البنك
السعودي
الفرنسي
Banque
Saudi
Fransi

INTERIM CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

FOR THE NINE MONTHS PERIOD ENDED

SEPTEMBER 30, 2018

Adel Mallawi

Chief Financial Officer

Rayan M. Fayez

Managing Director & CEO

KPMG Al Fozan & Partners
Certified Public Accountants

INDEPENDENT AUDITORS' REPORT ON REVIEW OF INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

TO: THE SHAREHOLDERS OF BANQUE SAUDI FRANSI
(A Saudi Joint Stock Company)

Introduction

We have reviewed the accompanying interim consolidated statement of financial position of Banque Saudi Fransi and its subsidiaries (the "Bank") as at September 30, 2018, and the related interim consolidated statements of income and comprehensive income for the three and nine month periods then ended, and the interim consolidated statements of changes in equity and cash flows for the nine month period then ended and other explanatory notes (the "interim condensed consolidated financial statements"). The Bank's management is responsible for the preparation and presentation of these interim condensed consolidated financial statements in accordance with International Accounting Standard 34 "Interim Financial Reporting" ("IAS 34") as modified by the Saudi Arabian Monetary Authority ("SAMA") for the accounting of zakat and income tax. Our responsibility is to express a conclusion on these interim condensed consolidated financial statements based on our review.

Scope of review

We conducted our review in accordance with the International Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" that is endorsed in the Kingdom of Saudi Arabia. A review of interim condensed consolidated financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing that are endorsed in the Kingdom of Saudi Arabia and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

KPMG Al Fozan & Partners
Certified Public Accountants

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IAS 34 as modified by SAMA for the accounting of zakat and income tax.

Other regulatory matters

As required by SAMA, certain capital adequacy information has been disclosed in note (19) to the accompanying interim condensed consolidated financial statements. As part of our review, we compared the information in note (19) to the relevant analysis prepared by the Bank for submission to SAMA and found no material inconsistencies.

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16 Safar 1440H
October 25, 2018

برايس وترهاوس كوبرز
محاسبون قانونيون
ترخيص ٣٢٣/١١/٢٥/٢
س.ت ٢٠٥١٠٦٢٣٨٤
PRICEWATERHOUSECOOPERS
CERTIFIED PUBLIC ACCOUNTANTS
Lic No. 323/11/25/2
C.R. 2051062384

KPMG
KPMG Al Fozan & Partners

BANQUE SAUDI FRANSI
INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As at

SAR '000	Notes	Sep 30, 2018 (Unaudited)	Dec 31, 2017 (Audited)	Sep 30, 2017 (Unaudited)
ASSETS				
Cash and balances with SAMA		14,696,612	22,393,237	15,303,420
Due from banks and other financial institutions		16,967,627	18,758,295	26,433,690
Investments, net	6	29,519,138	25,324,895	26,115,481
Positive fair value derivative	10	1,823,835	2,032,823	2,214,951
Loans and advances, net	7	123,704,173	121,940,394	128,948,477
Investment in associates	8	42,195	76,049	118,709
Property and equipment, net		701,264	736,927	728,579
Other real estate		479,830	504,830	504,830
Other assets		1,366,543	1,161,431	1,335,589
Total assets		**189,301,217**	**192,928,881**	**201,703,726**
LIABILITIES AND EQUITY				
Liabilities				
Due to banks and other financial institutions		3,134,545	2,963,273	5,147,367
Customers' deposits	9	146,694,017	150,954,187	155,472,013
Negative fair value derivative	10	1,763,830	1,197,475	1,302,874
Debt securities and sukuks		2,002,913	2,002,565	3,904,292
Other liabilities		3,869,946	4,150,000	4,322,711
Total liabilities		**157,465,251**	**161,267,500**	**170,149,257**
Equity				
Share capital		12,053,572	12,053,572	12,053,572
Statutory reserve		12,053,572	12,053,572	12,053,572
General reserve		982,857	982,857	982,857
Other reserves		(732,047)	(285,172)	6,557
Retained earnings		7,598,337	6,628,963	6,587,745
Proposed dividend		-	355,237	-
Treasury shares		(120,325)	(127,648)	(129,834)
Total equity		**31,835,966**	**31,661,381**	**31,554,469**
Total liabilities and equity		**189,301,217**	**192,928,881**	**201,703,726**

The accompanying notes 1 to 19 form an integral part of these interim condensed consolidated financial statements.

Adel Mallawi
Chief Financial Officer

Rayan M. Fayez
Managing Director & CEO

BANQUE SAUDI FRANSI
INTERIM CONSOLIDATED STATEMENT OF INCOME
Unaudited

SAR '000	For the three months ended		For the nine months ended	
	Sep 30, 2018	Sep 30, 2017	Sep 30, 2018	Sep 30, 2017
Special commission income	1,782,948	1,714,532	5,115,715	5,012,705
Special commission expense	521,603	507,399	1,346,019	1,526,672
Net special commission income	**1,261,345**	**1,207,133**	**3,769,696**	**3,486,033**
Fee and commission income, net	243,402	249,120	797,355	843,331
Exchange income, net	105,424	89,435	259,221	267,825
Gain on FVTPL financial instruments, net	76,162	48,552	141,602	244,912
Trading income, net	2,835	2,284	8,573	8,271
Dividend income	204	3,382	655	7,850
(Losses) / gains on FVOCI / non-trading investments, net	(9,530)	9,528	(17,639)	28,665
Gains on sale of associate	-	-	97,310	-
Other operating income	16,543	20,134	49,227	69,639
Total operating income	**1,696,385**	**1,629,568**	**5,106,000**	**4,956,526**
Salaries and employee related expenses	344,773	356,826	1,041,934	1,076,319
Rent and premises related expenses	43,608	46,453	126,014	132,764
Depreciation and amortization	38,851	39,953	115,829	113,262
Other general and administrative expenses	125,726	126,511	397,842	371,309
Impairment charge for credit losses, net	127,841	55,679	343,766	143,290
Impairment (reversal) / charge for investments and other financial assets, net	(3,945)	-	(18,552)	3,500
Other operating expenses	14,100	5,566	63,489	12,457
Total operating expenses	**690,954**	**630,988**	**2,070,322**	**1,852,901**
Net operating income	**1,005,431**	**998,580**	**3,035,678**	**3,103,625**
Share in earnings of associates, net	-	1,957	2,529	5,492
Net income for the period	**1,005,431**	**1,000,537**	**3,038,207**	**3,109,117**
Basic and diluted earnings per share for the period (SAR) - note 16	**0.84**	**0.83**	**2.53**	**2.59**

The accompanying notes 1 to 19 form an integral part of these interim condensed consolidated financial statements.

Adel Mallawi
Chief Financial Officer

Rayan M. Fayez
Managing Director & CEO

BANQUE SAUDI FRANSI
INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
Unaudited

SAR '000	For the three months ended		For the nine months ended	
	Sep 30, 2018	Sep 30, 2017	Sep 30, 2018	Sep 30, 2017
Net income for the period	1,005,431	1,000,537	3,038,207	3,109,117
Other comprehensive income / (loss):				
Items that cannot be recycled back to consolidated statement of income in subsequent periods				
Movement in fair value reserve (equity instruments)				
Net change in the fair value	(12,011)	(12,587)	(26,071)	(29,251)
Items that can be recycled back to consolidated statement of income in subsequent periods				
Debt instruments at fair value through other comprehensive income				
Net change in the fair value	(9,828)	17,446	(35,831)	72,691
Loss / (income) transferred to interim consolidated statement of income	9,530	(9,528)	17,639	(28,665)
Cash flow hedge				
Net change in the fair value	(182,994)	229,683	(295,638)	986,610
Loss / (income) transferred to interim consolidated statement of income	14,401	(79,845)	(106,974)	(131,244)
Total comprehensive income for the period	824,529	1,145,706	2,591,332	3,979,258

The accompanying notes 1 to 19 form an integral part of these interim condensed consolidated financial

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BANQUE SAUDI FRANSI
INTERIM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Unaudited

