,563	-	-	-	346,095	16,599,658
Inter-bank Wakala and Due from banks	46,317,478	-	-	-	-	46,317,478
Financing to customers - net	21,348,259	34,396,498	23,627,617	137,928,664	180,506,318	397,807,356
Financial assets at fair value through equity	5,644,945	-	-	5,600,565	11,114,000	22,359,510
Financial assets at amortized cost	-	-	-	7,000,000	-	7,000,000
Investment in real estate	-	14,175,000	-	-	-	14,175,000
Intangible asset	-	-	-	-	2,121,330	2,121,330
Property and equipment	-	-	-	-	3,105,323	3,105,323
Other assets	169,510	413,030	193,152	3,731,340	2,002,690	6,509,722
<b>Total assets</b>	<b>89,733,755</b>	<b>48,984,528</b>	<b>23,820,769</b>	<b>154,260,569</b>	<b>199,195,756</b>	<b>515,995,377</b>
Interbank Wakala	8,987,872	385,000	385,000	13,475,000	-	23,232,872
Customer accounts and unrestricted accountholders	35,471,918	57,510,655	78,958,082	133,763,516	45,624,940	351,329,111
Other liabilities	1,788,958	3,569,662	7,856,320	217,646	-	13,432,586
Investment risk and profit equalization reserve	-	-	-	-	939,363	939,363
Owners' equity	-	-	-	-	127,061,445	127,061,445
<b>Total liabilities, equity of unrestricted investment accountholders and owners' equity</b>	<b>46,248,748</b>	<b>61,465,317</b>	<b>87,199,402</b>	<b>147,456,162</b>	<b>173,625,748</b>	<b>515,995,377</b>
<b>Net gap</b>	<b>43,485,007</b>	<b>(12,480,789)</b>	<b>(63,378,633)</b>	<b>6,804,407</b>	<b>25,570,008</b>	<b>-</b>
<b>Cumulative net gap</b>	<b>43,485,007</b>	<b>31,004,218</b>	<b>(32,374,415)</b>	<b>(25,570,008)</b>	<b>-</b>	<b>-</b>

### Market risk

Market risk is the risk of loss due to unfavourable movements in market factors such as rates of return, exchange rates, commodities and equity prices. The Bank's Market risks arise generally due to open positions in foreign currencies, holding common equity, and fixed return products. All such instruments and transactions are exposed to general and specific market movements. For purpose of Capital Charge, the Bank uses Basel II standardized Approach.

The Bank seeks to mitigate market risk by employing strategies that correlate rate and price movements of its earning asset and liabilities. The Bank has Assets and Liability Committee (ALCO) which monitors Market and Liquidity Risk on regular basis. The details of market risk faced by the bank are discussed in the following notes.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued)

#### Market risk (continued)

#### (a) Currency risk

Currency risk is the risk of loss resulting from fluctuations in foreign exchange rates. Changes in currency rates affect the value of assets and liabilities denominated in foreign currencies and may affect revenues from foreign exchange dealings.

The Bank undertakes currency risk mostly to support its trade finance services and cross-border FX exposures. It maintains overall foreign exchange risk position to the extent of statutory Net Open Position limit prescribed by CBO. The major foreign currency to which the Bank is exposed is the US Dollar which is effectively pegged to Omani Rial. The Bank finances a significant portion of its financial assets in the same currencies as the relevant measurement currencies to mitigate its foreign currency risk. Foreign Exchange Risk exposures are managed as per Bank's Risk Management policies.

Exposure limits such as counterparty and currency limits are also in place in accordance with the Bank's approved policies to limit risk and concentration to the acceptable levels.

The foreign currency exposures are given below:

#### Foreign currency exposures

	2017	2016
	RO	RO
Net assets denominated in US Dollars	4,563,547	(37,005,524)
Net assets denominated in other foreign currencies	(2,295,757)	1,420,807

#### (b) Rate of Return Risk

Rate of Return Risk is the risk of deviations in earnings or economic value due to adverse movement of the yield curve. It is inherent primarily to the banking book mainly through advances and deposits portfolio.

The profit rate exposure of the Bank arises due to mismatches between contractual maturities or re-pricing of on and off-balance sheet assets and liabilities. It is addressed by an Asset and Liability Committee (ALCO) that reviews the profit rate dynamics at regular intervals and decides re-pricing of assets and liabilities ensuring that the spread of the Bank remains at an acceptable level.

The sensitivity of the statement of income is the effect of the assumed changes in profit rates on the earning for one year, based on the variable profit rate non-trading financial assets and financial liabilities held at reporting date.

The following table demonstrates the sensitivity to a reasonable possible change in profit rates, with all other variables held constant.

#### Impact on earnings due to profit rate risk in the banking book

	2017	2016
	RO	RO
+200 bps	3,281,878	1,634,000
+100 bps	1,640,939	817,000
-200 bps	(3,281,878)	(1,634,000)
-100 bps	(1,640,939)	(817,000)

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued)

Market risk (continued)

Rate of Return Risk (continued)

#### Profit rate sensitivity gap

Sensitivity to profit rates arises from mismatches in the period to repricing of assets and that of the corresponding liability. The Bank manages these mismatches by risk policy guidelines and reduces risk by matching the repricing of assets and liabilities

	Due on demand and up to 30 days	More than 1 month to 6 months	More than 6 months to 12 months	More than 1 year to 5 years	Due after 5 years	Non-profit bearing	Total
31 December 2017	RO	RO	RO	RO	RO	RO	RO
Cash and balances with Central Bank of Oman	-	-	-	-	-	42,813,968	42,813,968
Inter-bank Wakala and Due from banks	16,397,550	-	-	-	-	3,464,495	19,862,045
Financing to customers - net	136,415,232	81,159,071	80,151,364	199,458,493	63,361,200	-	560,545,360
Financial assets at fair value through equity	4,908,458	3,850,154	-	9,794,398	16,644,858	5,523,269	40,721,137
Financial assets at amortized cost	-	-	-	7,000,000	-	-	7,000,000
Investment in real estate	-	-	-	-	-	14,175,000	14,175,000
Intangible asset	-	-	-	-	-	2,203,452	2,203,452
Property and equipment	-	-	-	-	-	2,428,106	2,428,106
Other assets	29,181	160,017	89,337	1,237,562	2,044,086	3,328,720	6,888,903
<b>Total assets</b>	<b>157,750,421</b>	<b>85,169,242</b>	<b>80,240,701</b>	<b>217,490,453</b>	<b>82,050,144</b>	<b>73,937,010</b>	<b>696,637,971</b>
Interbank Wakala	1,925,000	17,325,000	-	-	-	88,529	19,338,529
Customer accounts, Wakala and unrestricted accountholders	9,438,427	35,922,972	45,011,722	288,601,015	78,584,928	68,310,218	525,869,282
Other liabilities	-	-	-	-	-	20,400,075	20,400,075
Investment risk and profit equalisation reserve	-	-	-	-	280,708	-	280,708
Shareholders' equity	-	-	-	-	-	130,749,377	130,749,377
<b>Total liabilities and shareholders' equity</b>	<b>11,363,427</b>	<b>53,247,972</b>	<b>45,011,722</b>	<b>288,601,015</b>	<b>78,865,636</b>	<b>219,548,199</b>	<b>696,637,971</b>
<b>On-balance sheet gap</b>	<b>146,386,994</b>	<b>31,921,270</b>	<b>35,228,979</b>	<b>(71,110,562)</b>	<b>3,184,508</b>	<b>(145,611,189)</b>	<b>-</b>
<b>Cumulative profit sensitivity gap</b>	<b>146,386,994</b>	<b>178,308,264</b>	<b>213,537,243</b>	<b>142,426,681</b>	<b>145,611,189</b>	<b>-</b>	<b>-</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued)

#### Market risk (continued)

#### Rate of Return Risk (continued)

#### Profit rate sensitivity gap (continued)

	Due on demand and up to 30 days	More than 1 month to 6 months	More than 6 months to 12 months	More than 1 year to 5 years	Due after 5 years	Non-profit bearing	Total
31 December 2016	RO	RO	RO	RO	RO	RO	RO
Cash and balances with Central Bank of Oman	-	-	-	-	-	16,599,658	16,599,658
Inter-bank Wakala and Due from banks	42,680,780	-	-	-	-	3,636,698	46,317,478
Financing to customers - net	66,390,033	53,762,599	45,642,039	148,119,952	83,892,733	-	397,807,356
Financial assets at fair value through equity	-	-	-	5,600,565	11,114,000	5,644,945	22,359,510
Financial assets at amortized cost	-	-	-	7,000,000	-	-	7,000,000
Investment in real estate	-	-	-	-	-	14,175,000	14,175,000
Intangible asset	-	-	-	-	-	2,121,330	2,121,330
Property and equipment	-	-	-	-	-	3,105,323	3,105,323
Other assets	111,759	191,777	66,174	605,085	1,268,664	4,266,263	6,509,722
<b>Total assets</b>	<b>109,182,572</b>	<b>53,954,376</b>	<b>45,708,213</b>	<b>161,325,602</b>	<b>96,275,397</b>	<b>49,549,217</b>	<b>515,995,377</b>
Interbank Wakala	8,937,840	385,000	385,000	13,475,000	-	50,032	23,232,872
Customer accounts & unrestricted accountholders	9,956,503	44,931,480	55,801,145	143,961,509	27,510,481	69,167,993	351,329,111
Other liabilities	-	-	-	-	-	13,432,586	13,432,586
Investment risk & profit equalization reserve	-	-	-	-	939,363	-	939,363
Shareholders' equity	-	-	-	-	-	127,061,445	127,061,445
<b>Total liabilities and shareholders' equity</b>	<b>18,894,343</b>	<b>45,316,480</b>	<b>56,186,145</b>	<b>157,436,509</b>	<b>28,449,844</b>	<b>209,712,056</b>	<b>515,995,377</b>
<b>On-balance sheet gap</b>	<b>90,288,229</b>	<b>8,637,896</b>	<b>(10,477,932)</b>	<b>3,889,093</b>	<b>67,825,553</b>	<b>(160,162,839)</b>	<b>-</b>
<b>Cumulative Profit sensitivity gap</b>	<b>90,288,229</b>	<b>98,926,125</b>	<b>88,448,193</b>	<b>92,337,286</b>	<b>160,162,839</b>	<b>-</b>	<b>-</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued)

**Market risk** (continued)

**Rate of Return Risk** (continued)

#### (c) Equity risk

Bank is exposed to the volatility in the prices of the securities (i.e. Sukuk and Shares) held under equity portfolio. Equity investments held are for strategic/long term rather than for trading purposes and hence, Bank does not hold trading positions in equity investments. Hence the exposure in listed and unlisted equity exposure as of date is taken in banking book and capital is calculated accordingly.

Since there is NIL exposure in trading book therefore no stress testing and sensitivity analysis is carried out.

#### **Operational risk**

Operational risk is the risk of direct or indirect losses resulting from inadequate or failed internal processes or systems, human factors, or from external events. The Bank's businesses are dependent on the ability to process a large number of transactions efficiently and accurately. Operational risks and losses originate from business/operational process failure, IT security failure, natural disasters, dependence on key suppliers, fraud, service quality compromised, regulatory non-compliance, loss of key staff, and social and environmental impacts.

The Bank has developed operational risk management policy and all the critical controls are implemented at all levels for curtailing operational risk. Each division has processes and systems in place to address operational risks within their area.

For the purpose of measuring capital charge, the Bank has adopted the Basic Indicator Approach under Basel II for Operational Risk. The approach requires the Bank to provide 15% of the average three years gross annual income as capital charge for operational risk.

#### **Capital risk management**

The Bank manages its capital to ensure that it will be able to continue as a going concern while maximising the return to shareholders within acceptable risk return framework. The Bank's overall strategy remains unchanged from prior year.

The Bank's regulatory capital is divided into two tiers:

- a. Tier 1 capital: share capital, retained earnings and reserves created by appropriations of retained earnings; and
- b. Tier 2 capital: general provision and unrealized gains arising on the fair valuation of equity instruments at fair value through equity.

Book value of other intangible assets including software is deducted from Tier 1 capital to arrive at the regulatory capital.

The risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature of and reflecting an estimate of credit, market and operational risks associated with each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of potential future exposure.

The Bank will continue to maintain the required regulatory capital either through its risk management strategies or by increasing the capital requirements in line with the business and capital needs.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued)

Capital risk management (continued)

#### Capital adequacy

The ratio of equity to risk weighted assets, as formulated by the Basel II and Basel III, for the year ended 31 December 2017 and 2016 as follows:

Capital structure	2017	2016
	RO	RO
<b>TIER I CAPITAL</b>		
Paid up capital	150,000,000	150,000,000
Share premium	2,091,192	2,091,192
Legal reserve	389,622	10,972
Accumulated losses	(21,771,158)	(25,175,033)
Fair value gains or losses on financial assets at fair value through equity	(123,463)	(169,430)
Less: Intangible assets	(2,203,452)	(2,121,330)
Deferred tax asset	(2,677,703)	(2,937,242)
<b>Total Tier I capital</b>	<b>125,705,038</b>	<b>121,699,129</b>
<b>TIER II CAPITAL</b>		
Fair value gains on financial assets at fair value through equity	79,627	159,264
General provision	7,142,919	5,291,807
<b>Total Tier II capital</b>	<b>7,222,546</b>	<b>5,451,071</b>
<b>Total eligible capital</b>	<b>132,927,584</b>	<b>127,150,200</b>
<b>Risk weighted assets</b>		
Credit risk	716,089,507	482,608,895
Market risk	22,391,617	32,047,791
Operational risk	32,302,324	23,006,077
<b>Total</b>	<b>770,783,448</b>	<b>537,662,763</b>
Tier I capital	125,705,038	121,699,129
Tier II capital	7,222,546	5,451,071
<b>Total regulatory capital</b>	<b>132,927,584</b>	<b>127,150,200</b>
<b>Tier I capital ratio</b>	<b>16.31%</b>	<b>22.63%</b>
<b>Total capital ratio</b>	<b>17.25%</b>	<b>23.65%</b>
<b>Common Equity Tier 1 (CET1)</b>	<b>128,705,038</b>	<b>121,699,129</b>
<b>Common Equity Tier 1 ratio</b>	<b>16.31%</b>	<b>22.63%</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued)

#### Liquidity coverage ratio (LCR)

The Basel Committee on Banking Supervision published the Basel III guidelines in June 2011. Central Bank of Oman has issued final guidelines on implementation of the new capital and liquidity norms to banks in the Country. The new regulations requires banks to calculate Liquidity Coverage Ratio (LCR) and Net-Stable Funding Ratio (NSFR) on period basis. This standard aims to ensure that a bank has an adequate stock of unencumbered High Quality Liquid Assets (HQLA) that consists of cash or assets that can be converted into cash at little or no loss of value in private markets, to meet its liquidity needs for a 30 calendar day liquidity stress scenario. At a minimum, the stock of unencumbered HQLA should enable the bank to survive until Day 30 of the stress scenario, by which time it is assumed that appropriate corrective actions can be taken by management and supervisors, or that the bank can be resolved in an orderly way. Furthermore, it gives the central bank additional time to take appropriate measures, should they be regarded as necessary.

			2017
Stock of High Quality Liquid Assets (HQLA)	Factor	Book Balance	Adjusted amount
Level 1 assets		RO	RO
Coins and bank notes	100%	5,267,318	5,267,318
<b>Total Level 1 assets</b>		5,267,318	5,267,318
<b>Level 2A</b>			
Sovereign, Central Bank, Public Sector Entity (PSE), multilateral development banks assets (qualifying for 20% risk weighing)	85%	28,688,230	24,384,996
<b>Total Level 2A</b>		28,688,230	24,384,996
<b>Level 2B</b>			
Qualifying corporate debt securities, rated between A+ and BBB-	50%	9,586,498	4,793,249
Qualifying common equity shares	50%	93,024	46,512
<b>Total Level 2B (maximum 15% of HQLA)</b>		9,679,522	4,839,761
<b>Total level 2 assets (Maximum 40% of HQLA)</b>		38,367,752	29,224,757
<b>Total Stock of high quality liquid assets</b>		43,635,070	8,778,863
<b>Cash outflows</b>			
Less stable retail deposits	10%	130,942,500	13,094,250
Less stable deposits	10%	62,266,423	6,226,642
Non-financial corporates, sovereigns, central banks and PSE	40%	25,665,206	10,266,082
<b>Currently undrawn portion of credit lines</b>			
Other Legal entity customers, credit and liquidity facilities	100%	497,000	497,000
Other contingent funding liabilities (Letters of credit, guarantee)	5%	10,287,227	514,361
<b>Total cash outflows</b>		261,173,714	30,598,336
<b>Cash inflows</b>			
All other assets	100%	11,520,461	11,520,461
Amounts to be received from retail counterparties	50%	2,763,496	1,381,748
Amounts to be received from non-financial wholesale counterparties from transactions other than those listed.	50%	20,992,409	10,496,205
Amounts to be received from financial institutions and central banks from transactions other than those listed	100%	37,046,649	37,046,649
Operational deposits held at other financial institutions	0%	3,464,495	-
<b>Total cash inflows</b>		75,787,510	60,445,063
<b>75% of outflows</b>			22,948,752
Inflows restricted to 75% of outflows			22,948,752
<b>Net cash outflows</b>			7,649,584
<b>LCR (%)</b>			114.76

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2017

### 41 Financial risk management (continued)

#### Liquidity coverage ratio (LCR)

		2016	
Stock of High Quality Liquid Assets (HQLA)	Factor	Book Balance	Adjusted amount
Level 1 assets		RO	RO
Coins and bank notes	100%	4,783,328	4,783,328
Total Level 1 assets		4,783,328	4,783,328
Level 2A			
Sovereign, Central Bank, Public Sector Entity (PSE), multilateral development banks assets (qualifying for 20% risk weighing)	85%	7,363,600	6,259,060
Total Level 2A		7,363,600	6,259,060
Level 2B			
Qualifying corporate debt securities, rated between A+ and BBB-	50%	10,641,808	5,320,904
Qualifying common equity shares	50%	99,826	49,913
Total Level 2B (maximum 15% of HQLA)		10,741,634	5,370,817
Total level 2 assets (Maximum 40% of HQLA)		18,105,234	11,629,877
Total Stock of liquid assets		22,888,562	7,972,213
Cash outflows			
Less stable retail deposits	10%	132,156,832	13,215,683
Less stable deposits	10%	10,859,480	1,085,948
Non-financial corporates, sovereigns, central banks and PSE	40%	4,243,630	1,697,452
Currently undrawn portion of credit lines			
Other Financial institutions-liquidity	100%	7,397,840	7,397,840
Other Legal entity customers, credit and liquidity facilities	100%	497,000	497,000
Other contingent funding liabilities (Letters of credit, guarantee)	5%	6,938,798	346,940
Total cash outflows		164,332,286	24,240,863
Cash inflows			
All other assets	100%	11,736,375	11,736,375
Amounts to be received from retail counterparties	50%	2,448,283	1,224,142
Amounts to be received from non-financial wholesale counterparties from transactions other than those listed.	50%	19,350,433	9,675,217
Amounts to be received from financial institutions and central banks from transactions other than those listed	100%	11,470,234	11,470,234
Operational deposits held at other financial institutions	0%	4,919,573	-
Total cash inflows		49,924,898	34,105,967
75% of outflows			18,180,647
Inflows restricted to 75% of outflows			18,180,647
Net cash outflows			6,060,216
LCR (%)			131.55

### 42 Corresponding figures

Corresponding figures have been rearranged and reclassified, wherever necessary for the purpose of comparison and for better presentation, the effect of which is not material.



