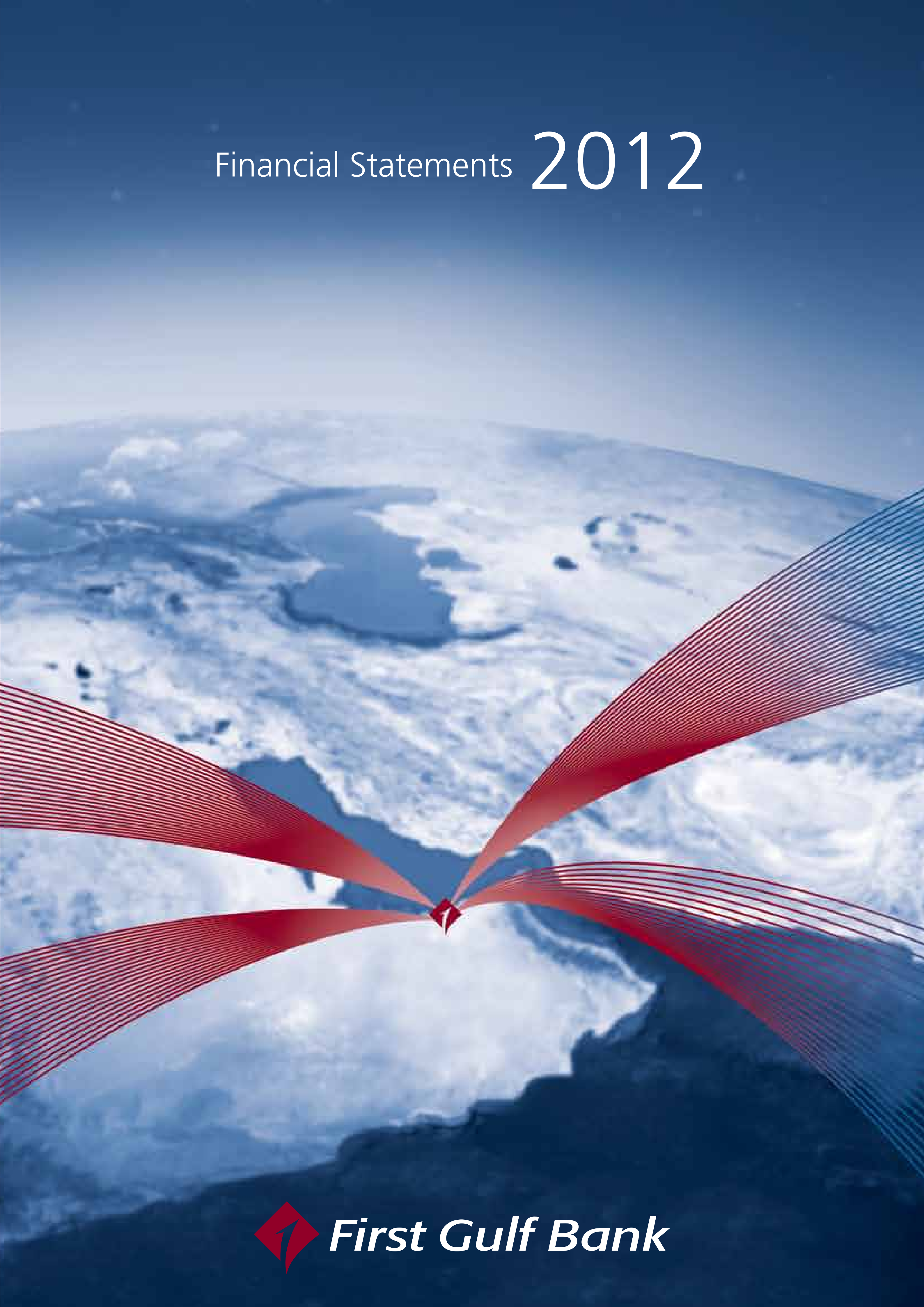
Financial Statements 2012



First Gulf Bank

Contents

Chairman's Report

On behalf of the Board of Directors, I am pleased to present to our shareholders the Audited Financial Statements of First Gulf Bank for the year end of 31 December 2012. The story that these results portrays is a testament to the ambition we have as a company, as well as our passion for excellence. During 2012 our primary focus was on driving forward our corporate and consumer propositions, and ensuring that the quality and effectiveness of our teams enabled us to continue to make new inroads in a highly competitive marketplace.