SAR '000	Share capital	Statutory reserve	General reserve	Retained earnings	Other reserves		Proposed dividend	Treasury shares	Total
					FVOCI reserve	Cash flow hedge			
For the nine months period ended September 30, 2018									
Balance at the beginning of the period	12,053,572	12,053,572	982,857	6,628,963	10,118	(295,290)	355,237	(127,648)	31,661,381
Impact of adopting IFRS 9 at 01 January 2018 (Note 4)	-	-	-	(862,875)	-	-	-	-	(862,875)
Restated balance at 1 January 2018	12,053,572	12,053,572	982,857	5,766,088	10,118	(295,290)	355,237	(127,648)	30,798,506
Net income for the period	-	-	-	3,038,207	-	-		-	3,038,207
Net change in the fair value	-	-	-	-	(61,902)	(295,638)	-	-	(357,540)
Net amount transferred to interim consolidated statement of income	-	-	-	-	17,639	(106,974)	-	-	(89,335)
Zakat liability	-	-	-	(86,167)	-	-	-	-	(86,167)
Tax liability	-	-	-	(91,587)	-	-	-	-	(91,587)
Interim net dividend	-	-	-	(1,028,204)	-	-	-	-	(1,028,204)
Final dividend paid 2017	-	-	-	-	-	-	(355,237)	-	(355,237)
Net change in treasury shares	-	-	-	-	-	-	-	7,323	7,323
Balance at the end of the period	12,053,572	12,053,572	982,857	7,598,337	(34,145)	(697,902)	-	(120,325)	31,835,966
For the nine months period ended September 30, 2017									
Balance at the beginning of the period	12,053,572	11,805,933	982,857	5,139,428	31,343	(894,927)	647,995	(67,198)	29,699,003
Net income for the period	-	-	-	3,109,117	-	-	-	-	3,109,117
Net change in the fair value	-	-	-	-	43,440	986,610	-	-	1,030,050
Net amount transferred to interim consolidated statement of income	-	-	-	-	(28,665)	(131,244)	-	-	(159,909)
Transferred to statutory reserves	-	247,639	-	(247,639)	-	-	-	-	-
Zakat liability	-	-	-	(75,005)	-	-	(32,791)	-	(107,796)
Tax liability	-	-	-	(197,525)	-	-	(84,838)	-	(282,363)
Interim net dividend	-	-	-	(1,140,631)	-	-	-	-	(1,140,631)
Final dividend paid 2016	-	-	-	-	-	-	(530,366)	-	(530,366)
Net change in treasury shares	-	-	-	-	-	-	-	(62,636)	(62,636)
Balance at the end of the period	12,053,572	12,053,572	982,857	6,587,745	46,118	(39,561)	-	(129,834)	31,554,469

The accompanying notes 1 to 19 form an integral part of these interim condensed consolidated financial statements.

Adel Mallawi
Chief Financial Officer

Rayan M. Fayez
Managing Director & CEO

BANQUE SAUDI FRANSI
INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS
Unaudited

SAR '000	Note	For the nine months ended Sep 30, 2018	Sep 30, 2017
OPERATING ACTIVITIES			
Net income for the period		3,038,207	3,109,117
Adjustments to reconcile net income to net cash from operating activities:			
Accretion of (premium) / discounts on investments not held as FVTPL, net		(7,756)	2,816
Gains on sale of associate		(97,310)	-
Losses / (gains) on FVOCI / non-trading investments, net		17,639	(28,665)
Depreciation and amortization		115,829	113,262
Gains disposal of property and equipment, net		(221)	(83)
Impairment charge for credit losses, net		343,766	143,290
Impairment (reversal) / charge for investments and other financial assets, net		(18,552)	3,500
Share in earnings of associates, net		(2,529)	(5,492)
Long term incentive scheme provision		7,323	8,739
Provision on other real estate		25,000	-
Change in fair value of financial instruments		(1,677)	(1,858)
Operating income before changes in operating assets and liabilities		3,419,719	3,344,626
Net (increase) / decrease in operating assets:			
Statutory deposit with SAMA		638,320	(470,499)
Due from banks and other financial institutions maturing after ninety days from the date of acquisition		198,000	(1,656,250)
Investments held as FVIS, trading		(382,358)	(99,883)
Loans and advances		(2,772,126)	365,454
Other assets		(397,261)	186,158
Net increase / (decrease) in operating liabilities:			
Due to banks and other financial institutions		171,272	858,835
Customers' deposits		(4,260,170)	(2,986,459)
Other liabilities		(17,470)	1,087,335
Net cash (used in) / generated from operating activities		(3,402,074)	629,317
INVESTING ACTIVITIES			
Proceeds from sales and maturities of investment not held as FVTPL		3,754,769	3,287,753
Purchase of investments not held as FVTPL		(7,615,153)	(5,191,846)
Proceeds from sale of associate		81,269	-
Purchase of property and equipment		(80,241)	(125,317)
Proceeds from sale of property and equipment		296	215
Net cash used in investing activities		(3,859,060)	(2,029,195)
FINANCING ACTIVITIES			
Dividends paid		(1,383,441)	(1,788,626)
Purchase of Treasury shares		-	(71,375)
Debt securities and sukuks		-	(2,812,500)
Net cash used in financing activities		(1,383,441)	(4,672,501)
(Decrease) / increase in cash and cash equivalents		(8,644,575)	(6,072,379)
Cash and cash equivalents at the beginning of the period		27,715,920	24,674,790
Cash and cash equivalents at the end of the period	12	19,071,345	18,602,411
Special commission received during the period		4,910,905	4,705,572
Special commission paid during the period		1,220,815	1,427,768
Supplemental non-cash information			
Net changes in fair value and transfers to interim condensed consolidated statement of income		(446,875)	870,141

The accompanying notes 1 to 19 form an integral part of these interim condensed consolidated financial statements.

Adel Mallawi
Chief Financial Officer

Rayan M. Fayez
Managing Director & CEO

1. General

Banque Saudi Fransi (the Bank) is a Saudi Joint Stock Company established by Royal Decree No. M/23 dated Jumada Al Thani 17, 1397H (corresponding to June 4, 1977). The Bank formally commenced its activities on Muharram 1, 1398H (corresponding to December 11, 1977), by taking over the branches of the Banque de l'Indochine et de Suez in the Kingdom of Saudi Arabia. The Bank operates under Commercial Registration Number 1010073368 dated Safar 4, 1410H (corresponding to September 5, 1989), through its 86 branches (September 30, 2017: 86 branches) in the Kingdom of Saudi Arabia, employing 3,025 people (September 30, 2017: 3,134 people).

The objective of the Bank is to provide a full range of banking services, including Islamic products, which are approved and supervised by an independent Shariah Board. The Bank's Head Office is located at King Saud Road, P.O. Box 56006, Riyadh 11554, Kingdom of Saudi Arabia.

The Bank owns a subsidiary, Saudi Fransi Capital (100% share in equity) engaged in brokerage, asset management and corporate finance business. The Bank also owns Saudi Fransi Insurance Agency (SAFIA), Saudi Fransi Financing & Leasing and Sofinco Saudi Fransi having 100% share in equity. The Bank owns 100% (95% direct ownership and 5% indirect ownership through its subsidiary) share in Sakan Real Estate Financing. These subsidiaries are incorporated in the Kingdom of Saudi Arabia.

The Bank also formed a subsidiary, BSF Markets Limited registered in Cayman Islands having 100% share in equity. The objective of this company is derivative trading and Repo activities.

The Bank has investments in associates and owns 27% shareholding in Banque BEMO Saudi Fransi, incorporated in Syria. During the nine months period, the Bank has sold its 3.7 million shares in Allianz Saudi Fransi Cooperative Insurance Company which represents 18.5% of (ASF) shares. Accordingly, the remaining shareholding in ASF is 14%.

2. Basis of preparation

The interim condensed consolidated financial statements of the Bank as at and for the quarter ended 30 September 2018 have been prepared in accordance with IAS 34 – Interim Financial Reporting as modified by the Saudi Arabian Monetary Authority ("SAMA") for the accounting of zakat and income tax.

The interim condensed consolidated financial statements do not include all the information and disclosures required in the annual consolidated financial statements, and should be read in conjunction with the Group's annual consolidated financial statements as at 31 December 2017. The Bank has adopted IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers from 1 January 2018 and accounting policies for these new standards are disclosed in the Note 4. Significant judgments and estimates relating to impairment are disclosed in the financial risk management note considering IFRS 9 first time adoption.

3. Basis of consolidation

The interim condensed consolidated financial statements comprise the financial statements of the Bank and its subsidiaries; Saudi Fransi Capital, Saudi Fransi Insurance Agency, Saudi Fransi Financing & Leasing, Sofinco Saudi Fransi, Sakan real estate financing and BSF Markets Limited. The financial statements of the subsidiaries are prepared for the same reporting period as that of the Bank, using consistent accounting policies. Adjustments are made wherever necessary in the financial statements of the subsidiaries to align with the Bank's interim condensed consolidated financial statements.

Subsidiaries are the entities that are controlled by the Bank. The Bank controls an entity when it is exposed, or has a right, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over that entity.

Subsidiaries are consolidated from the date on which control is transferred to the Bank and cease to be consolidated from the date on which the control is transferred from the Bank. The results of subsidiaries acquired or disposed during the period, if any, are included in the interim condensed consolidated statement of income from the effective date of the acquisition or up to the effective date of disposal, as appropriate.