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

## Report on factual findings to the Board of Directors of Bank Nizwa SAOG (the "Bank") in respect of Basel II - Pillar III and Basel III related Disclosures

We have performed the procedures agreed with you and as prescribed in Title 5 of the Islamic Banking Regulatory Framework, Central Bank of Oman (CBO) Circular No. BM 1027 dated 4 December 2007 with respect to the Basel II - Pillar III Disclosures and Basel III related Disclosures (the disclosures) of Bank Nizwa SAOG (the "Bank") as at and for the year ended 31 December 2017. The disclosures were prepared by the Bank's management in accordance with the related requirements set out in Title 5 of the Islamic Banking Regulatory Framework, CBO's Circular number BM 1009 dated 13 September 2006, Circular No. BM 1027 dated 4 December 2007 and Circular No. 1114 dated 17 November 2013. Our engagement was undertaken in accordance with the International Standard on Related Services applicable to agreed-upon procedures engagements. The procedures, as set out in Title 5 of Islamic Banking Regulatory Framework and Circular number BM 1027 dated 4 December 2007, were performed solely to assist you in evaluating the Bank's compliance with the related disclosure requirements as set out in Title 5 of Islamic Banking Regulatory Framework, CBO's Circular number BM 1009 dated 13 September 2006 and Circular No. BM 1114 dated 17 November 2013.

We report our findings as follows:

Based on performance of the procedures detailed above, we found the disclosures free from any material misrepresentation.

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the disclosures.

Had we performed additional procedures or had we performed an audit or review of the disclosures in accordance with the International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose. This report relates only to the accompanying disclosures to be included in the Bank's annual report for the year ended 31 December 2017 and does not extend to any financial statements of the Bank taken as a whole or to any other reports of the Bank.

*Ernst & Young LLC*

Muscat  
28 February 2018



# BASEL II PILLAR 3 ANNUAL DISCLOSURES 2017

## 1. Overview and Introduction

In compliance with the Central Bank of Oman ("CBO") guidelines on implementing Basel II Capital Accord for all banks operating in Oman as of September 2006, and in light of Islamic Banking Regulatory Framework (IBRF), Bank Nizwa has developed its risk management techniques to assure adequate monitoring and managing its risks.

The Basel II Accord is based on three pillars as follows:

- **Pillar I** - defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk.
- **Pillar II** - addresses a bank's internal processes for assessing overall capital adequacy in relation to risks ("ICAAP"). Pillar II also introduces the Supervisory Review and Evaluation Process ("SREP"), which can be used as a tool to assess the internal capital adequacy of any Organisation.
- **Pillar III** - complements the other two pillars and focuses on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy. The aim of these disclosures is to encourage market discipline by developing a set of disclosure requirements which allow market participants to assess certain specified information on the scope of application of Basel II, capital, particular risk exposures and risk assessment processes, and hence the capital adequacy of the institution.

Pillar III disclosures include information about Bank Nizwa relating to our governance structure, capital structure, capital adequacy and requirements, risk management objectives and policies, and various supporting quantitative and qualitative disclosures along with a comparison with Dec 2016 financials.

## 2. Scope of Application

### 2.1 Qualitative Disclosure

- The Bank was registered in the Sultanate of Oman as a public joint stock company on 15 August 2012.
- The Bank's shares are listed on the Muscat Securities Market "MSM" and its principle place of business is in Muscat, Sultanate of Oman.
- The Bank is not a part of any holding company or group and has no subsidiary.
- There is no single party that holds 10% or more share in the Bank.
- Financial and regulatory reporting is being done on standalone basis hence no associated disclosures related to consolidation is required.

### 2.2 Quantitative Disclosure

**(a) Total Interest in Takaful Entities: The Bank holds 0.57% of Oman Takaful and does not have any control in the Company and accordingly it is not consolidated in any form.**

## 3. Capital Structure

### 3.1 Qualitative Disclosure

The Bank's regulatory capital is calculated as per the guidelines issued by CBO and it includes common shares capital. The Bank's authorized capital is OMR 300,000,000 and issued share capital is OMR 150,000,000 comprises 1,500,000,000 fully paid shares of RO 0.100 each in accordance with Article 106 of the Omani Commercial Companies Law of 1974.

- The Bank has no other capital instruments or equity related instruments that are considered as part of its regulatory capital.
- Unrestricted Investment Accounts are defined under section Unrestricted Investment Accounts. These are not considered as part of the equity and will only affect Capital Adequacy Ratio calculation to reduce Risk Weighted Assets. However, the Bank is following conservative approach by not reducing Risk Weighted Assets.
- There is no minority interest, surplus capital from Takaful companies and the Bank has no shareholdings equal or exceeding 5% of total paid-up capital.

## 3.2 Quantitative Disclosure

The detailed breakdown of the capital structure of the Bank is as follows:

	2017	2016
	RO	RO
<b>(a) Tier I Capital</b>		
Paid up capital	150,000,000	150,000,000
Share premium	2,091,192	2,091,192
Legal Reserve	389,622	10,972
Accumulated Losses	(21,771,158)	(25,175,033)
Net Fair value losses on financial assets at fair value through equity	(123,463)	(169,430)
Less: Intangible Assets, Including Losses, Cumulative Unrealized Losses Recognized Directly In Equity	(2,203,452)	(2,121,330)
Less: Deferred Tax Assets	(2,677,703)	(2,937,242)
<b>Total Tier I capital</b>	<b>125,705,038</b>	<b>121,699,129</b>
<b>(b) Tier II Capital</b>		
General provision	7,142,919	5,291,807
Fair value gains on financial assets at fair value through equity	79,627	159,264
<b>Total Tier II capital</b>	<b>7,222,546</b>	<b>5,451,071</b>
<b>Total eligible capital</b>	<b>132,927,584</b>	<b>127,150,203</b>
<b>(c) Unrestricted Investment Account and Related Reserves</b>		
	2017	2016
	RO	RO
Amount of unrestricted Investment Accountholder (IAH) Funds	227,777,182	157,984,717
Investment fair value reserve	17,740	50,181
Profit Equalization Reserve (PER)	-	779,239
Investment Risk Reserve (IRR)	280,708	160,124

## 4. Capital Adequacy

### 4.1 Qualitative Disclosure

- The primary objective of the Bank's capital management is to ensure that the Bank complies with regulatory capital requirements and maintains healthy capital ratios in order to support its business and to optimize shareholders' value.
- The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return on capital to shareholders or issue Sukuk etc.
- The capital structure is primarily made up of its paid-up capital and including reserves. From a regulatory perspective, the significant amount of the capital is in Tier 1 form as defined by the CBO, i.e., most of the capital is of permanent nature.
- The Bank's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of financing facilities growth expectations for each business group, expected growth in off-balance sheet facilities, future sources and uses of funds.

- To assess its capital adequacy requirements in accordance with CBO requirements, the Bank adopts the Standardized Approach for its Credit and Market Risk and the Basic Indicator Approach for its Operational Risk. In normal course of business, all assets are funded by common pool unless otherwise approved by ALCO in advance. The Bank's Asset Liability Committee (ALCO) decides on the participation ratio in advance for funding the common pool of assets. On quarterly basis, based on the financials, the assessment of Risk Weighted Assets is according to utilization of Unrestricted Investment Account holder and shareholders' fund in funding assets through common pool.

## 4.2 Quantitative Disclosure

The ratio of equity to risk weighted assets, as formulated by the Basel II and Basel III, for the year ended 31 December 2017 is 17.25% (Dec 31, 2016:23.65%)

(a) Capital Requirements	2017		2016	
	RO		RO	
	Risk Weighted Assets (RWA)	Capital Requirement	Risk Weighted Assets (RWA)	Capital Requirement
Credit Risk	716,089,507	94,881,860	482,608,895	63,945,679
Market Risk	22,391,617	2,966,889	32,047,791	4,246,332
Operational Risk	32,302,324	4,280,058	23,006,077	3,048,305
Total	<u>770,783,448</u>	<u>102,128,807</u>	<u>537,662,763</u>	<u>71,240,316</u>

(b) Capital Requirements	2017	2016
Details	RO	RO
Tier I Capital (after supervisory deductions)	125,705,038	121,699,129
Tier II capital (after supervisory deductions & up to eligible limits)	7,222,546	5,451,071
Risk Weighted Assets – Banking Book	738,481,124	514,656,686
Risk Weighted Assets – Operational Risk	32,302,324	23,006,077
Total Risk Weighted Assets – Banking Book + Operational Risk	770,783,448	537,662,763
Minimum required capital to support RWAs of banking book & operational risk	102,128,807	71,240,316
i) Minimum required Tier I Capital for banking book & operational risk	94,906,261	65,789,242
ii) Tier II Capital required for banking book & operational risk	7,222,546	5,451,071
Tier I capital available for supporting Trading Book	30,798,777	55,909,887
Tier II capital available for supporting Trading book	-	-
Risk Weighted Assets – Trading Book	-	-
Total capital required to support Trading Book	-	-
Minimum Tier I capital required for supporting Trading Book	-	-
Total Regulatory Capital	132,927,584	127,150,200
Total Risk Weighted Assets – Whole bank	770,783,448	537,662,763
Common Equity Tier 1 (as a percentage of risk weighted assets)	16.31%	22.63%
Tier 1 (as a percentage of risk weighted assets)	16.31%	22.63%
Total capital (as a percentage of risk weighted assets)	17.25%	23.65%

(c) Capital Adequacy Ratio			2017	2016
			RO	RO
Total Risk Weighted Assets (RWA)			770,783,448	537,662,763
Total Eligible Capital			132,927,584	127,150,200
Capital Adequacy Ratio			17.25%	23.65%

(d) Ratio of Total and Tier 1 Capital to Total RWA			2017	2016
Tier 1 Capital			125,705,038	121,699,129
Total Capital			132,927,584	127,150,200
Total RWA			770,783,448	537,662,763
Ratio of Total Capital			17.25%	23.65%
Ratio of Tier 1 Capital			16.31%	22.63%
Ratio of CET 1 Capital			16.31%	22.63%

(e) Ratio of Total Capital to Total Assets			2017	2016
Total Capital			132,927,584	127,150,200
Total Assets			696,637,971	515,995,377
Total Capital to Total Assets			19.08%	24.64%

(f) Disclosure of Capital Requirements according to different risk categories for each shari'a compliant financing contract

	2017			2016		
	RO	RO	RO	RO	RO	RO
	Credit risk	Market risk	Risk Weighted Assets	Credit risk	Market risk	Risk Weighted Assets
Ijara Muntahia Bittamleek	25,020,643	-	188,835,041	31,382,573	-	236,849,608
Sales Receivable and Other Receivables	21,282,209	-	160,620,449	13,402,401	-	101,150,196
Wakala Bil Istethmar	24,441,781	-	184,466,272	16,823,703	-	126,971,343
Musharaka Financing	9,296,682	-	70,163,636	288,889	-	2,180,294
Letter of Guarantees	3,569,617	-	26,940,509	2,223,091	-	16,778,045
Letter of Credit	534,660	-	4,035,167	256,945	-	1,939,208
Acceptance and Bills for Collection (Wakala)	971,031	-	7,328,535	1,658,026	-	12,513,404
Total	85,116,623		642,389,609	66,035,628		498,382,098

## (g) Disclosure of Displaced Commercial Risk

The Bank is exposed to displaced commercial risk in the event of having equity of IAH profit rates that are lower than market rates. The Bank has mitigated this risk through the setting up of reserves that will be used in case of a drop in IAH profit rates. The related disclosure on Displaced Commercial Risk is given in Section 17.

### 5. Disclosures for Investment Accountholders (IAH)

#### 5.1 Qualitative Disclosure

- The Bank offers Unrestricted Investment Accounts based on fully sharia compliant concept of Mudaraba and Wakala.
- In Mudaraba, the Bank (Mudarib) manages Investment Account Funds (IAH) along with its own share of investment, to an unrestricted joint investment pool. Funds from this unrestricted joint investment pool are utilized to provide financing to customers under Islamic modes and to invest in other Sharia compliant investments opportunities. Such information is available for all customers at Bank's website, branches and call center.
- Under Wakala arrangement, Bank accepts funds from investors as Wakeel and invests in Sharia compliant assets. Wakeel is entitled to a fixed fee as a lump sum or percentage of fund provided. Expected profit payout is mentioned to investors upfront while any return generated in excess of expected profit is retained by the Bank as Wakeel. Wakeel should bear the loss in case of Wakeel's default, negligence or violation of any terms and conditions of the Wakala agreement, otherwise the loss would be borne by the investor or Muwakil.
- The Bank maintains necessary reserves as required by CBO.
- Any profits accrued out of the investment are shared between the two parties on a pre-agreed basis, while loss (if any) is borne by the Investor (Rab-ul-Maal). Operating expenses incurred by the Bank are not charged to investment account. In case of the loss resulting from the transactions in a jointly financed investment, such loss shall first be deducted from undistributed profits, if any. Any excess of such loss shall be deducted from Investment Risk Reserve (IRR). Any remaining of such loss shall be deducted from the total balance of fund available in the pool, as at that date, in the respective ratio of the Bank's and IAH's respective contribution to the fund.
- The investment profits are distributed between owners' equity and unrestricted investment accountholders as follows:

	2017	2016
Details	Percentage	Percentage
Unrestricted investment accounts share	50%	50%
Mudarib share	50%	50%

The investment risk reserve at 2 percent is deducted from customer's share after allocating the Mudarib share of profit as per the approved policy in order to cater against future losses of equity of unrestricted investment accountholders. Investment risk reserve will revert to the investment accountholders as per terms and conditions of Mudaraba contract.

The profit equalization reserve is the amount the bank appropriates in excess of the profit to be distributed to equity of unrestricted accountholders before allocating the Mudarib share of income to maintain a certain level of return. Profit equalization reserve will revert to owner equity and unrestricted investment accountholders.

Unrestricted investment accountholders are commingled with Bank funds for investment, no priority is granted to any party for the purpose of investments and distribution of profits. The administration expenses are only charged on the Bank expenses.

- IAH funds are managed according to Bank's approved policy and accordingly the Bank monitors the performance of the portfolio in order to achieve expected results. The prudential reserves have been established according to CBO and Sharia guidelines.

## 5.2 Quantitative Disclosure

The related disclosure of Unrestricted Investment Account is given below:

a) PER to PSIA Ratio	2017	2016
	RO	RO
Amount of Total PER	-	779,239
Amount of PSIA by IAH	227,777,182	157,984,717
PER to PSIA Ratio	0%	0.49%

b) IRR to PSIA Ratio	2017	2016
	RO	RO
Amount of Total IRR	280,708	160,124
Amount of PSIA by IAH	227,777,182	157,984,717
IRR to PSIA Ratio	0.13%	0.10%

c) Return on Assets (ROA)	2017	2016
	RO	RO
Amount of Total Net Income (before distribution of profit to unrestricted IAH)	27,956,017	17,981,771
Total Amount of Assets	696,637,971	515,995,377
Return on Assets (ROA)	4.01%	3.48%

Return on Equity (ROE)	2017	2016
	RO	RO
Amount of total net income (after distribution of profit to IAH)	16,671,013	13,502,069
Amount of shareholders' equity	130,749,377	127,061,445
Return on Equity (ROE)	12.75%	10.63%

### e) Ratios of profit distributed to PSIA by type of IAH

As of reporting date the Bank has only Unrestricted Investment Account holder and distributed profit amounting OMR 4,197,020 (Dec 2016: OMR 1,195,473) during the period to Investment Account holders.

### f) Ratios of financing to PSIA by type of IAH

As of reporting date, all jointly financing are funded by comingled pool which includes funds from Unrestricted Investment Account holder (including Mudaraba and Wakala) and Shareholders.

Gross Financing by type of contract	2017		2016	
	RO	%	RO	%
Sales Receivables and Other Receivables	189,353,137	31.92%	119,131,986	28.34%
Ijarah Muntahia Bittamleek	285,630,870	48.15%	236,908,190	56.36%
Musharaka financing	25,986,532	4.38%	807,517	0.20%
Wakala Bil Istethmar	92,233,136	15.55%	63,485,673	15.10%
Total Financing	593,203,675	100.00%	420,333,366	100.00%

## 6. Unrestricted Mudaraba Investment Accounts

### 6.1 Qualitative Disclosure

- There is no major change in the investment strategies that affect the investment accounts to the reporting date.
- The Bank has a single pool of comingled assets where the funds of investment account holders are invested and income is allocated to such accounts.

The investment profits distributed between equity shareholders and unrestricted investment accountholders is as follows:

	2017	2016
Details	Percentage	Percentage
Unrestricted investment accounts share	50%	50%
Mudarib share	50%	50%

- The investment risk reserve at 2% is deducted from customer's share after allocating the Mudarib share of profit. The profit equalization reserve is deducted from total revenue before allocating the Mudarib share based on ALCO decisions.
- The Bank does not charge Investment Accountholders for operating expenses incurred.

## 6.2 Quantitative Disclosure

a) Total amount of unrestricted IAH funds with respect category		
Account type	2017	2016
	RO	RO
<b>Saving account</b>	<b>137,475,222</b>	<b>82,915,579</b>
Investment accounts:		
One month	15,000	93,000
Three months	649,418	783,007
Six months	2,178,665	1,453,674
Nine months	181,100	92,000
One year	18,277,655	15,263,134
One year and a half	2,092,223	1,122,223
Two years	66,546,681	56,262,100
Three years	37,486	-
Four years	13,039	-
Five years	59,543	-
More than five years	251,150	-
	<b>227,777,182</b>	<b>157,984,717</b>

b) Share of profits earned by unrestricted IAH, before transfers to or from reserves (amount and as a percentage of funds invested)

	2017	2016
	RO	RO
Share of profits	4,197,020	1,195,473
Funds invested	227,777,182	157,984,717
Ratio	1.84%	0.76%

c) Share of profits paid out to unrestricted IAH, after transfers to or from reserves (amount and as a percentage of funds invested)

	2017	2016
	RO	RO
Share of profits	4,855,675	1,025,301
Funds invested	227,777,182	157,984,717
Ratio	2.13%	0.65%

#### d) Movements on PER and IRR during the year

During the reporting year the Bank utilized OMR 779,239 (Dec-16: 176,414) from PER. However, the total amount apportioned from the income distributable to equity of unrestricted investment accountholders amounted to OMR Zero (Dec 2016: OMR 51,354).