While the effects of the ongoing economic slowdown were still being felt by many of the UAE's key trading partners, the overall mood of the domestic economy started to improve. Clear signs of recovery were seen in a number of sectors such as real estate, project finance, manufacturing and services. Estimates of real GDP growth of up to 4% for 2013 have been supported by projected government spending and stronger private consumption. Moreover, this growth is expected to gather pace to around 5% over the next five years.

Additional refinements in the regulation of the banking sector implemented by the Central Bank have also helped to ensure better stability, as well as transparency and good governance among lenders into the market. The UAE has accordingly moved up key international economic tables, including those measuring global competitiveness (now 24th according to the World Economic Forum) and trading across borders (currently 5th by the Doing Business Project supported by the International Finance Corporation and the World Bank).

Following our record breaking year in terms of net profits and business growth in the previous year, 2012 took First Gulf Bank to a new level of performance with AED 4.15bn in net profits ($1.13bn), an increase of 12% over 2011. We have been able to grow our customer base and to break into new areas of customer service, as well as to position First Gulf Bank firmly among the top three banks in the country. Our award by Euromoney as the Best Bank in the UAE in 2012 underlines the progress we are making.

The Board of Directors has again sought to offer our shareholders a high return on their investment and trust in us. In view of the performance of First Gulf Bank in 2012 they have recommended the distribution of 83% as cash dividends to shareholders.

Looking ahead, we will continue to develop our international network both in terms of locations and the depth of services offered by our international branches and offices. We will also continue to invest both in our technology platforms and in our people, most notably through the FGB Business School, formally opened in 2012, which brings international standards of financial and business related learning to our staff at all levels.

I would like to express my gratitude as well as that of our Board to the President His Highness Sheikh Khalifa Bin Zayed Al Nahyan for his wisdom and vision which is enabling our country to grow and prosper, as well as to His Highness Sheikh Mohammed Bin Rashid Al Maktoum, Vice President, Prime Minister and Ruler of Dubai, His Highness Sheikh Mohammed Bin Zayed Al Nahyan, Crown Prince of Abu Dhabi and their Highnesses and all members of the Supreme Council for their guidance and support.

I would also like to take this opportunity to extend my appreciation to all our shareholders, customers, correspondent banks, and UAE Central Bank for their continued co-operation and support. Finally, I would like to thank all the Board Members, the Management Team and the staff for their dedication, hard work, and outstanding contribution to our continuing success.

Tahnoon bin Zayed Al Nahyan
Chairman

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF FIRST GULF BANK PJSC

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of First Gulf Bank PJSC and its subsidiaries ("the Bank"), which comprise the consolidated balance sheet as at 31 December 2012 and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and the applicable provisions of the articles of association of the Bank and the UAE Commercial Companies Law of 1984 (as amended) and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2012 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

We also confirm that, in our opinion, the consolidated financial statements include, in all material respects, the applicable requirements of the UAE Commercial Companies Law of 1984 (as amended) and the articles of association of the Bank; proper books of account have been kept by the Bank; and the contents of the Chairman's Report relating to these consolidated financial statements are consistent with the books of account. We have obtained all the information and explanations which we required for the purpose of our audit and, to the best of our knowledge and belief, no violations of the U.A.E. Commercial Companies Law of 1984 (as amended) or the articles of association of the Bank have occurred during the year which would have had a material effect on the business of the Bank or on its financial position.