3. Basis of consolidation (continued)

Balances between the Bank and its subsidiaries, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the interim condensed consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

4. Impact of changes in accounting policies due to adoption of new standards

Effective 1 January 2018 the Group has adopted two new accounting standards, the impact of the adoption of these standards is explained below:

IFRS 15 Revenue from Contracts with Customers

The Bank adopted IFRS 15 'Revenue from Contracts with Customers' resulting in a change in the revenue recognition policy of the Bank in relation to its contracts with customers.

IFRS 15 was issued in May 2014 and is effective for annual periods commencing on or after 1 January 2018. IFRS 15 outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue guidance, which is found currently across several Standards and Interpretations within IFRS. It established a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The Bank has opted for the modified retrospective application permitted by IFRS 15 upon adoption of the new standard. Modified retrospective application requires the recognition of the cumulative impact of adoption of IFRS 15 on all contracts as at 1 January 2018 in equity. The impact on opening retained earnings and other account balances as at 1 January 2018 is not significant.

IFRS 9 – Financial Instruments

The Bank has adopted IFRS 9 - Financial Instruments issued in July 2014 with a date of initial application of 1 January 2018. The requirements of IFRS 9 represent a significant change from IAS 39 Financial Instruments: Recognition and Measurement. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

As permitted by IFRS 9, the Bank has elected to continue to apply the hedge accounting requirements of IAS 39.

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

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost ("AC"), fair value through other comprehensive income ("FVOCI") and fair value through profit or loss ("FVTPL"). This classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. For an explanation of how the Bank classifies financial assets under IFRS 9, see respective section of significant accounting policies.

4. Impact of changes in accounting policies due to adoption of new standards (continued)

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

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

For an explanation of how the Bank classifies financial liabilities under IFRS 9, see respective section of significant accounting policies.

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model ("ECL"). IFRS 9 requires the Bank to record an allowance for ECLs for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset.

Under IFRS 9, credit losses are recognized earlier than under IAS 39. For an explanation of how the Bank applies the impairment requirements of IFRS 9, see respective section of significant accounting policies.

Transition

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

- Comparative periods have not been restated. Differences arising due to change in classification and the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognized in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.

- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

    i. The determination of the business model within which a financial asset is held.
    ii. The designation and revocation of previously designated financial assets and financial liabilities as measured at FVTPL.
    iii. The designation of certain investments in equity instruments not held for trading as FVOCI.
    iv. For financial liabilities designated as at FVTPL, the determination of whether presenting the effects of changes in the financial liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss.

4. Impact of changes in accounting policies due to adoption of new standards (continued)

a) Financial assets and financial liabilities

i) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Bank's financial assets and financial liabilities as at 1 January 2018.

SAR '000	Original classification under IAS 39	New classification under IFRS 9	Original carrying value under IAS 39	New carrying value under IFRS 9
Financial assets				
Cash and balances with SAMA	Amortised cost	Amortised cost	22,393,237	22,393,237
Due from banks and other financial institutions	Amortised cost	Amortised cost	18,758,295	18,757,392
Investments, net	FVTPL/AFS/Amortised cost	FVTPL/FVOCI/ Amortised cost	25,324,895	25,267,540
Positive fair value of derivatives	Fair value	Fair value	2,032,823	2,032,823
Loans and advances, net	Amortised cost	Amortised cost	121,940,394	121,275,749
Other assets	Amortised cost	Amortised cost	1,161,431	1,161,194
			191,611,075	**190,887,935**
Financial liabilities				
Due to banks and other financial institutions	Amortised cost	Amortised cost	2,963,273	2,963,273
Customers' deposits	Amortised cost	Amortised cost	150,954,187	150,954,187
Negative fair value of derivatives	Fair value	Fair value	1,197,475	1,197,475
Debt securities in issue	Amortised cost	Amortised cost	2,002,565	2,002,565
Other liabilities	Amortised cost	Amortised cost	4,150,000	4,289,735
			161,267,500	**161,407,235**

4. Impact of changes in accounting policies due to adoption of new standards (continued)

ii) Reconciliation of carrying amounts under IAS 39 to carrying amounts under IFRS 9 at the adoption of IFRS 9

The following table reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 on 1 January 2018.

SAR '000	IAS 39 carrying amount as at 31 December 2017	Reclassification	Re-measurement	IFRS 9 carrying amount as at 1 January 2018
Financial assets				
Amortized cost				
Cash and balances with SAMA:				
Opening balance	22,393,237	-	-	-
Remeasurement	-	-	-	-
Closing balance	**22,393,237**	**-**	**-**	**22,393,237**
Due from banks and other financial institutions:				
Opening balance	18,758,295	-	-	-
Remeasurement	-	-	(903)	-
Closing balance	**18,758,295**	**-**	**(903)**	**18,757,392**
Loans and advances:				
Opening balance	121,940,394	-	-	-
Remeasurement	-	-	(664,645)	-
Closing balance	**121,940,394**	**-**	**(664,645)**	**121,275,749**
Investments:				
Opening balance	16,980,120	-	-	-
Remeasurement	-	2,534,783	**(47,813)**	-
Closing balance	**16,980,120**	**2,534,783**	**(47,813)**	**19,467,090**
Positive fair value of derivatives:				
Opening balance	2,032,823	-	-	-
Remeasurement	-	-	-	-
Closing balance	**2,032,823**	-	**-**	**2,032,823**
Other assets:				
Opening balance	1,161,431	-	-	-
Remeasurement	-	-	(237)	-
Closing balance	**1,161,431**	-	**(237)**	**1,161,194**
Total amortized cost	**183,266,300**	**2,534,783**	**(713,598)**	**185,087,485**

4. Impact of changes in accounting policies due to adoption of new standards (continued)

(ii) Reconciliation of carrying amounts under IAS 39 to carrying amounts under IFRS 9 at the adoption of IFRS 9 (continued)

SAR '000	IAS 39 carrying amount as at 31 December 2017	Reclassification	Re-measurement	IFRS 9 carrying amount as at 1 January 2018
Financial assets				
Available for sale				
Investment:				
Opening balance	8,214,085	-	-	-
Transferred to:				
FVOCI – equity	-	(40,425)	-	-
FVOCI – debt	-	(5,638,877)	-	-
Amortized cost	-	(2,534,783)	-	-
Closing balance	**8,214,085**	**(8,214,085)**	**-**	**-**
FVOCI				
Investment:				
Opening balance	-	-	-	-
From available for sale		5,679,302	(9,542)	-
Total FVOCI	**-**	**5,679,302**	**(9,542)**	**5,669,760**
FVTPL				
Investment:				
Opening balance	-	-	-	-
From available for sale	130,690	-	-	-
Closing balance	**130,690**	**-**	**-**	**130,690**
Total FVTPL	**130,690**	**-**	**-**	**130,690**
Financial liabilities				
At Amortized cost				
Due to banks and other financial institutions	2,963,273	-	-	2,963,273
Customers' deposits	150,954,187	-	-	150,954,187
Debt securities in issue	2,002,565	-	-	2,002,565
Negative fair value of derivative	1,197,475	-	-	1,197,475
Other liabilities	4,150,000	-	139,735	4,289,735
Total amortized cost	**161,267,500**	**-**	**139,735**	**161,407,235**

4. Impact of changes in accounting policies due to adoption of new standards (continued)

iii) Reconciliation of reclassifications of financial assets and financial liabilities into amortized cost under IFRS 9

The following table shows the effects of the reclassification of financial assets and financial liabilities from IAS 39 categories into the amortized cost category under IFRS 9.

SAR '000	Sep 30, 2018 (Unaudited)
From available for sale financial assets under IAS 39	
Fair value at 30 September 2018	2,005,584
Fair value gain that would have been recognized during 2018 in OCI if the financial assets had not been reclassified	(12,729)

iv) Impact on retained earnings and other reserves

SAR '000	Retained earnings
Closing balance under IAS 39 (31 December 2017)	6,628,963
Recognition of expected credit losses under IFRS 9 - On statement of financial assets	(723,140)
- Commitment and contingencies	(139,735)
Opening balance under IFRS 9 (1 January 2018)	**5,766,088**

The following table reconciles the provision recorded as per the requirements of IAS 39 to that of IFRS 9:

- The closing impairment allowance for financial assets in accordance with IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets as at 31 December 2017; to
- The opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2018.

SAR '000	31 December 2017 (IAS 39 / IAS 37)	Reclassification	Re-measurement	1 January 2018 (IFRS 9)
Financial assets				
Cash and balances with SAMA	-	-	-	-
Due from banks and other financial institutions	-	-	903	**903**
Investments	187,500	-	57,355	**244,855**
Loans and advances	3,424,439	-	664,645	**4,089,084**
Other assets	48,287	-	237	**48,524**
Total	**3,660,226**	**-**	**723,140**	**4,383,366**
Commitments and contingencies	163,153	-	139,735	302,888
Total	**3,823,379**	**-**	**862,875**	**4,686,254**

5. Significant Accounting Policies

The accounting policies, estimates and assumptions used in the preparation of these interim condensed consolidated financial statements are consistent with those used in the preparation of the annual consolidated financial statements for the year ended December 31, 2017 except for the policies explained below. Based on the adoption of new standards explained in note 4, the following accounting policies are applicable effective 1 January 2018 replacing / amending or adding to the corresponding accounting policies set out in 2017 consolidated financial statements.

i) Classification of financial assets

On initial recognition, a financial asset is classified into following categories: amortized cost, FVOCI or FVTPL.