During the reporting year there was no utilization of IRR. However, the total amount apportioned from the income distributable to equity of unrestricted investment accountholders amounted to OMR 120,584 (Dec 2016: OMR 118,818).

Following is the movement of IRR and PER:

	2017		2016	
	PER	IRR	PER	IRR
Beginning Balance at the beginning of the year	779,239	160,124	727,885	41,306
Additions	-	120,584	227,768	118,818
Transferred	(779,239)	-	(176,414)	-
Balance at the end of the year	-	280,708	779,239	160,124

#### e) Disclosure of the utilization of PER and/or IRR during the period

OMR 779,239 (2016: OMR 176,414) utilized from PER during the year whereas no utilization in IRR.

#### f) Profits earned and profits paid out over the past three to five years (amounts and as a percentage of funds invested)

	2017	2016	2015	2014
	RO	RO	RO	RO
Profit Earned	27,956,017	17,981,771	10,063,445	5,537,082
Profit Distributed	4,197,020	1,195,473	896,195	243,609
Funds Invested	227,777,182	157,984,717	73,597,787	42,280,807
Return as % of Funds Invested	1.84%	0.76%	1.22%	0.58%

#### g) Amount of total administrative expenses charged to unrestricted IAH

As per Bank's policy, the administration expenses are only charged on the Bank expenses.

#### h) Average declared rate of return or profit rate on unrestricted PSIA by maturity (1-month, 3-month, 6-month, 9-month, 12-months, 18-months and 24 months)

Account type	2017	2016
	Average rate of return	Average rate of return
Mudaraba Saving account	1.40%	0.74%
One month tenure	1.35%	1.39%
Three months tenure	1.53%	1.55%
Six months tenure	1.89%	1.90%
Nine months tenure	2.05%	2.07%
One year tenure	2.42%	2.45%
Eighteen month tenure	3.21%	3.28%
Two year tenure	3.79%	3.79%

#### i) Changes in asset allocation in the last six months

There are no significant changes in the last six months of reporting date.

#### j) Off-balance sheet exposures arising from investment decisions, such as commitments and contingencies

Off-balance sheet items	2017	2016
	RO	RO
Financial guarantee	53,881,017	33,556,090
Financial letter of credits	20,071,723	9,696,018
Acceptances	7,328,535	12,513,402
Bills for collection	104,113	-
Commitments	144,059,426	105,411,154
Total	225,444,814	161,176,664

#### k) Disclosure of limits imposed on the amount that can be invested in any one type of asset

The Bank does not have any restricted Investment Account as of reporting date, as such there are no limits imposed to be invested in any type of asset other than limits set in Bank's policy and CBO regulations.

## 7. Unrestricted Wakala Investment Accounts

### 7.1 Qualitative Disclosure

- There is no major change in the investment strategies that affect the investment accounts to the reporting date.
- The Bank has single pool of comingled assets where the funds of investment accountholders are invested and income from which is allocated to such accounts according to the nature of agreement.

### 7.2 Quantitative Disclosure

#### a) Computation of Pool income is as follows:

Item RO	2017	2016
Pool Income from Financing	26,353,692	16,860,015
Income from Investments	1,602,325	1,121,756
Total Pool Income	27,956,017	17,981,771
Profit Equalization Reserve	779,239	(51,354)
Investment risk reserve	(120,584)	(118,818)
Pool Income	27,956,017	17,981,771
Mudarib fee	(4,626,678)	(1,199,838)
Movement to or from PER/IRR	658,655	(170,172)
Total amount paid to IAH Mudaraba	(4,855,675)	(1,025,301)
Total amount attributable to shareholders pool including Wakala	19,252,903	15,586,460

## 8. Restricted Investment Accounts

The Bank does not have Restricted Investment Accounts product as of reporting date.

## 9. Retail Investor-Oriented Disclosures for Investment Accounts

The Bank offers Unrestricted Investment Accounts in OMR, USD, AED only and maturity periods in OMR ranging from 1 month, 3 months, 6 months, 9 months, 12 months, 18 months, 24 months, 36 months, 48 months, 60 months, 84 months and 120 months based on fully Sharia compliant concept of Mudaraba. Profit is paid on average balance with a payout frequency of Monthly or Quarterly.

Following is the Product Structure of the Unrestricted Mudaraba Investment Account

### 9.1 Product Structure

#### Key Definitions and Concepts

Mudaraba – is a form of partnership where one party provides capital and the second party provides expertise and management skills. First party is referred to as Rab-ul-Maal (Investor) and the second party is referred to as the Mudarib (Investment Manager). Any profits accrued out of the joint business are shared between the two parties on a pre-agreed basis, while loss (if any) is borne by the Rab-ul-Maal (Investor) except for losses arising from the negligence of Mudarib.

Mudarib – is the entrepreneur or investment manager in a Mudaraba, the Mudarib manages the investor's funds through a common pool of investments called Mudaraba Pool in return for a share of profits through Sharia compliant investments.

Rab-ul-Maal – is the provider of the capital or investor in an Islamic contract such as Mudaraba.

#### Structure of the Mudaraba Investment Account Product

The Bank's Mudaraba Investment Account product will be based on the Islamic contract of Mudaraba.

In case of Mudaraba Investment Account under Mudaraba arrangement, the customer becomes an Investor (Rab-ul-Maal), and the Bank becomes the Manager (Mudarib) of the funds invested by the customers. Besides acting as Mudarib, the Bank can also invest a share of its equity and other funds that the bank did not receive on Mudaraba basis in the Mudaraba Pool.

For the Bank's funds invested in the joint Mudaraba pool, the Bank will become a partner of the customer. The Bank will accept funds from Mudaraba Investment Account holders under a Mudaraba agreement and allocate the funds received from the customers, along with its own share of investment, to an unrestricted joint investment pool. Funds from this unrestricted joint investment pool are utilized to provide financing to customers under Islamic modes and to invest in other Sharia compliant investment opportunities.

The profit earned from the investment and financing activities, using funds from the unrestricted joint investment pool shall be distributed between the Depositors and the Bank based on the Profit Distribution Methodology as approved by the Sharia Supervisory Board (SSB). There is no sharing of profits from the Bank's fee-based banking.

The Bank does not guarantee the Investment amount to the Mudaraba Investment Account holders, and in case of a loss from the investment and financing activities; the loss shall be borne by the customers in proportion of their respective share in the investment pool. Customer's share of loss shall be deducted from the customer's investment amount except for losses arising from the negligence of Mudarib (the Bank)

All Mudaraba Investment Accounts shall be assigned weightages, based on the features of the Mudaraba Investment Account such as amount, currency, period of investment, profit payment options and other applicable features for the purpose of the profit calculation, in accordance with the Sharia rulings issued by the Sharia Supervisory Board (SSB)

The pooled funds will be subjected to deductions for all direct expenses and fees incurred to generate the assets in the specific pool.

The Bank will deduct its Mudarib Share from net profit after deducting its share as fund provider "Rab-ul-Mal".

The Bank may change the Mudarib Share and weightages for calculation of profit from time to time.

In case of loss, Mudaraba Investment Account holders will suffer the loss exactly according to the ratio of their investment; and in case of profit, the profit will be distributed on the basis of the share of investment in the investment pool on pre agreed terms

The minimum balance criterion for Mudaraba Investment Account is essential as a balance requirement to participate in the Mudaraba pool. Once the Investment Amount has been invested, Profit is calculated on monthly basis on the Investment amount of the customer and is payable as per the selected profit payout option by the customer (Monthly or Quarterly). The Mudarib share ratio is disclosed on Bank's website for information to the customers.

In the event the Rab-ul-Mal wishes to terminate the Investment prior to the agreed Investment Maturity Date, the Rab-ul-Mal shall notify in writing to the Mudarib. Mudarib would be entitled to apply the declared profit rates of the nearest corresponding period for the actual investment period completed, provided a minimum ONE month of investment has been completed to be eligible for profit payment. Deduction from Principal amount is allowed in case profit amount already paid to the Customer (in case of profit payout option other than on maturity) is higher than the applicable declared profit rates for the actual completed investment period. A maximum of 1% can further be reduced from the payable profit rates as per the CBO guidelines

The Bank has set up prudential reserve account to minimize the adverse impact of income smoothing for PSIA on its shareholders' returns and to meet potential but unexpected losses that would be borne by the IAH on investments financed by PSIA, namely:

#### **Profit Equalization Reserve (PER)**

This is to secure suitable and competitive return to the investors in case there are certain extra ordinary circumstances, depressing the return, which were un-anticipated by the investors. The disposition of the reserve amount will take place with the prior approval of the Sharia Board. In case the balance in the reserve account is not sufficient to face the competition, the shareholders may grant part of their share of profit to the investors with the approval of Sharia Board. This reserve only applies to Mudaraba accounts. In case the rate of return to the investors in a certain profit distribution period is substantially higher than the market rates, the Bank's Management may decide to deduct, after taking approval from ALCO, after deducting the profit share of the investment manager as Mudarib and Rab Al Maal, a portion of the common pool share of profit and transfer the same to the Profit Equalization Reserve (PER) up to a maximum limit of 60% of the increased value. In addition, transfer amount from/to PER and IRR subject to Asset Liability Committee (ALCO) approval.

#### **Investment Risk Reserve (IRR)**

This reserve is created out of the investors' share of profit out of the Net Profit as per relevant guidelines (AAOIFI and/or CBO), post distribution of Mudarib share. This reserve is created to ensure certain level of cushion for the investment portfolio. The available balance in the reserve account shall be invested in the Common Pool and the profit earned by investing such balance will be added to the reserve account. This is to provide funds for unexpected and uncertain events taking place resulting in a decline in the value of the investments. This decline in value may be as a result of losses on financing or/and general reserves of the bank (as required by regulation). The disposition of the reserve amount will take place with the prior approval of the Sharia Board. In case the balance in the reserve account is not sufficient to face the competition, the shareholders may grant part of their share of profit to the investors with the approval of Sharia Board.

The Bank's ALCO decides in advance on the investment and asset allocation for IAH funds, including, with particular reference to unrestricted IAHs, the commingling of their funds with other funds managed by the Bank, the balance between shareholders' and IAH interests in terms of allocating investment funds and the risk-return characteristics of investments.

The Bank calculates the profit of the Mudaraba pool every month. Net Profit of the pool (after deduction of the direct costs/expenses attributable to the common pool) will be distributed amongst the investors and the shareholders, according to the following formula:

- (Average Investment amount x Aggregate weightages given to the shareholders and investors) for each category of investors.
- This aggregate weightages depends on: Amount and Profit Payout Frequency.

Then the Mudarib's fee is deducted from each category of the investors' share of profit, giving them the Net Profit.

**Losses arising from receivables, financing and investment assets that started and ended in the same year will be compensated as follows:**

- Will be covered from the profits of the same year.
- If losses exceeded profits in the same year, they will be covered from Investment Risk Reserve.
- If there is no sufficient fund available in Investment Risk Reserve, the losses will be covered directly from investor funds "Rab ul Mal share".

**Losses arising from receivables, financing and investment assets that initiated and continued from preceding years will be compensated as follows:**

- Will be covered from the Investment Risk Reserve.
- If there is no sufficient fund available in Investment Risk Reserve, they will be covered from current revenues.
- If the current revenues are not sufficient, the losses will be covered directly from investors' funds "Rabb ul Mal share".

In addition to the above, in all cases the shareholders may forego their share of profit or part of their equity in favor of the investors to cover such losses

## 10. Risk Management, Risk Exposures and Risk Mitigation

### 10.1 Qualitative Disclosure

- The Bank like all other major financial service Organisations is facing increasing demands to better understand its risks, both from management and from external stakeholders. Factors such as the global pace of change, resource constraints, product complexity and a growing demand for transparency, present a compelling case for stronger management of risk.
- The Bank's risk management and control principles shall continue to be implemented through a risk management and control framework. This framework shall comprise qualitative elements such as policies and authorities, and quantitative components including risk measurement methodologies and risk limits. In addition, the framework shall be dynamic and continuously adapted as Bank's businesses and the market environment evolve. It shall be based on:
  1. Strong managerial involvement throughout the entire Organisation, from the CEO down to operational field management teams;
  2. A firm structure of internal procedures and guidelines;
  3. Permanent supervision by an independent bodies to monitor risks and to enforce rules and procedures; and
  4. Continuous training that helps to foster a disciplined and constructive culture of risk management and control.

The overall objective of the Risk Management Framework is to improve shareholder value by optimizing risk and return. Specifically, Risk Management framework will:

1. Establish clear accountability or ownership of risk
  2. Enable management to make decisions on a well-informed, risk-adjusted, and aggregated basis
  3. Enable Bank to manage negative "what-if" scenarios
  4. Improve understanding of interactions and inter-relationships between risks
  5. Establish an "in control" status of significant risks
- Bank's Risk Management program is geared towards helping the Organisation to manage risk. A common risk framework and supporting processes aid in the comprehensive and consistent understanding and decision-making for risk. Through an integrated framework, the Bank intends to ingrain a strong and consistent risk culture across the Organisation.

- The Risk Management framework structure is summarized below:

The Risk Management framework has seven components: four that comprise the risk management decision phases and three that are support components.

The four risk management decision phases are:

- Policy** Top down direction providing definition for risk appetite, governance and risk management principles.
- Plan** Setting of risk strategy and objectives for business areas.
- Execute** The core risk process of risk identification, assessment, mitigation and measurement and reporting.
- Evaluate** Monitoring the program and evaluation of performance.

The three support components represent the tools and environment. They are:

- Infrastructure** The tools, technology, staffing and policy to support the risk management process.
- Internal Environment** The internal culture of the Bank and the tools to create and reinforce it.
- External Environment** Factors outside the Bank that may create risk that need to be monitored or against which the Bank’s Business plan may need to be evaluated.

- The Bank’s primary responsibility of managing Risk lies with Board of Directors (BOD) who has formed independent dedicated Board level committee, Board Governance Risk and Compliance Committee (BGRCC). The BGRCC is supported by independent Risk Management Group (RMG) that reports to BOD through BGRCC.
- Part of the risk governance, Senior Management Committees were established in the Bank to manage the overall level of each risk type. This includes: Assets and Liability Committee (ALCO), Credit and Investment Committee (CIC) and IT Steering Committee (ITSC). All the decisions taken by ALCO and CIC are submitted to BGRCC for their review and similarly decisions taken by BGRCC are submitted to BOD.



- To Bank has policies for each risk type and accordingly risk is identified, assessed, monitored and reported to the Board and Senior Management. For this, a comprehensive integrated risk management report covering is generated on regular basis that highlights risk and performance of portfolio and is reported to Senior Management and Board with analysis for their review.
- The Bank has comprehensive Risk Management Policies approved by the Board for all the major risk types. These are also supported by appropriate limit structures. These policies provide an enterprise-wide integrated risk management framework in the Bank.
- The risk appetite statement identifies risk objectives, policies, strategies and risk governance both at the Board and the management level. The capital management policy is aimed at ensuring financial stability by allocating enough capital to cover unexpected losses.
- Limit structures serve as key components in articulating risk strategy in quantifiable risk appetite. They are further supported by a comprehensive framework for various risk silos with its own policies and methodology documents. In addition, the Bank is in the process of implementing various risk systems to help quantify the regulatory capital allocated to various portfolios.
- The Bank is exposed to various types of risk, such as market, credit, profit rate, liquidity and operational, all of which require the comprehensive controls and ongoing oversight. The risk management framework summarises the spirit behind Basel II and III which includes management oversight and control, risk culture and ownership, risk recognition and assessment, control activities and segregation of duties, adequate information and communication channels, monitoring risk management activities and correcting deficiencies.
- For the purpose of Capital Adequacy calculation the exposure funded by IAH are taken completely in RWA and required capital as per CBO is allocated.

## 10.2 Quantitative Disclosure

### (a) Disclosure of the range and measures of risks facing each restricted IAH fund, based on its specific investment policies

As of reporting date the Bank does not have restricted IAH funds.

### (b) Disclosure of the treatment of assets financed by restricted IAH in the calculation of RWA for capital adequacy purposes

As of reporting date the Bank does not have restricted IAH funds.

### (c) Disclosure of the treatment of assets financed by unrestricted IAH in the calculation of RWA for capital adequacy purposes.

As per the Islamic Banking Regulatory Framework (IBRF), 30% (alpha ratio) of assets financed by IAH are required to be deducted from Total Risk Weighted Assets (RWA). However, the Bank has not taken into the consideration this and following conservative approach by not deducting the same from RWA.

### (d) Composition of financing by type of contract as a percentage of total financing.

Financing (gross) by type of contract	2017		2016	
	RO	%	RO	%
Sales Receivable and Other Receivables	189,353,137	31.92%	119,131,986	28.34%
Ijarah Muntahia Bittamleek	285,630,870	48.15%	236,908,190	56.36%
Musharaka financing	25,986,532	4.39%	807,517	0.20%
Wakala Bil Istethmar	92,233,136	15.55%	63,485,673	15.10%
Total Gross Financing	593,203,675	100.00%	420,333,366	100.00%

### (e) Percentage of financing for each category of counterparty to total financing

	2017		2016	
	Gross Financing		Gross Financing	
	RO	%	RO	%
Personal	316,307,269	53.32%	265,334,557	63.12%
Small Medium Enterprises	7,395,742	1.25%	3,244,000	0.77%
Corporate	269,500,664	45.43%	151,754,809	36.10%
Government	-	0%	-	0%
Total	593,203,675	100%	420,333,366	100%

### (f) Disclosure of the carrying amount of any assets pledged as collateral (excluding amounts pledged to the Central Bank) and the terms and conditions relating to each pledge.

As of reporting date, the Bank does not have any secured borrowing where Bank has pledge collateral to counterparty.

### (g) The amount of any guarantees or pledges given by the Licensee and the conditions attached to those guarantees or pledges.

The Bank issued Performance, Advance Payment and Shipping Guarantee amounting OMR 53,881,017 (Dec 2016: OMR 33,556,090) as of reporting date.

