The National Bank of Ras Al-Khaimah (P.S.C.)

Report and consolidated financial statements for the year ended 31 December 2016

The National Bank of Ras Al-Khaimah (P.S.C.)

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DIRECTORS' REPORT TO THE SHAREHOLDERS

We are pleased to present the results of RAKBANK (the "Bank") and its subsidiaries (collectively known as the "Group") for the year ended 31 December 2016. Net Profit for the year amounted to AED 663 million, a decrease of AED 742 million over the previous year. Total Assets stood at AED 42.5 billion, an increase of 4.7% compared to 31 December 2015. Gross Loans and Advances closed at AED 29.8 billion, up by 4.3% over the previous year. The Return on Average Assets ratio closed at 1.6% and the Return on Average Equity was 8.7%.

Financial performance

The decrease of AED 742 million in Net Profit was mainly due to an increase of AED 752.3 million in provision for impairment in loans. Total Operating Income decreased by 2.5%, while Operating Expenses decreased by AED 109.9 million, down by 7.4% over the previous year. Operating Expenses declined, mainly due to reductions in staff costs, outsourced staff costs and depreciation costs.

Operating Profit before impairment losses grew by AED 10 million over 2015. This was offset by an increase in provisions for loan impairment by 71.3% from the previous year, as a result of larger payment defaults in the unsecured loan products, Business Banking and Wholesale Banking segments. Total impairment provision for the year was AED 1.8 billion compared to AED 1.1 billion in 2015.

The decline in Total Operating Income by AED 99.9 million to AED 3.8 billion was mainly due to a decrease of AED 223.2 million in Net Interest Income and income from Islamic finance net of distribution to depositors compared to the previous year. Net Interest Income and income from Islamic financing fell to AED 2.8 billion. Interest income from conventional loans and investments decreased by 4.9%, while interest costs on conventional deposits and borrowings rose by 23.7%. Net income from Sharia-compliant financing was down by AED 27.3 million.

Non-interest income grew by AED 123.3 million to AED 1.0 billion. This was mainly due to increases of AED 132.5 million in income from investments, AED 17.7 million in gross insurance underwriting profit and AED 12.3 million in foreign exchange and derivative income. This was offset by a decrease of AED 27.3 million in commission income and AED 11.9 million in other income compared to 2015.

Operating costs were down by AED 109.9 million, a decrease of 7.4% on 2015. This was mainly due to a decrease of AED 68.3 million in staff costs, AED 21.7 million in outsourced staff costs and AED 11.1 million in depreciation costs. The Group's cost to revenue ratio reduced to 35.6% compared to 37.5% for the previous year.

The non-performing loans and advances to gross loans and advances ratio closed at 4.2% compared to 3.2% in the previous year. Net credit losses to average loans and advances closed at 6.2% compared to 3.8% in 2015. The Group is well provisioned against loan losses, with a conservative loan loss coverage ratio of 84.3% compared to 81.4% at the end of the previous year. This coverage ratio does not take into consideration mortgaged properties and other realizable asset collateral available against the loans. Additionally, the Bank has a non-distributable regulatory credit risk reserve equal to 1.5% of its credit risk rated assets, amounting to AED 421 million. Together with this reserve, the provision coverage ratio would increase to 118%.

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بَنك رَأس الخَيْمة الوَطنيّ (ش.م.ع)
The National Bank of Ras Al-Khaimah (P.S.C.)
Head Office, P.O. Box 5300, Ras Al-Khaimah, UAE.
Tel: +971 7 206 22 22, Fax: +971 7 243 54 54 / 243 52 22, Email: administration@rakbank.ae

DIRECTORS' REPORT TO THE SHAREHOLDERS (continued)

Financial performance (continued)

Total Assets rose by 4.7% to AED 42.5 billion compared to the end of 2015. This was due to an increase in Gross Loans and Advances of AED 1.2 billion, lending to banks - which grew by AED 722.4 million - and an increase in investments of AED 695.6 million. Wholesale Banking lending grew by 124.2%, up AED 2.5 billion from the previous year. Personal Banking's loan portfolio was down by AED 382 million and Business Banking's loan portfolio was down by AED 862.5 million compared to 31 December 2015.

Customer deposits grew by 5.7% to AED 29.4 billion compared to 2015. This growth came mainly from an increase of AED 1.1 billion in demand deposits and AED 455.4 million in time deposits.

During the year, the Group reclassified the investments carried in the 'held-to-maturity' portfolio (market value: AED 4.13 billion) into the 'available-for-sale' portfolio. The Group's investment portfolio grew by AED 695.6 million to AED 4.8 billion.

Before taking into consideration the profit for 2016 and any dividend, the Bank's Tier 1 ratio as per Basel II was 21.8% at the year-end. This compares with 22.3% at the end of 2015, against a requirement of 12% set by the UAE Central Bank. This level of capital provides the Bank with ample room for growth in 2017. The regulatory eligible liquid asset ratio at the end of the year was 16.9%, compared to 19.1% the previous year. The advances to stable resources ratio stood comfortably at 85.5% compared to 83.3% at the end of 2015.

Ratings

The Bank is currently rated by the following leading agencies. The ratings are given below:

Rating Agency	Last Update	Deposits	Outlook
Moody's	October 2016	Baa1/P-2	Stable
Fitch	September 2016	BBB+/F2	Stable
Capital Intelligence	September 2016	A-/A2	Stable

Developments in 2016

- Created a standalone Business Banking Division, providing a dedicated and holistic service for SMEs
- Launched RAKMoneyTransfer remittance service for instant transfers to India and the Philippines
- Launched Home in One, an innovative new mortgage facility
- Successfully merged our internet and mobile banking platforms to deliver a seamless digital experience, called RAKBANK Beyond
- Expanded the range of products offered by RAK Insurance
- Rebranded, strengthened and scaled-up our customer service activities and programmes
- Launched new Talent Management and Learning and Development initiatives for our employees

DIRECTORS' REPORT TO THE SHAREHOLDERS (continued)

Recognition in 2016

- Middle East Internet Banking Product of the Year for Web Authentication Chat at the Asian Banker Middle East Retail Product Awards.
- SME Bank of the Year at the Arabian Business StartUp Awards.
- 'First Launches in the Country' award for the launch of the Kalyan Jewellers co-branded credit card and MasterCard Titanium credit card at the MasterCard Customer Event.
- Most Outstanding Security Team of the Year at the Security Advisor Middle East Awards.
- Best Branding/Marketing Campaign for the launch of RAKelite at the Banker Middle East Awards.
- Security Leader of the Middle East at the Middle East Security Awards (MESA).
- Best Overall Website Service Olympian Award from Ethos Integrated Solutions.
- Best Customer Feedback Implementation Service Olympian Award from Ethos Integrated Solutions.
- Best Positive Sentiment Service Olympian Award from Ethos Integrated Solutions.
- Best New Products & Product Improvement Award for the Home in One mortgage facility at the Gulf Customer and Digital Experience Awards.
- Best Integrated Approach Award for MobileCash card-less withdrawals at the Gulf Customer and Digital Experience Awards.
- Best Internal Use of Digital Award for the Tablet Banking App at the Gulf Customer and Digital Experience Awards.
- Digital Pioneer Award for Web Authentication Chat at the Gulf Customer and Digital Experience Awards.
- Best Overall Customer Experience Award at the Gulf Customer and Digital Experience Awards.

Outlook for 2017

Looking to the future, we remain committed to generating solid and sustainable growth across our business segments. We are placing greater emphasis on optimizing synergies within the Group to increase efficiency, while supporting the diversification of our revenue streams. By doing so, we aim to better serve our customers, offering them a seamless experience across the Bank's diverse products and services through industry-leading customer service, innovation, and simplicity. We will also continue to strengthen our capacity to meet future challenges.

For and on behalf of the Board of Directors

H.E. Mohamed Omran Alshamsi
Chairman

1 February 2017

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The National Bank of Ras Al-Khaimah (P.S.C.)
Head Office, P.O. Box 5300, Ras Al-Khaimah, UAE.
Tel: +971 7 206 22 22, Fax: +971 7 243 54 54 / 243 52 22, Email: administration@rakbank.ae

Deloitte & Touche (M.E.)
Building 3, Level 6
Emaar Square
Downtown Dubai
P.O. Box 4254
Dubai
United Arab Emirates

Tel: +971 (0) 4 376 8888
Fax: +971 (0) 4 376 8899
www.deloitte.com/middleeast

INDEPENDENT AUDITOR'S REPORT

To the Shareholders
The National Bank of Ras Al-Khaimah (P.S.C.)
Ras Al-Khaimah
United Arab Emirates

Report on the audit of the consolidated financial statements

Opinion

We have audited the consolidated financial statements of **The National Bank of Ras Al-Khaimah P.S.C., Ras Al Khaimah, United Arab Emirates** (the "Bank") and its subsidiaries (together referred to as the "Group") which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

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

Key audit matters

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

Impairment against loans and advances

Risk	*How the matter was addressed in our audit*
We focused on this area because it requires management and those charged with governance to make significant judgements, such as the identification of loans that are deteriorating, the assessment of objective evidence of impairment, the assessment of the recoverable amount and the value of collateral. Due to the significance of net loans and advances (representing 68% of total assets) and the related estimation uncertainty, we consider this a key audit matter. The portfolios which give rise to the greatest uncertainty are typically those where impairments are derived from collective models, relate to unsecured exposures or are subject to potential collateral shortfalls.	Our audit procedures included the assessment of controls over the approval, recording and monitoring of loans, and evaluating the methodologies, inputs and assumptions used by the Bank in calculating collectively assessed impairments and assessing the adequacy of impairment allowances for individually assessed loans.

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Deloitte.

INDEPENDENT AUDITOR'S REPORT (continued)

Key audit matters (continued)

Impairment against loans and advances (continued)

Risk

It is the judgements for collective provisioning which are the most significant as they are the most sensitive to adjustment. The two key judgements in the collective provisioning assessment are the likelihood of default and the emergence period and it is the earlier which is the single most critical judgement.

The Bank's individual provisions are also subjective as a result of judgements needed and the relatively limited amount of data available for future cash flows. These loans are individually monitored and the assessment of individual provisions for these loan portfolios involves knowledge of each borrower. The key judgement for individual provisions on these portfolios is the recoverable value of underlying collateral.

A management overlay is applied to the modelled provisioning balances to reflect risk factors not taken into account by the models. This requires judgement in relation to the factors to be reflected as well as their estimated value.

Management also applies adjustments, or overlays, where they believe the data driven parameters and calculations are not appropriate, either due to emerging trends or models not capturing the risks in the loan portfolio. An example of this is an overlay for the concentration against certain borrowers which management apply on top of the impairment model output. These overlays require significant judgement.

How the matter was addressed in our audit

We tested the design and operating effectiveness of relevant controls to determine which loans are impaired and allowances against those assets. These included testing:

- System-based and manual controls over the timely recognition of impaired loans;
- Controls over the impairment calculation models; and
- Governance controls, including reviewing key meetings that form part of the approval process for loan impairment allowances.

We tested a sample of loans to assess whether impairment events had been identified in a timely manner.

In addition, we also focused on individually significant exposures. We tested the assumptions underlying the impairment identification and quantification including forecasts of future cash flows, valuation of underlying collateral and estimates of recovery on default.

We paid particular attention to collective impairment methodologies, focusing specifically on retail loans, either due to their relative size or the potential impact of changing inputs and assumptions. We also focused on portfolios that were potentially more sensitive to emerging economic trends.

Valuation of financial instruments

Accounting for financial investments in accordance with IAS 39 *'Financial Instruments'* and IFRS 13 *'Fair Value Measurement'* can be complex and has a significant impact on measuring the Bank's objectives. Financial instruments valuation carry high risk, in particular unquoted and illiquid investments valuation due to:

- Inherently a judgemental area for unquoted investments
- Using inappropriate models to value investments
- Using inappropriate assumptions to value investments
- Depending on valuation models not fully supported by robust and objective evidence
- Reliability of prices that are being used for valuation

Our audit procedures included

- Testing the design and operating effectiveness of the relevant controls in the Banks's financial instrument valuation processes including the controls over data feeds and other inputs into valuation models and the controls over testing and approval of new models or changes to existing models;
- Reviewing and testing internal controls related to valuation of financial instruments;
- Reviewing valuations for stale prices that may not be indicative of fair value for quoted investments;
- Reviewing specific investment valuation models for unquoted investments and assessing reasonableness of assumptions used in models;

Deloitte.

INDEPENDENT AUDITOR'S REPORT (continued)

Key audit matters (continued)

Valuation of financial instruments (continued)

Risk	How the matter was addressed in our audit
Hedge accounting is a complex accounting topic in financial reporting due to ▪ Methodology of designation, effectiveness testing, measuring of ineffectiveness and documentation; and ▪ Valuation of hedging instruments considering value adjustments for counterparty, own credit and funding risk.	Our audit procedures included (continued) ▪ Verifying market values of quoted investments (securities), comparing observable inputs against independent sources and externally available market data and evaluating compliance with IFRS 13 *'Fair Value Measurement'*; ▪ Reviewing accounting policy for impairment for quoted debt and equity available-for-sale investments; ▪ For instruments with significant, unobservable valuation inputs, we used our own internal valuation specialists to assess and challenge the valuation assumptions used, including considering alternative valuation methodologies used by other market participants; ▪ Comparing the Bank's pricing approach to other major institutions; ▪ Reviewing the Bank's policy for classification of valuations as level 1, 2 or 3 and other financial instruments disclosures; Reviewing risk management strategy and objectives; ▪ We also critically assessed the adequacy of the Bank's disclosures including the accuracy of the fair value measurement categorisation and adequacy of the disclosure of the valuation techniques, significant unobservable inputs, changes in estimate occurring during the period and the sensitivity to the key assumptions; ▪ Reviewing accounting for qualifying hedging relationships including hedge designation and effectiveness assessment; and ▪ Ensuring proper disclosures in the consolidated finance statements.

Reliability and continuity of the information technology and systems

Risk	How the matter was addressed in our audit
Failure of not having appropriate IT systems and controls in place may lead to severe consequences on business continuance and the financial reporting process.	Our audit procedures included: ▪ Reviewing major IT systems and applications; ▪ Reviewing general computer controls for key IT systems; ▪ Assessing IT security environment using our certified IT system auditors; and ▪ Focused on key controls testing on significant IT systems relevant to business processes.

INDEPENDENT AUDITOR'S REPORT (continued)

Other information

The Board of Directors is responsible for the other information. The other information comprises the annual report of the Group. We obtained the Board of Directors' report of the annual report prior to the date of this auditor's report, and the remaining information of the annual report is expected to be made available to us after that date. The other information does not include the consolidated financial statements and our auditor's report thereon.

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

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

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

When we read the remaining information of the annual report of the Group, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

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

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

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

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

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

INDEPENDENT AUDITOR'S REPORT (continued)

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the subsidiaries of the Bank to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

Report on other legal and regulatory requirements

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

i) We have obtained all the information we considered necessary for the purposes of our audit;

ii) The consolidated financial statements of the Bank have been prepared and comply, in all material respects, with the applicable provisions of the UAE Federal Law No. (2) of 2015;

iii) The Group has maintained proper books of account;

iv) The financial information included in the Directors' report is consistent with the Group's books of account;

v) Note 7 to the consolidated financial statements of the Group discloses securities purchased or invested in shares during the financial year ended 31 December 2016;

vi) Note 34 to the consolidated financial statements of the Bank discloses material related party transactions, the terms under which they were conducted and principles of managing conflict of interests;

vii) Based on the information that has been made available to us nothing has come to our attention which causes us to believe that the Bank has contravened during the financial year ended 31 December 2016 any of the applicable provisions of the UAE Federal Law No. (2) of 2015 or of its Articles of Association which would materially affect its activities or its financial position as at 31 December 2016; and

viii) Note 42 to the consolidated financial statements of the Bank discloses social contributions made during the financial year ended 31 December 2016.

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

Deloitte & Touche (M.E.)

Musa Ramahi
Registration No. 872
1 February 2017
Dubai - United Arab Emirates

Consolidated statement of financial position
as at 31 December 2016

	Notes	2016 AED'000	2015 AED'000
ASSETS			
Cash and balances with UAE Central Bank	4	**4,431,016**	4,908,196
Due from other banks	5	**2,629,230**	1,906,813
Loans and advances, net	6	**28,725,869**	27,798,096
Investment securities	7	**4,810,682**	4,115,072
Insurance contract assets and receivables	8	**340,959**	300,113
Other assets	9	**525,488**	484,284
Goodwill and other intangible assets	10	**174,141**	177,349
Property and equipment	11	**872,844**	897,450
Total assets		**42,510,229**	40,587,373
LIABILITIES AND EQUITY			
Liabilities			
Due to other banks	12	**1,561,877**	1,056,141
Deposits from customers	13	**29,398,185**	27,820,105
Debt securities in issue	14	**2,730,072**	2,864,727
Insurance contract liabilities and payables	15	**465,826**	389,783
Other liabilities	16	**773,890**	739,169
Total liabilities		**34,929,850**	32,869,925
Equity			
Share capital	17	**1,676,245**	1,676,245
Share premium	18	**-**	110,350
Legal reserve	18	**950,431**	839,590
Retained earnings		**1,879,029**	2,102,951
Other reserves	19	**3,031,209**	2,950,116
Equity attributable to owners of the Bank		**7,536,914**	7,679,252
Non-controlling interests	20	**43,465**	38,196
Total equity		**7,580,379**	7,717,448
Total Liabilities and Equity		**42,510,229**	40,587,373

....
H.E. Mohamed Omran Alshamsi
Chairman

....
Peter William England
Chief Executive Officer

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

Consolidated income statement
for the year ended 31 December 2016

	Notes	2016 AED'000	2015 AED'000
Interest income	21	**2,758,874**	2,901,754
Interest expense	21	**(276,794)**	(223,829)
Net interest income		**2,482,080**	2,677,925
Income from Islamic financing	22	**379,776**	405,287
Distribution to depositors	22	**(36,755)**	(34,917)
Net income from Islamic financing		**343,021**	370,370
Net interest income and net income from Islamic financing		**2,825,101**	3,048,295
Net fees and commission income	23	**655,002**	682,250
Foreign exchange and derivative income		**107,150**	94,894
Gross insurance underwriting profit	24	**55,240**	37,505
Investment income/(loss)	25	**126,305**	(6,168)
Other operating income		**70,515**	82,456
Non-interest income		**1,014,212**	890,937
Operating income		**3,839,313**	3,939,232
Operating expenses	26	**(1,368,621)**	(1,478,507)
Operating profit before provision for impairment		**2,470,692**	2,460,725
Provision for impairment of loans and advances, net	6(d)	**(1,807,714)**	(1,055,405)
Profit for the year		**662,978**	1,405,320
Attributed to:			
Owners of the Bank		**659,542**	1,400,387
Non-controlling interests		**3,436**	4,933
Profit for the year		**662,978**	1,405,320
Earnings per share:			
Basic and diluted in AED	27	**0.39**	0.84

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

Consolidated statement of comprehensive income for the year ended 31 December 2016

	Notes	2016 AED'000	2015 AED'000
Profit for the year		**662,978**	1,405,320
Other comprehensive income/(loss) *(Items that will be reclassified subsequently to profit or loss)*			
Net changes in fair value of available-for-sale investment securities		**39,577**	(14,274)
Other comprehensive income/(loss) for the year		**39,577**	(14,274)
Total comprehensive income for the year		**702,555**	1,391,046
Attributed to:			
Owners of the Parent		**696,144**	1,389,029
Non-controlling interests		**6,411**	2,017
Total comprehensive income for the year		**702,555**	1,391,046

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

The National Bank of Ras Al-Khaimah (P.S.C.)