Financial asset at amortized cost

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as at FVTPL:

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

Financial Asset at FVOCI

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

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Special commission income and foreign exchange gains and losses are recognised in profit or loss.

Equity Instruments: On initial recognition, for an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

Financial asset at FVTPL

All other financial assets are classified as measured at FVTPL (for example: equity held for trading and debt securities not classified either as AC or FVOCI).

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

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

5. Significant Accounting Policies (continued)

Business model assessment

The Bank makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual special commission income, maintaining a particular special commission rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated- e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realized.

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

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

Assessments whether contractual cash flows are solely payments of principal and special commission rate

For the purposes of this assessment, 'principal' is the fair value of the financial asset on initial recognition. ' special commission rate ' is the consideration for the time value of money, the credit and other basic lending risks associated with the principal amount outstanding during a particular period and other basic lending costs (e.g. liquidity risk and administrative costs), along with profit margin.

In assessing whether the contractual cash flows are solely payments of principal and special commission rate, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets(e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money e.g. periodical reset of interest rates.

5. Significant Accounting Policies (continued)

Designation at fair value through profit or loss

At initial recognition, the Bank has designated certain financial assets at FVTPL. Before 1 January 2018, the Bank also designated certain financial assets as at FVTPL because the assets were managed, evaluated and reported internally on a fair value basis.

ii) Classification of financial liabilities

(Policy applicable before 1 January 2018)

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair value in the trading portfolio with changes in fair value recognised in the consolidated statement of income.

All money market deposits, customer deposits, term loans, subordinated debts and other debt securities in issue are initially recognized at fair value less transaction costs.

Subsequently all commission bearing financial liabilities other than those held at FVIS or, where fair values have been hedged, are measured at amortized cost. Amortized cost is calculated by taking into account any discount or premium. Premiums are amortized and discounts are accreted on an effective yield basis to maturity and taken to special commission expense. Financial liabilities classified as FVTPL using fair value option, if any, after initial recognition, for such liabilities, changes in fair value related to changes in own credit risk are presented separately in OCI and all other fair value changes are presented in the income statement.

Amounts in OCI relating to own credit are not recycled to the income statement even when the liability is derecognized and the amounts are realized.

Financial guarantees and loan commitments that entities choose to measure at fair value through profit or loss will have all fair value movements recognized in profit or loss.

(Policy applicable after 1 January 2018)

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortized cost. Amortized cost is calculated by taking into account any discount or premium on issue funds, and costs that are an integral part of the EIR.

Embedded derivatives

Derivatives may be embedded in another contractual arrangement (a host contract). The Bank accounts for an embedded derivative separately from the host contract when:

- Separated embedded derivatives are measured at fair value, with all changes in fair value recognized in profit or loss unless they form part of a qualifying cash flow or net investment hedging relationship.
- Separated embedded derivatives are presented in the statement of financial position together with the host contract.

5. Significant Accounting Policies (continued)

iii) Derecognition

Financial assets

The Bank derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognized) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized in OCI is recognized in profit or loss.

From 1 January 2018, any cumulative gain/loss recognized in OCI in respect of equity investment securities designated as at FVOCI is not recognized in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognized as a separate asset or liability. When assets are sold to a third party with a concurrent total rate of return swap on the transferred assets, the transaction is accounted for as a secured financing transaction similar to sale and repurchase transactions, as the Bank retains all or substantially all of the risks and rewards of ownership of such assets.

In transactions in which the Bank neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognize the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

In certain transactions, the Bank retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognized if it meets the derecognition criteria. An asset or liability is recognized for the servicing contract if the servicing fee is more than adequate (asset) or is less than adequate (liability) for performing the servicing.

Before 1 January 2018, retained interests were primarily classified as available-for-sale investment securities and measured at fair value.

iv) Modifications of financial assets and financial liabilities

a- Financial assets

If the terms of a financial asset are modified, the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognized with the difference recognized as a de-recognition gain or loss and a new financial asset is recognized at fair value.

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

5. Significant Accounting Policies (continued)

b- Financial liabilities

The Bank derecognizes a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognized at fair value. The difference between the carrying amount of the financial liability extinguished and the new financial liability with modified terms is recognized in profit or loss.

v) Impairment

The Bank recognizes loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments;
- loan and advances;
- financial guarantee contracts issued; and
- loan commitments issued.

No impairment loss is recognized on equity investments.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition.

Loss allowances for lease receivables are always measured at an amount equal to lifetime ECL.

The Bank considers a debt security to have low credit risk when their credit risk rating is equivalent to the globally understood definition of 'investment grade'.

12-month ECL is the portion of ECL that measures Expected losses resultant from default or transition on a financial instrument within 12 months after the reporting date.

Measurement of ECL

ECL is an unbiased probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is fully drawn down and the cash flows that the Bank expects to receive; and
- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

5. Significant Accounting Policies (continued)

Restructured financial assets

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

If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.

If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition .This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective commission rate of the existing financial asset.

Credit-impaired financial assets

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

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

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

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

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Bank considers the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

5. Significant Accounting Policies (continued)

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortized cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- debt instruments measured at FVOCI: No loss allowance is recognized in the statement of financial position in respect of these assets, because the carrying amount of these assets is their fair value. Whereas, recognition of an impairment loss is reflected as a debit to profit or loss and a credit to OCI and does not affect carrying amount.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense.

Collateral valuation

To mitigate its credit risks on financial assets, the Bank seeks to use collateral, where possible. The collateral comes in various forms, such as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. The Bank’s accounting policy for collateral assigned to it through its lending arrangements under IFRS 9 is the same is it was under IAS 39. Collateral, unless repossessed, is not recorded on the Bank’s statement of financial position. However, the fair value of collateral affects the calculation of ECLs. It is generally assessed, at a minimum, at inception and re-assessed on a periodic basis. However, some collateral, for example, cash or securities relating to margining requirements, is valued daily.

To the extent possible, the Bank uses active market data for valuing financial assets held as collateral. Other financial assets which do not have readily determinable market values are valued using models. Non-financial collateral, such as real estate, is valued based on data provided by third parties such as mortgage brokers, or based on housing price indices.

Collateral repossessed

The Bank’s accounting policy under IFRS 9 remains the same as it was under IAS 39. The Bank’s policy is to determine whether a repossessed asset can be best used for its internal operations or should be sold. Assets determined to be useful for the internal operations are transferred to their relevant asset category at the lower of their repossessed value or the carrying value of the original secured asset. Assets for which selling is determined to be a better option are transferred to assets held for sale at their fair value (if financial assets) and fair value less cost to sell for non-financial assets at the repossession date in line with the Bank’s policy.

5. Significant Accounting Policies (continued)

In its normal course of business, the Bank does not physically repossess properties or other assets in its retail portfolio, but engages external agents to recover funds, generally at auction, to settle outstanding debt. Any surplus funds are returned to the customers/obligors. As a result of this practice, the residential properties under legal repossession processes are not recorded on the balance sheet.

vi) Financial guarantees and loan commitments

'Financial guarantees' are contracts that require the Bank to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. 'Loan commitments' are firm commitments to provide credit under pre-specified terms and conditions.

Financial guarantees issued or commitments to provide a loan at a below-market interest rate are initially measured at fair value and the initial fair value is amortized over the life of the guarantee or the commitment. Subsequently, they are measured as follows:

- from 1 January 2018: at the higher of this amortized amount and the amount of loss allowance; and
- before 1 January 2018: at the higher of this amortized amount and the present value of any expected payment to settle the liability when a payment under the contract has become probable.

The Bank has issued no loan commitments that are measured at FVTPL. For other loan commitments:

- from 1 January 2018: the Bank recognizes loss allowance;
- before 1 January 2018: the Bank recognizes a provision in accordance with IAS 37 if the contract was considered to be onerous.

vii) Foreign currencies

The interim condensed consolidated financial statements are presented in Saudi Arabian Riyals ("SAR"), which is also the Bank's functional currency.

Transactions in foreign currencies are translated into SAR at exchange rates prevailing on the dates of the transactions. Monetary assets and liabilities at the year-end (other than monetary items that form part of the net investment in a foreign operation), denominated in foreign currencies, are translated into SAR at exchange rates prevailing at the date of the interim consolidated statement of financial position.

The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the year adjusted for the effective profits rate and payments during the year and the amortized cost in foreign currency translated at exchange rate at the end of the year.