Ernst & Young

Signed by
Bassam E Hage
Partner
Ernst & Young
Registration No. 258

30 January 2013
Abu Dhabi

CONSOLIDATED BALANCE SHEET
31 December 2012

	Notes	2012 AED 000	2011 AED 000	2012 US$ 000	2011 US$ 000
Assets					
Cash and balances with U.A.E. Central Bank	3	**12,844,336**	9,586,770	**3,496,961**	2,610,065
Due from banks and financial institutions	27	**18,329,081**	12,225,320	**4,990,221**	3,328,429
Loans and advances	4	**114,644,479**	104,719,799	**31,212,763**	28,510,699
Investments	5	**17,278,266**	18,789,456	**4,704,129**	5,115,561
Investment in associates	6	**392,965**	443,810	**106,987**	120,830
Investment properties	7	**7,771,812**	7,537,900	**2,115,930**	2,052,246
Other assets	8	**3,147,027**	3,557,019	**856,800**	968,423
Property and equipment	9	**625,643**	620,263	**170,336**	168,871
Total assets		**175,033,609**	157,480,337	**47,654,127**	42,875,124
Liabilities					
Due to banks	10	**3,919,498**	8,247,336	**1,067,111**	2,245,395
Customers' deposits	11	**119,304,634**	103,473,733	**32,481,523**	28,171,449
Term loans	12	**13,400,771**	12,694,724	**3,648,454**	3,456,228
Sukuk financing instruments	13	**4,223,950**	2,387,450	**1,150,000**	650,000
Other liabilities	14	**4,321,666**	3,909,978	**1,176,604**	1,064,519
Total liabilities		**145,170,519**	130,713,221	**39,523,692**	35,587,591
Equity					
Equity attributable to equity holders of the Bank					
Share capital	16	**3,000,000**	1,500,000	**816,771**	408,385
Capital notes	18	**4,000,000**	4,000,000	**1,089,028**	1,089,028
Legal reserve	19	**8,780,110**	8,780,110	**2,390,446**	2,390,446
Special reserve	19	**1,262,083**	846,648	**343,612**	230,506
General reserve	19	**120,000**	120,000	**32,671**	32,671
Revaluation reserve	9	**87,554**	87,554	**23,837**	23,837
Proposed bonus shares	16	**-**	1,500,000	**-**	408,385
Proposed cash dividends	19	**2,500,000**	1,500,000	**680,643**	408,385
Retained earnings		**9,227,477**	8,256,566	**2,512,245**	2,247,908
Cumulative changes in fair values		**393,239**	83,053	**107,061**	22,612
Foreign currency translation reserve		**(22,253)**	(22,503)	**(6,059)**	(6,127)
		29,348,210	26,651,428	**7,990,255**	7,256,036
Non-controlling interests		**514,880**	115,688	**140,180**	31,497
Total equity		**29,863,090**	26,767,116	**8,130,435**	7,287,533
Total equity and liabilities		**175,033,609**	157,480,337	**47,654,127**	42,875,124

Chairman | Managing Director | Chief Executive Officer

The attached notes 1 to 34 form part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT
Year ended 31 December 2012

	Notes	2012 AED 000	2011 AED 000	2012 US$ 000	2011 US$ 000
Interest income and income from Islamic financing	21	**7,644,488**	7,073,337	**2,081,265**	1,925,766
Interest expense and Islamic financing expense	22	**(2,124,104)**	(1,994,446)	**(578,302)**	(543,002)
NET INTEREST INCOME AND INCOME FROM ISLAMIC FINANCING		**5,520,384**	5,078,891	**1,502,963**	1,382,764
Share of profit (losses) of associates	6	**43,084**	(7,570)	**11,730**	(2,061)
Other operating income	23	**1,706,303**	1,411,561	**464,553**	384,307
OPERATING INCOME		**7,269,771**	6,482,882	**1,979,246**	1,765,010
General and administrative expenses	24	**(1,425,895)**	(1,222,481)	**(388,210)**	(332,829)
PROFIT FROM OPERATIONS BEFORE IMPAIRED ASSETS CHARGE		**5,843,876**	5,260,401	**1,591,036**	1,432,181
Provision for impairment of loans and advances	25	**(1,653,128)**	(1,553,091)	**(450,076)**	(422,840)
PROFIT FOR THE YEAR BEFORE TAXATION		**4,190,748**	3,707,310	**1,140,960**	1,009,341
Income taxes		**(19,886)**	(1,555)	**(5,414)**	(423)
PROFIT FOR THE YEAR		**4,170,862**	3,705,755	**1,135,546**	1,008,918
Profit (loss) attributable to:					
Equity holders of the Bank		**4,154,345**	3,707,275	**1,131,049**	1,009,332
Non-controlling interests		**16,517**	(1,520)	**4,497**	(414)
		4,170,862	3,705,755	**1,135,546**	1,008,918
Basic and diluted earnings per share	26	**AED 1.33**	AED 1.15	**US $0.36**	US $ 0.31

The attached notes 1 to 34 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2012

	2012 AED 000	2011 AED 000	2012 US$ 000	2011 US$ 000
PROFIT FOR THE YEAR	**4,170,862**	3,705,755	**1,135,546**	1,008,918
OTHER COMPREHENSIVE INCOME:				
Net unrealised gains on available for sale investments	**361,883**	129,746	**98,525**	35,324
Realised gains on available for sale investments	**(51,766)**	(58,229)	**(14,094)**	(15,853)
Board of directors remuneration	**(28,000)**	(28,000)	**(7,623)**	(7,623)
Share of changes recognised directly in associates' equity	**70**	(260)	**19**	(71)
Foreign exchange translation	**250**	(4,014)	**68**	(1,093)
Other comprehensive income for the year	**282,437**	39,243	**76,895**	10,684
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**4,453,299**	3,744,998	**1,212,441**	1,019,602
Total comprehensive income (loss) attributable to:				
Equity holders of the Bank	**4,436,782**	3,746,518	**1,207,944**	1,020,016
Non-controlling interests	**16,517**	(1,520)	**4,497**	(414)
	4,453,299	3,744,998	**1,212,441**	1,019,602