Consolidated statement of changes in equity
for the year ended 31 December 2016

	Share capital AED'000	Share premium AED'000	Legal reserve AED'000	Retained earnings AED'000	Other reserves AED'000	Equity attributable to owners of the Bank AED'000	Non-controlling interests AED'000	Total AED'000
Balance at 1 January 2015	1,676,245	110,350	839,590	1,784,065	2,720,871	7,131,121	-	7,131,121
Profit for the year	-	-	-	1,400,387	-	1,400,387	4,933	1,405,320
Other comprehensive loss	-	-	-	-	(11,358)	(11,358)	(2,916)	(14,274)
Total comprehensive income for the year	-	-	-	1,400,387	(11,358)	1,389,029	2,017	1,391,046
Zakat	-	-	-	(378)	-	(378)	-	(378)
Transfer to regulatory credit risk reserve	-	-	-	(43,000)	43,000	-	-	-
Treasury stock elimination	-	-	-	-	(2,397)	(2,397)	-	(2,397)
Non-controlling interest on RAKNIC acquisition	-	-	-	-	-	-	36,179	36,179
Transfer to credit risk reserve	-	-	-	(100,000)	100,000	-	-	-
Transfer to general banking reserve	-	-	-	(100,000)	100,000	-	-	-
Dividend paid	-	-	-	(838,123)	-	(838,123)	-	(838,123)
Balance at 31 December 2015	1,676,245	110,350	839,590	2,102,951	2,950,116	7,679,252	38,196	7,717,448
Balance at 1 January 2016	1,676,245	110,350	839,590	2,102,951	2,950,116	7,679,252	38,196	7,717,448
Profit for the year	-	-	-	659,542	-	659,542	3,436	662,978
Other comprehensive income	-	-	-	-	36,602	36,602	2,975	39,577
Total comprehensive income for the year	-	-	-	659,542	36,602	696,144	6,411	702,555
Zakat	-	-	-	(482)	-	(482)	-	(482)
Transfer to regulatory credit risk reserve	-	-	-	(44,000)	44,000	-	-	-
Transfer to legal reserve	-	(110,350)	110,841	(491)	-	-	-	-
Transfer to voluntary reserve	-	-	-	(491)	491	-	-	-
Dividend paid	-	-	-	(838,000)	-	(838,000)	(1,142)	(839,142)
Balance at 31 December 2016	**1,676,245**	**-**	**950,431**	**1,879,029**	**3,031,209**	**7,536,914**	**43,465**	**7,580,379**

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

Consolidated statement of cash flows for the year ended 31 December 2016

	2016 AED'000	2015 AED'000
Cash flows from operating activities		
Profit for the year	**662,978**	1,405,320
Adjustments:		
Provision for impairment of loans and advances, net	**1,807,714**	1,055,405
Depreciation of property and equipment	**108,908**	121,302
Amortisation of intangible assets	**3,208**	1,872
Fair valuation of asset acquired	**550**	(5,400)
Provision for employees' end of service benefits	**19,844**	19,305
Gain on disposal of property and equipment	**(978)**	(934)
Amortisation of premium/discount relating to investments securities	**14,878**	16,129
Gain on sale of held-for-trading investment securities	**(4,219)**	799
Impairment provision investment securities	**25,611**	6,000
Gain on sale of available-for-sale investment securities	**(121,128)**	-
Gain on held for trading investment securities	**(227)**	-
Changes in operating assets and liabilities	**2,517,139**	2,619,798
Increase/(decrease) in deposits with the UAE Central Bank	**459,914**	(306,489)
Increase in due from other banks with original maturities of three months or over	**(1,003,041)**	(442,442)
Increase in loans and advances, net	**(2,735,487)**	(3,587,026)
Increase in insurance contract assets and receivables	**(40,846)**	(27,147)
Increase in other assets	**(41,754)**	(91,930)
Increase in due to other banks	**505,736**	294,334
Increase in deposits from customers	**1,578,080**	3,168,697
Increase/(decrease) in insurance contract liabilities and payables	**76,043**	(18,248)
Increase in other liabilities	**14,877**	49,337
Net cash generated from operating activities	**1,330,661**	1,658,884
Cash flows from investing activities		
Purchase of investment securities	**(3,901,196)**	(478,159)
Purchase of property and equipment	**(85,038)**	(79,069)
Proceeds from maturity/disposal of investment securities	**3,330,248**	163,187
Proceeds from disposal of property and equipment	**1,714**	18,174
Investment in RAKNIC, net	-	(203,956)
Net cash used in investing activities	**(654,272)**	(579,823)
Cash flows from financing activities		
Dividends paid	**(839,142)**	(838,123)
Zakat paid	**(482)**	(378)
(Purchase) of/issue of debt security	**(134,655)**	1,197,098
Net cash (used in)/generated from financing activities	**(974,279)**	358,597
Net (decrease)/increase in cash and cash equivalents	**(297,890)**	1,437,658
Cash and cash equivalents, beginning of the year	**2,439,849**	1,002,191
Cash and cash equivalents, end of the year (Note 32)	**2,141,959**	2,439,849

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

Notes to the consolidated financial statements for the year ended 31 December 2016

1. Incorporation and principal activities

The National Bank of Ras Al-Khaimah (P.S.C.) [the "Bank"] is a public shareholding company incorporated in the Emirate of Ras Al-Khaimah in the United Arab Emirates ("UAE"). The head office of the Bank is located at the National Bank of Ras Al-Khaimah building, Al Rifa area, Exit No. 129, Sheikh Mohammed Bin Zayed Road, Ras Al-Khaimah, UAE.

The Bank is engaged in providing retail and commercial banking services through a network of thirty eight branches in the UAE.

At 31 December 2016, The National Bank of Ras Al-Khaimah (P.S.C.) comprises the Bank and five subsidiaries (together referred to as the "Group"). The consolidated financial statements for the year ended 31 December 2016 comprises the Bank and following direct subsidiaries.

Subsidiary	*Authorised and issued capital*	*Ownership interest*	*Incorporated*	*Principal Activities*
Ras Al Khaimah National Insurance Company PSC	AED 110 million	79.23%	UAE	All type of insurance business.
RAK Islamic Finance Company Pvt. J.S.C.	AED 100 million	99.9%*	UAE	To sell sharia compliant financial products.
BOSS FZCO	AED 500,000	80%*	UAE	Back office support services to the Bank.
RAK Technologies FZCO	AED 500,000	80%*	UAE	Technological support services to the Bank.
Rakfunding Cayman Limited	USD 100	99.9%*	Cayman Island	To facilitate the issue of USD 800 million Euro medium term notes (EMTN) under the Bank's USD 1 billion EMTN programme.

*These represent legal ownership of the Bank. However, beneficial ownership is 100% as the remaining interest is held by a related party on trust and for the benefit of the Bank.

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

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

The following new and revised IFRS, which became effective for annual periods beginning on or after 1 January 2016, have been adopted in these consolidated financial statements. The application of these new and revised IFRS has not had any material impact on the amounts reported for the current and prior years but may affect the accounting for future transactions or arrangements.

- IFRS 14 *Regulatory Deferral Accounts.*
- Amendments to IAS 1 *Presentation of Financial Statements* relating to disclosure initiative.
- Amendments to IFRS 11 *Joint arrangements* relating to accounting for acquisitions of interests in joint operations.

2. Application of new and revised International Financial Reporting Standards ("IFRS") (continued)

2.1 New and revised IFRS applied with no material effect on the consolidated financial statements (continued)

- Amendments to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* relating to clarification of acceptable methods of depreciation and amortisation.
- Amendments to IAS 16 *Property, Plant and Equipment* and IAS 41 *Agriculture* relating to bearer plants.
- Amendments to IAS 27 *Separate Financial Statements* relating to accounting investments in subsidiaries, joint ventures and associates to be optionally accounted for using the equity method in separate financial statements.
- Amendments to IFRS 10 *Consolidated Financial Statements*, IFRS 12 *Disclosure of Interests in Other Entities* and IAS 28 *Investment in Associates and Joint Ventures* relating to applying the consolidation exception for investment entities.
- Annual Improvements to IFRS 2012-2014 Cycle covering amendments to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, IFRS 7 *Financial Instruments: Disclosures* and IAS 19 *Employee Benefits*.

2.2 New and revised IFRS in issue but not yet effective and not early adopted

The Group has not yet early applied the following new standard, amendments and interpretations that have been issued but are not yet effective:

New and revised IFRSs	*Effective for annual periods beginning on or after*
Annual Improvements to IFRS Standards 2014 - 2016 Cycle amending IFRS 1, IFRS 12 and IAS 28	The amendments to IFRS 1 and IAS 28 are effective for annual periods beginning on or after 1 January 2018, the amendment to IFRS 12 for annual periods beginning on or after 1 January 2017
Amendments to IAS 12 *Income Taxes* relating to the recognition of deferred tax assets for unrealised losses	1 January 2017
Amendments to IAS 7 *Statement of Cash Flows* to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities.	1 January 2017
IFRIC 22 *Foreign Currency Transactions and Advance Consideration* The interpretation addresses foreign currency transactions or parts of transactions where: • there is consideration that is denominated or priced in a foreign currency; • the entity recognises a prepayment asset or a deferred income liability in respect of that consideration, in advance of the recognition of the related asset, expense or income; and • the prepayment asset or deferred income liability is non-monetary.	1 January 2018

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

2. Application of new and revised International Financial Reporting Standards ("IFRS") (continued)

2.2 New and revised IFRS in issue but not yet effective and not early adopted (continued)

New and revised IFRSs	*Effective for annual periods beginning on or after*
Amendments to IFRS 2 *Share Based Payment* regarding classification and measurement of share based payment transactions	1 January 2018
Amendments to IFRS 4 *Insurance Contracts*: Relating to the different effective dates of IFRS 9 and the forthcoming new insurance contracts standard.	1 January 2018
Amendments to IAS 40 *Investment Property*: Amends paragraph 57 to state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use. The paragraph has been amended to state that the list of examples therein is non-exhaustive.	1 January 2018
Amendments to IFRS 7 *Financial Instruments: Disclosures* relating to disclosures about the initial application of IFRS 9	When IFRS 9 is first applied
IFRS 7 *Financial Instruments: Disclosures* relating to the additional hedge accounting disclosures (and consequential amendments) resulting from the introduction of the hedge accounting chapter in IFRS 9	When IFRS 9 is first applied
IFRS 9 *Financial Instruments* (revised versions in 2009, 2010, 2013 and 2014)	1 January 2018

IFRS 9 issued in November 2009 introduced new requirements for the classification and measurement of financial assets. IFRS 9 was subsequently amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition, and in November 2013 to include the new requirements for general hedge accounting. Another revised version of IFRS 9 was issued in July 2014 mainly to include a) impairment requirements for financial assets and b) limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' (FVTOCI) measurement category for certain simple debt instruments.

A finalised version of IFRS 9 which contains accounting requirements for financial instruments, replacing IAS 39 *Financial Instruments: Recognition and Measurement*. The standard contains requirements in the following areas:

- ***Classification and measurement:*** Financial assets are classified by reference to the business model within which they are held and their contractual cash flow characteristics. The 2014 version of IFRS 9 introduces a 'fair value through other comprehensive income' category for certain debt instruments. Financial liabilities are classified in a similar manner to under IAS 39, however there are differences in the requirements applying to the measurement of an entity's own credit risk.

2. Application of new and revised International Financial Reporting Standards ("IFRS") (continued)

2.2 New and revised IFRS in issue but not yet effective and not early adopted (continued)

New and revised IFRSs	*Effective for annual periods beginning on or after*
IFRS 9 *Financial Instruments* [revised versions in 2009, 2010, 2013 and 2014] (continued)	

- ***Impairment:*** The 2014 version of IFRS 9 introduces an 'expected credit loss' model for the measurement of the impairment of financial assets, so it is no longer necessary for a credit event to have occurred before a credit loss is recognised
- ***Hedge accounting:*** Introduces a new hedge accounting model that is designed to be more closely aligned with how entities undertake risk management activities when hedging financial and non-financial risk exposures.
- ***Derecognition:*** The requirements for the derecognition of financial assets and liabilities are carried forward from IAS 39.

IFRS 15 *Revenue from Contracts with Customers*	1 January 2018

In May 2014, IFRS 15 was issued which established a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and the related interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the standard introduces a 5-step approach to revenue recognition:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognises when (or as) a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

Amendments to IFRS 15 *Revenue from Contracts* with Customers to clarify three aspects of the standard (identifying performance obligations, principal versus agent considerations, and licensing) and to provide some transition relief for modified contracts and completed contracts.	1 January 2018

2. Application of new and revised International Financial Reporting Standards ("IFRS") (continued)

2.2 New and revised IFRS in issue but not yet effective and not early adopted (continued)

New and revised IFRSs	*Effective for annual periods beginning on or after*
IFRS 16 *Leases* IFRS 16 specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.	1 January 2019
Amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* (2011) relating to the treatment of the sale or contribution of assets from and investor to its associate or joint venture.	Effective date deferred indefinitely

Management anticipates that these new standards, interpretations and amendments will be adopted in the Group's consolidated financial statements for the period of initial application and adoption of these new standards, interpretations and amendments, except for IFRS 9, IFRS 15 and IFRS 16, may have no material impact on the consolidated financial statements of the Group in the period of initial application.

The application of IFRS 9 may have significant impact on amounts reported and disclosures made in the Group's consolidated financial statements in respect of Group's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of effects of the application until the Group performs a detailed review.

3. Significant accounting policies

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of preparation

The consolidated financial statements of the Group are prepared under the historical cost basis except for certain financial instruments which are measured at fair value. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

The UAE Federal Law No. 2 of 2015 ("Compliance Law") has come into force on July 1, 2015. The Bank has twenty four months from the effective date of Companies Law to comply with provisions (the "transitional provisions") and the Bank has availed the transitional provisions.

3. Significant accounting policies (continued)

(b) Consolidation

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

- has power over an investee,
- is exposed, or has rights, to variable returns from its involvement with the investee, and
- has the ability to use its power over the investee to affect the amount of the investor's returns.

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

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

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

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

Profit or loss of each component of other comprehensive income is attributable to the owners of the Group and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Bank and to the non-controlling interest even if this results in the non-controlling interests having a deficit balance.

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

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

3. Significant accounting policies (continued)

(b) Consolidation (continued)

Changes in the Group's ownership interest in existing subsidiaries

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

When the Group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), and liabilities of the subsidiary and any non-controlling interests. When assets of the subsidiary are carried at revalued amounts or fair values and the related cumulative gain or loss have been recognised in the consolidated statement of comprehensive income and accumulated in equity, the amounts previously recognised in the consolidated statement of comprehensive income and accumulated in equity are accounted for as if the Parent had directly disposed of the relevant assets (i.e. reclassified to profit or loss or transferred directly to retained earnings as specified by applicable IFRSs). The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting or, when applicable, the cost on initial recognition of an investment in an associate or a joint venture.

(c) Loans and advances and provision for impairment

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances are initially recognised at fair value, which is the cash consideration to originate or purchase a loan including any transaction costs, and measured subsequently at amortised cost using the effective interest method.

The Group assesses at each financial position date whether there is objective evidence that loans and advances are impaired. Loans and advances are impaired and impairment losses are incurred only if there is objective evidence that the Group will not be able to collect all amounts due.

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

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower;
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower's competitive position;
- Deterioration in the value of collateral; and
- Observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:

  (i) adverse changes in the payment status of borrowers in the portfolio; and

  (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

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

3. Significant accounting policies (continued)

(c) Loans and advances and provision for impairment (continued)

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the consolidated income statement.

If the amount of impairment subsequently decreases due to an event occurring after the write down, the release of the provision is credited to the consolidated income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

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

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Group's grading process that considers asset type, industry, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

Estimates of changes in future cash flows for groups of assets reflect and are directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectable, it is written off against the related provision for impairment. This is normally done within six to twelve months of the loan becoming past due, depending on the type of the loan. Non performing mortgage loans, however, are written off after considering each individual case. If no related provision exists, it is written off to the consolidated income statement. Subsequent recoveries are credited to the consolidated income statement.

Loans that are either subject to collective impairment assessment or individually significant and whose terms have been renegotiated are no longer considered to be past due but are treated as new loans.

(d) Islamic financing

The Group engages in Shari'ah compliant Islamic banking activities through various Islamic instruments such as Murabaha, Salam, Mudaraba, and Wakala. The accounting policy for initial recognition, subsequent measurement and derecognition of Islamic financial assets and liabilities are as per Note 3(c).

3. Significant accounting policies (continued)

(d) Islamic financing (continued)

i) Murabaha financing

A sale contract whereby the Group sells to a customer commodities and other assets at an agreed upon profit mark up on cost. The Group purchases the assets based on a promise received from customer to buy the item purchased according to specific terms and conditions. Profit from Murabaha is quantifiable at the commencement of the transaction. Such income is recognised as it accrues over the period of the contract on effective profit rate method on the balance outstanding.

ii) Salam

Bai Al Salam is a Sale contract where the Customer (Seller) undertakes to deliver/supply a specified tangible asset to the Group (Buyer) at mutually agreed future date(s) in exchange for an advance price fully paid on the spot by the buyer.