Realized and unrealized gains or losses on exchange are credited or charged to the interim consolidated statement of income.

Foreign currency differences arising from the translation of Non-monetary items are recognized in OCI. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

5. Significant Accounting Policies (continued)

viii) Revenue / expenses recognition

Special commission income and expenses

Special commission income and expense are recognized in profit or loss using the effective commission rate basis. The 'effective commission rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the amortized cost of the financial instrument.

When calculating the effective commission rate for financial instruments other than credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not expected credit losses. For credit-impaired financial assets, a credit-adjusted effective commission rate is calculated using estimated future cash flows including expected credit losses.

In calculating special commission income and expense, the effective commission rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortized cost of the liability.

However, for financial assets that have become credit-impaired subsequent to initial recognition, special commission income is calculated by applying the effective commission rate to the amortized cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of special commission income reverts to the gross basis.

The calculation of the effective commission rate includes transaction costs and fees and points paid or received that are an integral part of the effective commission rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Measurement of amortized cost and special commission income and expense

The 'amortized cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortization using the effective commission method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance.

The 'gross carrying amount of a financial asset' is the amortized cost of a financial asset before adjusting for any expected credit loss allowance.

ix) Critical accounting judgements, estimates and assumptions

The preparation of the interim condensed consolidated financial statements in conformity with IFRS requires the use of certain critical accounting judgements, estimates and assumptions that affect the reported amounts of assets and liabilities. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. Such judgements, estimates, and assumptions are continually evaluated and are based on historical experience and other factors, including obtaining professional advices and expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised, if the revision affects only that period, or in the period of revision and in future periods if the revision affects both current and future periods. Significant areas where management has used estimates, assumptions or exercised judgements are as follows:

i. Impairment for losses on financial assets (notes 15)
ii. Fair value Measurement (note 14)
iii. Determination of control over investees

6. Investments, net

Investments are classified as follows:

SAR '000	September 30, 2018 (Unaudited)	December 31, 2017 (Audited)	September 30, 2017 (Unaudited)
Trading investments	-	130,690	277,439
Investments at FVTPL	513,048	-	-
Available for sale investments	-	8,214,085	9,349,913
Investments at FVOCI	6,325,825	-	-
Investments held at amortised cost	22,680,265	16,980,120	16,488,129
Total	**29,519,138**	**25,324,895**	**26,115,481**

7. Loans and advances, net

Loans and advances held at amortised cost

SAR '000	September 30, 2018 (Unaudited)			
	Overdraft & Commercial Loans	Credit Cards	Consumer Loans	Total
Performing loans and advances - gross	111,630,166	482,257	12,566,146	124,678,569
Non performing loans and advances, net	2,458,194	78,573	261,340	2,798,107
Total loans and advances	**114,088,360**	**560,830**	**12,827,486**	**127,476,676**
Allowance for impairment	(3,383,020)	(80,712)	(308,771)	(3,772,503)
Loans and advances held at amortised cost, net	**110,705,340**	**480,118**	**12,518,715**	**123,704,173**

SAR' 000	December 31, 2017 (Audited)			
	Overdraft & Commercial Loans	Credit Cards	Consumer Loans	Total
Performing loans and advances - gross	109,827,075	494,050	11,621,667	121,942,792
Non performing loans and advances, net	3,198,613	55,955	167,473	3,422,041
Total loans and advances	**113,025,688**	**550,005**	**11,789,140**	**125,364,833**
Allowance for impairment	(3,088,685)	(71,022)	(264,732)	(3,424,439)
Loans and advances held at amortised cost, net	**109,937,003**	**478,983**	**11,524,408**	**121,940,394**

SAR' 000	September 30, 2017 (Unaudited)			
	Overdraft & Commercial Loans	Credit Cards	Consumer Loans	Total
Performing loans and advances - gross	117,541,145	544,370	11,590,971	129,676,486
Non performing loans and advances, net	2,117,002	52,256	188,071	2,357,329
Total loans and advances	**119,658,147**	**596,626**	**11,779,042**	**132,033,815**
Allowance for impairment	(2,757,789)	(69,501)	(258,048)	(3,085,338)
Loans and advances held at amortised cost, net	**116,900,358**	**527,125**	**11,520,994**	**128,948,477**

7. Loans and advances, net (continued)

The movement in the allowance for impairment of Loans and advances to customers for the period ended 30 September 2018 is as follows:

SAR' 000	September 30, 2018 (Unaudited)
Closing loss allowance as at 31 December 2017 (calculated under IAS 39)	3,424,439
Amounts restated through opening retained earnings	664,645
Opening loss allowance as at 1 January 2018 (calculated under IFRS 9)	**4,089,084**
Charge for the period, net	343,766
Bad debts written off against provision	(660,347)
Balance at the end of the period	**3,772,503**

8. Investment in associates

SAR' 000	September 30, 2018 (Unaudited)	December 31, 2017 (Audited)	September 30, 2017 (Unaudited)
Cost	78,517	110,017	106,427
Share of earnings	65,678	68,032	114,282
Impairment provision	(102,000)	(102,000)	(102,000)
Total	**42,195**	**76,049**	**118,709**

9. Customers' deposits

SAR' 000	September 30, 2018 (Unaudited)	December 31, 2017 (Audited)	September 30, 2017 (Unaudited)
Demand	70,608,868	81,474,079	83,031,134
Saving	547,778	518,928	514,806
Time	71,748,614	64,627,605	67,581,381
Other	3,788,757	4,333,575	4,344,692
Total	**146,694,017**	**150,954,187**	**155,472,013**

10. Derivatives

In the ordinary course of business, the Bank utilizes the following derivative financial instruments for both trading and hedging purposes:

a) Swaps

Swaps are commitments to exchange one set of cash flows for another. For commission rate swaps, counterparties generally exchange fixed and floating rate commission payments in a single currency without exchanging principal. For currency rate swaps, fixed and floating commission payments and principal are exchanged in different currencies.

b) Forwards and futures

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specified price and date in the future. Forwards are customized contracts transacted in the over the counter market. Foreign currency and commission rate futures are transacted in standardized amounts on regulated exchanges and changes in futures contract values are settled daily.

c) Forward rate agreements

Forward rate agreements are individually negotiated commission rate contracts that call for a cash settlement for the difference between a contracted commission rate and the market rate on a specified future date, on a notional principal for an agreed period of time.

d) Options

Options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, to either buy or sell at fixed future date or at any time during a specified period, a specified amount of a currency, commodity or financial instrument at a pre-determined price.

e) Held for trading purposes

Most of the Bank's derivative trading activities relate to sales, positioning and arbitrage. Sales activities involve offering products to customers, Banks and other financial institutions in order, inter alia, to enable them to transfer, modify or reduce current and future risks. Positioning involves managing market risk positions with the expectation of profiting from favorable movements in prices, rates or indices. Arbitrage involves identifying, with the expectation of profiting from price differentials between markets or products. The bank also holds structured derivative which are fully back to back in accordance with the bank's risk management strategy.

f) Held for hedging purposes

The Bank has adopted a comprehensive system for the measurement and the management of risk. Part of the risk management process involves managing the Bank's exposure to fluctuations in foreign exchange and commission rates to reduce its exposure to currency and commission rate risks to an acceptable level as determined by the Board of Directors in accordance with the guidelines issued by SAMA. The Board of Directors has established the levels of currency risk by setting limits on counterparty and currency position exposures. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits. The Board of Directors has also established the level of commission rate risk by setting commission rate sensitivity limits. Commission rate exposure in terms of the sensitivity is reviewed on a periodic basis and hedging strategies are used to reduce the exposure within the established limits.

10. Derivatives (continued)

As part of its asset and liability management the Bank uses derivatives for hedging purposes in order to adjust its own exposure to currency and commission rate risks. This is generally achieved by hedging specific transactions as well as strategic hedging against overall consolidated statement of financial position exposures. Strategic hedging does not qualify for special hedge accounting and the related derivatives are accounted for as held for trading.

The Bank uses forward foreign exchange contracts and currency rate swaps to hedge against specifically identified currency risks. In addition, the Bank uses commission rate swaps and commission rate futures to hedge against the commission rate risk arising from specifically identified fixed commission rate exposures. The Bank also uses commission rate swaps to hedge against the cash flow risk arising on certain floating rate exposures. In all such cases, the hedging relationship and objective, including details of the hedged items and hedging instrument are formally documented and the transactions are accounted for as fair value or cash flow hedges.

g) Cash flow hedges

The Bank is exposed to variability in future special commission income cash flows on non-trading assets and liabilities which bear variable commission rate. The Bank uses commission rate swaps as cash flow hedges of these commission rate risks. Also, as a result of firm commitments in foreign currencies, such as its issued foreign currency debt, the Bank is exposed to foreign exchange and commission rate risks which are hedged with cross currency commission rate swaps.