The attached notes 1 to 34 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2012

	Notes	2012 AED 000	2011 AED 000	2012 US$ 000	2011 US$ 000
OPERATING ACTIVITIES					
Profit for the year before taxation		**4,190,748**	3,707,310	**1,140,960**	1,009,341
Adjustments for:					
Depreciation		**61,996**	69,993	**16,879**	19,056
Loss on sale of property and equipment	23	**42**	29	**11**	8
Provision for impairment of loans and advances	25	**1,653,128**	1,553,091	**450,076**	422,840
(Gain) loss on revaluation of investment properties	7	**(62,260)**	56,139	**(16,951)**	15,284
Loss (gain) on sale of investment properties		**10,095**	(13,863)	**2,749**	(3,774)
(Gain) loss from investments		**(67,520)**	(53,490)	**(18,383)**	(14,563)
Share of (gain) loss of associates	6	**(43,084)**	7,570	**(11,730)**	2,061
Operating profit before changes in operating assets and liabilities:		**5,743,145**	5,326,779	**1,563,611**	1,450,253
Deposits with banks		**3,376,508**	(6,065,335)	**919,278**	(1,651,330)
Loans and advances		**(12,470,626)**	(11,573,235)	**(3,395,215)**	(3,150,894)
Other assets		**413,951**	(403,059)	**112,701**	(109,736)
Due to banks		**(4,315,951)**	6,720,635	**(1,175,048)**	1,829,740
Customers' deposits		**15,704,783**	6,144,195	**4,275,737**	1,672,800
Other liabilities		**307,165**	(214,375)	**83,627**	(58,365)
Cash from (used in) operations		**8,758,975**	(64,395)	**2,384,691**	(17,532)
Directors' remuneration paid		**(28,000)**	(48,000)	**(7,623)**	(13,068)
Net cash from (used in) operating activities		**8,730,975**	(112,395)	**2,377,068**	(30,600)
INVESTING ACTIVITIES					
Purchase of investments		**(11,758,800)**	(31,079,038)	**(3,201,416)**	(8,461,486)
Proceeds from redemption and sale of investments		**13,254,059**	27,812,612	**3,608,510**	7,572,179
Purchase of property and equipment	9	**(55,562)**	(78,530)	**(15,127)**	(21,380)
Dividends from associates		**93,998**	63,750	**25,592**	17,356
Deposits with U.A.E. Central bank		**(1,000,000)**	(1,500,000)	**(272,257)**	(408,386)
Additions to investment properties	7	**(532,539)**	(661,250)	**(144,987)**	(180,030)
Proceeds from sale of investment properties		**350,792**	130,328	**95,505**	35,483
Proceeds from disposal of property and equipment		**41**	193	**11**	53
Net cash from (used in) investing activities		**351,989**	(5,311,935)	**95,831**	(1,446,211)
FINANCING ACTIVITIES					
Dividends paid	19	**(1,479,818)**	(864,830)	**(402,891)**	(235,456)
Interest on mandatory convertible bonds		**-**	(81,462)	**-**	(22,179)
Interest on capital notes		**(240,000)**	(240,000)	**(65,342)**	(65,342)
Sukuk financing instruments		**1,836,500**	2,387,450	**500,000**	650,000
Drawdown of term loans		**4,385,658**	1,521,999	**1,194,026**	414,375
Movement in non-controlling interests		**(192)**	-	**(52)**	-
Repayment of term loans		**(3,679,611)**	(550,950)	**(1,001,800)**	(150,000)
Net cash from financing activities		**822,537**	2,172,207	**223,941**	591,398
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**9,905,501**	(3,252,123)	**2,696,840**	(885,413)
Cash and cash equivalents at 1 January		**10,251,155**	13,507,292	**2,790,948**	3,677,454
Cash and cash equivalents of Subsidiary		**625,449**	-	**170,283**	-
Net changes in foreign currency translation reserve		**2,040**	(4,014)	**555**	(1,093)
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	27	**20,784,145**	10,251,155	**5,658,626**	2,790,948
Operating cash flows from interest and Islamic financing					
Interest and Islamic financing income received		**7,450,996**	6,847,090	**2,028,586**	1,864,168
Interest and Islamic financing expense paid		**1,896,039**	2,028,908	**516,210**	552,384