Revenue on Salam financing is recognised on the effective profit rate basis over the period of the contract, based on the Salam capital outstanding.

iii) Mudaraba

A contract between the Group and a customer, whereby one party provides the funds (Rab Al Mal-customer) and the other party (the Mudarib- the Group) invests the funds in a project or a particular activity and any profits generated are distributed between the parties according to the profit shares that were pre-agreed in the contract. The Mudarib would bear the loss in case of default, negligence or violation of any of the terms and conditions of the Mudaraba, otherwise, losses are borne by the Rab Al Mal.

iv) Wakala

An agreement between the Group and customer whereby one party (Rab Al Mal-principal) provides a certain sum of money to an agent (Wakil), who invests it according to specific conditions in return for a certain fee (a lump sum of money or a percentage of the amount invested). The agent is obliged to return the invested amount in case of default, negligence or violation of any of the terms and conditions of the Wakala. The Group may be Wakil or Rab Al Mal depending on the nature of the transaction.

Estimated income from Wakala is recognised on an accrual basis over the period, adjusted by actual income when received. Losses are accounted for on the date of declaration by the agent.

v) Ijara

Ijara financing is a finance lease agreement whereby the Group (lessor) leases an asset based on the customer's (lessee) request and promise to lease the assets for a specific period in lieu of rental instalments. Ijara ends in transferring the ownership of the asset to the lessee at the end of the lease inclusive of the risks and rewards incident to an ownership of the leased assets. Ijara assets are stated at amounts equal to the net investment outstanding in the lease including the income earned thereon less impairment provisions.

3. Significant accounting policies (continued)

(e) Business combination and goodwill

Business combination

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition related costs are generally recognised in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any noncontrolling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any noncontrolling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquire (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Non-controlling interests that are present ownership interests and entitle their holder to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at the noncontrolling interests' proportionate share of the recognised amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis. Other types of non-controlling interests are measured at fair value or, when applicable, on the basis specified in another IFRS.

When the consideration transferred by the Group in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisitiondate fair value and included as part of the consideration transferred in a business combination. Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the 'measurement period' (which cannot exceed one year from acquisition date) about facts and circumstances that existed at the acquisition date.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is remeasured at subsequent reporting dates in accordance with IAS 39 and IAS 37 Provisions, Contingent Liabilities and Contingent Assets, as appropriate, with the corresponding gain or loss being recognised in profit and loss.

When a business combination is achieved in stages, the Group's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date (i.e. the date when the Group obtains control) and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in consolidated statement of comprehensive income are reclassified to profit or loss where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see above), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognised at that date.

3. Significant accounting policies (continued)

(e) Business combination and goodwill (continued)

Goodwill

For the purposes of impairment testing, goodwill is allocated to each of the Group's cash-generating units (or groups of cash-generating units) that is expected to benefit from the synergies of the combination.

A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently when there is an indication that the unit might be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata based on the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in profit or loss. An impairment loss recognised for goodwill is not reversed in the subsequent periods.

On disposal of the relevant cash-generating unit, the atributable amount of goodwill is included in the determination of the profit or loss on disposal.

(f) Financial instruments

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the instrument.

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

(g) Financial assets

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

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

Classification of financial assets

For the purposes of classifying financial assets, an instrument is an 'equity instrument' if it is a non-derivative and meets the definition of 'equity' for the issuer except for certain non-derivative puttable instruments presented as equity by the issuer. All other non-derivative financial assets are 'debt instruments'.

Debt instruments, including loans and advances and Islamic financing and investments products, are measured at amortised cost if both of the following conditions are met:

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

All other financial assets are subsequently measured at fair value.

3. Significant accounting policies (continued)

(g) Financial assets (continued)

Foreign exchange gains and losses

The fair value of financial assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the end of each reporting period. The foreign exchange component forms part of its fair value gain or loss.

For foreign currency denominated debt instruments measured at amortised cost at the end of each reporting period, the foreign exchange gains and losses are determined based on the amortised cost of the financial assets and are recognised in the consolidated income statement.

Impairment of financial assets

Financial assets that are measured at amortised cost are assessed for impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial assets, the estimated future cash flows of the asset have been affected.

Objective evidence of impairment could include:

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

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

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

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

Impairment of loans and advances measured at amortised costs are assessed by the Group as per Note 3(c) to the consolidated financial statements.

Derecognition of financial assets

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

3. Significant accounting policies (continued)

(h) Financial liabilities and equity instruments

Classification as debt or equity

Debt and equity instruments issued by the Group are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement and the definitions of a financial liability and an equity instrument.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Group are recognised at the proceeds received, net of direct issue costs.

Financial liabilities

All financial liabilities are subsequently measured at amortised cost using the effective interest rate method.

Financial liabilities subsequently measured at amortised cost

Financial liabilities that are not held-for-trading are measured at amortised cost at the end of subsequent accounting periods. The carrying amounts of financial liabilities that are subsequently measured at amortised cost are determined based on the effective interest method. Interest expense that is not capitalised as part of costs of an asset is included in the consolidated income statement.

Foreign exchange gains and losses

For financial liabilities that are denominated in a foreign currency and are measured at amortised cost at the end of each reporting period, the foreign exchange gains and losses are determined based on the amortised cost of the instruments and are recognised in the consolidated income statement.

The fair value of financial liabilities denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the end of the reporting period.

Derecognition of financial liabilities

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable, including any non-cash assets transferred or liabilities assumed, is recognised in consolidated income statement.

(i) Investment securities

The Group classifies its investment securities in the following categories: Held-for-trading securities, held-to-maturity and available-for-sale. Management determines the classification of its investments at initial recognition.

Held-for-trading securities: Investment securities held at fair value through profit and loss are those which are acquired principally for the purpose of trading with the objective of generating profit.

Held-to-maturity: Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. If the Group were to sell other than an insignificant amount of held-to-maturity assets, the entire category would be reclassified as available for sale except if sale is due to significant deterioration of the issuer.

3. Significant accounting policies (continued)

(i) Investment securities (continued)

Available-for-sale: Available-for-sale investments are those non-derivative financial assets that are designated as available-for-sale or are not classified as (a) loans and advances, (b) held-to-maturity investments.

Regular purchases and sales of financial assets at held-to-maturity and available-for-sale are recognised on settlement date.

Financial assets, except assets that are held for trading are initially recognised at fair value plus transaction costs. For financial assets acquired for trading, transaction costs are charged to profit and loss. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Available-for-sale financial assets are subsequently carried at fair value. Held-to-maturity investments are carried at amortised cost using the effective interest method.

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

The fair values of quoted investments in active markets are based on current bid prices, as the Group considers the bid prices to be most representative of fair value, if the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques.

Interest earned whilst holding investment securities is reported as under interest income in the consolidated income statement.

Dividends on available-for-sale equity instruments are recognised in the consolidated income statement when the Group's right to receive payment is established.

The Group assesses at each financial position date whether there is objective evidence that a financial asset is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the asset is impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss - is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on available-for-sale equity instruments are not reversed through the income statement. Impairment on debt securities classified as available-for-sale and those held to maturity is assessed as outlined in the accounting policy for impairment of loans and advances [Note 3(c)].

(j) Due from banks

Amounts due from banks are initially recognized at fair value and measured subsequently at amortised cost using the effective interest method. Impairment of amount due from banks is assessed as outlined in the accounting policy for loans and advances [Note 3(c)].

(k) Cash and cash equivalents

In the consolidated statement of cash flows, cash and cash equivalents include cash on hand, money in current and call accounts and placements with original maturity of less than three months excluding the statutory deposit required to be maintained with the UAE Central Bank.

3. Significant accounting policies (continued)

(l) Derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of various derivative instruments are disclosed in Note 31.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The Group only applies fair value hedge accounting for hedging fixed interest risk on debt securities issued. The gain or loss relating to the effective portion of interest rate swaps hedging fixed rate debt securities issued is recognised in the income statement within 'Interest expense'. The gain or loss relating to the ineffective portion is recognised in the income statement within 'Other operating income'. Changes in the fair value of the hedge fixed rate debt securities issued attributable to interest rate risk are recognised in the income statement within 'Interest expense'.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to profit or loss over the period to maturity.

(m) Debt securities issued

Debt issued is recognised initially at fair value, net of transaction costs incurred. After initial measurement, debt issued is subsequently measured at amortised cost using the effective interest rate. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.

(n) Property and equipment

Land and buildings comprise branches, offices and certain residential premises purchased for occupation of management and staff. Property and equipment is stated at cost less accumulated depreciation. Cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent expenditures are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repair and maintenance costs are charged to the income statement during the financial period in which they are incurred.

3. Significant accounting policies (continued)

(n) Property and equipment (continued)

Land is not depreciated as it is deemed to have an infinite life. Depreciation on other assets is calculated using the straight-line method to write down the cost of assets to their estimated residual values over their expected useful economic lives as follows:

	Years
Buildings	15 - 30
Computer equipment and software	4 -15
Furniture, fixtures and equipment	4 - 6
Leasehold improvements	2 - 6
Motor vehicles	2 - 4

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

Capital work in progress is stated at cost and is transferred to the appropriate asset category when it is brought into use and is depreciated in accordance with the Group's accounting policy.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Gains and losses on disposal of property and equipment are determined by comparing the sales proceeds to the carrying value of the asset disposed and are taken into account in determining operating income.

(o) Employee benefits

(i) Defined contribution plan

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an employee benefit expense in consolidated income statement in the periods during which services are rendered by employees. Pension contributions are made in respect of UAE national employees to the UAE General Pension and Social Security Authority in accordance with the UAE Federal Law No (7), 1999 for Pension and Social Security.

(ii) Defined benefit plan

Provision is made for the end of service benefits due to non-UAE nationals in accordance with the UAE Labour Law for their periods of service up to the financial position date. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation. The provision arising is disclosed as 'provision for employees' end of service benefits' under other liabilities in the consolidated statement of financial position.

(iii) Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

A provision is made for the estimated liability for employees' entitlements to annual leave and leave passage as a result of services rendered by the employees up to financial position date. This provision is included in other liabilities.

3. Significant accounting policies (continued)

(p) Fiduciary assets

Assets and the income arising on the Bank's fiduciary activities, where it acts in a fiduciary capacity such as nominee, trustee or agent, are excluded from these consolidated financial statements. Income earned by the Group from its fiduciary services is recognised in accordance with the accounting policy on fees and commission income [Note 3(v)].

(q) Share capital

(i) Share issue costs

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds.

(ii) Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's shareholders.

(r) Provisions and contingent liabilities

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

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

Contingent liabilities, which include certain guarantees and letters of credit, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the Group's control; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the consolidated financial statements but are disclosed in the notes to the consolidated financial statements, unless they are remote.

(s) Due to customers

Due to customers are recognised initially at fair value, net of transaction costs incurred. Due to customers are subsequently carried at amortised cost using the effective interest method.

(t) Foreign currencies

Items included in the consolidated financial statements of the Group are measured using UAE Dirhams which is the currency of the primary economic environment in which the Group operates ('functional currency'). The consolidated financial statements are presented in UAE Dirhams. Foreign currency transactions are translated into the UAE Dirham at the rate ruling on the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated into UAE Dirhams at the rates ruling at the consolidated statement of financial position date. Any resultant gains or losses are accounted for in the consolidated income statement other than for items presented in other comprehensive income.

3. Significant accounting policies (continued)

(u) Interest income and expense

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest method. Interest earned whilst holding investment securities is reported in interest income in the consolidated income statement.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(v) Fee and commission income

Fees and commissions, other than loan arrangement fees, are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred and recognised as an adjustment to the effective interest rate on the loan. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-proportionate basis. Fees earned on the Bank's fiduciary activities are recognised over the period in which the service is provided. The same principle is applied to custody services that are continuously provided over an extended period of time.

(w) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(x) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker is the person or group that allocates resources to and assesses the performance of the operating segments of an entity. All transactions between business segments are conducted on an arm's length basis, with intra-segment revenue and costs being eliminated. Income and expenses directly associated with each segment are included in determining business segment performance. In accordance with IFRS 8, the Bank has the following business segments: retail banking, business banking and treasury.

(y) Intangible assets

Intangible assets acquired in a business combination are measured on initial recognition at cost, which is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the statement of income in the expense category consistent with the function of the intangible asset.

3. Significant accounting policies (continued)

(y) Intangible assets (continued)

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash generating unit level. Such intangibles are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

(i) License

The license represents the right to conduct insurance operations, which is granted by the relevant insurance regulator. This license is assessed as having an indefinite useful life and included in goodwill.

(ii) Customer relationships

The value of customer relationships represents the value of future cash flows expected from renewals and the cross-selling of new products to customers known and identified at the time of the acquisition and will be amortised on a straight line basis over the estimated useful life which is 4 years.

(z) Insurance contracts

Insurance and reinsurance contracts held

The Group, through its insurance subsidiary RAKNIC, issues contracts that transfer insurance risks in the general insurance category. The general insurance category comprises Casualty, Group Life, Financial Lines, Fire, Marine, Energy and Accident and Health.

The Group writes the following types of insurance contracts:

- Accident insurance
- Property insurance
- Motor insurance
- Fire insurance
- Casualty insurance
- Medical insurance
- Marine insurance
- Engineering insurance
- Group life insurance

Provision is made for premium deficiency arising from general insurance contracts where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the reporting date exceeds the unearned premiums provision and already recorded claim liabilities in relation to such policies. The provision for premium deficiency is calculated by reference to classes of business which are managed together, after taking into account the future investment return on investments held to back the unearned premiums and claims provisions.

Insurance and other receivables

Insurance and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less impairment losses. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables.

3. Significant accounting policies (continued)

(z) Insurance contracts (continued)

Insurance and other receivables (continued)

Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate.

The carrying amount of the receivable is reduced through the use of an allowance account, and the amount of the loss is recognised in the consolidated income statement within general and administration expenses. When a receivable is uncollectible, it is written off against the allowance account for that receivable. Subsequent recoveries of amounts previously written off are credited against other operating expenses in the consolidated income statement.

Deferred acquisition costs

The costs attributable to the acquisition of new business for insurance contracts and renewing existing contracts are capitalised as an intangible asset under Deferred Acquisition Costs (DAC). All other costs are recognised as expenses when incurred. DAC are subsequently amortised over the life of the contracts as premium is earned.

Deferred acquisition costs are reviewed by category of business at the end of each reporting period and are written off where they are no longer considered to be recoverable.

(i) Classification

The Group issues contracts that transfer either insurance risk or both insurance and financial risks.

Contracts under which the Group accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder are classified as insurance contracts. Insurance risk is significant if an insured event could cause the Group to pay significant additional benefits due to happening of the insured event compared to its non-happening.

Insurance contracts may also transfer some financial risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

Contracts where insurance risk is not significant are classified as investment contracts.

Once a contract is classified as an insurance contract it remains classified as an insurance contract until all rights and obligations are extinguished or expired.

(ii) Recognition and measurement

Premiums

Gross premiums written reflect business incepted during the year, and exclude any fees and other amounts collected with and calculated based on premiums. These are recognised when underwriting process is complete and policies are issued.

The earned position of premium is recognised as an income. Premiums are earned from the date of attachment of risk over the indemnity period and unearned premium is calculated using the basis described below.

3. Significant accounting policies (continued)

(z) Insurance contracts (continued)

<u>*Deferred acquisition costs*</u> *(continued)*

(ii) Recognition and measurement (continued)

Unearned premium provision

Unearned premiums are computed using statistical models to spread premium written evenly over period of coverage and are at least equal to the minimum stipulated by the UAE Insurance Law.

(iii) Claims

Claims outstanding comprise provisions for the Group's estimate of the ultimate cost of settling all claims incurred but unpaid at the reporting date whether reported or not, and related internal and external claims handling expense reduced by expected salvage and other recoveries. Claims outstanding are assessed by reviewing individual reported claims. Provisions for claims outstanding are not discounted. Adjustments to claims provisions established in prior periods are reflected in the financial statements of the period in which the adjustments are made. The methods used, and the estimates made, are reviewed regularly. Provision is also made for any claims incurred but not reported ("IBNR") at the date of statement of financial position on the basis of management estimates.

(iv) Liability adequacy test

At the end of each reporting period, the Group assesses whether its recognised insurance liabilities are adequate using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities is inadequate in the light of estimated future cash flows, the entire deficiency is immediately recognised in profit or loss and an unexpired risk provision is created.

Provision is made for premium deficiency arising from general insurance contracts where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the reporting date exceeds the unearned premiums provision and already recorded claim liabilities in relation to such policies. The provision for premium deficiency is calculated by reference to classes of business which are managed together, after taking into account the future investment return on investments held to back the unearned premiums and claims provisions.

(v) Reinsurance

The Group cedes reinsurance in the normal course of business for the purpose of limiting its net loss potential through the diversification of its risks. Assets, liabilities and income and expense arising from ceded reinsurance contracts are presented separately from the assets, liabilities, income and expense from the related insurance contracts because the reinsurance arrangements do not relieve the Group from its direct obligations to its policyholders.

Amounts due to and from reinsurers are accounted for in a manner consistent with the related insurance policies and in accordance with the relevant reinsurance contracts. Reinsurance premiums are deferred and expensed using the same basis as used to calculate unearned premium reserves for related insurance policies. The deferred portion of ceded reinsurance premiums is included in reinsurance assets.

Reinsurance assets are assessed for impairment at each reporting date. A reinsurance asset is deemed impaired if there is objective evidence, as a result of an event that occurred after its initial recognition, that the Group may not recover all amounts due, and that event has a reliably measurable impact on the amounts that the Group will receive from the reinsurer. Impairment losses on reinsurance assets are recognised in statement of profit or loss in the period in which they are incurred.

Profit commission in respect of reinsurance contracts is recognised on an accrual basis.

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

4. Significant accounting policies (continued)

(z) Insurance contracts (continued)

Deferred acquisition costs (continued)

(vi) Deferred acquisition cost

For general insurance contracts, the deferred acquisition cost asset represents the position of acquisition costs which corresponds to the proportion of gross premiums written that is unearned at the reporting date.

(vii) Insurance receivables and payables

Amounts due from and to policyholders, agents and reinsurers are financial instruments and are included in insurance receivables and payables, and not in insurance contract provisions or reinsurance assets.