The net gain on cash flow hedges transferred to the consolidated statement of income during the period was as follows:

SAR' 000	Sep 30, 2018 (Unaudited)	Sep 30, 2017 (Unaudited)
Special commission income	1,226,925	1,241,926
Special commission expense	(1,119,951)	(1,110,682)
Net gain on cash flow hedges transferred to consolidated statement of income	**106,974**	131,244

The tables below show the positive and negative fair values of derivative financial instruments held, together with their notional amounts. The notional amounts, which provide an indication of the volumes of the transactions outstanding at the year end, do not necessarily reflect the amounts of future cash flows involved. These notional amounts, therefore, are neither indicative of the Bank's exposure to credit risk, which is generally limited to the positive fair value of the derivatives, nor to market risk.

10. Derivatives (continued)

The tables below show the positive and negative fair values of derivative financial instruments held, together with their notional amounts. The notional amounts, which provide an indication of the volumes of the transactions outstanding at the year end, do not necessarily reflect the amounts of future cash flows involved. These notional amounts, therefore, are neither indicative of the Bank's exposure to credit risk, which is generally limited to the positive fair value of the derivatives, nor to market risk.

SAR '000	September 30, 2018 (Unaudited)			December 31, 2017 (Audited)			September 30, 2017 (Unaudited)		
	Positive fair value	Negative fair value	Notional amount	Positive fair value	Negative fair value	Notional amount	Positive fair value	Negative fair value	Notional amount
Held for trading									
Special commission rate swaps	1,139,352	1,026,368	161,597,135	801,994	669,252	181,680,691	1,230,850	1,033,261	180,267,790
Special commission rate futures and options	290,908	290,908	61,332,567	350,663	341,504	75,712,040	52,818	52,818	73,668,262
Forward rate agreements	-	-	-	-	-	750,000	-	248	1,500,000
Forward foreign exchange contracts	159,987	12,952	23,641,858	207,326	50,908	49,999,337	239,829	98,396	51,714,378
Currency options	9,103	9,103	1,024,962	6,158	6,158	2,636,084	12,179	12,179	5,755,393
Others	8,901	8,901	696,675	15,889	15,889	640,021	11,349	11,349	735,404
Held as fair value hedges									
Special commission rate swaps	-	-	-	-	1,608	264,000	-	1,879	264,000
Held as cash flow hedges									
Special commission rate swaps	215,584	415,598	61,310,760	650,793	112,156	73,058,082	667,926	92,744	73,210,106
Total	**1,823,835**	**1,763,830**	**309,603,957**	**2,032,823**	**1,197,475**	**384,740,255**	**2,214,951**	**1,302,874**	**387,115,333**

11. Credit related commitments and contingencies

The Bank's credit related commitments and contingencies are as follows:

SAR '000	September 30, 2018 (Unaudited)	December 31, 2017 (Audited)	September 30, 2017 (Unaudited)
Letters of credit	6,779,640	8,260,731	8,372,606
Letters of guarantee	42,787,164	44,774,754	45,622,478
Acceptances	1,960,862	2,541,110	2,546,455
Irrevocable commitments to extend credit	3,765,303	2,758,962	2,732,831
Total	**55,292,969**	**58,335,557**	**59,274,370**

The bank has made impairment provision amounting to SAR 290 million against credit related commitments and contingencies which has been classified into other liabilities. The Group is subject to legal proceedings in the ordinary course of business. There was no change in the status of legal proceedings as disclosed at December 31, 2017.

12. Cash and cash equivalents

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

SAR '000	Sep 30, 2018 (Unaudited)	December 31, 2017 (Audited)	Sep 30, 2017 (Unaudited)
Cash and balances with SAMA excluding statutory deposit	6,699,320	13,757,625	6,286,971
Due from banks and other financial institutions maturing within three months from the date of acquisition	12,372,025	13,958,295	12,315,440
Total	**19,071,345**	**27,715,920**	**18,602,411**

Cash and cash equivalents include amount of SAR 255 million (December 31, 2017: 183 million) held with CA-CIB group.

13. Segment information

Operating segments are identified on the basis of internal reports about components of the Bank that are regularly reviewed by the Bank's Board of Directors in its function as chief decision maker in order to allocate resources to the segments and to assess its performance.

Transactions between operating segments are approved by the management as per agreed terms and are reported according to the Bank's internal transfer pricing policy. These terms are in line with normal commercial terms and conditions. The revenue from external parties report to the Board is measured in a manner consistent with that in the consolidated statement of income.

There have been no changes to the basis of segmentation or the measurement basis for the segment profit or loss since 31 December 2017.

The Bank is organised into the following main operating segments:

Retail banking – incorporates private and small establishment customers' demand accounts, overdrafts, loans, saving accounts, deposits, credit and debit cards, consumer loans, certain forex products and auto leasing.

Corporate banking – incorporates corporate and medium establishment customers' demand accounts, deposits, overdrafts, loans and other credit facilities and derivative products.

Treasury – incorporates treasury services, trading activities, investment securities, money market, Bank's funding operations and derivative products.

Investment banking and brokerage – Investment management services and asset management activities related to dealing, managing, arranging, advising and custody of securities, retail investments products, corporate finance and international and local shares brokerage services and insurance.

13. Segment information (continued)

The Bank's total assets and liabilities, together with total operating income, total operating expenses and net income for the nine months then ended, by operating segments, are as follows:

(Unaudited) SAR '000"	Retail banking	Corporate banking	Treasury	Investment banking and brokerage	Total
September 30, 2018 (Unaudited)					
Total assets	18,983,399	107,144,487	61,803,181	1,370,150	**189,301,217**
Total liabilities	68,706,786	78,774,391	8,674,197	1,309,877	**157,465,251**
Total operating income	1,277,325	2,289,888	1,336,285	202,502	**5,106,000**
Total operating expenses	943,661	718,233	277,447	130,981	**2,070,322**
Share in earnings of associates, net	-	-	2,529	-	**2,529**
Net income for the period	333,664	1,571,655	1,061,367	71,521	**3,038,207**
Inter-segment revenue	689,419	169,449	(858,868)	-	**-**
Impairment charges for financial assets, net	91,376	233,885	(47)	-	**325,214**
December 31, 2017 (Audited)					
Total assets	17,791,035	107,093,458	66,836,088	1,208,300	**192,928,881**
Total liabilities	71,996,172	80,341,090	7,844,173	1,086,065	**161,267,500**
September 30, 2017 (Unaudited)					
Total assets	17,919,516	114,276,436	68,199,712	1,308,062	**201,703,726**
Total liabilities	79,524,162	78,016,657	11,380,775	1,227,663	**170,149,257**
Total operating income	1,179,113	2,272,731	1,314,491	190,191	**4,956,526**
Total operating expenses	970,856	516,058	240,000	125,987	**1,852,901**
Share in earnings of associates, net	-	-	5,492	-	**5,492**
Net income for the period	208,257	1,756,673	1,079,983	64,204	**3,109,117**
Inter-segment revenue	654,033	108,243	(762,276)	-	**-**
Impairment charges for financial assets, net	78,222	65,068	3,500	-	**146,790**

14. 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. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either in the principal market for the asset or liability, or in the absence of a principal market, in the most advantageous market for the asset or liability.

For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

14. Fair values of financial assets and liabilities (continued)

Valuation models

Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which market observable prices exist. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premium used in estimating discount rates, bond and equity prices and foreign currency exchange rates.

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. The Bank uses widely recognized valuation models for determining the fair value of common and simpler financial instruments.

Observable prices or model inputs are usually available in the market for listed debt and equity securities, exchange-traded derivatives and simple over-the-counter derivatives such as interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgment and estimation and also reduces the uncertainty associated with determining fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

Valuation models that employ significant unobservable inputs require a higher degree of management judgment and estimation in the determination of fair value. Management judgment and estimation are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued, determination of the probability of counterparty default and prepayments and selection of appropriate discount rates. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties; to the extent that the Bank believes that a third party market participant would take them into account in pricing a transaction. Fair values aims also to reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Bank and the counterparty where appropriate.

Valuation Framework

The Bank has an established control framework with respect to the measurement of fair values. This framework includes a Market Risk Department, which is independent of Front Office management and reports to the Chief Risk Officer, and which has overall responsibility for independently verifying the results of trading and investment operations and all significant fair value measurements.

Determination of fair value and fair value hierarchy

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments:

Level 1: quoted prices in active markets for the same instrument (i.e. without modification or repackaging)

Level 2: quoted prices in active markets for similar assets and liabilities or other valuation techniques for which all significant inputs are based on observable market data: and

Level 3: valuation techniques for which any significant input is not based on observable market data.

For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

Derivative products valued using a valuation technique with market observable inputs are mainly commission rate swaps and options, currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including foreign exchange spot and forward rates and commission rate curves. Other investments in level 2 are valued based on market observable date including broker rates etc.