## 11. Credit Risk

- Credit risk is the risk that a customer or counterparty may not settle an obligation for full value, either when due or at any time thereafter. This risk arises from potential that a customer or counterparty's willingness to meet an obligation or its ability to meet such an obligation is impaired, resulting in an economic loss to the Bank.
- Credit risk is primarily managed as per BOD approved Credit risk policy where proper assessment of inherent risks is carried out in credit proposals to ensure a balanced portfolio of customers meeting the risk appetite of the Bank. The Bank also ensures dealing with customers of good credit standing, a thorough and professional credit assessment process, obtaining collaterals to mitigate risks and continuous monitoring of the accounts.
- Credit risk management, administration and control are carried out by risk management teams, which report to the Board Governance, Risk and Compliance Committee. The Bank has well defined credit structures under which credit committees, comprising of senior officers with requisite banking background, critically scrutinize and sanction financing up to the delegated authority. The Bank's exposure to credit is measured on an individual counterparty basis, as well as by groups of counterparties that share similar attributes. All credit decisions are taken as per the Bank's risk policies and CBO regulations and are monitored accordingly.
- The Bank relies on external ratings for rated corporate customers and counterparties. The Bank uses CBO approved External Credit Assessment Institutions i.e. Standard & Poor's, Fitch and Moody's to provide ratings for such counterparties. In case of unrated counterparties, the Bank assesses the credit risk based on the internal rating system/mechanism which the Bank has recently implemented.
- For all Past Due receivables and Impaired Financial assets, Specific Provisions is created and for Performing Financing Assets, General Provision is created according to CBO regulation. Specific Provisions is created where any payments of principal and/or profit are overdue by 90 days and above (in line with the CBO guidelines issued time to time) or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract.
- Due to the nature of Islamic banking in which underlying asset must be tangible and acceptable for purpose of transaction structure which has resulted in increased concentration on specific asset/sector type i.e. Real Estate. However, the Bank has adopted a sound and prudent portfolio management and control practices that involve the minimization of concentration risk by developing and implementing policies and procedures to ensure the diversification of the portfolio.

## 11.1 Quantitative Disclosure

### (a) Total Gross Credit and Average Gross Credit

	2017		2016	
	Gross Financing	Average Gross Financing	Gross Financing	Average Gross Financing
	RO	RO	RO	RO
Sales Receivables and Other Receivables	189,353,137	154,242,562	119,131,986	104,267,569
Ijarah Muntahia Bittamleek	285,630,870	261,269,530	236,908,190	197,283,858
Musharaka financing	25,986,532	13,397,025	807,517	403,759
Wakala Bil Istethmar	92,233,136	77,859,405	63,485,673	50,756,741
Investments in Sukuk & securities	47,721,137	38,540,324	29,359,510	27,185,730
Interbank Wakala Placements	19,862,045	33,089,762	46,317,478	29,628,815
<b>Total</b>	<b>660,786,857</b>	<b>578,398,606</b>	<b>496,010,354</b>	<b>409,526,471</b>

The breakup of Investment in Sukuk & securities and Interbank Wakala placements with respect to external ratings are given below:

External Ratings	2017		2016	
	Investment in Sukuk and Securities	Interbank Wakala Placements and Due from Banks	Investment in Sukuk and Securities	Interbank Wakala Placements and Due from Banks
	RO	RO	RO	RO
AAA	-	-	-	-
AA+,AA-AA	3,849,846	234,581	-	2,413,438
A+, A, A-	4,908,766	2,052,869	115,500	7,034,302
BBB+, BBB, BBB-	26,296,833	15,879,281	8,996,655	34,643,524
BB+, BB, BB-	2,597,294	1,693,815	904,624	2,225,462
B+, B, B-	620,222	-	625,029	-
Unrated	9,448,175	1,499	18,717,702	688
<b>Total</b>	<b>47,721,137</b>	<b>19,862,045</b>	<b>29,359,510</b>	<b>46,317,414</b>

### (b) Exposure in terms of geographical area

	Assets			Liabilities		
	Due from banks & Interbank Wakala investment	Gross financing	Investments in Sukuk & securities	Customer account, unrestricted IAH and customer Wakala	Interbank Wakala	Contingent liabilities and commitments
	RO	RO	RO	RO	RO	RO
<b>31 December 2017</b>						
Sultanate of Oman	15,610,219	591,310,758	30,347,758	525,851,542	11,550,000	214,478,975
Other GCC countries	2,707,746	1,892,917	11,759,755	-	7,700,000	2,772,990
Europe and North America	1,471,414	-	-	-	-	4,270,267
Africa and Asia	72,665	-	5,613,624	-	88,529	3,922,582
<b>Total</b>	<b>19,862,045</b>	<b>593,203,675</b>	<b>47,721,137</b>	<b>525,851,542</b>	<b>19,338,529</b>	<b>225,444,814</b>

	Assets			Liabilities		
	Due from banks & Interbank Wakala investment	Gross financing	Investments in Sukuk & securities	Customer account, unrestricted IAH and customer Wakala	Interbank Wakala	Contingent liabilities and commitments
	RO	RO	RO	RO	RO	RO
<b>31 December 2016</b>						
Sultanate of Oman	34,495,427	418,183,783	18,213,426	351,278,930	8,937,840	156,742,432
Other GCC countries	8,895,030	2,149,583	7,647,548	-	13,745,000	560,221
Europe and North America	2,872,324	-	1,342,854	-	-	2,786,916
Africa and Asia	54,697	-	2,155,682	-	550,032	1,087,095
<b>Total</b>	<b>46,317,478</b>	<b>420,333,366</b>	<b>29,359,510</b>	<b>351,278,930</b>	<b>23,232,872</b>	<b>161,176,664</b>

(c) Customer concentrations

2017	Assets			Liabilities		
	Due from banks & Interbank Wakala investment	Gross Financing	Investments in Sukuk & securities	Current, unrestricted IAH and customer Wakala	Interbank Wakala	Contingent liabilities and commitments
	RO	RO	RO	RO	RO	RO
Personal	-	316,307,269	-	201,467,257	-	35,712
Corporate	19,862,045	276,896,406	22,680,255	40,855,418	19,338,529	206,409,102
Government	-	-	25,040,882	283,528,867	-	19,000,000
<b>Total</b>	<b>19,862,045</b>	<b>593,203,675</b>	<b>47,721,137</b>	<b>525,851,542</b>	<b>19,338,529</b>	<b>225,444,814</b>

2016	Assets			Liabilities		
	Due from banks & Interbank Wakala investment	Gross Financing	Investments in Sukuk & securities	Current, unrestricted IAH and customer Wakala	Interbank Wakala	Contingent liabilities and commitments
	RO	RO	RO	RO	RO	RO
Personal	-	265,334,557	-	157,703,285	-	31,436
Corporate	46,317,478	154,998,809	19,380,253	33,849,361	23,232,872	142,145,228
Government	-	-	9,979,257	159,726,284	-	19,000,000
<b>Total</b>	<b>46,317,478</b>	<b>420,333,366</b>	<b>29,359,510</b>	<b>351,278,930</b>	<b>23,232,872</b>	<b>161,176,664</b>

(d) Industry concentrations

31 December 2017	Assets			Liabilities		
	Due from banks and interbank Wakala	Investments in Sukuk & securities	Gross financing	Current, unrestricted IAH and customer Wakala	Interbank Wakala	Contingent liabilities and commitments
	RO	RO	RO	RO	RO	RO
Personal	-	-	316,307,269	201,467,257	-	35,712
Construction	-	-	55,268,843	2,532,312	-	65,606,155
Manufacturing	-	-	52,141,605	3,361,125	-	33,847,672
Financial services	19,862,045	704,858	-	-	19,338,529	-
Government	-	25,040,882	-	283,528,867	-	19,000,000
Other services	-	-	37,172,759	1,424,800	-	12,826,432
Others	-	21,975,397	132,313,199	33,537,181	-	94,128,843
<b>Total</b>	<b>19,862,045</b>	<b>47,721,137</b>	<b>593,203,675</b>	<b>525,851,542</b>	<b>19,338,529</b>	<b>225,444,814</b>

31 December 2016	Assets			Liabilities		
	Due from banks and interbank Wakala	Investments in Sukuk & securities	Gross financing	Current, unrestricted IAH and customer Wakala	Interbank wakala	Contingent liabilities and commitments
	RO	RO	RO	RO	RO	RO
Personal	-	-	265,334,557	163,525,970	-	31,436
Construction	-	-	33,727,662	2,440,460	-	34,445,522
Manufacturing	-	-	1,499,956	994,558	-	31,925,044
Financial services	46,317,478	707,515	-	1,250,000	23,232,872	-
Government	-	9,979,257	-	152,706,569	-	19,000,000
Other services	-	-	10,444,266	2,182,241	-	8,889,103
Others	-	18,672,738	109,326,925	28,179,132	-	66,885,559
<b>Total</b>	<b>46,317,478</b>	<b>29,359,510</b>	<b>420,333,366</b>	<b>351,278,930</b>	<b>23,232,872</b>	<b>161,176,664</b>

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

	Due from banks and interbank Wakala	Gross sales receivables and other receivables	Gross Ijarah Muntahia Bittamleek	Gross Musharaka financing	Gross Wakala Bil Istethmar	Investment in Sukuk & securities	Total	Off balance sheet exposures
2017	RO	RO	RO	RO	RO	RO	RO	RO
Construction	-	8,424,567	10,634,998	1,033,914	35,175,364	-	55,268,843	65,606,155
Electricity, gas and water	-	24,047,289	1,206,534	-	27,558,249	-	52,812,072	34,430,842
Financial institutions	19,862,045	-	-	-	-	704,858	20,566,903	-
Services	-	13,403,343	2,249,690	17,645,290	3,874,436	-	37,172,759	12,826,432
Personal financing	-	101,917,352	214,389,917	-	-	-	316,307,269	-
Government	-	-	-	-	-	25,040,882	25,040,882	19,000,000
Non-resident financing	-	-	1,892,917	-	-	-	1,892,917	-
Others	-	41,560,586	55,256,814	7,307,328	25,625,087	21,975,397	151,725,212	93,581,385
<b>Total</b>	<b>19,862,045</b>	<b>189,353,137</b>	<b>285,630,870</b>	<b>25,986,532</b>	<b>92,233,136</b>	<b>47,721,137</b>	<b>660,786,857</b>	<b>225,444,814</b>

	Due from banks and interbank Wakala	Gross Sales receivables and other receivables	Gross Ijarah Muntahia Bittamleek	Gross Musharaka financing	Gross Wakala Bil Istethmar	Investment in Sukuk & securities	Total	Off balance sheet exposures
2016	RO	RO	RO	RO	RO	RO	RO	RO
Construction	-	1,924,597	7,299,555	-	24,503,510	-	33,727,662	34,445,522
Electricity, gas and water	-	1,010,905	133,182	-	31,873,134	-	33,017,221	33,582,778
Financial institutions	46,317,478	-	-	-	-	707,515	47,024,993	-
Services	-	295,191	135,205	-	3,290,310	-	3,720,706	8,889,103
Personal financing	-	92,047,398	173,287,159	-	-	-	265,334,557	-
Government	-	-	-	-	-	9,979,257	9,979,257	19,000,000
Non-resident financing	-	-	2,149,583	-	-	-	2,149,583	-
Others	-	23,853,895	53,903,506	807,517	3,818,719	18,672,738	101,056,375	65,259,261
<b>Total</b>	<b>46,317,478</b>	<b>119,131,986</b>	<b>236,908,190</b>	<b>807,517</b>	<b>63,485,673</b>	<b>29,359,510</b>	<b>496,010,354</b>	<b>161,176,664</b>

(f) Residual contractual maturities of the portfolio by major types of Islamic financing assets:

	Due from banks and interbank Wakala	Gross Sales receivables and other receivables	Gross Ijarah Muntahia Bittamleek	Gross Musharaka financing	Gross Wakala Bil Istethmar	Investment in Sukuk & securities	Total	Off balance sheet exposures
2017	RO	RO	RO	RO	RO	RO	RO	RO
<b>Upto 1 month</b>	19,862,045	5,449,979	1,766,917	39,691	16,499,319	10,431,751	54,049,703	49,521,661
<b>1 to 3 months</b>	-	12,383,038	6,186,156	707,821	15,187,640	3,850,154	38,314,809	22,235,199
<b>3 to 6 months</b>	-	14,284,252	5,129,593	231,021	11,962,594	-	31,607,460	12,308,442
<b>6 to 9 months</b>	-	16,388,337	5,432,637	641,537	13,183,375	-	35,645,886	15,981,073
<b>9 to 12 months</b>	-	13,273,026	5,759,645	287,827	9,363,108	-	28,683,606	73,707,913
<b>1 to 3 years</b>	-	56,185,513	50,824,625	4,344,826	9,829,222	1,325,080	122,509,266	32,397,295
<b>3 to 5 years</b>	-	40,377,760	46,360,271	4,136,122	13,917,003	8,469,318	113,260,474	8,313,201
<b>Over 5 years</b>	-	31,011,232	164,171,026	15,597,687	2,290,875	23,644,834	236,715,653	10,980,030
	<b>19,862,045</b>	<b>189,353,137</b>	<b>285,630,870</b>	<b>25,986,532</b>	<b>92,233,136</b>	<b>47,721,137</b>	<b>660,786,857</b>	<b>225,444,814</b>

	Due from banks and interbank Wakala	Gross Sales receivables and other receivables	Gross Ijarah Muntahia Bittamleek	Gross Musharaka financing	Gross Wakala Bil Istethmar	Investment in Sukuk & securities	Total	Off balance sheet exposures
2016	RO	RO	RO	RO	RO	RO	RO	RO
Upto 1 month	46,317,478	2,834,249	1,137,867	3,863	17,826,600	5,647,945	73,768,002	35,404,390
1 to 3 months	-	6,577,418	2,487,371	8,444	12,027,200	-	21,100,433	15,896,552
3 to 6 months	-	8,019,245	3,533,100	11,994	3,911,196	-	15,475,535	8,799,642
6 to 9 months	-	6,615,903	3,788,955	12,863	457,700	-	10,875,421	11,425,306
9 to 12 months	-	7,125,904	4,307,462	14,623	3,634,636	-	15,082,625	52,695,803
1 to 3 years	-	44,076,604	37,348,713	126,790	7,081,257	1,604,327	90,237,691	23,161,712
3 to 5 years	-	23,415,830	32,476,438	110,250	3,966,878	10,993,238	70,962,634	5,943,335
Over 5 years	-	20,466,833	151,828,284	518,690	14,580,206	11,114,000	198,508,013	7,849,924
	<u>46,317,478</u>	<u>119,131,986</u>	<u>236,980,190</u>	<u>807,517</u>	<u>63,485,673</u>	<u>29,359,510</u>	<u>496,010,354</u>	<u>161,176,664</u>

(g) Total gross exposure and average gross exposure to equity based financing structures by type of financing contract during the previous year and over the period.

As of reporting date, the Bank does not have any equity based financing.

(h) Distribution of impaired financing, past due and not past due financing by type of industry:

	Performing financing	Non-performing financing	Specific provisions held	General provisions held
31-Dec-17	RO	RO	RO	RO
Construction	55,268,843	-	-	552,688
Electricity, gas and water	52,812,072	-	-	528,121
Financial institutions	-	-	-	-
Services	37,172,759	-	-	371,728
Personal financing	316,307,269	159,027	73,632	4,373,955
Non-resident financing	1,892,917	-	-	18,929
Others	129,749,815	188,362	52,965	1,297,498
	<u>593,203,675</u>	<u>347,389</u>	<u>126,597</u>	<u>7,142,919</u>

	Performing financing	Non-performing financing	Specific provisions held	General provisions held
31-Dec-16	RO	RO	RO	RO
Construction	33,727,662	-	-	337,277
Electricity, gas and water	33,017,221	-	-	110,258
Financial institutions	-	-	-	-
Services	3,720,706	-	-	104,443
Personal financing	265,306,097	28,460	25,512	3,741,820
Non-resident financing	2,149,583	-	-	21,496
Others	82,174,515	104,561	26,140	976,513
	<u>420,200,345</u>	<u>133,021</u>	<u>51,652</u>	<u>5,291,807</u>

(i) Distribution of impaired financing and past due financing by geographical distribution:

	Performing financing	Non-performing financing	Specific provisions held	General provisions held
<b>31 December 2017</b>	<b>RO</b>	<b>RO</b>	<b>RO</b>	<b>RO</b>
Sultanate of Oman	591,310,758	347,389	126,597	7,123,990
Other countries	1,892,917	-	-	18,929
<b>Total</b>	<b>593,203,675</b>	<b>347,389</b>	<b>126,597</b>	<b>7,142,919</b>

	Performing financing	Non-performing financing	Specific provisions held	General provisions held
<b>31 December 2016</b>	<b>RO</b>	<b>RO</b>	<b>RO</b>	<b>RO</b>
Sultanate of Oman	418,050,762	133,021	51,652	5,270,311
Other countries	2,149,583	-	-	21,496
<b>Total</b>	<b>420,200,345</b>	<b>133,021</b>	<b>51,652</b>	<b>5,291,807</b>

(j) Distribution of provision with type of Islamic financing asset:

	Performing financing	Non-performing financing	Specific provisions held	General provisions held
<b>31 December 2017</b>	<b>RO</b>	<b>RO</b>	<b>RO</b>	<b>RO</b>
Personal financing	316,307,269	159,027	73,632	4,510,067
Non-resident corporate financing	1,892,917	-	-	18,929
Resident corporate financing	275,003,489	188,362	52,965	2,613,923
<b>Total</b>	<b>593,203,675</b>	<b>347,389</b>	<b>126,597</b>	<b>7,142,919</b>

	Performing financing	Non-performing financing	Specific provisions held	General provisions held
<b>31 December 2016</b>	<b>RO</b>	<b>RO</b>	<b>RO</b>	<b>RO</b>
Personal financing	265,306,097	28,460	25,512	3,289,645
Non-resident corporate financing	2,149,583	-	-	21,496
Resident corporate financing	152,744,665	104,561	26,140	1,980,666
<b>Total</b>	<b>420,200,345</b>	<b>133,021</b>	<b>51,652</b>	<b>5,291,807</b>

(k) Change in loss provisions during the financial year

	2017	2016
	RO	RO
Balance at 1 January	5,343,459	3,927,988
General provision made during the year on sales receivables and other receivables	644,963	358,507
General provision made during the year on Ijara Muntahia Bittamleek	666,884	775,290
General provision made during the year on Wakala Bil Istethmar	287,475	254,578
General provision made during the year on Musharaka financing	251,790	8,076
Specific provision made during the year on sales receivable and other receivables	74,945	19,020
General and specific provision expense	1,926,057	1,415,471
<b>Balance at 31 December</b>	<b>7,269,516</b>	<b>5,343,459</b>

## (l) Penalty imposed on customers for default, and the disposition of any monies received as penalty

During the year, OMR 67,466 (Dec 2016: OMR 35,412) penalty is imposed to customer for delayed payment and OMR 85,427 (2016: OMR 17,451) has been transferred to Bank Muscat Charity Project Fund and Oman Charitable Association as per the policy.