(viii) Insurance contract provision and reinsurance assets

Insurance contract liabilities towards outstanding claims are made for all claims intimated to the Group and still unpaid at the statement of financial position date, in addition for claims incurred but not reported. The unearned premium considered in the insurance contract liabilities comprise the estimated proportion of the gross premiums written which relates to the periods of insurance subsequent to the consolidated statement of financial position date.

The reinsurers' portion towards the above outstanding claims, claims incurred but not reported and unearned premium is classified as reinsurance contract assets in the consolidated financial statements.

4. Cash and balances with UAE Central Bank

	2016 AED'000	2015 AED'000
Cash in hand	**819,539**	802,647
Balances with the UAE Central Bank	**243,677**	277,835
Statutory deposit with the UAE Central Bank	**3,017,800**	2,827,714
Certificates of deposit with the UAE Central Bank	**350,000**	1,000,000
	4,431,016	4,908,196

Statutory deposits maintained with the UAE Central Bank represent deposits at stipulated percentages of the Bank's demand, savings, time and other deposits. These are only available for day-to-day operations under certain specified conditions and can not be withdrawn without the Central Bank's prior approval.

Cash in hand, balances and statutory deposit with the UAE Central Bank are non-interest bearing. Certificates of deposit carry an interest rate of 0.62% to 0.72% (2015: 0.22% to 0.40%) per annum.

5. Due from other banks

	2016 AED'000	2015 AED'000
Placements with other banks	**885,923**	999,523
Demand deposits	**270,310**	495,858
Banker's acceptances	**964,000**	408,567
Syndicated loans	**439,437**	-
Other	**69,560**	2,865
	2,629,230	1,906,813

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

5. Due from other banks (continued)

The below represents deposits and balances due from:

	2016 AED'000	2015 AED'000
Banks in UAE	**976,034**	1,042,530
Banks outside UAE	**1,653,196**	864,283
	2,629,230	1,906,813

6. Loans and advances, net

	2016 AED'000	2015 AED'000
(a) Loans and advances		
Retail banking loans	**17,749,598**	18,131,609
Wholesale banking loans	**4,479,118**	1,998,004
Business banking loans	**7,550,582**	8,413,083
Total loans and advances [Note 6(b)]	**29,779,298**	28,542,696
Provision for impairment [Note 6(c)]	**(1,053,429)**	(744,600)
Net loans and advances	**28,725,869**	27,798,096
(b) Analysis of loans and advances		
Personal loans	**5,897,413**	6,361,103
Mortgage loans	**4,419,270**	4,098,837
Credit cards	**3,542,744**	3,379,655
Auto loans	**2,645,465**	3,158,750
Business banking RAK finance loans	**4,995,594**	6,221,087
Business banking other loans	**2,554,988**	2,191,996
Wholesale banking loans	**4,479,118**	1,998,004
Other retail loans	**1,244,706**	1,133,264
Total loans and advances	**29,779,298**	28,542,696
(c) Provision for impairment		
Balance at the beginning of the year	**744,600**	539,227
Impairment allowance for the year	**1,877,770**	1,108,461
Written-off during the year	**(1,568,941)**	(903,088)
Balance at the end of the year	**1,053,429**	744,600
(d) Provision for impairment of loans and advances, net		
Impairment allowance for the year	**1,877,770**	1,108,461
Net recovery during the year	**(70,056)**	(53,056)
	1,807,714	1,055,405

Net recovery mainly represents amounts subsequently recovered from fully written-off loans.

6. Loans and advances, net (continued)

	2016 AED'000	2015 AED'000
(e) Impairment loans and advances provision coverage		
Aggregate impaired loans	**1,249,458**	914,368
Provision held	**1,053,429**	744,600
Coverage ratio	**84.31%**	81.43%

The ratio of provision held to aggregate impaired loans (coverage ratio) does not take into account collateral available, including cash, property and other realisable assets. For computation of the above ratio, the Group has considered total impairment provision including the portfolio provision for risk inherent in the Group's portfolio.

(f) Islamic financing assets

The below table summaries the Islamic financing assets that are part of loans and advances above:

	2016 AED'000	2015 AED'000
i) Islamic financing assets		
Islamic retail financing assets	**3,153,673**	3,433,666
Islamic business banking assets	**927,810**	1,099,223
Islamic wholesale banking assets	**203,555**	-
Total Islamic financing assets	**4,285,038**	4,532,889
Provision for impairment	**(145,234)**	(120,849)
	4,139,804	4,412,040
ii) Analysis of Islamic financing assets		
Islamic Salam Personal finance	**1,508,935**	1,733,838
Islamic Auto Murabaha	**915,370**	1,156,072
Islamic Business banking Finance	**927,810**	1,099,223
Islamic Ijara Property Finance	**587,572**	381,486
Islamic Credit Cards	**141,066**	161,531
Islamic wholesale banking	**203,555**	-
Islamic finance - other	**730**	739
	4,285,038	4,532,889

Notes to the consolidated financial statements
for the year ended 31 December 2016 (continued)

7. Investment securities

a) Investments

	2016 AED'000	2015 AED'000
Securities available-for-sale		
Quoted equity securities	**7,279**	41,784
Unquoted equity securities	**107**	107
Quoted funds	**20,637**	-
Quoted debt securities*	**4,546,570**	74,746
Unquoted debt securities	**219,100**	-
	4,793,693	116,637
Securities held-for-trading		
Quoted debt securities	**12,804**	-
Quoted mutual funds	**4,185**	3,966
	16,989	3,966
Securities held-to-maturity		
Unquoted debt securities	**-**	220,380
Quoted debt securities	**-**	3,774,089
	-	3,994,469
Total investment securities	**4,810,682**	4,115,072

*As at 31 December 2016, quoted debt securities with book value of AED 583 million (31 December 2015: AED 658 million) have been given as collateral against repo borrowings of AED 546 million (31 December 2015: AED 591 million) [Note 12].

During the year, the Group reclassified the investments carried at held-to-maturity portfolio with market value of AED 4,130 million to the available-for-sale portfolio. As a result, the Group can not classify any investment as held-to-maturity up until the year 2018.

7. Investment securities (continued)

b) The composition of the investment portfolio by category is as follows:

	2016 AED'000	2015 AED'000
Federal and local Government - UAE	**592,743**	702,109
Government related entity - UAE	**892,945**	1,034,464
Government - GCC	**603,952**	74,800
Government related entity - GCC	**166,244**	87,478
Government - other	**85,437**	-
Banks and financial institutions - UAE	**661,609**	590,819
Banks and financial institutions - GCC	**152,992**	22,016
Banks and financial institutions - other	**1,199,636**	1,044,733
Public limited companies - UAE	**317,812**	185,090
Public limited companies - GCC	**10,847**	-
Public limited companies - other	**94,257**	327,706
Total debt securities	**4,778,474**	4,069,215
Quoted equity securities	**7,279**	41,784
Quoted mutual funds	**24,822**	3,966
Unquoted equity securities	**107**	107
Total investment securities	**4,810,682**	4,115,072

c) Movement in investment securities

	Securities available for sale AED'000	Securities held for trading AED'000	Securities held to maturity AED'000	Total AED'000
At 1 January 2016	**116,637**	**3,966**	**3,994,469**	**4,115,072**
Portfolio transfer	**3,994,469**	**-**	**(3,994,469)**	**-**
Purchases	**2,708,675**	**1,192,521**	**-**	**3,901,196**
Disposal/maturities	**(2,025,176)**	**(1,179,725)**	**-**	**(3,204,901)**
Net changes in fair value through OCI	**39,577**	**-**	**-**	**39,577**
Impairment/net changes in fair value through PL	**(25,611)**	**227**	**-**	**(25,384)**
Amortization of premium	**(14,878)**	**-**	**-**	**(14,878)**
At 31 December 2016	**4,793,693**	**16,989**	**-**	**4,810,682**
At 1 January 2015	60,291	-	3,725,089	3,785,380
Investments acquired on RAKNIC acquisition	43,450	4,765	3,707	51,922
Purchases	36,986	-	441,173	478,159
Disposal/maturities	(3,673)	-	(159,514)	(163,187)
Net changes in fair value through OCI	(14,274)	-	-	(14,274)
Impairment/net changes in fair value through PL	(6,000)	(799)	-	(6,799)
Amortization of premium	(143)	-	(15,986)	(16,129)
At 31 December 2015	116,637	3,966	3,994,469	4,115,072

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

8. Insurance contract assets and receivables

	2016 AED'000	2015 AED'000
Reinsurance contract assets		
Claims reported unsettled	**77,826**	83,687
Claims incurred but not reported	**14,917**	11,044
Deferred reinsurance premium and commission	**37,064**	45,458
Total reinsurance contract assets	**129,807**	140,189
Insurance related receivables		
Premium receivables	**202,456**	157,877
Reinsurance companies	**26,356**	9,427
Insurance agents and brokers	**835**	3,165
Gross insurance related receivables	**229,647**	170,469
Provision for doubtful receivables	**(18,495)**	(10,545)
Net insurance related receivables	**211,152**	159,924
Insurance contract assets and receivables	**340,959**	300,113

9. Other assets

	2016 AED'000	2015 AED'000
Interest receivable	**207,088**	214,791
Profit receivable on Islamic financing assets	**34,012**	43,055
Prepayments and deposits	**105,928**	79,570
Interest rate swaps and other derivatives (Note 31)	**17,292**	23,496
Customer acceptances	**49,563**	34,319
Insurance related receivables and assets	**62,087**	38,392
Others	**49,518**	50,661
	525,488	484,284

10. Goodwill and other intangible assets

	Goodwill including insurance license AED'000	Intangibles- customer relationship AED'000	Goodwill and other intangible assets AED'000
Cost			
At 1 January 2015	-	-	-
RAKNIC acquisition	166,386	12,835	179,221
At 31 December 2015	166,386	12,835	179,221
Additions	-	-	-
At 31 December 2016	**166,386**	**12,835**	**179,221**
Accumulated amortization			
At 1 January 2015	-	-	-
Charge for the year	-	(1,872)	(1,872)
At 31 December 2015	-	(1,872)	(1,872)
Charge for the year	-	(3,208)	(3,208)
At 31 December 2016	-	**(5,080)**	**(5,080)**
Net book value			
At 31 December 2016	**166,386**	**7,755**	**174,141**
At 31 December 2015	166,386	10,963	177,349

For the purpose of impairment assessment, goodwill is allocated to the Group's insurance business. Goodwill is tested for impairment annually or at a more frequent basis when there is evidence that the fair value of the unit is less than the carrying value. The impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit, pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognized for goodwill is not reversed in a subsequent period.

Management has carried out an impairment test for goodwill at the year end and has concluded that no impairment has taken place. For this purpose, the recoverable amount of each cash generating unit has been determined based on a value-in-use calculation using cash flow projections, based on financial budgets approved by senior management, covering a five year period. Cash flows beyond the five-year period are extrapolated using a growth rate, which management believes approximates the long term growth rate for the industry in which the cash generating unit operates.

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

11. Property and equipment

	Land and buildings AED'000	Leasehold improvements AED'000	Other fixed assets AED'000	Capital work-in-progress AED'000	Total AED'000
Cost					
At 1 January 2015	643,532	123,956	790,613	10,744	1,568,845
RAKNIC acquisition	16,068	-	3,141	-	19,209
Additions	-	71	36,800	42,198	79,069
Transfers	48,628	(25,258)	9,052	(32,422)	-
Disposals	(20,121)	-	(5,130)	-	(25,251)
At 31 December 2015	688,107	98,769	834,476	20,520	1,641,872
Additions	973	-	18,003	66,062	85,038
Transfers	17,113	4,806	45,443	(67,362)	-
Disposals	(570)	-	(3,430)	-	(4,000)
At 31 December 2016	**705,623**	**103,575**	**894,492**	**19,220**	**1,722,910**
Accumulated depreciation					
At 1 January 2015	86,676	87,439	457,016	-	631,131
Charge for the year	24,454	12,490	84,358	-	121,302
Transfers	30,899	(17,060)	(13,839)	-	-
Disposals	(3,247)	-	(4,764)	-	(8,011)
At 31 December 2015	138,782	82,869	522,771	-	744,422
Charge for the year	26,218	8,586	74,104	-	108,908
Disposals	(422)	-	(2,842)	-	(3,264)
At 31 December 2016	**164,578**	**91,455**	**594,033**	-	**850,066**
Net book value					
At 31 December 2016	**541,045**	**12,120**	**300,459**	**19,220**	**872,844**
At 31 December 2015	549,325	15,900	311,705	20,520	897,450

Other fixed assets include computer equipment, furniture and fixtures, equipment and motor vehicles. Capital work in progress mainly comprises the costs pertaining to various system enhancements and set up costs for branches/offices.

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

12. Due to other banks

	2016 AED'000	2015 AED'000
Term borrowings	**1,014,261**	462,942
Repurchase agreements (Note 7)	**545,723**	591,403
Demand deposits	**1,893**	1,796
	1,561,877	1,056,141

13. Deposits from customers

	2016 AED'000	2015 AED'000
Time deposits	**8,178,941**	7,723,523
Current accounts	**16,426,022**	15,057,746
Saving deposits	**3,560,687**	3,740,321
Call deposits	**1,232,535**	1,298,515
	29,398,185	27,820,105

Time deposits include AED 468 million (2015: AED 484 million) held by the Bank as cash collateral for loans and advances granted to customers.

The below table summaries the Islamic deposits of customers that are part of deposits from customers above:

	2016 AED'000	2015 AED'000
Wakala deposits	**1,025,959**	1,728,368
Mudaraba term investment deposits	**42,468**	36,928
Murabaha Term Deposit	**7,350**	-
Qard-E-Hassan - current accounts	**559,917**	521,847
Mudaraba - current accounts	**924,682**	1,030,169
Mudaraba - saving accounts	**133,730**	142,794
Mudaraba - call deposits	**38,372**	30,633
	2,732,478	3,490,739

14. Debt securities in issue

	2016 AED'000	2015 AED'000
USD 500 million medium term note issued at discount in June 2014	**1,829,618**	1,826,768
USD 300 million medium term note issued at premium in March 2015	**1,107,636**	1,110,252
Less: Own investment in debt securities issued	**(210,859)**	(84,053)
Less: Debt security issue costs	**(7,545)**	(10,865)
Fair value adjustment on hedged debt securities in issue	**11,222**	22,625
	2,730,072	2,864,727

The Group issued USD 500 million medium term note in June 2014 under its USD 1 billion medium term note programme through its subsidiary RAK Funding Cayman Limited. The initial tranche of the note was issued at a discounted rate of 99.275%. In March 2015 second tranche of USD 300 million notes were issued under this programme at a premium rate of 100.875%. These notes mature in 2019 and carry a fixed interest rate of 3.25% per annum. Interest on these medium term notes is payable half-yearly in arrears.

15. Insurance contract liabilities and payables

	2016 AED'000	2015 AED'000
Insurance contract liabilities		
Claims reported unsettled	**114,618**	133,230
Claims incurred but not reported	**45,814**	25,544
Unearned premiums	**178,224**	160,908
Total insurance contract liabilities	**338,656**	319,682
Insurance related payables		
Creditors	**68,733**	7,834
Reinsurance payables	**36,506**	48,371
Commission payables	**21,931**	13,896
Total insurance related payables	**127,170**	70,101
Insurance contract liabilities and payables	**465,826**	389,783

16. Other liabilities

	2016 AED'000	2015 AED'000
Interest payable	**50,081**	34,332
Profit distributable on Islamic deposits	**21,900**	22,535
Accrued expenses	**110,843**	195,275
Managers cheques issued	**131,296**	119,380
Provision for employees' end-of-service benefits (Note 29)	**96,754**	96,051
Derivatives (Note 31)	**5,390**	3
Customer acceptances	**49,563**	34,319
Mortgage payables and liabilities	**22,769**	25,880
Credit card payables and liabilities	**90,562**	12,427
Asset based finance payables and liabilities	**19,991**	12,445
Insurance realated payables and liabilities	**39,354**	66,575
Other	**135,387**	119,947
	773,890	739,169

17. Share capital and dividend

At 31 December 2016, the authorised, issued and fully paid share capital of the Bank comprised 1,676 million shares of AED 1 each (31 December 2015: 1,676 million shares of AED 1 each).

At the meeting held on 17 April 2016, the shareholders of the Bank approved a cash dividend of 50% amounting to AED 838 million of the issued and paid up capital in respect of the year ended 31 December 2015 (2014: 50% cash dividend amounting to AED 838 million). These dividends were paid out during the second quarter of 2016.

18. Legal reserve

In accordance with the UAE Federal Law No (2) of 2015 and Articles of Association of the Bank, 10% of the Bank's net profit for the year is transferred to a legal reserve, until such time as the balance in the reserve equals 50% of the issued share capital. Since the legal reserve of the Bank is equal to 50% of Bank's issued capital, profit was not appropriated to legal reserve during the year. This reserve is not available for distribution. Additionally, the subsidiaries of the Bank also appropriate their profit to a legal reserve which is added to the Bank's legal reserve.

Share premium represents amounts received from shareholders in excess of the nominal value of the shares allotted to them. In accordance with the Articles of Association of the Bank, share premium is not available for distribution. Share premium was transferred to legal reserve in 2016 according to the UAE Federal Law No (2) of 2015.

Notes to the consolidated financial statements
for the year ended 31 December 2016 (continued)

19. Other reserves

	Voluntary reserve AED'000	General banking risk reserve AED'000	Credit risk reserve AED'000	Regulatory credit risk reserve AED'000	Treasury stock elimination AED'000	Fair value reserve AED'000	Total AED'000
At 1 January 2015	336,717	900,000	1,150,000	334,000	-	154	2,720,871
Changes during the year	-	100,000	100,000	43,000	(2,397)	(11,358)	229,245
At 31 December 2015	336,717	1,000,000	1,250,000	377,000	(2,397)	(11,204)	2,950,116
Changes during the year	491	-	-	44,000	-	36,602	81,093
At 31 December 2016	**337,208**	**1,000,000**	**1,250,000**	**421,000**	**(2,397)**	**25,398**	**3,031,209**

In accordance with the Articles of Association of the Bank, 10% of the net profit for the year is to be transferred to a voluntary reserve until such time as the balance in the reserve equals 20% of the issued share capital. Since the voluntary reserve of the Bank is equal to 20% of Bank's issued capital, profit was not appropriated to voluntary reserve during the year. Additionally, the subsidiaries of the Bank also appropriate their profit to such reserve which is added to the Bank's voluntary reserve. This reserve is available for distribution.