14. Fair values of financial assets and liabilities (continued)

SAR '000	Level 1	Level 2	Level 3	Total
September 30, 2018 (Unaudited)				
Financial assets				
Derivative financial instruments positive fair value	-	1,823,835	-	**1,823,835**
Financial investments designated at FVTPL	359,392	153,656	-	**513,048**
Financial investments at FVOCI	2,094,006	4,225,710	6,109	**6,325,825**
Total	**2,453,398**	**6,203,201**	**6,109**	**8,662,708**
Financial Liabilities				
Derivative financial instruments negative fair value	-	1,763,830	-	**1,763,830**
Total	**-**	**1,763,830**	**-**	**1,763,830**
December 31, 2017 (Audited)				
Financial assets				
Derivative financial instruments positive fair value	-	2,032,823	-	**2,032,823**
Financial investments designated at FVIS (trading)	127,654	3,036	-	**130,690**
Financial investments available for sale	1,037,217	4,601,660	2,575,208	**8,214,085**
Total	**1,164,871**	**6,637,519**	**2,575,208**	**10,377,598**
Financial Liabilities				
Derivative financial instruments negative fair value	-	1,197,475	-	**1,197,475**
Total	**-**	**1,197,475**	**-**	**1,197,475**
September 30, 2017 (Unaudited)				
Financial assets				
Derivative financial instruments positive fair value	-	2,214,951	-	**2,214,951**
Financial investments designated at FVIS (trading)	271,297	6,142	-	**277,439**
Financial investments available for sale	1,781,915	4,643,688	2,924,310	**9,349,913**
Total	**2,053,212**	**6,864,781**	**2,924,310**	**11,842,303**
Financial Liabilities				
Derivative financial instruments negative fair value	-	1,302,874	-	**1,302,874**
Total	**-**	**1,302,874**	**-**	**1,302,874**

14. Fair values of financial assets and liabilities (continued)

The fair values of investments held at amortized cost are SAR 22,519 million (December 31, 2017: SAR 16,786 million and September 30, 2017: SAR 16,436 million) against carrying value of SAR 22,680 million (December 31, 2017: SAR 16,980 million and September 30, 2017: SAR 16,488 million).The fair values of commission bearing customers' deposits, debt securities, due from and due to banks and other financial institutions which are carried at amortized cost, are not significantly different from the carrying values included in the interim condensed consolidated financial statements, since the current market commission rates for similar financial instruments are not significantly different from the contracted rates, and due to the short duration of due from and due to banks and other financial institutions. An active market for these instruments is not available and the Bank intends to realize the carrying value of these financial instruments through settlement with the counter party at the time of their respective maturities.

The estimated fair values of investments held at amortized cost are based on quoted market prices when available or pricing models when used in the case of certain fixed rate bonds. Consequently, differences can arise between carrying values and fair value estimates. The fair values of derivatives are based on the quoted market prices when available or by using the appropriate valuation technique. The Bank uses the discounted cash flow method using current yield curve to arrive at the fair value of loans and advances after adjusting internal credit spread which is SAR 125,835 million (December 31, 2017: SAR 123,602 million and September 30, 2017: SAR 130,439 million). The carrying values of those loans and advances are SAR 123,704 million (December 31, 2017: SAR 121,940 million and September 30, 2017 SAR 128,948 million).

15. Financial Risk Management

Credit Risk

The Board of Directors is responsible for the overall risk management approach and for approving the risk management strategies and principles. The Board has appointed the Board Risk Committee which has the responsibility to monitor the overall risk process within the bank.

The Board Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits.

The Risk Committee is responsible for managing risk decisions and monitoring risk levels and reports on a weekly basis to the Supervisory Board.

The Bank manages exposure to credit risk, which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Credit exposures arise principally in lending activities that lead to loans and advances, and investment activities. There is also credit risk in off-balance sheet financial instruments, such as loan commitments.

The bank assesses the probability of default of counterparties using internal rating tools with an overlay of credit assessment, where necessary. Also the bank uses the external ratings, of the major rating agency, where available.

The Bank attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties. The bank's risk management policies are designed to identify and to set appropriate risk limits and to monitor the risks and adherence to limits. Actual exposures against limits are monitored daily. In addition to monitoring credit limits, the Bank manages the credit exposure relating to its trading activities by entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposure. In certain cases the Bank may also close out transactions or assign them to other counterparties to mitigate credit risk. The bank's credit risk for derivatives represents the potential cost to replace the derivative contracts if counterparties fail to fulfill their obligation, and to control the level of credit risk taken, the bank assesses counterparties using the same techniques as for its lending activities.

15. Financial Risk Management (continued)

Concentrations of credit risk 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 of credit risk indicate relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

The Bank seeks to manage its credit risk exposure through diversification of lending activities to ensure that there is no undue concentration of risks with individuals or groups of customers in specific locations or business. It also takes collateral / security when appropriate. The bank also seeks additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

The Bank regularly reviews its risk management policies and systems to reflect changes in markets products and emerging best practice.

a) Amounts arising from ECL – Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Bank's historical experience and expert credit assessment and including forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime probability of default (PD) as at the reporting date; with
- the remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

Credit risk grades

The Bank allocates each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgment. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower.

Credit risk grades are defined and calibrated such that the risk of default occurring increases exponentially as the credit risk deteriorates so, for example, the difference in risk of default between credit risk grades 1 and 2 is smaller than the difference between credit risk grades 2 and 3.

Each corporate exposure is allocated to a credit risk grade at initial recognition based on available information about the borrower. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade. The monitoring of exposures involves use of the following data.

15. Financial Risk Management (continued)

Corporate exposures	Retail exposures	All exposures
• Information obtained during periodic review of customer files – e.g. audited financial statements, management accounts, budgets and projections. Examples of areas of particular focus are: gross profit margins, financial leverage ratios, debt service coverage, compliance with covenants, quality management, and senior management changes. • Data from credit reference agencies, press articles, changes in external credit ratings • Quoted bond and credit default swap (CDS) prices for the borrower where available • Actual and expected significant changes in the political, regulatory and technological environment of the borrower or in its business activities	• Internally collected data and customer behavior – e.g. utilization of credit card facilities • Affordability metrics • External data from credit reference agencies including industry-standard credit scores	• Payment record – this includes overdue status as well as a range of variables about payment ratios • Utilization of the granted limit • Requests for and granting of forbearance • Existing and forecast changes in business, financial and economic conditions

i) Generating the term structure of PD

Credit Risk grades mapped to probabilities, Credit transition probabilities and Macroeconomic inputs determine the term structure of Probability of Default. The Bank collects performance and default information about its credit risk exposures analyzed by type of product and borrower as well as by credit risk grading. For some portfolios, information derived from external credit reference agencies is also used.

The Bank employs analytical models to analyze the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

This analysis includes the identification and calibration of relationships between changes in default rates and macro-economic factors as well as in-depth analysis of the impact of certain other factors (e.g. forbearance experience) on the risk of default. Forward looking predictions of key macro-economic indicators e.g. GDP growth, inflation, unemployment or CDS spreads are translated analytically into the impact on Risk Factors, especially PD.

Based on advice from the Bank Market Risk Committee and economic experts and consideration of a variety of external actual and forecast information, the Bank formulates a 'base case' view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios (see discussion below on incorporation of forward-looking information). The Bank then uses these forecasts to adjust its estimates of PDs.

ii) Determining whether credit risk has increased significantly

The criteria for determining whether credit risk has increased significantly vary by portfolio and include quantitative changes in PDs and qualitative factors, including a backstop based on delinquency.

This is assessed by comparing lifetime risk of default at the reporting date with the lifetime risk of default at origination through a series of quantitative (e.g. comparison against rating at origination) and qualitative measures specific to each exposure class, which is enshrined in the Board approved Staging Policy.

Using its expert credit judgment and, where possible, relevant historical experience, the Bank may determine that an exposure has undergone a significant increase in credit risk based on particular qualitative indicators that it considers are indicative of such and whose effect may not otherwise be fully reflected in its quantitative analysis on a timely basis.

15. Financial Risk Management (continued)

As a backstop, the Bank considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due though technical rebuttals on a case by case basis is possible exceptionally. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower.

The Bank monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- the criteria do not align with the point in time when an asset becomes 30 days past due; and
- there is no unwarranted volatility in loss allowance from transfers between 12-month PD (stage 1) and lifetime PD (stage 2).

iii) Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognized and the renegotiated loan recognized as a new loan at fair value in accordance with the accounting policy.

When the terms of a financial asset are modified and the modification does not result in de-recognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- its remaining lifetime PD at the reporting date based on the modified terms; with
- the remaining lifetime PD estimated based on data at initial recognition and the original contractual terms.