## 12. Credit Risk Mitigation

- Credit risk mitigation refers to the use of a number of techniques, like collaterals and guarantees to mitigate credit risks that the Bank is exposed to. Credit risk mitigants reduces the credit risk by allowing the Bank to protect against counterparty non-performance of credit contracts through collaterals, netting agreements and guarantees.

### 12.1 Qualitative Disclosure

- The Bank only considers Sharia approved collaterals and guarantees to mitigate credit risk. Assets offered by customer must meet the following criteria to be acceptable as collateral:
  - Assets must be maintaining their value, at the level prevalent at inception, until maturity of the facility approved;
  - Such assets should be easily convertible into cash, if required;
  - There should be a reasonable market for the assets; and
  - The Bank should be able to enforce its right over the assets if necessary
- For assets financed under Ijarah Muntahiya Bittamleek, the underlying asset is used to mitigate the default risk (Loss Given Default).
- The Bank accepts Hamish Jiddiyah, Urbun, Profit Sharing Investment Accounts, pledged assets, Sukuk (rated/unrated), third party guarantees (by sovereigns, banks, corporate entities and High net-worth Individuals) as risk mitigant.
- Where eligible collaterals are available against facilities, the Bank takes independent valuation by approved valuers only and ensures that the assets held as collateral meet the criteria mentioned above. The Bank as per the CBO guidelines takes the value of collateral after applying appropriate haircut before assigning provisions. In cases, whenever the bank acquires/disposes assets as a last resort on fair market value, the decision is on case to case basis to acquire or not for its operations.
- The Bank considers guarantees and if the risk profile/weight of the guarantor is better than the counterparty then risk weight is applied based on the rating of guarantor.

### 12.2 Quantitative Disclosure

(a) Disclosure of the total carrying amounts by type of collateral of any assets held as collateral by the Licensee (including any haircuts) and the terms and conditions relating to the pledges

	2017	2016
	RO	RO
Real Estate	302,132,132	215,812,867
Movable Assets	57,959,187	60,018,010
Total	360,091,320	275,830,877

The value of the collateral is adjusted by relevant haircut as mandated by IBRF. Since Bank does not have any financing against eligible financial instruments (equity shares or Sukuk) therefore no haircut is applied for the purpose of calculation of Risk Weighted Assets or assessment of specific provision requirements.

(b) Disclosure of the carrying amount of assets owned and leased under Ijara Muntahia Bittamleek

	2017	2016
	RO	RO
Ijarah Muntahia Bittamleek	285,630,870	236,908,190

## 13. Liquidity risk

Liquidity risk is the potential inability to meet the Bank's liabilities as they become due. It arises when the Bank is unable to generate cash to cope with a decline in deposits or increase in assets.

### 13.1 Qualitative Disclosure

- Bank's Liquidity Risk Management is governed by the Liquidity Risk Management Policy document approved by the Board of Directors as well as the provisions of relevant CBO guidelines on liquidity risk management. The Liquidity risk policy incorporates contingency funding plans and measures so as the Bank is always in a position to meet all maturing liabilities as well as to fund asset growth and business operations.
- The Bank monitors its liquidity risk of funding related to current account, saving accounts, investment accountholder on individual basis as well as on aggregate basis through cash flow approach and stock approach.
- Treasury department of the Bank and Asset Liability Committee (ALCO) controls and monitors the liquidity and ensures that the Bank is not exposed to undue liquidity risk and at the same time makes optimum use of its funds through Sharia compliant financing and investment activities.
- The bank has already implemented Basel III standards for liquidity that includes Liquidity Coverage Ratio and Net Stable Funding Ratio. These ratios are used as an indicator to show the Bank's liquidity position to honor its short-term and long-term commitments.
- "Basel III" is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector.
- These measures aim to:
  - improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source
  - improve risk management and governance
  - strengthen banks' transparency and disclosures

### 13.2 Quantitative Disclosure

The related disclosure on Liquidity Risk is given below:

#### (a) Indicators of exposure to liquidity risk - short-term assets to short-term liabilities

	2017	2016
	RO	RO
Short-term Assets	236,941,457	162,539,052
Short-term Liabilities	251,654,084	194,913,467
Short-term Assets to Short-term Liabilities	94.15%	83.39%

#### (b) Indicators of exposure to liquidity risk - liquid assets ratio

	2017	2016
	RO	RO
Liquid Assets	62,676,013	62,917,136
Short-term Liabilities	251,654,084	194,913,467
Total Liabilities	565,888,594	388,933,932
Liquid Asset to Short-term Liabilities	24.91%	32.28%
Liquid Asset to Total Liabilities	11.08%	16.18%

## (c) Maturity profile of assets and liabilities

	Due on demand and up to 30 days	More than 1month to 6 months	More than 6 months to 12 months	More than 1 year to 5 years	Over 5 years	Total
31 December 2017	RO	RO	RO	RO	RO	RO
Cash and balances with Central Bank of Oman	42,313,967	-	-	-	500,001	42,813,968
Inter-bank Wakala and Due from banks	19,862,045	-	-	-	-	19,862,045
Financing to customers - net	23,140,226	62,287,336	60,103,140	211,424,184	203,590,474	560,545,360
Financial assets at fair value through equity	10,431,751	3,850,154	-	2,794,398	23,644,834	40,721,137
Financial assets at amortized cost	-	-	-	7,000,000	-	7,000,000
Investment in real estate	-	-	14,175,000	-	-	14,175,000
Intangible asset	-	-	-	-	2,203,452	2,203,452
Property and equipment	-	-	-	-	2,428,106	2,428,106
Other assets	86,931	488,881	202,026	3,820,733	2,290,332	6,888,903
<b>Total assets</b>	<b>95,834,920</b>	<b>66,626,371</b>	<b>74,480,166</b>	<b>225,039,315</b>	<b>234,657,199</b>	<b>696,637,971</b>
Interbank Wakala	2,013,529	17,325,000	-	-	-	19,338,529
Customer accounts, Wakala and unrestricted acountholders	23,586,681	59,618,832	128,956,122	216,822,354	96,885,293	525,869,282
Other liabilities	5,544,238	3,925,700	10,683,982	246,155	-	20,400,075
Investment risk and profit equalization reserve	-	-	-	-	280,708	280,708
Owners' equity	-	-	-	-	130,749,377	130,749,377
<b>Total liabilities, equity of unrestricted investment acountholders and owners' equity</b>	<b>31,144,448</b>	<b>80,869,532</b>	<b>139,640,104</b>	<b>217,068,508</b>	<b>227,915,378</b>	<b>696,637,971</b>
<b>Net gap</b>	<b>64,690,472</b>	<b>(14,243,161)</b>	<b>(65,159,938)</b>	<b>7,970,806</b>	<b>6,741,821</b>	<b>-</b>
<b>Cumulative net gap</b>	<b>64,690,472</b>	<b>50,447,311</b>	<b>(14,712,627)</b>	<b>(6,741,821)</b>	<b>-</b>	<b>-</b>

	Due on demand and up to 30 days	More than 1 month to 6 months	More than 6 months to 12 months	More than 1 year to 5 years	Over 5 years	Total
31 December 2016	RO	RO	RO	RO	RO	RO
Cash and balances with Central Bank of Oman	16,253,563	-	-	-	346,095	16,599,658
Inter-bank Wakala and Due from banks	46,317,478	-	-	-	-	46,317,478
Financing to customers - net	21,348,259	34,396,498	23,627,617	137,928,664	180,506,318	397,807,356
Financial assets at fair value through equity	5,644,945	-	-	5,600,565	11,114,000	22,359,510
Financial assets at amortized cost	-	-	-	7,000,000	-	7,000,000
Investment in real estate	-	14,175,000	-	-	-	14,175,000
Intangible asset	-	-	-	-	2,121,330	2,121,330
Property and equipment	-	-	-	-	3,105,323	3,105,323
Other assets	169,510	413,030	193,152	3,731,340	2,002,690	6,509,722
<b>Total assets</b>	<b>89,733,755</b>	<b>48,984,528</b>	<b>23,820,769</b>	<b>154,260,569</b>	<b>199,195,756</b>	<b>515,995,377</b>
Interbank Wakala	8,987,872	385,000	385,000	13,475,000	-	23,232,872
Customer accounts, Wakala and unrestricted acountholders	35,471,918	57,510,655	78,958,082	133,763,516	45,624,940	351,329,111
Other liabilities	1,788,958	3,569,662	7,856,320	217,646	-	13,432,586
Investment risk and profit equalization reserve	-	-	-	-	939,363	939,363
Owners' equity	-	-	-	-	127,061,445	127,061,445
Total liabilities, equity of unrestricted investment acountholders and owners' equity	46,248,748	61,465,317	87,199,402	147,456,162	173,625,748	515,995,377
Net gap	43,485,007	(12,480,789)	(63,378,633)	6,804,407	25,570,008	-
Cumulative net gap	43,485,007	31,004,218	(32,374,415)	(25,570,008)	-	-

## 14. Market Risk

Market risk is the risk of loss due to unfavorable movements in market factors such as profit rates, exchange rates, and commodity and equity prices. The Bank's Market risks arise generally due to open positions in currency, holding common equity, and other products. All such instruments and transactions are exposed to general and specific market movements.

### 14.1 Qualitative Disclosure

- The Bank seeks to mitigate market risk by employing strategies that correlate rate and price movements of its earning asset and liabilities. The Bank has Assets and Liability Committee (ALCO) which monitors Market and Liquidity Risk on regular basis. The details of market risk faced by the bank are discussed in the following notes.

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

#### Profit Rate Risk

Profit rate risk is the risk that the Bank will incur a financial loss as a result of mismatch in the profit rate on the assets and balances from fund providers. The profit distribution is based on profit sharing agreements instead of guaranteed return to investment account holders. Therefore, the Bank is not subject to any significant profit rate risk.

However, the profit sharing arrangements will result in displaced commercial risk when the Bank's results do not allow the Bank to distribute profits in line with the market rates. In respect of monitoring the impact of profit rate changes on the earnings and economic value of the Bank, the Bank has developed suitable risk management tool that identify gaps based on the repricing of the assets and liabilities. The result of this sensitivity analysis is presented to Assets and Liability Committee to that necessary decision, if required can be taken for protect the interest of the Bank.

#### Foreign Exchange Risk

Forex risk is the risk that a bank may suffer losses as a result of adverse exchange rate movements during a period in which it has an open position in an individual foreign currency.

The Bank has exposure in foreign currency. However, significant portion of the foreign currency exposure is in USD and GCC pegged currencies. In addition to this, the Bank has internal limits and mechanism for controlling foreign currency risk for unpegged currencies.

#### Commodity Price Risk

Commodity price risk is defined as the risk of losses in on- or off-balance sheet position arising from movements in market prices i.e. fluctuations in value in tradable or marketable commodities. The risk related to the current and future volatility of market values of specific assets (for example, the commodity price of Salam asset or the market value of Murabaha assets purchased to be delivered over a specific period).

The Bank however is not exposed to commodity market as the bank whenever enter into any transaction or specific agreement, the commodity price risk is either hedged or the transaction is performed on spot basis so there is not fluctuation of market price from the moment bank takes an asset in possession and sells an asset to the buyer/customer.

#### Price Risk

Price Risk or Equity Investment Risk is risk to earnings or capital that results from adverse changes in the value of equity related portfolios of the Bank.

The Bank has investments in Sukuks and Mutual Funds. All the investments are marked-to-market on regular basis. All the investment are made after a careful due diligence after taking necessary approvals including from Sharia to ensure that investments are made as per Sharia standards. The day-to-day monitoring and management of investments is done by Treasury, Risk Management and Asset Liability Committee of the Bank. All strategic investments are regularly reviewed by Risk Management and Credit and Investment Committee of the Bank.

## 14.2 Quantitative Disclosure

(a) Breakdown of Market RWA	2017	2016
	RO	RO
Equity Position	-	-
Foreign Exchange Risk	22,391,617	32,047,791
Commodity Risk	-	-
Total	22,391,617	32,047,791

### (b) Foreign Exchange Net Open Position to Capital

	2017	2016
Foreign Exchange Net Open Position to Capital	16.84%	25.20%

As of reporting date, the bank does not have any trading book instruments. Most of the exposure is in USD and OMR is pegged with USD therefore the sensitivity analyses is immaterial to be reported.

### (c) Commodity Net Open Position to Capital

The Bank does not have any commodity available for sale as of reporting date.

### (d) Equity Net Open Position to Capital

The Bank does not have any equity in its trading book as of reporting date.

### (e) Total Amounts of assets subject to market risk by type of assets

The Bank does not have any investments/assets in Trading Book. Market risk weighted assets only comprise FX position which is mentioned above in item (a).

### (f) Measure of Value-at-risk or other sensitivity analyses for different types of market risk

As of reporting date, the bank does not have any trading book instruments. Most of the exposure is in USD and OMR is pegged with USD therefore the sensitivity analyses is immaterial to be reported.

## 15. Operational risk

### 15.1 Qualitative Disclosure

Operational Risk is the risk of direct or indirect losses resulting from inadequate or failed internal processes or systems, human factors, or from external events. The Bank's businesses are dependent on the ability to process a large number of transactions efficiently and accurately. Operational risks and losses originate from business/operational process failure, IT security failure, natural disasters, dependence on key suppliers, fraud, service quality compromised, regulatory non-compliance, loss of key staff, and social and environmental impacts. It also includes the risk that arises from the bank's failure to comply with the Shariah rules and principles. Being an Islamic Bank, sharia non-compliance risk is managed by an independent function that ensures bank's adherence to the Sharia standards and rules.

- The Bank has developed operational risk management policy and all the critical controls are implemented at all levels for curtailing operational risk. Each division has processes and systems in place to address operational risks within their area are accordingly performance of the department is reviewed on regular basis. The Risk Appetite statement also sets a target for the Management related to Operational Risk and accordingly business plans, product programs are designed to minimize potential operational risk.
- The Bank has defined process for reporting and escalation of operational incidents that stores in the master database for tracking in future. Also, on an annual basis the potential high risk exposures are identified by each business and support function and accordingly controls are discussed/implemented to minimize risk exposures. The Bank's Sharia Compliance department checks independently the processes on regular basis to ensure there is no sharia related issue that could trigger operational loss to the Bank.

- As per the Bank's policy, operational risk is responsibility of all the staff members and all line managers are responsible for management of operational risk within their unit. Process and Control Improvement is a business as usual for the Bank, accordingly all the line managers are required to perform process and control improvement on regular/need basis to ensure the Bank is not taking any unnecessary risk in carrying out business activities.
- The Bank has well-defined Business Continuity Management policy which is approved by Board of Directors. During the year the Bank also conducted a drill at Head Office to see the Bank's readiness to attend to any major event that could result in major disruption to the Business. The Bank also conducted testing of critical functions in order to continue critical transaction in case of any unforeseen events.

## 15.2 Quantitative Disclosure

### (a) RWA Equivalent for Quantitative Operational Risk

- For the purpose of measuring capital charge, the Bank has adopted the Basic Indicator Approach under Basel II for Operational Risk. The approach requires the Bank to provide 15% of the average three years gross annual income as capital charge for operational risk.

(a) Breakdown of Market RWA	2017	2016
	RO	RO
Net income from financing activities	26,666,609	17,114,949
Add: Net income from investment activities	3,092,157	2,610,617
Add: Fee income	3,502,187	1,921,936
Less: Investment Accountholders share of income	11,285,004	4,479,702
Add : Other Income	415,766	211,239
Total Revenues	22,391,715	17,379,039
Less: Exceptional and extraordinary income	-	-
Gross Income	22,391,715	17,379,039
Gross Income times of Alpha (15%)	3,358,757	2,606,856
Operational Risk Weighted Assets 12.5x	41,984,466	32,585,698
Operational Risk Weighted Assets (Average of last 3 Years)	32,302,324	23,006,077

### (b) Indicators for Operational risk exposures

	2017	2016
	RO	RO
• Gross Income taken in RWA calculation	22,391,715	17,379,039

- There is no Sharia non-compliance income recognized during the year and whenever such incident happens, the Bank's policy is to transfer such funds to charity.

## 16. Rate of Return Risk

Rate of Return Risk is the risk of deviations in earnings or economic value due to adverse movement of the yield curve. It is inherent primarily to the banking book mainly through financing and deposits portfolio.

### 16.1 Qualitative Disclosure

- The profit rate exposure of the Bank arises due to mismatches between contractual maturities or re-pricing of on- and off-balance sheet assets and liabilities. It is addressed by an Asset and Liability Management Committee (ALCO) that reviews the profit rate dynamics at regular intervals and decides re-pricing of assets and liabilities ensuring that the spread of the Bank remains at an acceptable level.
- The sensitivity of the income statement is the effect of the assumed changes in profit rates on the earning for one year, based on the variable profit rate non-trading financial assets and financial liabilities held at 31 December 2017.