The Bank maintains a general banking risk reserve to address the risks inherent in the Bank's operating environment. Contributions to this reserve are made at the discretion of the Directors. This reserve is available for distribution.

The Bank has also established a special reserve for credit risk. Contributions to this reserve are voluntary and made at the discretion of the Directors. This reserve is available for distribution.

The Bank has created a non-distributable special reserve titled as 'Regulatory Credit Risk Reserve' and this reserve is maintained at least at a level of 1.5% of the credit risk weighted assets at the end of each financial year, as instructed by the Central Bank of U.A.E.

Treasury stock elimination amount represents the shares of the National Bank of Ras Al-Khaimah (P.S.C.) owned by RAK National Insurance Company P.S.C.

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

20. Non-controlling interests

	Year ended 31 December 2016 AED'000	Period from 28 May 2015 to 31 December 2015 AED'000
Balance at the beginning of the year/period	**38,196**	-
RAKNIC acquisition*	**-**	36,179
Profit for the year/period	**3,436**	4,933
Dividends paid	**(1,142)**	-
Change in other comprehensive income for the year/period	**2,975**	(2,916)
Balance at the end of the year/period	**43,465**	38,196

*On 28 May 2015 RAKBANK acquired 79.23% stake in RAKNIC through public offer. Non-controlling interest on acquisition of AED 36.179 million amounts to 20.77% of the fair value of net assets on acquisition date.

21. Interest income and interest expense

	2016 AED'000	2015 AED'000
Interest income		
Personal loans	**338,153**	385,630
Mortgage loans	**156,455**	180,652
Credit cards	**754,885**	696,460
Auto loans	**129,081**	148,673
Business banking RAK finance loans	**773,506**	968,717
Wholesale banking loans	**141,050**	84,917
Business banking loans	**239,571**	226,046
Other retail loans	**37,810**	28,618
Investment securities	**178,247**	175,014
Deposits with the U.A.E. Central Bank	**4,091**	3,745
Other banks	**6,025**	3,282
	2,758,874	2,901,754
Interest expense		
Due to customers	**196,515**	168,425
Debt securities issued	**62,544**	49,969
Borrowings from other banks	**17,735**	5,435
	276,794	223,829

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

22. Income from Islamic financing and distribution to depositors

	2016 AED'000	2015 AED'000
Income from Islamic financing		
Islamic Salam personal finance	**125,692**	140,557
Islamic Auto Murabaha	**73,210**	78,084
Islamic business finance	**152,833**	174,025
Islamic finance wholesale banking	**911**	-
Islamic asset based finance	**6,520**	2,668
Islamic Ijara property finance	**20,610**	9,953
	379,776	405,287
Distribution to depositors		
Distribution of profit on Islamic term investment deposits	**29,117**	29,536
Distribution of profit on Islamic demand deposits	**7,638**	5,381
	36,755	34,917

23. Net fees and commission income

	2016 AED'000	2015 AED'000
Personal loans	**23,566**	26,764
Mortgage loans	**27,776**	31,418
Credit cards	**267,177**	248,060
Auto loans	**21,814**	17,488
RAK Finance business loans	**37,449**	66,936
Wholesale banking	**42,109**	13,757
Other business banking	**84,075**	72,088
Fiduciary income	**46,766**	79,051
Bancassurance	**45,290**	67,333
Other	**58,980**	59,355
	655,002	682,250

24. Gross insurance underwriting profit

	2016 AED'000	2015 AED'000
Gross insurance premium	**414,902**	238,395
Less: insurance premium ceded to reinsurers	**(87,728)**	(57,245)
Net retained premium	**327,174**	181,150
Net change in unearned premium reserve	**(11,728)**	(11,446)
Net insurance premium	**315,446**	169,704
Gross claims incurred	**(323,723)**	(183,998)
Insurance claims recovered from reinsurers	**99,123**	54,562
Net claims incurred	**(224,600)**	(129,436)
Gross commission earned	**5,194**	5,259
Less: commission incurred	**(40,800)**	(8,022)
Net commission incurred	**(35,606)**	(2,763)
Gross underwriting profit	**55,240**	37,505

The acquisition for RAKNIC was completed on 28 May 2015, the results for RAKNIC have been consolidated into those of the Group from that day onwards. RAKNIC income for 2015 is for the period 28 May 2015 to 31 December 2015.

25. Investment income/(loss)

	2016 AED'000	2015 AED'000
Dividend income	**1,742**	632
Net gain on disposal of investments	**125,347**	-
Fair value loss, net	**(784)**	(6,800)
	126,305	(6,168)

26. Operating expenses

	2016 AED'000	2015 AED'000
Staff costs (Note 28)	**546,331**	614,646
Occupancy costs	**98,028**	94,634
Marketing expenses	**30,487**	32,648
Depreciation and amortization	**112,116**	123,174
Communication costs	**38,462**	35,372
Legal and consultancy fees	**53,641**	52,687
Computer expenses	**77,813**	77,583
Outsourced staff costs	**345,811**	367,544
Other	**65,932**	80,219
	1,368,621	1,478,507

27. Earnings per share

The basic earnings per share is calculated by dividing the net profit attributable to owners of the Parent by the weighted average number of ordinary shares in issue during the year.

	2016	2015
Profit for the year (AED'000) (attributed to owners of the Bank)	**659,542**	1,400,387
Weighted average number of shares in issue (in 000's)	**1,676,245**	1,676,245
Basic earnings per share (AED)	**0.39**	0.84

There were no potentially dilutive shares as at 31 December 2016 and 2015.

28. Staff costs

	2016 AED'000	2015 AED'000
Salaries, allowances and bonus	**500,801**	564,362
Pension	**9,522**	5,073
End-of-service benefits	**16,005**	15,564
Other	**20,003**	29,647
	546,331	614,646

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

29. Provision for employees' end of service indemnity

	2016 AED'000	2015 AED'000
Balance at 1 January	**96,051**	84,852
Charge for the year	**19,844**	19,305
Amount acquired on RAKNIC acquisition	**-**	3,557
Payment during the year	**(19,141)**	(11,663)
	96,754	96,051

In accordance with the provisions of IAS 19, management has carried out an exercise to assess the present value of its obligations as at 31 December 2016, using the projected unit credit method, in respect of employees' end of service benefits payable under the UAE Labour Law. The expected liability at the date of leaving the service has been discounted to net present value. Under this method an assessment has been made of an employee's expected service life with the Group and the expected basic salary at the date of leaving the service. Management has assumed average annual increment/promotion costs of 3.0 % (2015: 3.5%).

30. Contingencies and commitments

	2016 AED'000	2015 AED'000
Irrevocable commitments to extend credit	**31,788**	37,646
Letters of guarantee	**858,289**	723,420
Letters of credit	**61,526**	76,847
Capital commitments and other contingencies	**26,401**	19,018
	978,004	856,931

Letters of credit are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank, up to a stipulated amount, under specific terms and conditions. These letters of credit are collateralised by the underlying shipments of goods to which they relate and therefore have significantly less risk.

Guarantees commit the Bank to make payment on behalf of customers contingent upon the production of documents or failure of the customer to perform under the terms of the contract. Guarantees include AED 100 million guarantee given by the Bank for its subsidiary RAK Islamic Finance Company.

Cash requirements under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss, though not easy to quantify, is considerably less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. While there is some risk associated with the remainder of commitments, the risk is viewed as modest, since it results firstly from the possibility of the unused portion of loan authorisations being drawn by the customer, and second, from these drawings subsequently not being repaid as due. The Bank monitors the term to maturity of credit commitments because longer term commitments generally have a greater degree of risk than shorter term commitments. Commitments to extend credit amounting to AED 8,536 million (2015: AED 8,618 million) are revocable at the option of the Bank and not included in the above table.

Notes to the consolidated financial statements
for the year ended 31 December 2016 (continued)

31. Forward foreign exchange and other derivative contracts

Foreign exchange contracts comprise commitments to purchase foreign and domestic currencies on behalf of customers and in respect of the Bank's undelivered spot transactions.

Outstanding forward foreign exchange contracts, interest rate swaps and other derivative contracts at 31 December 2016 and 31 December 2015 are as follows:

	Fair Values		
	Assets AED'000	**Liability AED'000**	**Notional AED'000**
31 December 2016			
Foreign exchange contracts	**3,853**	**3,845**	**873,776**
Interest rate swaps	**12,981**	**536**	**2,916,406**
Other derivative contracts	**458**	**1,009**	**514,220**
Total	**17,292**	**5,390**	
31 December 2015			
Foreign exchange contracts	238	3	745,446
Interest rate swaps	23,258	-	2,850,248
Other derivative contracts	-	-	-
Total	23, 496	3	

32. Cash and cash equivalents

	2016 AED'000	2015 AED'000
Cash in hand and current account with UAE Central Bank	**1,063,216**	1,080,482
Due from other banks	**2,629,230**	1,906,813
	3,692,446	2,987,295
Less: Due from other banks with original maturity of three months or more	**(1,550,487)**	(547,446)
	2,141,959	2,439,849

33. Operating segments

Following the management approach of IFRS 8, operating segments are reported in accordance with the internal reporting to the management, which is responsible for allocating resources to the reportable segments and assesses its performance. All operating segments used by the Group meet the definition of a reportable segment under IFRS 8.

The Group has five main business segments:

- Retail banking - incorporating individual customer and certain business current accounts, savings accounts, deposits, credit and debit cards, individual customer loans and mortgages;
- Wholesale banking - incorporating transactions with corporate bodies including government and public bodies and comprising of loans, advances, deposits and trade finance transactions of corporate customers and financial institutions;
- Business banking - incorporating transactions comprising of loans, advances, deposits and trade finance transactions of SME;
- Treasury - incorporating activities of the dealing room, related money market, and foreign exchange transactions and hedging activities with other banks and financial institutions including the UAE Central Bank, none of which constitute a separately reportable segment; and
- Insurance business - incorporating all insurance related transactions of its subsidiary Ras Al Khaimah National Insurance Company PSC.

The above segments include conventional and Islamic products and services of the Group.

As the Group's segment operations are all financial with a majority of revenues deriving from interest and fees and commission income, the management relies primarily on revenue and segmental results to assess the performance of the segment.

Funds are ordinarily allocated between segments, resulting in funding cost transfers disclosed in inter-segment revenue. Interest charged for these funds is based on the Bank's funds transfer pricing policy. There are no other material items of income or expense between the business segments.

The Group's management reporting is based on a measure of net profit comprising net interest income, loan impairment charges, net fee and commission income, other income and non-interest expenses.

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

33. Operating segments (continued)

The segment information provided to the management for the reportable segments for the period ended 31 December 2016 and 2015 is as follows:

	Retail Banking AED'000	Wholesale Banking AED'000	Business Banking AED'000	Treasury and other AED'000	Insurance business AED'000	Unallocated AED'000	Consolidation elimination AED'000	Total AED'000
31 December 2016								
Net external interest income	1,324,786	100,887	963,938	88,037	4,432	-	-	2,482,080
Income from Islamic financing net of distribution to depositors	186,124	911	155,986	-	-	-	-	343,021
Transfer pricing (expense)/income	(66,252)	(8,655)	19,177	55,730	-	-	-	-
Net interest income and net income from Islamic financing	1,444,658	93,143	1,139,101	143,767	4,432	-	-	2,825,101
Non-interest income	552,537	48,725	169,123	187,683	59,882	-	(3,738)	1,014,212
Operating income	1,997,195	141,868	1,308,224	331,450	64,314	-	(3,738)	3,839,313
Operating expense excluding depreciation and amortisation	(825,762)	(31,248)	(147,064)	(11,198)	(44,526)	(200,445)	3,738	(1,256,505)
Depreciation and amortisation	(29,082)	(1,025)	(1,718)	(389)	(6,578)	(73,324)	-	(112,116)
Total operating expense	(854,844)	(32,273)	(148,782)	(11,587)	(51,104)	(273,769)	3,738	(1,368,621)
Impairment charge, net	(796,167)	(101,002)	(910,545)	-	-	-	-	(1,807,714)
Net profit/(loss)	346,184	8,593	248,897	319,863	13,210	(273,769)	-	662,978
Segment assets	18,123,356	5,815,927	7,259,633	9,849,526	574,290	-	(74,525)	41,548,207
Unallocated assets	-	-	-	-	-	962,022	-	962,022
Total assets	18,123,356	5,815,927	7,259,633	9,849,526	574,290	962,022	(74,525)	42,510,229
Segment liabilities	13,769,223	4,206,822	10,642,302	5,469,429	510,506	-	(74,525)	34,523,757
Unallocated liabilities	-	-	-	-	-	406,093	-	406,093
Total liabilities	13,769,223	4,206,822	10,642,302	5,469,429	510,506	406,093	(74,525)	34,929,850

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

33. Operating segments (continued)

31 December 2015	Retail banking AED'000	Wholesale banking AED'000	Business banking AED'000	Treasury and other AED'000	Insurance business AED'000	Unallocated AED'000	Consolidation elimination AED'000	Total AED'000
Net external interest income	1,345,726	68,620	1,147,854	113,595	2,130	-	-	2,677,925
Income from Islamic financing net of distribution to depositors	196,024	-	174,346	-	-	-	-	370,370
Net transfer pricing income/(expense)	(40,987)	3,067	4,406	33,514	-	-	-	-
Net interest income and net income from Islamic financing	1,500,763	71,687	1,326,606	147,109	2,130	-	-	3,048,295
Non-interest income	604,080	19,134	161,657	69,356	46,316	-	(9,606)	890,937
Operating income	2,104,843	90,821	1,488,263	216,465	48,446	-	(9,606)	3,939,232
Operating expense excluding depreciation and amortisation	(914,464)	(22,560)	(171,676)	(7,081)	(23,613)	(225,545)	9,606	(1,355,333)
Depreciation and amortisation	(37,393)	(845)	(2,321)	(149)	(2,950)	(79,516)	-	(123,174)
Total operating expense	(951,857)	(23,405)	(173,997)	(7,230)	(26,563)	(305,061)	9,606	(1,478,507)
Impairment charge net of (write off)/recovery	(578,667)	(29,021)	(447,717)	-	-	-	-	(1,055,405)
Net profit/(loss)	574,319	38,395	866,549	209,235	21,883	(305,061)	-	1,405,320
As at 31 December 2015								
Segment assets	18,621,454	2,395,428	8,253,915	9,874,195	525,519	-	(69,616)	39,600,895
Unallocated assets	-	-	-	-	-	986,478	-	986,478
Total assets	18,621,454	2,395,428	8,253,915	9,874,195	525,519	986,478	(69,616)	40,587,373
Segment liabilities	15,525,221	2,636,858	9,325,145	4,528,642	483,896	-	(69,616)	32,430,146
Unallocated liabilities	-	-	-	-	-	439,779	-	439,779
Total liabilities	15,525,221	2,636,858	9,325,145	4,528,642	483,896	439,779	(69,616)	32,869,925

Notes to the consolidated financial statements
for the year ended 31 December 2016 (continued)

34. Related parties balances

Related parties comprise key management, businesses controlled by shareholders and directors as well as businesses over which they exercise significant influence. During the year, the Group entered into transactions with related parties in the ordinary course of business. The transactions with related parties and balances arising from these transactions are as follows:

	2016 AED'000	2015 AED'000
Transactions during the year		
Interest income	**184**	213
Interest expense	**29,836**	14,245
Commission income	**124**	638
Directors' and key management personnel's remuneration and other expenses	**20,155**	20,364
Balances		
Loans and advances:		
- Shareholders and their related companies	**170**	129
- Directors and their related companies	**1,155**	131
- Key management personnel	**4,397**	5,050
	5,722	5,310
Deposits		
- Shareholders and their related companies	**2,003,955**	1,683,511
- Directors and their related companies	**10,036**	12,945
- Key management personnel	**5,629**	9,540
	2,019,620	1,705,996
Irrecoverable commitments and contingent liabilities and forward contracts		
- Shareholders and their related companies	**120,975**	140,179
- Directors and their related companies	**403**	423
	121,378	140,602
Insurance related receivables		
Due from policy holders	**24,154**	19,312
Insurance related payables		
Due to policy holders	**294**	614

Notes to the consolidated financial statements
for the year ended 31 December 2016 (continued)

35. Fiduciary activities

The Bank holds assets in a fiduciary capacity for its customers without recourse. At 31 December 2016, such assets amounted to AED 1,722 million (2015: AED 1,786 million) and are excluded from the consolidated financial statements of the Group.

36. Legal proceedings

The Bank is involved in various legal proceedings and claims arising in the ordinary course of business. While the outcome of these matters cannot be predicted with certainty, management does not believe that these matters will have a material adverse effect on the Bank's consolidated financial statements if settled unfavourably.

The Bank's subsidiary, RAKNIC in common with other insurance companies, is involved as defendant in a number of legal cases in respect of its underwriting activities. A provision is made in respect of each individual case where it is probable that the outcome would result in a loss to the Group in terms of an outflow of economic resources and a reliable estimate of the amount of outflow can be made.

37. Comparative figures

In accordance with the requirements of IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, certain items have been reclassified in the consolidated statement of financial position for the prior year ended 31 December 2015, as previously reported:

Extract of consolidated statement of financial position:

	As previously reported AED'000	*Reclassifications AED'000*	*As reclassified AED'000*
Assets - extract			
Investment securities	4,114,981	91	4,115,072
Insurance contract assets and receivables	325,493	(25,380)	300,113
Other assets	424,676	59,608	484,284
Total	4,865,150	34,319	4,899,469
Liabilities - extract			
Other liabilities	704,850	34,319	739,169
Contingencies and commitments	891,250	(34,319)	856,931

The reclassification does not have an impact on the opening reserves of 2015 or on 2014 consolidated financial statements.

Notes to the consolidated financial statements
for the year ended 31 December 2016 (continued)

38. Business combination

On 28 May 2015 the Bank acquired a 79.23% stake in insurance provider Ras Al Khaimah National Insurance Company PSC (RAKNIC) operating in UAE through a public offer made to shareholders of RAKNIC. Management assessed the acquisition as a business combination under IFRS 3, 'Business Combinations'. As a result of the acquisition, the Bank further consolidated its position in the insurance market which was earlier through its Bancassurance window.