The Bank renegotiates loans to customers in financial difficulties (referred to as 'forbearance activities' to maximize collection opportunities and minimize the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of special commission income payments and amending the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy. The Bank Audit Committee regularly reviews reports on forbearance activities.

For financial assets modified as part of the Bank's forbearance policy, the estimate of PD reflects whether the modification has improved or restored the Bank's ability to collect special commission income and principal and the Bank's previous experience of similar forbearance action. As part of this process, the Bank evaluates the borrower's payment performance against the modified contractual terms and considers various behavioral indicators.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired /in default. A customer needs to demonstrate consistently good payment behavior over a period of time before the exposure is no longer considered to be credit-impaired/ in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to 12-month ECL in case of assets with significant increase in credit risk.

15. Financial Risk Management (continued)

iv) Definition of 'Default'

The Bank considers a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realizing security (if any is held); or
- the borrower is past due more than 90 days on any material credit obligation to the Bank. Overdrafts are considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than the current amount outstanding.

  In assessing whether a borrower is in default. The Bank considers indicators that are:

- qualitative- e.g. breaches of covenant ;
- quantitative- e.g. overdue status and non-payment on another obligation of the same issuer to the Bank; and
- based on data developed internally and obtained from external sources.

  Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

The definition of default largely aligns with that applied by the Bank for regulatory capital purposes.

v) Incorporation of forward looking information

The Bank incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. Based on advice from the Bank Market Risk Committee and economic experts and consideration of a variety of external actual and forecast information, the Bank formulates a 'base case' view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios. This process involves developing two or more additional economic scenarios and considering the relative probabilities of each outcome. External information includes economic data and forecasts published by governmental bodies and monetary authorities in the Kingdom and selected private-sector and academic forecasters.

The base case represents a most-likely outcome and is aligned with information used by the Bank for other purposes such as strategic planning and budgeting. The other scenarios represent more optimistic and more pessimistic outcomes. Periodically, the Bank carries out stress testing of more extreme shocks to calibrate its determination of these other representative scenarios.

The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses. The economic scenarios used as at 30 September 2018 included the following ranges of key indicators.

- Investment as percent of GDP
- National Savings as percent of GDP
- Inflation
- Gross Government debt etc.

Predicted relationships between the key indicators and default and loss rates on various portfolios of financial assets have been developed based on analyzing historical data over the past 10 to 15 years.

15. Financial Risk Management (continued)

vi) Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

I. probability of default (PD);
II. loss given default (LGD);
III. exposure at default (EAD).

These parameters are generally derived from internally developed statistical models, regulatory inputs (e.g. in case of LDG) and other historical data. They are adjusted to reflect forward-looking information as described above.

PD estimates are estimates at a certain date, which are calculated based on analytical rating models, and assessed using rating tools tailored to the various categories of counterparties and exposures. These analytical models are based on internally and externally compiled data comprising both quantitative and qualitative factors. Where it is available, market data may also be used to derive the PD for large corporate counterparties. If a counterparty or exposure migrates between ratings classes, then this will lead to a change in the estimate of the associated PD. PDs are estimated considering the contractual maturities of exposures and estimated prepayment rates.

LGD is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For loans secured by retail property, LTV ratios are a key parameter in determining LGD. They are calculated on a discounted cash flow basis using the effective commission rate as the discounting factor.

EAD represents the expected exposure in the event of a default. The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract including amortization. The EAD of a financial asset is its gross carrying amount. For lending commitments and financial guarantees, the EAD includes the amount drawn, as well as potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts or Regulatory guidelines.

As described above, and subject to using a maximum of a 12-month PD for financial assets for which credit risk has not significantly increased, the Bank measures ECL considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for risk management purposes, the Bank considers a longer period. The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee.

However, for retail overdrafts and credit card facilities that include both a loan and an undrawn commitment component, the Bank measures ECL over a period longer than the maximum contractual period if the Bank's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Bank's exposure to credit losses to the contractual notice period. These facilities do not have a fixed term or repayment structure and are managed on a collective basis. The Bank can cancel them with immediate effect but this contractual right is not enforced in the normal day-to-day management but only when the Bank becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Bank expects to take and that serve to mitigate ECL. These include a reduction in limits. Cancellation of the facility and/or turning the outstanding balance into a loan with fixed repayment terms. The portfolios for which external benchmark information represents a significant input into measurement of ECL is Non Retail portfolio where the Bank has used LGD estimates as per BASEL guidelines."

15. Financial Risk Management (continued)

Where modeling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics that include:

- instrument type;
- credit risk grading;
- collateral type;
- LTV ratio for retail mortgages;
- date of initial recognition;
- remaining term to maturity;
- industry; and
- geographic location of the borrower.

The Banking is subject to regular review to ensure that exposures within a particular Bank remain appropriately homogeneous.

b) Loss allowance

The following table shows reconciliations from the opening to the closing balance of the loan loss allowance.

SAR '000	September 30, 2018 (Unaudited)			
	12 month ECL	Lifetime ECL not credit impaired	Lifetime ECL credit impaired	Total
Loans and advances to customers at amortized cost				
Balance at 1 January	367,969	1,608,722	2,112,393	**4,089,084**
Transfer from12-month ECL	(23,941)	18,108	5,833	**-**
Transfer from lifetime ECL not credit –impaired	182,000	(225,413)	43,413	**-**
Net charge / (reversal) for the period	46,099	(127,555)	425,222	**343,766**
Write-offs	-	-	(660,347)	**(660,347)**
Balance as at 30 September 2018	**572,127**	**1,273,862**	**1,926,514**	**3,772,503**

c) Collateral

The banks in the ordinary course of lending activities hold collaterals as security to mitigate credit risk in the loans and advances. These collaterals mostly include time and demand and other cash deposits, financial guarantees, local and international equities, real estate and other fixed assets. The collaterals are held mainly against commercial and consumer loans and are managed against relevant exposures at their net realizable values. For financial assets that are credit impaired at the reporting period, quantitative information about the collateral held as security is needed to the extent that such collateral mitigates credit risk.

16. Share capital and Earnings per share

The authorised, issued and fully paid share capital of the Bank consists of 1,205 million shares of SAR 10 each (December 31, 2017: 1,205 million shares of SAR 10 each and September 30, 2017: 1,205 million shares of SAR 10 each).

Basic and diluted earnings per share for the periods ended September 30, 2018 and 2017 are calculated on a weighted average basis by dividing the net income for the period by 1,205 million shares after excluding treasury shares consists of 6 million shares as of September 30, 2018 (December 31, 2017: 6 million shares and September 30, 2017: 6 million shares).

The final net dividend of SAR 0.35 per share for the year ended 2017 has been approved by the shareholders at the General Assembly Meeting held on April 19, 2018.

17. Interim dividends

The Board of Directors recommended on 01 July 2018 an interim net dividend of SAR 0.90 per share (2017: SAR 1.05 per share) of SAR 1,028 million (2017: SAR 1,141 million).

18. Comparative figures

Certain prior period figures have been reclassified to conform to the current period's presentation.

19. Capital Adequacy

The Bank's objectives when managing capital are, to comply with the capital requirements set by SAMA; to safeguard the Bank's ability to continue as a going concern; and to maintain a strong capital base. Capital adequacy and the use of regulatory capital are monitored daily by the Bank's management.

The Bank monitors the adequacy of its capital using ratios established by SAMA. These ratios measure capital adequacy by comparing the Bank's eligible capital with its statement of financial position assets, commitments and notional amount of derivatives at a weighted amount to reflect their relative risk.

SAMA requires holding the minimum level of the regulatory capital of and maintaining a ratio of total regulatory capital to the risk-weighted asset (RWA) at or above the agreed minimum of 8%.

SAMA through its circular number 391000029731 Dated 15/03/1439AH, which relates to the interim approach and transitional arrangements for the accounting allocations under IFRS9, has directed banks that the initial impact on the capital adequacy ratio as a result of applying IFRS shall be transitioned over five years.

19. Capital Adequacy (continued)

Bank's total risk weighted assets and total Tier I & Tier I + Tier II Capital are as follows:

SAR '000	Sep 30, 2018 (Unaudited)	December 31, 2017 (Audited)	Sep 30, 2017 (Unaudited)
Credit Risk RWA	169,056,532	167,323,175	181,375,277
Operational Risk RWA	12,394,475	12,222,300	12,079,400
Market Risk RWA	2,214,966	2,542,165	3,363,086
Total RWA	**183,665,973**	**182,087,640**	**196,817,763**
Tier I Capital	33,224,168	31,897,613	31,586,117
Tier II Capital	3,986,189	3,417,941	3,795,190
Total Tier I & II Capital	**37,210,357**	**35,315,554**	**35,381,307**
Capital Adequacy Ratio %			
Tier I ratio	**18.09%**	17.52%	**16.05%**
Tier I + Tier II ratio	**20.26%**	19.39%	**17.98%**