## 16.2 Quantitative

- Indicators Of Exposures To Rate Of Return Risk – Expected Payments/Receipts On Financing And Funding At Different Maturity

	Due on demand and within 30 days	Due within 1 to 6 months	Due within 6 to 12 months	Due within 1 to 5 years	Due after 5 years	Non-profit bearing	Total
31 December 2017	RO	RO	RO	RO	RO	RO	RO
Cash and balances with Central Bank of Oman	-	-	-	-	-	42,813,968	42,813,968
Inter-bank Wakala and Due from banks	16,397,550	-	-	-	-	3,464,495	19,862,045
Financing to customers - net	136,415,232	81,159,071	80,151,364	199,458,493	63,361,200	-	560,545,360
Financial assets at fair value through equity	4,908,458	3,850,154	-	9,794,398	16,644,858	5,523,269	40,721,137
Financial assets at amortized cost	-	-	-	7,000,000	-	-	7,000,000
Investment in real estate	-	-	-	-	-	14,175,000	14,175,000
Intangible asset	-	-	-	-	-	2,203,452	2,203,452
Property and equipment	-	-	-	-	-	2,428,106	2,428,106
Other assets	29,181	160,017	89,337	1,237,562	2,044,086	3,328,720	6,888,903
<b>Total assets</b>	<b>157,750,421</b>	<b>85,169,242</b>	<b>80,240,701</b>	<b>217,490,453</b>	<b>82,050,144</b>	<b>73,937,010</b>	<b>696,637,971</b>
Interbank Wakala	1,925,000	17,325,000	-	-	-	88,529	19,338,529
Customer accounts, Wakala and unrestricted accountholders	9,438,427	35,922,972	45,011,722	288,601,015	78,584,928	68,310,218	525,869,283
Other liabilities	-	-	-	-	-	20,400,075	20,400,075
Investment risk and profit equalisation reserve	-	-	-	-	280,708	-	280,708
Shareholders' equity	-	-	-	-	-	130,749,377	130,749,377
<b>Total liabilities and shareholders' equity</b>	<b>11,363,427</b>	<b>53,247,972</b>	<b>45,011,722</b>	<b>288,601,015</b>	<b>78,865,636</b>	<b>219,548,199</b>	<b>696,637,971</b>
<b>On-balance sheet gap</b>	<b>146,386,994</b>	<b>31,921,270</b>	<b>35,228,979</b>	<b>(71,110,562)</b>	<b>3,184,508</b>	<b>(145,611,189)</b>	<b>-</b>
<b>Cumulative profit sensitivity gap</b>	<b>146,386,994</b>	<b>178,308,264</b>	<b>213,537,243</b>	<b>142,426,681</b>	<b>145,611,189</b>	<b>-</b>	<b>-</b>

	Due on demand and within 30 days	Due within 1 to 6 months	Due within 6 to 12 months	Due within 1 to 5 years	Due after 5 years	Non-profit bearing	Total
31 December 2016	RO	RO	RO	RO	RO	RO	RO
Cash and balances with Central Bank of Oman	-	-	-	-	-	16,599,658	16,599,658
Inter-bank Wakala and Due from banks	42,680,780	-	-	-	-	3,636,698	46,317,478
Financing to customers – net	66,390,033	53,762,599	45,642,039	148,119,952	83,892,733	-	397,807,356
Financial assets at fair value through equity	-	-	-	5,600,565	11,114,000	5,644,945	22,359,510
Financial assets at amortized cost	-	-	-	7,000,000	-	-	7,000,000
Investment in real estate	-	-	-	-	-	14,175,000	14,175,000
Intangible asset	-	-	-	-	-	2,121,330	2,121,330
Property and equipment	-	-	-	-	-	3,105,323	3,105,323
Other assets	111,759	191,777	66,174	605,085	1,268,664	4,266,263	6,509,722
<b>Total assets</b>	<b>109,182,572</b>	<b>53,954,376</b>	<b>45,708,213</b>	<b>161,325,602</b>	<b>96,275,397</b>	<b>49,549,217</b>	<b>515,995,377</b>
Interbank Wakala	8,937,840	385,000	385,000	13,475,000	-	50,032	23,232,872
Customer accounts, Wakala and unrestricted accountholders	9,956,503	44,931,480	55,801,145	143,961,509	27,510,481	69,167,993	351,329,111
Other liabilities	-	-	-	-	-	13,432,586	13,432,586
Investment risk and profit equalisation reserve	-	-	-	-	939,363	-	939,363
Shareholders' equity	-	-	-	-	-	127,061,445	127,061,445
<b>Total liabilities and shareholders' equity</b>	<b>18,894,343</b>	<b>45,316,480</b>	<b>56,186,145</b>	<b>157,436,509</b>	<b>28,449,844</b>	<b>209,712,056</b>	<b>515,995,377</b>
<b>On-balance sheet gap</b>	<b>90,288,229</b>	<b>8,637,896</b>	<b>(10,477,932)</b>	<b>3,889,093</b>	<b>67,825,553</b>	<b>(160,162,839)</b>	<b>-</b>
<b>Cumulative profit sensitivity gap</b>	<b>90,288,229</b>	<b>98,926,125</b>	<b>88,448,193</b>	<b>92,337,286</b>	<b>160,162,839</b>	<b>-</b>	<b>-</b>

- Sensitivity Analysis of the Bank's Profits And The Rate Of Return To Price Or Profit Rate Movements In The Market

#### Impact on earnings due to rate of return risk in the banking book

	2017	2016
	RO	RO
+200 bps	3,281,878	3,581,417
+100 bps	1,640,939	1,790,709
-200 bps	(3,281,878)	(3,581,417)
-100 bps	(1,640,939)	(1,790,709)

## 17. Displaced Commercial Risk

Displaced Commercial Risk (DCR) refers to the magnitude of risks that are transferred to shareholders in order to cushion the Profit Sharing Investment Account (PSIA) from bearing some or all of the risks to which they are contractually exposed in Mudaraba funding contracts. Under a Mudaraba (profit sharing and loss-bearing) contract, in principle, unrestricted PSIA are exposed to the aggregate impact of risks arising from the assets in which their funds are invested, but they benefit from the DCR assumed by the Bank. This risk-sharing is achieved by constituting and using various reserves such as Profit Equalization Reserve (PER), and by adjusting the Mudarib's (Bank as fund manager) profit share in order to smooth the returns payable to the IAH from exposure to the volatility of aggregate returns arising from banking risks, and thereby to enable payment of returns that are competitive in the marketplace.

### 17.1 Qualitative Disclosure

- The Bank has set up prudential reserve account to minimize the adverse impact of income smoothing for PSIA on its shareholders' returns and to meet potential but unexpected losses that would be borne by the IAH on investments financed by PSIA, namely:
  - Profit Equalization Reserve (PER)  
PER comprises amounts appropriated out of the gross income from the Mudaraba to be available for smoothing returns paid to the IAH and the shareholders, and consists of a PSIA portion and a shareholders' portion;
  - Investment Risk Reserve (IRR)  
IRR comprises amounts appropriated out of the income of IAH after deduction of the Mudarib share of income, to meet any future losses on the investments financed by the PSIA.

The analysis of distribution of Mudaraba profit during the period is as follows:

	2017	2016
Items	RO	RO
Total distributable profits	27,956,017	17,981,771
Bank Share As "Mudarib and Rab ul Maal"	16,671,013	13,502,069
Depositors Share of profits	8,823,698	2,395,311
Bank Share As "Mudarib"	4,626,678	1,199,838
Net profit to be distributed to the depositors before IRR & PER	4,197,020	1,195,473
Investment Risk Reserve "IRR"	(120,584)	(118,818)
Profit Equalization Reserve "PER"	779,239	(51,354)
Net profit to be distributed to the depositors after IRR & PER	4,855,675	1,025,301

- During the period the Bank utilized OMR 779,239 (FY2016: 176,414) from PER for the purpose of enhancing the returns to depositors
- The Bank is taking all the Risk Weighted Assets funded by IAH for the purpose of arriving at Total Risk Weighted Assets and capital requirement is calculated accordingly.

### 17.2 Quantitative Disclosures

Historical Rate of Return of unrestricted Investment Account holder:

	2017	2016	2015	2014
Items	RO	RO		
Profit Earned	27,956,017	17,981,771	10,063,445	5,537,082
Profit Distributed	4,197,020	1,195,473	896,195	243,609
Funds Invested	227,777,182	157,984,717	73,597,787	42,280,807
Return as % of Funds Invested	1.84%	0.76%	1.22%	0.58%

## 18. Contract-Specific Risk

In each type of Islamic Financing asset is exposed to a varying mix of credit and market risk. This mix can also vary according to the stage of the contract. However, the product structure does not change the nature of risk at the stage of contract. Further policy restricts undue exposure of any risk at any given time and all the contracts are in line with Sharia and regulatory guidelines. Accordingly capital is required to be allocated for such risk exposures in line with IBRF.

### 18.1 Qualitative Disclosure

- As of reporting date financing assets only carries credit risk and accordingly capital is allocated as per the required regulations by CBO. The current product mix does not change the nature of risk according to the stage of contract.

### 18.2 Quantitative Disclosure

Disclosure of Capital Requirements according to different risk categories for each shari'a compliant financing contract

Items	2017			2016		
	RO	RO	RO	RO	RO	RO
	Credit risk	Market risk	Risk Weighted Assets	Credit risk	Market risk	Risk Weighted Assets
Ijara Muntahia Bittamleek	26,200,862	-	188,835,041	31,382,573	-	236,849,608
Sales Receivable and Other Receivables	22,286,087	-	160,620,449	13,402,401	-	101,150,196
Wakala Bil Istethmar	25,594,695	-	184,466,272	16,823,703	-	126,971,343
Musharaka Financing	9,735,204	-	70,163,636	288,889	-	2,180,294
Letter of Guarantees	3,737,996	-	26,940,509	2,223,091	-	16,778,045
Letter of Credit	559,879	-	4,035,167	256,945	-	1,939,208
Acceptance and Bills for Collection (Wakala)	1,016,834	-	7,328,535	1,658,026	-	12,513,404
<b>Total</b>	<b>89,131,558</b>		<b>642,389,609</b>	<b>66,035,628</b>		<b>498,382,098</b>

## 19. General Disclosure from Corporate Governance

### 19.1 Qualitative Disclosure

- An important objective of these disclosures is to ensure transparency regarding Sharia compliance by the Bank and applicable reporting standard. As such all material information are published as soon as practicable while meeting the deadlines set by the disclosure requirements of the CBO and the Bank is compliant with the applicable financial reporting standards.
- Corporate Governance is the system of rules, practices and processes by which the Bank is directed and controlled. Corporate governance essentially involves balancing the interests of the many stakeholders in the Bank- these include its shareholders, management, customers, suppliers, financiers, government and the community. Since corporate governance also provides the framework for attaining the Bank's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.
- The Capital Market Authority (CMA) Code of Corporate Governance for Public Listed Companies and the CBO guidelines as per the IBRF Corporate Governance of Banking and Financial Institutions are the principal codes and drivers of Corporate Governance practices in the Sultanate of Oman. Bank Nizwa complies with all of their provisions. The CMA Code of Corporate Governance can be found at the following website, [www.cma.gov.om](http://www.cma.gov.om). Corporate Governance has also been defined more narrowly as the relationship of an entity to its shareholders or more broadly as its relationship to society

The following disclosure summarizes disclosure of related party:

31 December 2017	Principal shareholders	Sharia'a Board	Senior management	Total
	RO	RO	RO	RO
Sales receivables & other receivables	311,095	15,731	90,085	416,911
Ijara Muntahia Bittamleek	1,598,966	80,977	552,635	2,232,578
Wakala Bil Istethmar	1,200,000	-	-	1,200,000
Customers' accounts	1,110,079	167	401,042	1,511,288
Unrestricted investment accountholders	9,303,444	10	237	9,303,691

31 December 2016	Principal shareholders	Sharia'a Board	Senior management	Total
	RO	RO	RO	RO
Sales receivables & other receivables	419,453	19,361	120,133	558,947
Ijara Muntahia Bittamleek	1,837,778	83,835	610,529	2,532,142
Customers' accounts	612,990	1,799	200,508	815,297
Unrestricted investment accountholders	3,354,000	13	-	3,354,013

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

31 December 2017	Principal shareholders	Sharia'a Board	Senior management	Total
	RO	RO	RO	RO
Profit account	66,543	4,895	18,941	90,379
Commission income	160	-	6	166
Operating expenses				
Staff expense	-	-	1,111,957	1,111,957
Other expenses	64,050	59,623	-	123,673

31 December 2016	Principal shareholders	Sharia'a Board	Senior management	Total
	RO	RO	RO	RO
Profit account	114,517	3,061	18,832	136,410
Commission income	209	-	1	210
Operating expenses				
Staff expense	-	-	1,112,459	1,112,459
Other expenses	72,350	54,598	-	126,948

- During the year the Bank organized general awareness program through road shows on Islamic Banking and banks products and services in all major cities. This initiative brings the professional staff closer to the community and enables visitors to gain in-depth information on all of its products and services. The Bank was also the part of campaign launched by local newspaper and incorporated discussions at a number of high profile forums, debates at colleges and universities throughout Muscat. Information related to Islamic Banking products that currently bank is offering is also available on its website.
- The Bank maintains formal procedure on handling of customer complaints. The Bank has set up a call center equipped with the required resources to respond to customer calls in a professional manner. There is a form for registration of complaints on Bank's website along with the contact details for customer to register their complaints. A dedicated team under supervision of CEO for management of customer complaints and feedbacks on the Bank's products and services is already operational. The customer care and quality services team of the Bank takes active part in resolution of customers' complaint and considers customers' feedback on products and services. All complaints are logged in dedicated system acquired for customer complaints handling and investigated by persons not directly related to the subject matter of the complaint. The Bank endeavors to address all complaints in minimum timeframe. Whenever this is not possible, the customer is contacted directly and timeframe for rectification of complaint is advised. A periodical report on status of complaints is also submitted to CEO, Senior Management and Board of Directors. In order to provide our customers with easy access to financial services, fair terms and pricing and at the same time to ensure that we remain committed to being at the heart of customers we serve, an independent customer feedback collection is being carried. This will help us to follow our passion to go above and beyond the expectation of our customers in providing enhanced value in the diversity of our products and services.

## 20. Sharia Governance Disclosures

### 20.1 Qualitative Disclosure

- Sharia Compliance Department (SCD) is an integral element and backbone of the Sharia Governance structure established in Bank Nizwa and approved by the Bank's Sharia Supervisory Board (SSB). An effective Sharia policy enhances the diligent supervision of the Board of Directors (BOD), the SSB and the Management of the Bank to ensure that the operations and end-to-end business activities of the Bank remain consistent with Islamic Sharia principles and its requirements.
- To ensure Sharia compliance in all aspects of Islamic banking activities of the Bank, the Central Bank of Oman (CBO) have mandated several provisions in relation to the establishment of the Sharia Supervisory Board and an internal SCD in an Islamic Bank as per the Islamic Banking Regulatory Framework (IBRF) issued by the CBO which in tandem with recommended Sharia Governance guidelines as issued by AAOIFI and IFSB. The SSB is an independent Sharia Supervisory Body which plays a vital role in providing Sharia views and rulings (Fatawa) pertaining to Islamic finance transactions including investments, products and services as well as all activities which the Bank undertakes. The SSB also acts as a monitoring body which performs a supervisory role through SCD to maintain Sharia compliance in the operations and business activities of the Bank.
- At the institutional level, SCD acts as an intermediary between the SSB and the Management team of the Bank. The SCD together with the SSB has the statutory role to provide Sharia resolutions and guidelines to the Management who shall ensure that all activities of the Bank are in compliance with the Sharia rules and principles, in accordance with the guidelines laid down by IBRF as well as the Fatwa / Sharia Ruling as issued by the SSB. The accountability to ensure Sharia compliance as well as the implementation of SSB's Sharia rulings remains with the BOD and the Management of the Bank.
- As a function, SCD reports directly to SSB, and reports in parallel to CEO of the Bank with respect to administrative issues. SSB through SCD provides copies of its Sharia decisions and resolutions to BOD and CEO because the management is responsible to assure that Sharia resolutions are executed in the transactions and all products and services of the Bank. SSB reports its findings directly to the general assembly of shareholders at the end of each year.
- Sharia Compliance Department performs its functions based on the Sharia guidelines provided by CBO in the IBRF and by Sharia rulings and resolutions issued by SSB as well as the Sharia Standards issued by AAOIFI. To ensure Sharia compliance of transactions, SCD consistently conducts Sharia review before execution of transactions (ex-ante) and Sharia audit after execution (ex-post). Sharia review and audit encompasses each type of transaction across business lines, the relevant documentation and execution procedures. The overall Sharia Compliance activities are reported in the monthly report which is sent to CEO and the same report is provided to the SSB on its quarterly meeting.
- Sharia Audit unit executes continuous audit for transactions of all departments. Its observations and findings are reported by Sharia Audit report to SSB which is also conveyed and discussed with Management, with documentation of Management responses in addition to recommending action plan for each observation.
- To ensure Sharia compliance in execution, all transactions are executed according to Standard Operating Procedures (SOP) prepared by the Operations Department and approved by the concerned department Heads including Sharia. Sharia audit uses check lists as per SSB Sharia guidelines to meet Sharia requirement and ensure that the SOPs are adhered to during execution.
- Sharia audit reports are presented for review during the quarterly SSB meetings. In case SSB rules any earnings as Sharia non-compliant, such income is diverted to a charity account and disbursed to charitable Organisational, officially recognized and registered, as nominated and approved by SSB. Usually, Sharia non-compliant income is generated from delay penalty charges whereby clients undertake to donate to charity a certain amount in case of delay in installment payments to charity. Any Sharia non-compliant income or expense is presented by Sharia audit unit to SSB who issues a Sharia ruling regarding these amounts as indicated.

- As per IBRF, Islamic banks are required to apply Sharia standards as issued by AAOIFI and abide by the comprehensive IBRF regulatory framework and guidelines. IBRF is mostly in agreement with Sharia standards issued by AAOIFI, and therefore, both references are applied with IBRF as the priority reference as the official regularity authority. Any Sharia resolutions or Fatwas issued by SSB are communicated directly to Management of the bank. Such Sharia resolutions are mandatory for application and it is the responsibility of management at the bank to assure that various business departments at the bank abide by these Sharia resolutions which are mandatory to be applied.
- Sharia Audit is performed on continuous basis for all transactions of business units and other relevant department such as finance and branches. Sharia Supervisory Board approves the Sharia audit plan annually, based on which the Sharia Audit is performed. Sharia Audit Unit Manager delegates Sharia audit responsibilities among Sharia audit department staff members to audit the executed transactions. Retail and International Trade transactions including Treasury are audited on sample basis at a minimum of 10%. All other business transactions such as Corporate and Investment departments are audited on 100% basis. During the year, Sharia Audit was conducted as per the plan and the approach mentioned earlier. Sharia audit also performs monthly review of profit distribution calculation in Finance department and disclosure in branches in addition to reviewing Sharia non-compliant revenues, if any, with proper disbursement to charity as per guidelines set by Sharia Supervisory Board.
- Sharia audit findings and observations in these transactions are directly reported to Sharia Ex-Com who give immediate instructions and Sharia ruling regarding any violations. In case the violation is confirmed, Sharia Ex-com diverts the profit of such transaction to charity account, and the same cases are reported to SSB in the quarterly SSB Sharia Audit Report.
- Branches are also subject to Sharia audit on regular basis, with visits conducted by Sharia audit unit manager accompanied by members of Sharia audit unit as needed. Such visits to branches in all regions of Oman have three basic objectives: Conduct Sharia audit of transactions processed at branch level, maintain contact with branch staff and provide updated Sharia training, and providing answers on Sharia related issues to staff and customers. All the above described Sharia audit activities are reported to Sharia Supervisory Board in a quarterly report, while any Sharia non-compliant observation is reported monthly to Sharia Executive Committee for their review and resolution. All Sharia audit observations are documented in Sharia audit reports which are shared with the head of Internal Audit as a member of the Internal Audit Committee in addition to the heads of all concerned business units.
- In conclusion, Sharia audit function is a continuous process which is supervised by the Internal Sharia reviewer based on screen sheets and check-lists for every transaction type, with follow up for any required regularization or amendments in addition to confirming documentation of all Sharia audit observations. The annual Sharia audit plan is also updated and upgraded based on business requirements and presented to Sharia Supervisory Board for approval before implementation.
- Sharia Compliance Department prepared a Sharia Training Policy which covers the objectives and scope of Sharia training in addition to Sharia Training Plan which is updated annually and approved by Sharia Supervisory Board and includes the training topics and training methods to be utilized. All Staff members at the bank participate by attending in-house Sharia training delivered by Sharia compliance department members who provide the preliminary information in the induction program for new entry staff about Islamic Banking, financing and investment tools, in addition to the functions and services provided by the bank. Providing Sharia training in induction programs are concluded in coordination with HR department who arrange training programs for new comers.
- In addition to the above, Sharia Compliance Department provides training on continuous basis to staff of other departments as arranged based on training time allocation for all business units such as corporate, treasury, investment, operation units, and support units. Unscheduled special training modules are conducted for specific case discussion based on business requirements.
- Sharia training is not only internal, but encompasses the outside environment also. The bank has already hosted several Sharia training sessions for professionals, teachers, and students on the bank premises in addition to many other Sharia training events and awareness campaigns in several locations in Oman including universities, schools, busi-

ness entities, conferences and writing articles for newspapers. Such training is delivered in both Arabic and English languages with reading material made available to attendees.