The following table summarises the consideration paid for acquisition and the fair value of identifiable assets acquired at the acquisition date:

		AED'000
Consideration		
Total cash consideration (a)		317,244
Recognised amounts of identifiable intangible assets acquired		
	Book value	*Fair Value*
Property and equipment	9,092	19,209
Investment securities	54,320	34,320
Cash and cash equivalents	113,288	113,288
Net receivables	56,914	7,384
Value of identifiable net assets on acquisition - (b)	233,614	174,201
Fair value of identifiable net assets acquired: (b x 79.23%) - (c)		138,023
Intangibles :		
Customer relationships		12,835
Total Intangibles (Note 10) - (d)		12,835
Goodwill including insurance license (Note 10): (a) - (c) - (d)		166,386
Cash consideration transferred		317,244
Cash & cash equivalents acquired		(113,288)
Net cash out flow on RAKNIC acquisition		203,956

In addition to the insurance license acquired, the goodwill acquired can be attributed to the well positioned business of RAKNIC which has an established franchise and reputation in UAE. RAKNIC has a sound management team and skilled workforce with strong sales and risk management skills. There are substantial synergies of the acquisition with the Bank which will be exploited in the future.

39. Financial risk management

Risk management review

The Group's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial services business. The Group's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Group's financial performance.

The Group's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Group regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

Credit risk

Credit risk is defined as the risk that the Group's customers, clients or counter parties fail to perform or are unwilling to pay interest, repay the principal or otherwise to fulfil their contractual obligations under loan agreements or other credit facilities, thus causing the Group to suffer a financial loss.

Credit risk also arises through the downgrading of counter parties, whose credit instruments are held by the Group, thereby resulting in the value of the assets to fall. As credit risk is the Group's most significant risk, considerable resources, expertise and controls are devoted to managing this risk within the core departments of the Bank.

The Group's credit policy provides for the development of a systematic and consistent approach to identifying and managing borrower and counter party risks contained in all retail and wholesale banking assets.

The divisional heads of retail and wholesale credit and their team including collections are responsible for recognition and management of credit risk both at transaction and portfolio levels and to ensure that risk procedures are adhered to in a manner consistent with the framework set out in the Credit Policy, Product Programs Guidelines, Credit circulars and comply with regulatory norms.

The Group manages, limits and controls concentration of credit risk wherever it is identified - in particular, to individual counterparties and groups, and to industries and countries. The Group has a Product Program Guide that sets limits of exposure and lending criteria. The Group also has credit limits that set out the lending and borrowing limits to/from other banks.

The Group stratifies the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on an ongoing basis. Limits on the level of credit risk by product, industry sector and by country are approved by the Credit Committee and the Board of Directors.

The exposure to any one borrower, including banks, is further restricted by sub-limits covering on- and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored on an ongoing basis.

The Group has in place policies which govern the determination of eligibility of various collaterals including credit protection, to be considered for credit risk mitigation which includes the minimum operational requirements that are required for the specific collateral to be considered as effective risk mitigants. The Group's major collaterals are mortgaged properties, investments, vehicles & other register-able assets.

39. Financial risk management (continued)

Credit risk (continued)

The collateral is valued periodically ranging from quarterly to annually, depending on the type of collateral. Specifically for mortgaged property, a framework for valuation of mortgaged properties is established to ensure adequate policies and procedures are in place for efficient and proper conduct of valuation of mortgaged properties and other related activities in relation to the interpretation, monitoring and management of valuation of mortgaged properties.

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

	Maximum exposure	
	2016 AED'000	2015 AED'000
Credit risk exposures relating to on-balance sheet assets are as follows:		
Due from other banks	**2,629,230**	1,906,813
Loans and advances	**28,725,869**	27,798,096
Insurance contract assets	**303,895**	254,655
Investment securities	**4,810,682**	4,115,072
Other assets	**336,475**	316,599
Credit risk exposures relating to off-balance sheet items are as follows:		
Loan commitments and other off balance sheet items	**951,603**	837,913
	37,757,754	35,229,148

The above table represents a worst case scenario of credit risk exposure to the Group at 31 December 2016 and 2015 without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the consolidated statement of financial position.

As can be seen above, the most significant exposures arise from loans and advances to customers (including commitments) and amounts due from banks.

Management is confident in its ability to continue to control and minimise the loss arising from its exposure to credit risk resulting from its loans and advances portfolio, investment securities portfolio and amounts due from banks based on the following:

- 88% (2015: 90%) of the loans and advances are categorised in the top grades of the Bank's internal grading system.
- Mortgage loans, loan against investments, asset based finance and auto loans, which are backed by collateral together, represent a significant portion 31% (2015: 31 %) of loans and advances.
- 7.8 % (2015: 6.2%) of the loans comprise of restructured loans, where the Group has aligned its lending rates to current prevailing market lending rates and extended or modified payment arrangements to manage credit risk.
- The Bank continuously reviews its credit and credit underwriting policies and changes are made based on the Management Information System (MIS) reports and the patterns that emerge from these reports.

A significant portion of investment securities comprise debt instruments that are issued by government, reputable quasi-government organisations and financial institutions.

Notes to the consolidated financial statements
for the year ended 31 December 2016 (continued)

39. Financial risk management (continued)

Credit risk (continued)

Loans and advances to customers and amounts due from banks

Loans and advances to customers and amounts due from banks are summarised as follows:

	31 December 2016		31 December 2015	
	Loans and advances to customers AED'000	**Amounts due from banks AED'000**	Loans and advances to customers AED'000	Amounts due from banks AED'000
Neither past due nor impaired	**26,064,577**	**2,629,230**	25,683,132	1,906,813
Past due but not impaired	**2,465,263**	-	1,945,196	-
Individually impaired	**1,249,458**	-	914,368	-
Gross	**29,779,298**	**2,629,230**	28,542,696	1,906,813
Less: allowance for impairment	**(1,053,429)**	-	(744,600)	-
Net	**28,725,869**	**2,629,230**	27,798,096	1,906,813
Neither past due nor impaired				
Loans and advances	**26,064,577**	-	25,683,132	-
Due from banks	-	**2,629,230**		1,906,813
Gross	**26,064,577**	**2,629,230**	25,683,132	1,906,813

Loans and advances

The Group uses the grading of loans into different buckets in assessing the impairment loss in the Group's loan portfolio. The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by the Group.

Retail banking loans are graded into buckets according to the number of installments past due. All loans that are not in default of interest payment and installment are graded as bucket 0, while loans and advances that are in default of interest payment and installments are graded upwards from bucket 1 onwards, depending on the number of days past due. The wholesale banking credit rating matrix is used to rate wholesale banking loans under various characteristics. There are 18 categories of performing loans and 3 categories of non-performing loans. These ratings and wholesale banking facilities are reviewed at least once a year, or more frequently as required. Loans and advances are classified as delinquent after 90 days of non-payment of interest and installments. The credit policy has set internal lending limits for various industry exposures.

Amounts due from banks

The Group held amounts due from banks of AED 2,629 million (2015: AED 1,907 million) which represents its maximum credit exposure on these assets. The balance due from banks includes AED 885.9 million (2015: AED 999.5 million) placements with banks, banker's acceptances of AED 964 million (2015: AED 408.6 million) and syndicated loans of AED 439.4 million (2015: Nil). Remaining balances due from banks and other financial institutions are held with reputable organisations within and outside UAE, where the risk of default is considered low.

39. Financial risk management (continued)

Credit risk (continued)

Past due but not impaired

Loans and advances less than 90 days past due are not considered impaired in a collective assessment. Gross amount of loans and advances by class of customers that were past due but not impaired are as follows:

	2016	2015
	AED'000	AED'000
Past due up to 30 days	**1,547,283**	1,129,989
Past due 30 to 60 days	**500,361**	480,821
Past due more than 60 days	**417,619**	334,386
Total	**2,465,263**	1,945,196

Individually Impaired

The breakdown of the gross amount of individually impaired loans and advances, Islamic financing assets along with the fair value of related collateral held by the bank as security, are as follows:

	2016	2015
	AED'000	AED'000
Individually impaired loans	**1,249,458**	914,368
Fair value of collateral	**(256,018)**	(268,037)
Net	**993,440**	646,331

The total impairment provision for loans and advances is AED 1,053.4 million (2015: AED 744.6 million) of which AED 936.6 million (2015: AED 657.9 million) represents provision in respect of the individually impaired loans and advances and the remaining AED 116.8 million (2015: AED 86.7 million) represents the portfolio provision to reflect the risk inherent in the Group's loan portfolio. AED 256.02 million fair value of collateral shown above represents AED 250.9 million (2015: AED 259.7 million) fair value of collateral against mortgage loans and AED 5.12 million (2015: AED 8.3 million) against wholesale and business banking loans.

Restructured loans and advances

Restructuring activities include interest rate adjustments, extended payment arrangements and modification of payments. The majority of restructuring activity is undertaken to improve cash flow and is within the terms and conditions of the Group's product programme guideline. These policies are kept under continuous review. The Group has reviewed the entire portfolio and reported only restructured loans with financial difficulties under this note. The table below presents loans restructured during the year 2016 and 2015.

Notes to the consolidated financial statements
for the year ended 31 December 2016 (continued)

39. Financial risk management (continued)

Credit risk (continued)

Restructured loans during the year:

Product	2016 No of Accounts	2016 Loan Amount AED'000	2015 No of Accounts	2015 Loan Amount AED'000
Personal loans	**1,083**	**493,716**	692	394,083
Mortgage loans	**14**	**40,774**	8	12,999
Credit cards	**4,912**	**213,355**	1,266	54,724
Auto loans	**2,042**	**151,400**	600	53,270
Small and medium business banking loans	**75**	**83,663**	14	11,722
Wholesale banking loans	**21**	**129,538**	8	36,484
RAK finance business loans	**1,512**	**510,154**	373	202,009
Total	**9,659**	**1,622,600**	2,961	765,291

The table below presents restructured loan portfolio outstanding as at 31 December:

Product	2016 No of accounts	2016 Loan amount AED'000	2015 No of accounts	2015 Loan amount AED'000
Personal loans	**2,235**	**1,151,817**	1,939	1,123,081
Mortgage loans	**69**	**161,743**	60	137,969
Credit cards	**7,329**	**212,927**	3,873	71,472
Auto loans	**2,290**	**163,637**	799	63,207
Small and medium business loans	**88**	**91,556**	14	10,076
Wholesale banking loans	**28**	**156,260**	9	36,053
RAK finance business loans	**1,874**	**631,314**	754	315,923
Total	**13,913**	**2,569,254**	7,448	1,757,781

Investment securities

Investment securities comprise debt securities issued by the Government, organisations which are quasi-governmental and local and foreign reputable organisations.

The table below presents an analysis of debt securities by rating agency designation at 31 December 2016 and 2015, based on Moody's and Fitch ratings or their equivalent.

	2016 AED'000	2015 AED'000
AA to A-	**1,173,989**	1,109,814
BBB+ to BBB-	**2,058,559**	1,840,778
BB+ to B-	**624,300**	-
Unrated	**921,626**	1,118,623
	4,778,474	4,069,215

39. Financial risk management (continued)

Credit risk (continued)

Repossessed collateral

The Group occasionally takes possession of mortgaged property which is held as collateral for loans. During the year 2015, the Group took possession of a property with current market value of AED 4.8 million (5.4 million as at 31 December 2015) mortgaged by a wholesale banking customer. The acquired property is reported under other assets of the Group's balance sheet. In the case of retail auto loans and wholesale banking asset based finance where the underlying asset is repossessed as a part of recovery process, these are disposed of in an auction by authorised third parties and the Bank does not carry any such assets in its books.

Concentration of risks of financial assets with credit risk exposure

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

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to limit concentrations of exposures to counterparties, geographies and industries. Identified concentration of credit risk is controlled and managed accordingly.

Geographical risk concentration

The following table breaks down the Group's credit exposures at their carrying amounts, categorised by geographical region as of 31 December 2016 and 2015.

For this table, the Group has allocated exposures to regions based on the country of domicile of its counterparties:

On balance sheet items:

	UAE AED'000	OECD AED'000	Others AED'000	Total AED'000
31 December 2016				
Due from other banks	**975,883**	**636,269**	**1,017,078**	**2,629,230**
Loans and advances - net	**27,658,244**	**387,821**	**679,804**	**28,725,869**
Insurance contract assets	**303,895**	-	-	**303,895**
Investment securities:				
- Held- for-trade	**15,208**	-	**1,781**	**16,989**
- Available-for-sale	**2,465,695**	**325,739**	**2,002,259**	**4,793,693**
Other assets	**336,475**	-	-	**336,475**
Total	**31,755,400**	**1,349,829**	**3,700,922**	**36,806,151**
31 December 2015				
Due from other banks	1,042,529	668,062	196,222	1,906,813
Loans and advances - net	26,798,839	756,511	242,746	27,798,096
Insurance contract assets	249,036	-	5,619	254,655
Investment securities:				
- Held-to-maturity	2,475,385	220,836	1,298,248	3,994,469
- Available-for-sale	78,989	-	37,648	116,637
- Held for trade	3,966	-	-	3,966
Other assets	315,935	-	664	316,599
Total	30,964,679	1,645,409	1,781,147	34,391,235

Notes to the consolidated financial statements
for the year ended 31 December 2016 (continued)

39. Financial risk management (continued)

Credit risk (continued)

Concentration of risks of financial assets with credit risk exposure (continued)

Off balance sheet items

	UAE AED'000	OECD AED'000	Others AED'000	Total AED'000
31 December 2016				
Credit commitments	**30,614**	**-**	**1,174**	**31,788**
Guarantees, letter of credit and other exposures	**895,888**	**5,210**	**18,717**	**919,815**
	926,502	**5,210**	**19,891**	**951,603**
31 December 2015				
Credit commitments	37,646	-	-	37,646
Guarantees, letter of credit and other exposures	779,082	5,381	15,804	800,267
	816,728	5,381	15,804	837,913

39. Financial risk management (continued)

Credit risk (continued)

<u>Concentration of risks of financial assets with credit risk exposure</u> *(continued)*

The following table breaks down the Bank's credit exposures on loans and advances, investment securities, due from other banks and off balance sheet items categorised by industry as of 31 December 2016 and 2015:

	On balance sheet items					
31 December 2016	Loans and advances AED'000	Investment securities AED'000	Due from other banks AED'000	Total funded AED'000	Off balance sheet Items AED'000	Total AED'000
Agriculture, fishing & related activities	67	-	-	67	156	223
Crude oil , gas, mining & quarrying	7,399	-	-	7,399	116,160	123,559
Manufacturing	1,345,692	20,192	-	1,365,884	42,070	1,407,954
Electricity & water	4,637	558,445	-	563,082	1,215	564,297
Construction	1,118,709	325,690	-	1,444,399	141,528	1,585,927
Trading	5,385,264	-	-	5,385,264	183,316	5,568,580
Transport, storage & communication	1,472,200	389,103	-	1,861,303	19,764	1,881,067
Financial Institutions	1,350,156	2,144,273	2,629,230	6,123,659	108,233	6,231,892
Services	3,281,408	161,384	-	3,442,792	280,509	3,723,301
Government	-	1,211,595	-	1,211,595	12,276	1,223,871
Retail and consumer banking	14,760,337	-	-	14,760,337	46,376	14,806,713
Total exposures	**28,725,869**	**4,810,682**	**2,629,230**	**36,165,781**	**951,603**	**37,117,384**

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

39. Financial risk management (continued)

Credit risk (continued)

Concentration of risks of financial assets with credit risk exposure *(continued)*

	On balance sheet items					
	Loans and advances AED'000	Investment securities AED'000	Due from other banks AED'000	Total funded AED'000	Off balance sheet Items AED'000	Total AED'000
31 December 2015						
Agriculture, fishing and related activities	96	-	-	96	156	252
Crude oil , gas, mining & quarrying	4,827	-	-	4,827	117,530	122,357
Manufacturing	714,332	218,264	-	932,596	23,529	956,125
Electricity and water	5,220	650,730	-	655,950	1,595	657,545
Construction	663,417	190,959	-	854,376	76,544	930,920
Trading	6,120,175	-	-	6,120,175	161,422	6,281,597
Transport, storage & communication	1,296,181	353,592	-	1,649,773	24,113	1,673,886
Financial Institutions	1,027,995	1,676,087	1,906,813	4,610,895	111,549	4,722,444
Services	3,284,830	248,531	-	3,533,361	246,094	3,779,455
Government	-	776,909	-	776,909	31,785	808,694
Retail and consumer banking	14,681,023	-	-	14,681,023	43,596	14,724,619
Total exposures	27,798,096	4,115,072	1,906,813	33,819,981	837,913	34,657,894

39. Financial risk management (continued)

Credit risk (continued)

<u>*Individually impaired loans by industry*</u>

The breakdown of the gross amount of individually impaired loans and advances by industry is as follows:

	Less than 90 days AED'000	Overdue above 90 days AED'000	Total AED'000	Specific provision AED'000
31 December 2016				
Manufacturing	347	48,271	48,618	27,683
Construction	1,891	54,984	56,875	46,351
Trading	10,521	456,726	467,247	411,634
Transport, storage & communication	1,485	54,368	55,853	47,918
Services	10,654	124,939	135,593	119,382
Retail and consumer banking	47,059	438,213	485,272	283,660
Total impaired loans	71,957	1,177,501	1,249,458	936,628
31 December 2015				
Manufacturing	-	12,448	12,448	12,655
Construction	1,212	20,718	21,930	20,674
Trading	29,314	276,353	305,667	252,653
Transport, storage and communication	3,543	45,554	49,097	45,425
Services	5,769	68,587	74,356	71,458
Retail and consumer banking	28,323	422,547	450,870	255,038
Total impaired loans	68,161	846,207	914,368	657,903

Market risk

The Group takes on exposure to market risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity instruments, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

The Asset and Liability Committee (ALCO) is chaired by the Chief Executive Officer and comprises the Divisional heads of Finance, Treasury, Risk, Operations, Wholesale Banking, Business Banking and Retail Banking. It meets on a regular basis to monitor and manage market risk.

ALCO is responsible for formalising the Group's key financial indicators and ratios, sets the thresholds to manage and monitor the market risk and also analyses the sensitivity of the Group's interest rate and maturity mis-matches. ALCO also guides the Group's investment decisions and provides guidance in terms of interest rate and currency movements.

Further the Group does not enter into derivative trades for speculative purposes. The only exposure to derivatives is in respect of forward exchange contracts which are entered to meet customer needs or interest rate swaps for economic hedging purposes.

39. Financial risk management (continued)

Market risk (continued)

Price risk

The Group is exposed to price risk as a result of its holdings in debt securities classified as available-for-sale investment securities. The fair values of investments quoted in active markets are based on current bid prices senior management meets regularly to discuss the return on investment and concentration across the Group's investment portfolio.

The sensitivity analysis for price risk illustrates how changes in the fair value of securities held by the Group will fluctuate because of changes to market prices whether those changes are caused by factors specific to the individual issuer, or factors affecting all similar securities traded in the market.

Interest rate risk

Cash flow interest risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce losses in the event that unexpected movements arise. The Group monitors interest rate risk through the use of a detailed gap report and stress tests to analyse the impact of anticipated movements in interest rates.

Financial assets that are not subject to any interest-rate risk mainly comprise investments in equity investments, cash, balances with central banks excluding certificates of deposit.

The Group uses financial simulation tools to periodically measure and monitor interest-rate sensitivity.

The National Bank of Ras Al-Khaimah (P.S.C.)

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

39. Financial risk management (continued)

Market risk (continued)

Interest rate risk *(continued)*

The Group is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The table below sets out the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	Less than 3 months AED'000	3 months to 1 year AED'000	1 - 3 years AED'000	3 - 5 years AED'000	Over 5 years AED'000	Non -interest bearing AED'000	Total AED'000
At 31 December 2016							
Assets							
Cash and balances with the UAE Central Bank	150,000	200,000	-	-	-	4,081,016	4,431,016
Due from other banks	1,336,939	893,021	59,400	-	-	339,870	2,629,230
Loans and advances, net	7,140,468	9,245,916	6,804,344	1,724,383	3,810,758	-	28,725,869
Investment securities	224,656	193,721	417,610	1,419,354	2,523,133	32,208	4,810,682
Insurance contract assets and receivables	-	-	-	-	-	340,959	340,959
Goodwill, property and equipment and other assets	-	-	-	-	-	1,572,473	1,572,473
Total	8,852,063	10,532,658	7,281,354	3,143,737	6,333,891	6,366,526	42,510,229
Liabilities and shareholders' equity							
Due to other banks	1,149,932	410,052	-	-	-	1,893	1,561,877
Deposits from customers	15,575,040	5,153,053	144,551	-	-	8,525,541	29,398,185
Debt securities in issue 1	2,730,072	-	-	-	-	-	2,730,072
Insurance contract liabilities and payables	-	-	-	-	-	465,826	465,826
Other liabilities	-	-	-	-	-	773,890	773,890
Shareholders' equity	-	-	-	-	-	7,580,379	7,580,379
Total	19,455,044	5,563,105	144,551	-	-	17,347,529	42,510,229
Interest rate sensitivity gap	(10,602,981)	4,969,553	7,136,803	3,143,737	6,333,891	(10,981,003)	-

[1] *The Group has converted the fixed rate debt securities issued into a floating rate using an interest rate swap.*

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

39. Financial risk management (continued)

Market risk (continued)

Interest rate risk (continued)

At 31 December 2015	Less than 3 months AED'000	3 months to 1 year AED'000	1 - 3 years AED'000	3 - 5 years AED'000	Over 5 years AED'000	Non -interest bearing AED'000	Total AED'000
Assets							
Cash and balances with the UAE Central Bank	200,000	800,000	-	-	-	3,908,196	4,908,196
Due from other banks	1,164,983	259,107	21,263	-	-	461,460	1,906,813
Loans and advances, net	4,452,911	8,851,182	7,175,220	2,426,045	4,892,738	-	27,798,096
Investment securities	6,354	274,470	619,188	966,813	2,202,481	45,766	4,115,072
Insurance contract assets and receivables	-	-	-	-	-	300,113	300,113
Goodwill, property and equipment and other assets	-	-	-	-	-	1,559,083	1,559,083
Total	5,824,248	10,184,759	7,815,671	3,392,858	7,095,219	6,274,618	40,587,373
Liabilities and shareholders' equity							
Due to other banks	783,228	271,117	-	-	-	1,796	1,056,141
Deposits from customers	15,308,817	3,640,828	452,357	-	-	8,418,103	27,820,105
Debt securities in issue	2,864,727	-	-	-	-	-	2,864,727
Insurance contract liabilities and payables	-	-	-	-	-	389,783	389,783
Other liabilities	-	-	-	-	-	739,169	739,169
Shareholders' equity	-	-	-	-	-	7,717,448	7,717,448
Total	18,956,772	3,911,945	452,357	-	-	17,266,299	40,587,373
Interest rate sensitivity gap	(13,132,524)	6,272,814	7,363,314	3,392,858	7,095,219	(10,991,681)	-

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

39. Financial risk management (continued)

Market risk (continued)

Interest rate risk (continued)

Interest rate risk is assessed by measuring the impact of reasonable possible change in interest rate movements. The Group assumes a fluctuation in interest rates of 25 basis points (bps) and estimates the following impact on the net profit for the year and net assets at that date:

	2016 AED'000	2015 AED'000
Fluctuation in interest rates by 25 bps	24,015	22,506

The interest rate sensitivities set out above are worst case scenarios and employ simplified calculations. They are based on the gap between AED 19,385 million (2015: AED 16,009 million) of interest bearing assets with maturities within one year and AED 25,018 million (2015: AED 22,869 million) of interest bearing liabilities with maturities within one year. The sensitivity does not incorporate actions that could be taken by management to mitigate the effect of interest rate movements.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates and arises from financial instruments denominated in a foreign currency. Positions are closely monitored and strategies are used to ensure positions are maintained within established limits.

The Group's assets are typically funded in the same currency as that of the business transacted in order to eliminate foreign exchange exposure. However, the Group does maintain a US dollar open position within limits approved by the Bank's ALCO.

At 31 December 2016, the Bank had the following net exposures denominated in UAE and foreign currencies:

On balance sheet items

	AED AED'000	**USD AED'000**	**Others AED'000**	**Total AED'000**
At 31 December 2016				
Assets				
Cash and balances with the UAE Central Bank	3,887,566	543,029	421	4,431,016
Due from other banks	607,961	1,754,102	267,167	2,629,230
Loans and advances	25,374,851	3,337,058	13,960	28,725,869
Insurance contract assets	303,895	-	-	303,895
Investment securities	10,505	4,800,177	-	4,810,682
Other assets	236,017	98,447	2,011	336,475
Total assets	**30,420,795**	**10,532,813**	**283,559**	**41,237,167**

39. Financial risk management (continued)

Market risk (continued)

Currency risk (continued)

On balance sheet items (continued)

	AED AED'000	USD AED'000	Others AED'000	Total AED'000
At 31 December 2016				
Liabilities				
Due to other banks	483,000	924,042	154,835	1,561,877
Deposits from customers	24,784,746	3,849,562	763,877	29,398,185
Debt securities in issue	-	2,730,072	-	2,730,072
Insurance contract liabilities and payables	465,826	-	-	465,826
Other liabilities	626,333	47,010	3,793	677,136
Total liabilities	**26,359,905**	**7,550,686**	**922,505**	**34,833,096**
Net position of financial instruments	**4,060,890**	**2,982,127**	**(638,946)**	**6,404,071**
At 31 December 2015				
Assets				
Cash and balances with the UAE Central Bank	4,400,330	507,473	393	4,908,196
Due from other banks	748,695	1,032,713	125,405	1,906,813
Loans and advances	26,109,784	1,676,719	11,593	27,798,096
Insurance contract assets	254,655	-	-	254,655
Investment securities	49,564	4,065,508	-	4,115,072
Other assets	234,190	76,637	5,772	316,599
Total assets	31,797,218	7,359,050	143,163	39,299,431
Liabilities				
Due to other banks	100,000	955,246	895	1,056,141
Deposits from customers	23,789,921	3,231,781	798,403	27,820,105
Debt securities in issue	-	2,864,727	-	2,864,727
Insurance contract liabilities and payables	389,783	-	-	389,783
Other liabilities	608,587	27,795	6,736	643,118
Total liabilities	24,888,291	7,079,549	806,034	32,773,874
Net position of financial instruments	6,908,927	279,501	(662,871)	6,525,557

The Group has no significant exposure to foreign currency risk as its functional currency is pegged to the USD, the currency in which the Bank has the largest net open position at 31 December 2016 and 2015. All currency positions are within limits laid down by ALCO.

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

39. Financial risk management (continued)

Market risk (continued)

<u>Currency risk</u> *(continued)*

Off-balance sheet items

	AED AED'000	USD AED'000	Others AED'000	Total AED'000
At 31 December 2016				
Credit commitments	31,788	-	-	31,788
Guarantees, letter of credit and other exposures	647,336	253,611	18,868	919,815
Total	**679,124**	**253,611**	**18,868**	**951,603**
At 31 December 2015				
Credit commitments	37,646	-	-	37,646
Guarantees, letter of credit and other exposures	531,088	224,483	44,696	800,267
Total	568,734	224,483	44,696	837,913

Foreign exchange contracts

	AED AED'000	USD AED'000	Others AED'000	Total AED'000
At 31 December 2016				
Foreign exchange contracts	9,919	104,746	759,111	873,776
Interest rate swaps	-	2,916,406	-	2,916,406
Other derivatives	-	514,220	-	514,220
Total	**9,919**	**3,535,372**	**759,111**	**4,304,402**
At 31 December 2015				
Foreign exchange contracts	408	73,481	671,557	745,446
Interest rate swaps	-	2,850,248	-	2,850,248
Total	408	2,923,729	671,557	3,595,694

<u>Liquidity risk</u>

Liquidity risk is the risk that the Group is unable to meet its obligations when they fall due as a result of customer deposits being withdrawn, cash requirements from contractual commitments, or other cash outflows, such as debt maturities. Such outflows would deplete available cash resources for customer lending, trading activities and investments. In extreme circumstances, lack of liquidity could result in reductions in the balance sheet and sales of assets, or potentially an inability to fulfil lending commitments. The risk that the Group will be unable to do so is inherent in all banking operations and can be affected by a range of institution-specific and market-wide events including, but not limited to, credit events, systemic shocks and natural disasters.

Liquidity risk management process

The Group manages its liquidity in accordance with Central Bank of the U.A.E. requirements and the Group's internal guidelines mandated by ALCO. Based on the directives of the ALCO, the Treasury manages the liquidity of the Bank.

39. Financial risk management (continued)

Market risk (continued)

Liquidity risk (continued)

Liquidity risk management process (continued)

On the funding side, the Group has a large proportion of its funds in the form of own funds which reduces the requirement for external funds. The Group relies on deposits from its relationship based retail and wholesale banking customers as its primary source of funding and only on a short term basis relies on interbank borrowings to fund its assets. The Group's debt securities typically are issued with maturities of greater than three years. Deposits from customers generally have shorter maturities and a large portion of them are repayable on demand as is endemic to these markets. The short term nature of these deposits increases the Group's liquidity risk and the bank manages this risk through maintaining competitive pricing and constant monitoring of market trends. Also, a most of the deposit customers of the Group are relationship based and based on past trends these deposits that they maintain are sticky in nature, thus reducing the liquidity risk to a large extent. The Group does not rely on large ticket deposits and its depositor profile is very diverse leading to a more stable deposit funding. The Group raised USD 500 million under Euro Medium Term Notes under USD 1 billion EMTN programme launched in June 2014. In March 2015 a second tranche of USD 300 million notes were issued under this programme. This helped the Group achieve long term funding. The Group may raise further amounts through EMTNs.

On the deployment side, the Group maintains a portfolio of highly liquid assets largely made up of balances with the UAE Central Bank, certificates of deposits issued by the Central Bank, inter-bank facilities and investment securities including investments in local government bonds which can be repoed to meet short term liquidity mismatches and be offloaded to meet longer term mismatches. The Central Bank of the U.A.E. has prescribed reserve requirements on deposits ranging between 1% and 14% on time and demand deposits. As a contingency funding plan, the Group evaluates and keeps ready debt financing plans which can be quickly executed if required.

The table below analyses assets and liabilities of the Group into relevant maturity groupings based on the remaining years from the reporting date to the contractual cash flow date. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates and exchange rates.

The Central Bank of the U.A.E. also imposes mandatory 1:1 Loans to Stable Resources Ratio (LSRR) whereby loans and advances (combined with inter-bank placements having a remaining term of greater than three months) should not exceed stable funds as defined by the Central Bank of the U.A.E. ALCO monitors loans to stable resources ratios on a daily basis. The Group on a daily basis also monitors the liquid assets to total assets ratio and the eligible Liquid Asset Ratio and has set up internal management Action Triggers to take suitable corrective actions once the internal thresholds have been reached.

At 31 December 2016, 24.3% (2015: 23.9%) of the Group's total assets was in liquid assets. The LSRR as at 31 December, 2016 stood at 85.45% (2015: 83.3%) which is significantly lower than the maximum requirement of 100%. Similarly the Liquid Assets Ratio of the Group stood at 16.9% (2015: 19.1%) as at 31 December 2016, also reflecting a healthy liquidity position.

Notes to the consolidated financial statements
for the year ended 31 December 2016 (continued)

39. Financial risk management (continued)

Market risk (continued)

Liquidity risk (continued)

Liquidity risk management process (continued)

	Up to 3 months AED'000	3 – 12 months AED'000	1 – 3 years AED'000	3 to 5 years AED'000	Over 5 years AED'000	Total AED'000
At 31 December 2016						
Assets						
Cash and balances with the UAE Central Bank	4,231,016	200,000	-	-	-	4,431,016
Due from other banks	1,091,482	1,380,402	157,346	-	-	2,629,230
Loans and advances	6,333,485	5,438,849	7,652,060	2,795,174	6,506,301	28,725,869
Investment securities	4,810,682	-	-	-	-	4,810,682
Insurance contract assets and receivables	70,378	248,109	20,516	1,956	-	340,959
Goodwill and other intangible assets	-	-	-	-	174,141	174,141
Property and equipment and other assets	459,324	57,209	8,267	688	872,844	1,398,332
Total	16,996,367	7,324,569	7,838,189	2,797,818	7,553,286	42,510,229
Liabilities and shareholders' equity						
Due to other banks	1,076,825	485,052	-	-	-	1,561,877
Due to customers	24,480,539	4,773,169	144,477	-	-	29,398,185
Debts security in issue	-	-	2,730,072	-	-	2,730,072
Insurance contract liabilities and payables	-	465,826	-	-	-	465,826
Other liabilities	673,681	3,455	-	-	96,754	773,890
Shareholders' equity	-	-	-	-	7,580,379	7,580,379
Total	26,231,045	5,727,502	2,874,549	-	7,677,133	42,510,229
Net cumulative liquidity gap	(9,234,678)	(7,637,611)	(2,673,971)	123,847	-	-
At 31 December 2015						
Total assets	11,924,402	6,961,414	8,355,458	3,622,178	9,723,921	40,587,373
Total liabilities and equity	24,857,892	4,584,430	466,489	2,864,727	7,813,835	40,587,373
Net cumulative liquidity gap	(12,933,490)	(10,556,506)	(2,667,537)	(1,910,086)	-	-

The Group has a large proportion of its liabilities as demand deposits which do not have a fixed maturity. Although behaviourally these deposits are stable, these have been grouped under up to 3 months category in accordance with the UAE Central Bank guideline.

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

39. Financial risk management (continued)

Derivative cash flows

The Group's derivatives that will be settled on a gross basis comprise foreign exchange contracts.

The table below analyses the Group's derivative financial instruments that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows related to foreign exchange contract. Cash flows from interest rate swap not included in below note.

Since the interest swap does not have any significant impact on liquidity they have not been considered in the below table:

	Up to 1 month AED'000	1 -3 months AED'000	3 -12 months AED'000	1-5 years AED'000	Over 5 years AED'000	Total AED'000
At 31 December 2016						
Foreign exchange contracts and other Derivative						
-Outflow	**866,838**	**10,199**	**31,226**	**78,738**	**-**	**987,001**
-Inflow	**866,765**	**3,559**	**52,613**	**76,634**	**-**	**999,571**
At 31 December 2015						
Foreign exchange contracts and other derivatives						
- Outflow	468,747	55,742	220,957	-	-	745,446
- Inflow	468,747	55,742	220,957	-	-	745,446

Off-balance sheet items

	No later than 1 year AED'000	1-5 years AED'000	Over 5 years AED'000	Total AED'000
At 31 December 2016				
Credit commitments	**31,788**	-	-	**31,788**
Guarantees and other financial facilities	**764,737**	**130,075**	**25,003**	**919,815**
Total	**796,525**	**130,075**	**25,003**	**951,603**
At 31 December 2015				
Credit commitments	37,646	-	-	37,646
Guarantees and other financial facilities	499,177	126,750	174,340	800,267
Total	536,823	126,750	174,340	837,913

39. Financial risk management (continued)

Fair values of financial assets and liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Consequently, differences can arise between the carrying values and fair value estimates of financial assets and liabilities. At 31 December 2016, the carrying value of the Group's financial assets and liabilities measured at amortised cost approximate their fair values, except for the below mentioned financial asset:

	Fair value		Carrying value	
	2016	2015	**2016**	2015
	AED'000	AED'000	**AED'000**	AED'000
Financial assets				
Investment securities	**4,810,682**	4,193,909	**4,810,682**	4,115,072

Investment securities

Investment securities comprise mainly of interest-bearing debt instruments that are available for sale or quoted debt securities. Investment in equity shares is based on quoted prices.

39. Financial risk management (continued)

Financial instruments

Categories of financial instruments

The following tables analyse the Group's financial assets and financial liabilities in accordance with categories of financial instruments under IAS 39.

At 31 December 2016	Loans and receivables AED'000	Available for sale AED'000	Hedging derivatives AED'000	Fair value through profit or loss AED'000	Total AED'000
Assets					
Investment securities	-	4,793,693	-	16,989	4,810,682
Derivative financial instruments	-	-	12,928	4,364	17,292
Cash and balances with the UAE central Bank	4,431,016	-	-	-	4,431,016
Due from other banks	2,629,230	-	-	-	2,629,230
Loans and advances	28,725,869	-	-	-	28,725,869
Insurance contract assets and receivables	303,895	-	-	-	303,895
Other assets	336,475	-	-	-	336,475
Total financial assets	**36,426,485**	**4,793,693**	**12,928**	**21,353**	**41,254,459**

Liabilities	Financial liabilities at amortised cost AED'000	Available for sale AED'000	Hedging derivatives AED'000	Fair value through profit or loss AED'000	Total AED'000
Due to other banks	1,561,877	-	-	-	1,561,877
Deposits from customers	29,398,185	-	-	-	29,398,185
Debt securities in issue	2,730,072	-	-	-	2,730,072
Insurance contract liabilities and payables	465,826	-	-	-	465,826
Derivative financial instruments	-	-	483	4,907	5,390
Other liabilities	121,544	-	-	-	121,544
Total financial liabilities	**34,277,504**	**-**	**483**	**4,907**	**34,282,894**

39. Financial risk management (continued)

Financial instruments (continued)

Categories of financial instruments (continued)

The following tables analyse the Group's financial assets and financial liabilities in accordance with categories of financial instruments under IAS 39.