- Internal Sharia Reviewer assumes the responsibilities of Head of Sharia Compliance Department. Functions include supervising Sharia audit and providing Sharia training. The major technical role of internal Sharia reviewer is to execute Sharia review of all financing and investment proposals in coordination with Sharia compliance manager. Consequently, a Sharia Review Report is prepared for each proposal and presented to Sharia Ex-com and Sharia Supervisory Board in the monthly and quarterly meetings. Review of proposals within current approved product programs and Sharia Supervisory Board guidelines are presented to the respective business units as part of the required documents for execution. This function is the pre-execution Sharia review activity.
- In addition to these daily functions, the Internal Sharia Reviewer with assistance from the assigned team member acts as the coordinator for the Sharia Supervisory Board and prepares the meeting file and the minutes of meetings. Sharia resolutions and guidelines are then communicated to the respective business unit heads for adherence. Any approval required from business units before the next meeting of Sharia Supervisory Board is communicated by the Internal Sharia Reviewer to Sharia Supervisory Board members by email for review and providing Sharia resolution. Sharia Supervisory Board has also delegated specific authorities to Sharia Ex-com whereby its members are entitled to issue Sharia resolutions for such cases. Internal Sharia Reviewer also prepares the agenda and minutes of meetings for Sharia Ex-com and communicates its Sharia resolutions to relevant business unit heads.

### Quantitative Disclosure

- **Disclosure of the nature, size and number of violations of Sharia compliance during the year**
- Sharia Audit Unit conducts ongoing Sharia audit on all business transactions of the bank. Wholesale banking transactions are subject to 100% Sharia audit, while retail transactions are subject to Sharia audit based on sample basis as approved by SSB in the annual Sharia Audit Plan. Sharia audit findings and observations in these transactions are directly reported to Sharia Ex-Com who gives immediate instructions and Sharia ruling regarding any violations. In case the violation is confirmed, Sharia Ex-com diverts the profit of such transaction to charity account, and the same cases are reported to SSB in the quarterly SSB Sharia Audit Report.
- There is no violation to SSB's Sharia ruling and AAOIFI Sharia standard have been found during the year. However, they were cases identified in previous years as sharia non-compliant, for which income of OMR 67,466 has been transferred to Charity account in CY2017. An incident identified in which the Bank charged some customers who have delayed payment an amount of OMR 58,474/- over and above the applicable penalty. The same will be returned during 1Q2018 to the customers.
- **Disclosure of annual Zakah contributions of the Licensee, where relevant, according to constitution, general assembly or national requirements or as required by the respective SSB**
- SSB issues its Sharia compliance certificate where it identifies that Sharia compliance has been observed in the bank's transactions and contracts, and in case of any violation, the observation is listed in the report. In addition, and as per Management decision, SSB certificate also stipulates that Zakat calculation and payment is the responsibility of the shareholders.
- **Remuneration of Sharia board members**
- SSB members are compensated for their contribution in the business supervision by an agreed remuneration, in addition to SSB meeting attendance fees. SSB members who participate from outside Oman are also entitled to travel and hotel accommodation expenses.
- During the year, the Bank paid OMR 59,623 (Dec 2016: OMR 54,598) on account of remuneration to the SSB which includes accommodation, travelling expenses, meeting and annual fees.

## 21. Disclosures on Remuneration

- The Bank has engaged a consultant to achieve compliance with CBO requirements issued in January 2015 covering the main components of sound compensation practices, consistent with Basel Committee for Banking Supervision (BCBS) paper on Pillar 3 disclosure requirements for remuneration issued in July 2011.
- In line with the CBO guidelines on remuneration disclosures as part of Pillar III, the Bank has outlined the relevant qualitative and quantitative disclosures in this report.
- The Bank is committed to fair, balanced, performance-oriented compensation practices that align long-term employee and shareholder interests. The policy is aimed to attract, retain and motivate the best people in the industry as it believes that human capital is fundamental to the bank's success.
- The Bank has a Board appointed Human Resource Committee whose primary objectives are – setting the principles, parameters and governance framework for the Bank's compensation policy; and ensuring the Bank is equipped to meet standards of international best practice.
- **Material Risk Takers**
- The Bank has identified the members as material risk takers as their activities have a significant influence on the risk profile of the Bank.
- The main factors that have been used to identify the material risk-takers in the bank are:
  - -the level of the job position in the management hierarchy as defined by grade (arrived at by objective Job Evaluation)
  - responsibilities of the job that expose it to risk
- **Remuneration policy**
- The scope of the Bank's remuneration policy extends to all employees of the bank and is an integral part of Bank's Human Resource policy.
- Remuneration of employees of control functions like Risk Management, Internal Audit and Compliance is independent of the business performance they oversee and the policy is designed to attract, retain and motivate the best talent in the industry.
- The remuneration for Senior Management of these functions are directly designed and approved by the Board Human Resource Committee.
- **Performance awards**
- Performance awards are based on the achievement of both financial and non-financial objectives. The Performance Management System is aimed at achieving the Bank's business plans and objective through continuous and focused performance of the employees. It uses Key Result Areas/ performance factors and competencies to measure and enhance the performance of employees.
- The policy and payment of reward is in line with CBO guidelines on Sound Compensation Principles and Standards with effect from January 1, 2016.
- The Bank is committed to follow fair compensation practices where reward will be based on performance. The compensation is designed to contribute to the Bank's objectives and encourages prudent risk taking and adherence to applicable laws, guidelines and regulations.

- **Quantitative Disclosures**

- The Board Human Resource Committee held four meetings in 2017 and OMR 5,400 was paid to the members in lieu of sitting fees.

- The key management comprises of 11 members (2016: 13 members) of the management executive committee. The below table provides details of key management compensation:

	2017	2016
	RO	RO
Salaries and Benefits	1,327,585	1,317,834
End of Service Benefits	115,717	158,211
Total	<u>1,443,302</u>	<u>1,476,045</u>

End of Basel II Pillar 3 Disclosures

## BASEL III COMMON DISCLOSURE

(as per the template to be used during the transition of regulatory adjustments i.e. from 1 January 2013 to 1 January 2018)

		Dec-17	Dec-16
	Common Equity Tier 1 capital: instruments and reserves	RO	RO
1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	152,091,192	152,091,192
2	Retained earnings	(21,771,158)	(25,284,755)
3	Accumulated other comprehensive income (and other reserves)	389,622	10,972
4	Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies)	-	-
5	Public sector capital injections grandfathered until 1 January 2018		
6	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	-	-
7	<b>Common Equity Tier 1 capital before regulatory adjustments</b>	<b>130,709,656</b>	<b>126,817,409</b>
8	<b>Common Equity Tier 1 capital: regulatory adjustments</b>		
9	Prudential valuation adjustments	(123,463)	(169,430)
10	Unrealized losses		
11	Goodwill (net of related tax liability)	-	-
12	Other intangibles other than mortgage-servicing rights (net of related tax liability)	(2,203,452)	(2,121,330)
13	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	(1,606,622)	(1,174,897)
14	Mortgage Servicing rights (amount above 10% threshold)		
15	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)		
16	Amount exceeding the 15% threshold		
17	of which: significant investments in the common stock of financials		
18	of which: mortgage servicing rights		
19	of which: deferred tax assets arising from temporary differences	(1,071,081)	(1,762,345)
20	National specific regulatory adjustments		
21	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions		
22	<b>Total regulatory adjustments to Common equity Tier 1</b>	<b>(5,004,618)</b>	<b>(5,228,002)</b>
23	<b>Common Equity Tier 1 capital (CET1)</b>	<b>125,705,038</b>	<b>121,699,129</b>
24	<b>Additional Tier 1 capital: instruments</b>		
25	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	-	-
26	of which: classified as equity under applicable accounting standards	-	-
27	of which: classified as liabilities under applicable accounting standards 6	-	-
28	Directly issued capital instruments subject to phase out from Additional Tier 1	-	-
29	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	-	-
30	of which: instruments issued by subsidiaries subject to phase out	-	-
31	<b>Additional Tier 1 capital before regulatory adjustments</b>	<b>-</b>	<b>-</b>
32	<b>Additional Tier 1 capital: regulatory adjustments</b>		
33	Investments in own Additional Tier 1 instruments		
34	Reciprocal cross-holdings in Additional Tier 1 instruments	-	-
35	Investments in the capital of banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)	-	-

36	Significant investments in the capital of banking, financial, insurance and takaful entities that are outside the scope of regulatory consolidation (net of eligible short positions)		
37	National specific regulatory adjustments	-	-
38	<b>REGULATORY ADJUSTMENTS APPLIED TO ADDITIONAL TIER 1 IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT</b>	-	-
39	of which: Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	-	-
40	of which: Other intangibles other than mortgage-servicing rights (net of related tax liability)	-	-
41	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions	-	-
42	Total regulatory adjustments to Additional Tier 1 capital	-	-
43	Additional Tier 1 capital (AT1)	-	-
44	<b>Tier 1 capital (T1 = CET1 + AT1)</b>	<b>125,705,038</b>	<b>121,699,129</b>
45	<b>Tier 2 capital: instruments and provisions</b>		
46	Directly issued qualifying Tier 2 instruments plus related stock surplus	-	-
47	Directly issued capital instruments subject to phase out from Tier 2	-	-
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	-	-
49	of which: instruments issued by subsidiaries subject to phase out	-	-
50	Provisions	<b>7,142,919</b>	5,291,807
51	<b>Tier 2 capital before regulatory adjustments</b>	<b>7,142,919</b>	<b>5,291,807</b>
52	<b>Tier 2 capital: regulatory adjustments</b>		
53	Investments in own Tier 2 instruments	-	-
54	Reciprocal cross-holdings in Tier 2 instruments	-	-
55	Total regulatory adjustments to Tier 2 capital	<b>79,627</b>	159,264
56	Tier 2 capital (T2)	<b>7,222,546</b>	5,451,071
57	Total capital (TC = T1 + T2)	<b>132,927,584</b>	127,150,200
58	<b>RISK WEIGHTED ASSETS IN RESPECT OF AMOUNTS SUBJECT TO PRE-BASEL III TREATMENT</b>		
59	OF WHICH: [INSERT NAME OF AJUSTMENT]	-	-
60	OF WHICH.....	-	-
61	Total risk weighted assets (60a+60b+60c)	<b>770,783,448</b>	<b>537,662,763</b>
62	Of which: Credit risk weighted assets	<b>716,089,507</b>	482,608,895
63	Of which: Market risk weighted assets	<b>22,391,617</b>	32,047,791
64	Of which: Operational risk weighted assets	<b>32,302,324</b>	23,006,077
65	<b>Capital Ratios</b>		
66	Common Equity Tier 1 (as a percentage of risk weighted assets)	<b>16.31%</b>	22.63%
67	Tier 1 (as a percentage of risk weighted assets)	<b>16.31%</b>	22.63%
68	Total capital (as a percentage of risk weighted assets)	<b>17.25%</b>	23.65%

Table 2 (A)	Balance sheet as in published financial statements	Under regulatory scope of consolidation	Balance sheet as in published financial statements	Under regulatory scope of consolidation
	RO	RO	RO	RO
	Dec-17	Dec-17	Dec-16	Dec-16
Assets				
Cash and balances with Central Bank of Oman	42,813,968	42,813,968	16,599,658	16,599,658
Certificates of deposit	-	-	-	-
Due from banks	19,862,045	19,862,045	46,317,478	46,317,478
Islamic Financing	560,545,360	560,545,360	397,807,356	397,807,356
Investments in Sukuk and Securities	47,721,137	47,721,137	29,359,510	29,359,510
Financing to banks	-	-	-	-
Investment in Assets generated revenue	14,175,000	14,175,000	14,175,000	14,175,000
Property and equipment	2,428,106	2,428,106	3,105,323	3,105,323
Deferred tax assets	2,677,703	2,677,703	2,937,242	2,937,242
Other assets	6,414,652	6,414,652	5,693,810	5,693,810
Total assets	696,637,971	696,637,971	515,995,377	515,995,377
Liabilities				
Due to banks	19,338,529	19,338,529	23,232,872	23,232,872
Customer deposits	526,149,990	526,149,990	352,268,474	352,268,474
Current and deferred tax liabilities	-	-	-	-
Other liabilities	20,400,075	20,400,075	13,432,586	13,432,586
Subordinated Sukuk	-	-	-	-
Total liabilities	565,888,594	565,888,594	388,933,932	388,933,932
Shareholders' Equity				
Paid-up share capital	150,000,000	150,000,000	150,000,000	150,000,000
Share premium	2,091,192	2,091,192	2,091,192	2,091,192
Legal reserve	389,622	389,622	10,972	10,972
General reserve	3,975	3,975	-	-
Retained earnings	(21,771,158)	(21,771,158)	(25,175,033)	(25,175,033)
Cumulative changes in fair value of investments	35,746	35,746	134,314	134,314
Subordinated debt reserve	-	-	-	-
Total shareholders' equity	130,749,377	130,749,377	127,061,445	127,061,445
Total liability and shareholders' funds	696,637,971	696,637,971	515,995,377	515,995,377

Table 2 (B)	Balance sheet as in published financial statements	Under regulatory scope of consolidation	Balance sheet as in published financial statements	Under regulatory scope of consolidation
Assets	Dec-17	Dec-17	Dec-16	Dec-16
Cash and balances with CBO	42,813,968	42,813,968	16,599,658	16,599,658
Balance with banks and money at call and short notice	19,862,045	19,862,045	46,317,478	46,317,478
Investments	-	-	-	-
Of which Held to Maturity	7,000,000	7,000,000	7,000,000	7,000,000
Out of investments in Held to Maturity:				
Investments in subsidiaries	-	-	-	-
Investments in Associates and Joint Ventures	-	-	-	-
Available for Sale				
Of which: Investments in Sukuks and Securities	40,721,137	40,721,137	22,359,510	22,359,510
Held for Trading				
Investments in Real Estate	14,175,000	14,175,000	14,175,000	14,175,000
Islamic Financing Of which :				
Islamic Financing to domestic banks				
Islamic Financing to non-resident banks				
Islamic Financing to domestic customers	388,518,697	388,518,697	392,435,269	392,435,269
Islamic Financing to non-resident Customers for domestic operations				
Islamic Financing to non-resident Customers for operations abroad	1,892,917	1,892,917	2,128,087	2,128,087
Islamic Financing to SMEs	7,395,742	7,395,742	3,244,000	3,244,000
Islamic Financing from Islamic banking window				
Fixed assets	2,428,106	2,428,106	3,105,323	3,105,323
Other assets of which:				
Profit Receivable	3,560,366	3,560,366	2,243,460	2,243,460
Prepaid Expense	386,614	386,614	279,003	279,003
Refundable Deposits	83,388	83,388	83,388	83,388
Goodwill				
Other intangibles	2,203,452	2,203,452	2,121,330	2,121,330
Deferred tax assets	2,677,703	2,677,703	2,937,242	2,937,242
Others	162,918,836	162,918,836	966,629	966,629
Debit balance in Profit & Loss account				
<b>Total Assets</b>	<b>696,637,971</b>	<b>696,637,971</b>	<b>515,995,377</b>	<b>515,995,377</b>

Table 2 (B)	Balance sheet as in published financial statements	Under regulatory scope of consolidation	Balance sheet as in published financial statements	Under regulatory scope of consolidation
Assets	Dec-17	Dec-17	Dec-16	Dec-16
Paid-up Capital	150,000,000	150,000,000	150,000,000	150,000,000
Of which:		-		-
Amount eligible for CET1	126,927,131	126,927,131	126,927,131	126,927,131
Amount eligible for AT1	-	-	-	-
Reserves & Surplus	35,746	35,746	134,314	134,314
Total Capital	130,749,377	130,749,377	127,061,445	127,061,445
Deposits Of which:		-		-
Deposits from banks		-		-
Customer deposits	526,149,990	526,149,990	352,268,474	352,268,474
Deposits of Islamic Banking window		-		-
Other deposits(please specify)		-		-
Borrowings Of which: From CBO		-		-
From banks	19,338,529	19,338,529	23,232,872	23,232,872
From other institutions & agencies	-	-	-	-
Borrowings in the form of bonds, Debentures and Sukuk	-	-	-	-
Others (Please specify)		-		-
Other liabilities & provisions Of which:		-		-
Creditors and Accrual	11,755,939	11,755,939	7,976,235	7,976,235
Payment Order	3,925,700	3,925,700	3,569,662	3,569,662
Profit Payables	4,532,723	4,532,723	1,669,044	1,669,044
Others	185,713	185,713	217,645	217,645
Total Equity and Liabilities	696,637,971	696,637,971	515,995,377	515,995,377

Table 3

### Disclosure template for main features of regulatory capital instruments

Common equity comprises of 1,500,000,000 equity shares of RO 100 each fully paid up, issued and governed under the law of Sultanate of Oman.

1	Issuer	Bank Nizwa
2	Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for Private placement)	BKNZ:OM
3	Governing law (s) of the instrument Regulatory treatment	Sultanate of Oman
4	Transitional Basel III rules	Tier 1
5	Post-transitional Basel III rules	Eligible
6	Eligible at solo/group/group & solo	Solo
7	Instrument type (types to be specified by each jurisdiction)	Paid-up Capital
8	Amount recognized in regulatory capital (Currency in mil, as of most recent reporting date)	OMR 152.091 Millions
9	Par value of instrument	100 Bz
10	Accounting classification	Paid-up Capital
11	Original date of issuance	23-Apr-12
12	Perpetual or dated	N/A
13	Original maturity date	N/A
14	Issuer call subject to prior supervisory approval	N/A
15	Optional call date, contingent call dates and redemption amount	N/A
16	subsequent call dates, if applicable Coupons/dividends	N/A
17	Fixed or floating dividend/coupon	N/A
18	Coupon rate and any related index	N/A
19	Existence of dividend stopper	N/A
20	Fully discretionary, partially discretionary or mandatory	N/A
21	Existence of step up or other incentive to redeem	N/A
22	Noncumulative or cumulative	N/A
23	Convertible or non-convertible	N/A
24	if convertible, conversion trigger (s)	N/A
25	If convertible, fully or partially	N/A
26	If convertible, conversion rate	N/A
27	If convertible, mandatory or optional conversion	N/A
28	If convertible, specify instrument type convertible into	N/A
29	If convertible, specify issuer of instrument it converts into	N/A
30	Write-down feature	N/A
31	If write-down, write-down trigger (s)	N/A
32	If write-down, full or partial	N/A
33	If write-down, permanent or temporary	N/A
34	If temporary write-down, description of write-up mechanism	N/A
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	N/A
36	Non-compliant transitioned features	N/A
37	If yes, specify non-compliant features	N/A

**Private and Confidential**

Sayyid Amjad bin Mohammed bin Ahmed Al Busaidi  
Board Chairperson  
Bank Nizwa S.A.O.G.  
Oman

6<sup>th</sup> March 2018

Dear Sirs,

Subject: Annual Board Evaluation

In line with the revised **"Code of Corporate Governance (COCG) for Public Listed Companies"**, issued in **July 2015** and subsequent clarification via Circular Ref. E/20/2016 issued on October 2016, we have completed our exercise of the Board evaluation for Bank Nizwa.