At 31 December 2015	Loans and receivables AED'000	Available for sale AED'000	Hedging derivatives AED'000	Fair value through profit or loss AED'000	Total AED'000
Assets					
Investment securities	3,994,469	116,637	-	3,966	4,115,072
Derivative financial instruments	-	-	23,258	238	23,496
Cash and balances with the UAE central Bank	4,908,196	-	-	-	4,908,196
Due from other banks	1,906,813	-	-	-	1,906,813
Loans and advances	27,798,096	-	-	-	27,798,096
Insurance contract assets and receivables	254,655	-	-	-	254,655
Other assets	316,599	-	-	-	316,599
Total financial assets	**39,178,828**	**116,637**	**23,258**	**4,204**	**39,322,927**

Liabilities	Financial liabilities at amortised cost AED'000	Available for sale AED'000	Hedging derivatives AED'000	Fair value through profit or loss AED'000	Total AED'000
Due to other banks	1,056,141	-	-	-	1,056,141
Deposits from customers	27,820,105	-	-	-	27,820,105
Debt securities in issue	2,864,727	-	-	-	2,864,727
Insurance contract liabilities and payables	389,783	-	-	-	389,783
Derivative financial instruments	-	-	-	3	3
Other liabilities	91,186	-	-	-	91,186
Total financial liabilities	**32,221,942**	**-**	**-**	**3**	**32,221,945**

39. Financial risk management (continued)

Fair value hierarchy

The fair value measurements are categorised into different levels in the fair value hierarchy based on the inputs to valuation techniques used. The different levels are defined as follows:

Quoted market prices - Level 1

Financial instruments are classified as Level 1 if their values are observable in an active market. Such instruments are valued by reference to unadjusted quoted prices for identical assets or liabilities in active markets where the quoted price is readily available, and the price represents actual and regularly occurring market transactions.

Valuation techniques using observable inputs - Level 2

Financial instruments classified as Level 2 have been valued using models whose inputs are observable in an active market. Valuation based on observable inputs include financial instruments such as forwards foreign exchange contracts which are valued using market standard pricing techniques.

Valuation techniques using significant unobservable inputs - Level 3

Financial instruments are classified as Level 3 if their valuation incorporates significant inputs that are not based on observable market data (unobservable inputs). A valuation input is considered observable if it can be directly observed from a transaction in an active market.

Unobservable input levels are generally determined based on observable inputs of a similar nature, historical observations or other analytical techniques.

This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible. The table below analyses recurring fair value measurements for assets and liabilities.

Notes to the consolidated financial statements for the year ended 31 December 2016 (continued)

39. Financial risk management (continued)

Fair value hierarchy (continued)

The assets measured at fair value as per the hierarchy are disclosed in the table below:

31 December 2016	Quoted market prices Level 1 AED '000	Observable inputs Level 2 AED '000	Significant unobservable inputs Level 3 AED '000	Total AED'000
Asset at fair value				
Available for sale financial assets				
- Investment securities - debt	4,546,570	-	219,100	4,765,670
- Investment securities - equity	7,279	-	107	7,386
- Investment securities - Funds	20,637	-	-	20,637
- Foreign exchange contracts	-	3,853	-	3,853
Derivative financial instruments	-	13,439	-	13,439
Held for trading				
Investments market fund	4,185	-	-	4,185
Investment - debt securities	12,804	-	-	12,804
	4,591,475	**17,292**	**219,207**	**4,827,974**
31 December 2015				
Asset at fair value				
Available for sale financial assets				
- Investment securities - debt	74,746	-	-	74,746
- Investment securities - Equity	29,284	-	107	29,391
- Foreign exchange contracts	-	238	-	238
Derivative financial instruments	-	23,258	-	23,258
Held for trading				
- Investments market fund	3,966	-	-	3,966
Asset at amortised cost				
Investment securities	3,865,421	-	220,385	4,085,806
	3,973,417	23,496	220,492	4,217,405

There are no transfers between levels during the period hence no Level 3 reconciliation is presented.

39. Financial risk management (continued)

Fair values of financial assets and liabilities

Fair value is the 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 the carrying values and fair value estimates of financial assets and liabilities. At 31 December 2016, the carrying value of the Group's financial assets and liabilities approximate their fair values, except for the below mentioned financial assets and liabilities:

	Fair value		Carrying value	
	31 December 2016	31 December 2015	**31 December 2016**	31 December 2015
	AED'000	AED'000	**AED'000**	AED'000
Assets				
Loans and advances	**28,934,906**	28,005,631	**28,725,869**	27,798,096
Investment securities	**4,810,682**	4,193,909	**4,810,682**	4,115,072
Cash and balances with the UAE central Bank	**4,432,543**	4,911,482	**4,431,016**	4,908,196
Due from other banks	**2,616,126**	1,907,656	**2,629,230**	1,906,813
Total financial assets	40,794,257	39,018,678	**40,596,797**	38,728,177
Liabilities				
Due to other banks	**1,561,818**	1,057,492	**1,561,877**	1,056,141
Deposits from customers	**29,461,531**	27,883,754	**29,398,185**	27,820,105
Debt securities issued	**2,730,072**	2,864,727	**2,730,072**	2,864,727
Total financial liabilities	33,753,421	31,805,973	**33,690,134**	31,740,973

Capital management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on the face of statement of financial position, are:

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

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

The Bank's capital management is driven by short- and long-term strategies and organisational requirements with due consideration to the regulatory, economic and commercial environment in which the Bank operates.

The Bank seeks to optimise returns on capital, and its objective has always been to maintain a strong capital base to support business development and to meet regulatory capital requirements at all times.

39. Financial risk management (continued)

Capital management (continued)

Capital structure and capital adequacy as per Basel II requirement as at 31 December 2016

The Bank is required to report capital resources and risk-weighted assets under the Basel II Pillar 1 framework, as shown in the following table. The Bank has adopted standardised approach for calculation of credit risk and market risk capital charge. On operational risk, alternative standardized approach is followed for capital charge calculation under Pillar 1.

	2016 AED'000	2015 AED'000
Tier 1 capital		
Ordinary share capital	**1,676,245**	1,676,245
Legal and other reserves	**3,939,809**	3,670,578
Retained earnings (excludes current year profit)	**1,246,414**	945,564
Total	**6,862,468**	6,292,387
Deductions		
Investment in RAKNIC	**(312,886)**	(317,244)
Tier 1 Capital	**6,549,582**	5,975,143
Tier 2 capital	-	-
Total regulatory capital	**6,549,582**	5,975,143
Risk weighted assets		
Credit risk	**28,012,825**	25,084,932
Market risk	**19,663**	8,547
Operational risk	**1,988,195**	1,735,802
Total risk weighted assets	**30,020,683**	26,829,281
Capital adequacy ratio on regulatory capital	**21.82%**	22.27%
Capital adequacy ratio on Tier 1 capital	**21.82%**	22.27%

Risk assets ratios computed considering the current year profit and without deducting any cash dividend for the year 2016 will be as follows:

	2016 AED'000	2015 AED'000
Total Tier 1 capital	**7,522,010**	7,692,774
Total Tier 2 capital	-	-
Total capital base	**7,522,010**	7,692,774
Investment in RAKNIC	**(312,886)**	(317,244)
Total regulatory capital	7,209,124	7,375,530
Risk asset ratio on total capital base (%)	**24.01%**	27.49%
Risk asset ratio on tier 1 capital base (%)	**24.01%**	27.49%

40. Insurance risk

The Group accepts insurance risk through its written insurance contracts. The Group is exposed to uncertainty surrounding the timing, frequency and severity of claims under these contracts.

The principal risk the Group faces under insurance contracts is that the actual claims and benefit payments or the timing thereof, differ from expectations. This is influenced by the frequency of claims, severity of claims, actual benefits paid and subsequent development of long-term claims. Therefore, the objective of the Group is to ensure that sufficient reserves are available to cover these liabilities.

The above risk exposure is mitigated by diversification across a large portfolio of insurance contracts. The variability of risks is also improved by careful selection and implementation of underwriting strategy guidelines, as well as the use of reinsurance arrangements. The Group mainly issues short term insurance contracts in connection with property, motor, marine and casualty risks.

Two key elements of the Group's insurance risk management framework are its underwriting strategy and reinsurance strategy, as discussed below.

Underwriting strategy

The Group's underwriting strategy is to build balanced portfolios based on a large number of similar risks. This reduces the variability of the portfolios outcome.

The underwriting strategy is set out by the Group that establishes the classes of business to be written, the territories in which business is to be written and the industry sectors in which the Group is prepared to underwrite. This strategy is cascaded by the business units to individual underwriters through detailed underwriting authorities that set out the limits that any one underwriter can write by line size, class of business, territory and industry in order to ensure appropriate risk selection within the portfolio. All general insurance contracts except marine, are annual in nature and the underwriters have the right to refuse renewal or to change the terms and conditions of the contract at renewal.

Frequency and amounts of claims

The Group has developed their underwriting strategy to diversify the type of insurance risks accepted and within each of the categories to achieve sufficiently large populations of risk to reduce the variability of the expected outcome. The frequency and amounts of claims can be affected by several factors. The Group underwrites mainly property, motor, casualty, medical and marine risks. These are regarded as short-term insurance contracts as claims are normally advised and settled within one year of the insured event taking place.

Property

Property insurance covers a diverse collection of risks and therefore property insurance contracts are subdivided into four risks groups, fire, business interruption, weather damage and theft. These contracts are underwritten by reference to the commercial replacement value of the properties and contents insured. The cost of rebuilding properties, of replacement or indemnity for contents and time taken to restart operations for business interruptions are the key factors that influence the level of claims under these policies. The greatest likelihood of significant losses on these contracts arises from storm, flood damage or other weather related incidents.

40. Insurance risk (continued)

Frequency and amounts of claims (continued)

Motor

Motor insurance contracts are designed to compensate policies holders for damage suffered to vehicles, disability to third parties arising through accidents and fire or theft of their vehicles.

Underwriting limits and guidelines are in place to enforce appropriate risk selection criteria.

The level of court awards for deaths and to injured parties and the replacement costs of motor vehicles are the key factors that influence the level of claims

Marine

Marine insurance is designed to compensate contract holders for damage and liability arising through loss or damage to marine craft and accidents at sea resulting in the total or partial loss of cargoes.

For marine insurance, the main risks are loss or damage to marine craft and accidents resulting in the total or partial loss of cargoes.

The underwriting strategy for the marine class of business is to ensure that policies are well diversified in terms of vessels and shipping routes covered.

Casualty

For casualty class of business, such as workmen's compensation, personal accident, general third party liability and loss of money, the extent of loss or damage and the potential court awards are the main factors that influence the level of claims.

The Group manage these risks through their underwriting strategy, adequate reinsurance arrangements and proactive claims handling. The underwriting strategy attempts to ensure that the underwritten risks are well diversified in terms of type and amount of risk. Underwriting limits are in place to enforce appropriate risk selections.

The Group proactively manage and pursue early settlement of claims to reduce their exposure to unpredictable developments.

The Group has adequate reinsurance arrangements to protect their financial viability against such claims for all classes of business.

The Group has obtained adequate non-proportionate reinsurance cover for all classes of an amount considered appropriate by the management.

Medical

Medical selection is part of the Group's underwriting procedures, whereby contributions are charged to reflect the health condition and family medical history of the applicants. Pricing is based on assumptions, such as mortality and persistency, which consider past experience and current trends. Contracts including specific risks and guarantees are tested for profitability according to predefined procedures before approval.

Products are reviewed by the business units on an annual basis to confirm, or otherwise, that pricing assumptions remain appropriate. Analysis is performed on earnings and liability movements to understand the source of any material variation in actual results from what was expected. This confirms the appropriateness of assumptions used in underwriting and pricing.

Concentration of insurance risk

The insurance risk arising from insurance contracts is concentrated mainly in the United Arab Emirates. The geographical risk profile is similar to last year.

40. Insurance risk (continued)

Assumptions and sensitivities

Process used to determine the assumptions

The method used by the Group for provision of IBNR takes into account historical data, past estimates and details of the reinsurance programme, to assess the expected size of reinsurance recoveries.

The assumptions that have the greatest effect on the measurement of insurance contract provisions are the expected loss ratios for the most recent accident years.

Reinsurance strategy

The Group reinsures a portion of the insurance risks it underwrites in order to control its exposure to losses and protect capital resources.

Ceded reinsurance contains credit risk, as discussed in the financial risk management note. The Group has a Reinsurance department that is responsible for setting the minimum security criteria for acceptable reinsurance and monitoring the purchase of reinsurance by the business units against those criteria. The department monitors developments in the reinsurance programme and its ongoing adequacy.

The Group buys a combination of proportionate and non-proportionate reinsurance treaties to reduce the net exposure to the Group. In addition, underwriters are allowed to buy facultative reinsurance in certain specified circumstances. All purchases of facultative reinsurance are subject to business unit pre-approval and the total expenditure on facultative reinsurance is monitored regularly by reinsurance department.

41. Critical accounting estimates and judgements in applying accounting policies

The Group's consolidated financial statements and its financial results are influenced by accounting policies, assumptions, estimates and management judgement, which necessarily have to be made in the course of preparation of the consolidated financial statements. The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. All estimates and assumptions required in conformity with IFRS are best estimates undertaken in accordance with applicable standards. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Accounting policies and management judgement for certain items are especially critical for the Group's results and financial situation due to their materiality.

a) Impairment losses on loans and advances and insurance receivables

The Group reviews its loan portfolio and receivables to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans or receivables before the decrease can be identified with an individual loan or receivables in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management takes into account the historical loss experience in estimating future cash flows in assessing the loan portfolio and receivables for impairment. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. A +/-5% change in the provision would increase/decrease the profit by AED 53 million (2015: AED 37 million).

Notes to the consolidated financial statements
for the year ended 31 December 2016 (continued)

41. Critical accounting estimates and judgements in applying accounting policies (continued)

b) Classification of and measurement of financial assets and liabilities

The Group classifies financial instruments, or its component parts, at initial recognition as a financial asset, a financial liability or an equity instrument in accordance with the substance of the contractual agreement and the definitions of the instruments. The substance of the financial instrument, rather than the legal form, governs its reclassification in the statement of financial position.

The Group determines the classification at initial recognition and, when allowed and appropriate, re-evaluates this designation at every statement of financial position date.

In measuring financial assets and liabilities, some of the Group's assets and liabilities are measured at a fair value for financial reporting purposes. In estimating the fair value of an asset or a liability, the Group uses market-observable data to the extent it is available. Where Level 1 inputs are not available, the Group engages independent professionally qualified valuers to perform the valuation. The Bank works closely with the qualified external valuers to establish the appropriate valuation techniques and inputs to the model.

c) Fair value measurement

Where the fair values of financial assets and financial liabilities recorded on the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data are not available, judgment is required to establish fair values. The judgments include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities. The management believes that the chosen valuation techniques and assumptions used are appropriate in determining the fair value of financial instruments.

d) Derivative financial instruments

Subsequent to initial recognition, the fair values of derivative financial instruments measured at fair value are generally obtained by reference to quoted market prices, discounted cash flow models and recognised pricing models as appropriate. When prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. The main factors which management considers when applying a model are:

(i) The likelihood and expected timing of future cash flows on the instrument. These cash flows are usually governed by the terms of the instrument, although management judgment may be required in situations where the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt; and

(ii) An appropriate discount rate of the instrument. Management determines this rate, based on its assessment of the appropriate spread of the rate for the instrument over the risk-free rate. When valuing instruments by reference to comparable instruments, management takes into account the maturity, structure and rating of the instrument with which the position held is being compared. When valuing instruments on a model basis using the fair value of underlying components, management considers, in addition, the need for adjustments to take account of a number of factors such as bid-offer spread, credit profile, servicing costs of portfolios and model uncertainty.

41. Critical accounting estimates and judgements in applying accounting policies (continued)

e) Impairment of available for sale investments

The Group treats available-for-sale investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgment.

f) Provision for outstanding claims, whether reported or not

Considerable judgment by the management is required in the estimation of amounts due to the contract holders arising from claims made under insurance contracts. Such estimates are necessarily based on significant assumptions about several factors involving varying, and possible significant, degrees of judgment and uncertainty and actual results may differ from management's estimates resulting in future changes in estimated liabilities.

In particular, estimates have to be made both for the expected ultimate cost of claims reported at the date of statement of financial position and for the expected ultimate cost of claims incurred but not reported ("IBNR") at the date of statement of financial position. Claims requiring court or arbitration decisions are estimated individually. Independent loss adjusters normally estimate property claims. Management reviews its provisions for claims incurred and IBNR claims regularly.

g) Useful lives of property and equipment

The management determines the useful lives of property and equipment and the related depreciation charge. The depreciation charge for the year will change significantly if the actual life is different from the estimated useful life of the asset. The review carried out by management in the current year did not indicate any necessity for changes in the useful lives of property and equipment.

h) Impairment of goodwill

The calculation of value-in-use is sensitive to the following assumptions:

(i) Growth rate

Growth rates are based on the management's assessment of the market share having regard to the forecasted growth and demand for the products offered. Growth rate of 3% per annum have been applied in the calculation.

(ii) Profit margins

Profit margins are based on the management's assessment of achieving a stabilized level of performance based on the approved business plan of the cash generating unit for the next five years.

(iii) Discount rates

Management has used the discount rate of 10.4% per annum throughout the assessment period, reflecting the estimated weighted average cost of capital of the Group and specific market risk profile.

42. Social contributions

The social contributions made (including donations and charity) during the year to various beneficiaries amounted to AED 1.72 million (2015: AED 1.63 million).

43. Approval of the consolidated financial statements

The consolidated financial statements were approved on 1 February 2017.