The primary objective of the engagement was to evaluate the Board of Directors to ensure the compliance with the revised code referred above and suggest any improvement opportunities to enhance the effectiveness and efficiency of the Board of Directors.

The evaluation was performed based on the parameters approved by Shareholders in the AGM in 2017.

On a sample basis, we conducted a high level of review of key governance documentation along with the BOD Minutes of Meeting and other supporting information.

Protiviti highlighted certain improvement opportunities and shared the same with the Board Chairperson.

Yours sincerely,



**Darshan Mehta**  
Managing Director

**APPENDIX- SHARIA  
SUPERVISORY BOARD  
RESOLUTIONS  
(Fatwas)**

## FATWA: RBG: the procedures of buying a property from Islamic bank / Islamic window they using a DM contract via lease to own which has been used at Bank Nizwa.

- Sharia SSB discussed the request from retail division in the following case:

If the customer wants to transfer his financing from an Islamic bank / window to Bank Nizwa and the customer already took the finance with other bank / window via DM. what are the procedures that we need to use since we don't have DM contract in Bank Nizwa?

- After discussing the Sharia Board has decided to use the following steps:
  1. Customer comes to Bank Nizwa to make a request to transfer his finance which he had by DM contract from the other bank.
  2. Customer needs to get a new evaluation for the property from third party. In the same time customer needs to present a liability certificate from the other bank / window as an evidence for Bank Nizwa regarding the remaining balance.
  3. After receiving the evaluation report, Bank Nizwa sends an MOU to the other bank and then they sign an internal sale contract with other Bank / Window and customer to purchase their share from the property according to the evaluation report.
  4. After all parties agree and sign on the internal sale contract, Bank Nizwa will sign a lease to own contract with the customer with instruction of payment.
  5. Then Bank Nizwa will send the price of other bank / window share which equal to their part of the property.
  6. The remaining balance will consider as advance rental payment.
  7. The original title deed may it be under both customer name and the other bank/window or only customer name as an agent of the Musharaka contract. So the title deed should be transferred to Bank Nizwa as a new owner of the property.

- Another inquiry from Risk division :

According to the fatwa, a changed is done in the Ijarah contract which states the percentage owned by the customer which is then reviewed and approved by the SSB. According to the previous steps, the finance will be done through a lease to own contract whereby he bank will be the sole owner of the property and hence, there will be no indication for any percentage owned by the customer.

The department is therefore asking if it can buy the property without identifying the percentage owned by customer.

### Resolution (3/21/09042017):

"The SSB sees that in this case the principle of exit should be applied to buy the shares of the Islamic window/ Islamic Bank only; whereby Bank Nizwa buys the other bank's share and therefore leases the shares to the customer. Bank Nizwa can also buy the whole property (window share and customer), and lease it back to the customer and the Ijarah may be fixed or diminishing according to the client's payments. The SSB also sees that it is important to accelerate the activation of the diminishing Musharakah finance.

## FATWA: Call Account Mudarbah investment fatwa

The SSB of Bank Nizwa has thoroughly reviewed the Call Account program (Mudaraba Investment account) which depends on the following steps:

- The Mudaraba contract is an investment agreement between the clients and Bank Nizwa whereby the first party provides the capital (Rab AIMal) while the second party (Mudarib) manages the investment and invests the capital after exchanging the offer and acceptance for the investment period agreed.
- The Mudaraba investment will be open-ended whereby the investment manager invests the Mudaraba capital in Sharia Compliant investments. The Mudarib is also allowed to invest his personal funds in the Mudaraba investment.
- During the exchange of the offer and acceptance, both parties agree on an expected profit rate from the Mudaraba investment. Also, it is allowed to refer to an index to estimate an expected profit.
- In case of losses, the Rab AIMal only bears the losses while the Mudarib does not but loses his efforts except for the cases of gross negligence, willful misconduct or breaching the terms of the agreement.
- The Mudaraba investment becomes restricted if the Rab AIMal restricts the Mudaraba investment in a specific

sector or good or in any other restriction.

- When the Mudaraba investment matures, and after the IFI receives its share from the Mudaraba investment, the Mudaraba investment manager shall distribute the actual profits according to the profit percentage and rate agreed.
- The Mudaraba investment manager shall retain, as an incentive, any excess profit over and above of the expected profit rate.
- The Rab AlMal shall bear the risk of the investment and its losses, if any, and that the Mudarib shall not be a guarantor except in cases of gross negligence, willful misconduct or breaching the terms of the agreement.
- It is allowed to give a prepaid profit during the investment as long as a settlement takes place whereby the actual profit is compared to the prepaid paid profit at the end of the Mudaraba investment.
- All direct expenses and fees from the investment shall be deducted from the invested funds.
- It is allowed to have a minimum balance to participate in the Mudaraba investment.
- In the event the Rab AlMal wishes to end the investment before maturity, the Rab AlMal must then send a notice to the Mudarib whereby he will calculate the profit that will be paid to the client according to the profit paid at the end of the investment period in the savings account. This percentage will then be used to calculate the client's profit for the period invested by the client.
- The Mudaraba investment will be renewed automatically, and if the Rab AlMal wishes to continue in the investment pool, then the principal and actual profit will be reinvested.
- The client also has the option to not renew the investment automatically, and in such an event an acceptance notice will be sent directly to the client for his approval.

The Sharia Supervisory Board assures that "Call Account" Mudaraba program is compliant with Sharia rules issued by the SSB of the bank and is also in compliant with AAOIFI standards especially Mudaraba standard no.13 and also other related sharia and accounting standards, and the laws of the Sultanate of Oman.

## FATWA: SSB Fatwa for the Internet banking program for corporates

The Shariah Supervisory Board has reviewed the Internet Banking Program for corporate adequately. This program is based on the details mentioned in the program and on the following basic operational steps:

- The Bank provides Internet services to corporate that maintain current or Mudarabah investment accounts or have commercial financing in the Bank in ( LC Murabaha / Lc wakalah and can use the website to carry out account related services, cards, transfer of funds, payment orders, Other.
- The Bank provides the necessary protection and control methods such as anti-hacking systems and security programs to ensure user identity, as well as sending a text message or email confirmation after any transaction.
- Online transactions are subject to the general terms and conditions posted on the Bank's website and fees related to each
- Operations are carried out via the Internet at the rate and amounts determined by the Bank on a daily and monthly basis for each transaction. Customers may change the limits set by the Bank for daily and monthly transactions and for each transaction, and if Customer's actions exceed these limits, the Customer will receive an error message
- The Bank applies the Privacy Policy so that all information is used in accordance with legal requirements to improve services. The Bank provides internet services by its own independent decision and is not liable for any losses resulting from the transactions executed according to customers' request and instructions or due to a defect in the Internet systems. All Internet services are subject to the laws in force in Oman.
- All the instructions of the account holders to execute the transactions received through the Internet to be audited by the operation executor and supervisor before the introduction of the process to the accounting system, and the bank will collect the fees for each process during implementation within two days. The services include a special section of the frequently asked questions that customers ask with their answers to facilitate the provision of information.
- The Sharia Supervisory Board assures that "Call Account" Mudaraba program is compliant with Sharia rules issued by the SSB of the bank and is also in compliant with AAOIFI standards especially Mudaraba standard no.13 and also other related sharia and accounting standards, and the laws of the Sultanate of Oman.

The Sharia Supervisory Board assures that “E-banking services” program for the Corporate Dept. is compliant with Sharia rules Issued by the SSB of the bank and is also in compliant with AAOIFI standards especially Mudaraba standard no. (38) And accounting standard N (1) General presentation and Disclosure and also other related sharia and accounting standards, and the laws of the Sultanate of Oman.

## **FATWA: SSB fatwa related the Investment in mixed shares and profit-purification mechanism.**

The Shariah Board reviewed the offer memorandum submitted by the Shariah Compliance Department regarding the investment in the shares of mixed companies and insurance companies and placed the following controls:

### **Resolution (3/22/05072017):**

1. It is permissible to invest and trade in shares of shareholding companies that are sharia compliant according to the conditions of islamic sale contracts.
2. It is not permissible to invest and trade in shares of shareholding companies with prohibited intent and activity whereby the company's activities are reliant on it, such as: riba-based banks and gambling companies, companies producing and selling forbidden foods and beverages, forbidden entertainment companies and traditional insurance companies. And the reference in knowing this is to their reality and practice.
3. In the case of companies whose activity is permissible but has elements of haraam in some of its dealings, such as taking or giving interest, acquiring and investing in sharia non-compliant transactions, or engaging in a sharia non-compliant activity in a subsidiary or affiliate; the haraam element only remains haraam, even though it is intermingled or has a minor contribution. However, it is permissible to invest and trade in shares of sharia compliant companies that have some element of haraam according to the following provisions and controls:
  - That the amount of income generated from prohibited component does not exceed 5% of the total income of the company, irrespective of the income being generated by undertaking a prohibited activity, by ownership of a prohibited asset or in some other way, if a source of income is not properly disclosed then more effort is to be exerted for identification thereof giving due care and caution in this respect.
  - That the collective amount raised as loan on interest- whether long-terms or short- terms debt – does not exceed 33.33% of total assets of the Company or the average market value of the last twelve months whichever is more, knowingly that raising loans on interest is prohibited whatsoever the amount is.
  - That the total amount of interest based deposits, whether long-terms or short- term debt, does not exceed 33.33% of the total assets of the company or the average market value of the last twelve, whichever is more, knowingly that interest based deposits are prohibited whatsoever the collective amount is.
4. The following must be added to the conditions of trading in shares of Takaful companies:
  - Adherence of the insurance company to Shariah principles in its business.
  - The insurance company shall have a SSB.
  - The insurance company shall have an internal sharia control.
  - The existence of periodic or annual reports on the sharia performance of the insurance company presented to its shareholders.
5. Method of reading the financial statements:

The following is to be used as a reference to know the activities of the company and the percentages determined for entry into the investment and trading shares of companies is:

- The earliest financial statements, audited or unaudited, whether annual, quarterly or monthly, and if the nature of certain items are not disclosed, then we attempt to identify them.
- Unless otherwise stated in the financial statements, such as: advertising in official channels such as through circulation, market authority, or certified correspondence from the company, its financiers, or the responsible parties, whether for the past or subsequent periods of the lists issued by the company.
- Investments transactions authorized by Sharia Boards are originally not included in prohibited transactions. Also, Islamic finance contracts, which do not apply proper sharia standards, are considered among prohibited transactions, such as debt rescheduling, Inah transactions, etc.
- The terms of prohibited transactions included in the financial statements are three types; finance, investment and income, unless otherwise proven and detailed as follows:
  1. Bank loans, credit facilities, bank accounts payable, bank overdrafts, commercial loans, and the rolling

premium of a long-term loan (i.e. the amount to be repaid during the year from the long-term loan) and the debt that has been rescheduled.

- 2. Investment terms/vocabulary that are contrary to Shariah regulations such as: bank deposits, bonds and instruments which the SSB considers to be non-sharia compliant in its contracts and applications, short-term investments, current accounts (with commissions), and loans to other companies (Interest-bearing loan).
- 3. Income terms/vocabulary arising from transactions that are contrary to Shariah principles such as : income from bonds, bank commissions, income from deposits (bank interest), loan income, prohibited share income (such as conventional bank shares) and income from prohibited funds.
- There are terms in the financial statements that need to be looked at in accordance with their attached notes and the correspondence of the companies, and the action to be taken is determined through analyzing its data and evidence. Examples include: cash in the fund or bank, cash and cash equivalents, investments, other investments, investment income, accounts payable or other receivables, other income, miscellaneous income, bank balances, demand deposits or other credit balances, loans of subsidiaries and unused bank facilities.

#### 6. General Provisions:

- If the conditions of the companies change so that it is not in compliance with previous controls made for investment and trading shares of companies, the shares must then be sold immediately from the date the non-compliance becomes known and the proceeds must be then purified according to the specific sharia standard which states to calculate the percentage of interest income in each share and then purify that amount according to the number of shares he owns according to the financial statements at the end of that financial year. If the direct sale of the shares will cause a loss, the shareholder should then wait no later than ninety days from the date of knowledge of their change until the purchase price is recovered. If the purchase period expires, he then sells at the available price, and the profits earned will be forgiven and he will not be required then to dispose the share but only purify it.
- There is no objection to invest or act as a broker in shares of permissible companies that comply with the prescribed Shariah regulations if the amount exceeded the percentage determined for one of the Shariah controls is in proportion to the next correct number, with this company being committed to other controls.
- Investment guidelines and trading in listed preferred shares - if available in the Omani market – should not be sold separately but must be part of the share.

#### 7. All the above controls shall apply the following:

- To invest by acquiring the share for the purpose of its annual dividends.
- Trading, selling and buying in order to profit from the difference between the two share prices.
- Management of shares such as in funds and investment portfolios e.g. Ijara or Mudarabah , and investment in funds managed by third parties whereby it is approved by and established SSB and is under their supervision.
- Brokering , as well as brokering in trading, through the following conditions:
- It is not permissible to manage an investment portfolio that includes shares that are sharia non-compliant, unless it is for the purpose of restructuring to dispose off the forbidden shares because it is a matter of helping to dispose sharia non-compliant income, the bank must the dispose the brokerage fee which is also sharia non-compliant and notify the client accordingly of the percentage that needs to be disposed.

## FATWA: Wealth management product

Introduction: The Wealth Management Department in Bank Nizwa offers special and unique services that include a portfolio of new and exquisite products and services through personal and direct contact via a specialized and trained team to the degree that satisfies our clients and exceeds their expectations.

The following Terms & Conditions apply to Bank Nizwa Wealth Management clients in addition to the General Terms & Conditions of Bank Nizwa:

1. **Membership** the bank has the right to upgrade / downgrade the clients to wealth management. Clients can also opt out by providing a written communication to the bank branch.
2. **Waiver of Charges** Wealth Management clients will be eligible to the waiver of the following charges:
3. **Platinum Debit Card** clients will be eligible for waiver of debit card issuance, annual fees, and supplement & replacement charges.
4. **Pay Orders** issuance charges.
5. **Standing Instructions** waiver of charges for set up of SI.

6. **Cheque Books:** Waived Cheque books charges.
7. Waiver of Bank Nizwa charges on international remittances.
8. **Membership Validity:** 1 year and will be reviewed by the Bank annually. The Bank has the right to withdraw client membership without providing the reasons.
9. **Criteria** The criteria for selecting the eligible customers under each segment are the prepared by the Bank. The Bank's classification of segments that provide a range of services, products, prices and service channels that suit the requirements and needs of clients.
10. The clients are assigned to Bank's segments when opening the account according to several criteria's.
11. 6. These criteria are several alternatives. The bank may use a combined criteria according to the following:
  - Monthly salary transformer
  - Open a current account
  - Opening an investment account.
  - Initial deposit
  - Average balance (last 3 months) in all accounts.
  - Work Title.
  - Social status / social Influence.
12. The current account balance will not be viewed as single criteria when upgrading the client, but rather a combined criteria and the relationship with the Bank in terms of financing, deposits and investment.
13. Bank Nizwa will design products and services for wealth management clients. The customers can access and avail all the products and services available at the Bank within the limits of each product and service offered by the Bank different channels.
14. In accordance with the Bank's Sharia rules, the Bank does not grant gifts or waivers on commissions or fees to wealth management customers based on their current account balances, but after analyzing the Bank's relationship which reflects all transactions from other accounts, investments and others.
15. **Offers:** Bank Nizwa customers are entitled to upgrade their wealth management customer(s) accounts by depositing an average amount of not less than RO 30,000 for 3 months (excluding current accounts) or a monthly salary of RO 3,000.
16. **Offers and privileges:** The customer is eligible for a range of privileges and offers provided by third parties from time to time. The bank is not responsible for the offers and privileges provided by any third parties where the bank does not pay the merchants or take from the customer a fee in exchange for that, provided that the goods are permissible. The Bank is not responsible for not receiving notices or letters related to the Bank or Abut the quality of services and goods provided. The Bank does not guarantee the quality of the services or the quality of the goods provided. Under no circumstances shall the Bank be liable for any direct or indirect consequential losses. Unless only in cases of gross negligence, misconduct, underperformance, transgression or violation T&C.
17. **AMENDMENT OF TERMS AND CONDITIONS:** The Bank reserves the right to amend, add, or delete any of above terms and conditions. The terms and conditions will be added on the Bank's website. The Bank will also inform the wealth management customers of any amendments via electronic means of communication
18. **Resolution (6/21/09042017):**
19. After further review and discussion, the SSB has decided the following:" There is no issue in in using this product as long as the services are explained according to SSB regulations and as explained above. Also, the charges exempt from the current account, are the charges related to depositing and withdrawing, and all other activities are subject to charges.
20. The SSB has therefore ruled the following:
21. It is allowed for the bank to provide free services related to the withdrawal and deposit of funds e.g. cheques, ATM cards, account statements; customer requests through phone, fax, and internet; transaction notifications via SMS and internet; lounge services, and remittances. These services are not considered haram, as to a creditor giving a loan, because these services are either related to the bank's fulfillment to the client, which is mandatory by the bank (debtor), or it is related to receiving funds from the client, which is related to the benefit of the bank (debtor).
22. It is not allowed for the bank to deposit interest in clients' current accounts in the form of cash, gifts, services, benefits, and exemption of fees not related to withdrawals and deposits e.g. exemption of Safe locker fees, credit card fees, and L.C. fees all of which bears a cost to the bank and is considered a benefit on the loan.

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And Allah knows best.

**Dr. Abdul-Sattar Abu-Ghuddah**

Chairman of Sharia Supervisory Board

**Dr. Sheikh Muhammad Bin Rashed Al-Gharbi**

Member of Sharia Supervisory Board

**Sheikh Ibrahim Bin Naser Al-Sawwafi**

Member of Sharia Supervisory Board