The attached notes 1 to 34 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
31 December 2012

	Attributable to equity holders of the Bank															
	Share capital AED 000	Treasury shares AED 000	Capital notes AED 000	Legal reserve AED 000	Special reserve AED 000	General reserve AED 000	Revaluation reserve AED 000	Proposed bonus shares AED 000	Proposed dividends AED 000	Retained earnings AED 000	Cumulative changes in fair values AED 000	Foreign currency translation reserve AED 000	Mandatory convertible bonds AED 000	Total AED 000	Non-controlling interests AED 000	Total equity AED 000
As of 1 January 2011	1,375,000	(1,056,332)	4,000,000	5,305,110	846,648	120,000	87,554	-	900,000	8,955,085	11,796	(18,489)	3,600,000	24,126,372	504,776	24,631,148
Total comprehensive income for the year	-	-	-	-	-	-	-	-	-	3,679,275	71,257	(4,014)	-	3,746,518	(1,520)	3,744,998
Transfer to dividends payable	-	-	-	-	-	-	-	-	(900,000)	-	-	-	-	(900,000)	-	(900,000)
Mandatory convertible bonds converted to shares (note 20)	125,000	-	-	-	-	-	-	-	-	-	-	-	(125,000)	-	-	-
Share premium on conversion of mandatory convertible bonds transferred to legal reserve (note 20)	-	-	-	3,475,000	-	-	-	-	-	-	-	-	(3,475,000)	-	-	-
Interest on mandatory convertible bonds (note 20)	-	-	-	-	-	-	-	-	-	(81,462)	-	-	-	(81,462)	-	(81,462)
Interest on capital notes (note 18)	-	-	-	-	-	-	-	-	-	(240,000)	-	-	-	(240,000)	-	(240,000)
Non controlling interests derecognized (note 1)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(387,568)	(387,568)
Proposed cash dividends (note 19)	-	-	-	-	-	-	-	-	1,500,000	(1,500,000)	-	-	-	-	-	-
Proposed bonus shares (note 19)	-	-	-	-	-	-	-	1,500,000	-	(1,500,000)	-	-	-	-	-	-
Treasury shares distributed (note 17)	-	1,056,332	-	-	-	-	-	-	-	(1,056,332)	-	-	-	-	-	-
As of 31 December 2011	1,500,000	-	4,000,000	8,780,110	846,648	120,000	87,554	1,500,000	1,500,000	8,256,566	83,053	(22,503)	-	26,651,428	115,688	26,767,116
As of 1 January 2012	1,500,000	-	4,000,000	8,780,110	846,648	120,000	87,554	1,500,000	1,500,000	8,256,566	83,053	(22,503)	-	26,651,428	115,688	26,767,116
Total comprehensive income for the year	-	-	-	-	-	-	-	-	-	4,126,346	310,186	250	-	4,436,782	16,517	4,453,299
Transfer to special reserve (note 19)	-	-	-	-	415,435	-	-	-	-	(415,435)	-	-	-	-	-	-
Transfer to dividends payable	-	-	-	-	-	-	-	-	(1,500,000)	-	-	-	-	(1,500,000)	-	(1,500,000)
Interest on capital notes (note 18)	-	-	-	-	-	-	-	-	-	(240,000)	-	-	-	(240,000)	-	(240,000)
Non controlling interests recognized (note 1)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	382,675	382,675
Proposed cash dividends (note 19)	-	-	-	-	-	-	-	-	2,500,000	(2,500,000)	-	-	-	-	-	-
Proposed bonus shares converted to shares (note 19)	1,500,000	-	-	-	-	-	-	(1,500,000)	-	-	-	-	-	-	-	-
As of 31 December 2012	3,000,000	-	4,000,000	8,780,110	1,262,083	120,000	87,554	-	2,500,000	9,227,477	393,239	(22,253)	-	29,348,210	514,880	29,863,090

The attached notes 1 to 34 form part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2012

1 ACTIVITIES

First Gulf Bank PJSC ("the Bank") is a public joint stock company with limited liability incorporated in Abu Dhabi in accordance with U.A.E. Federal Law No. (8) of 1984 (as amended). The Bank carries on commercial and retail banking, investment and real estate activities through its Head Office, branches and subsidiaries in Abu Dhabi and its other branches in Dubai, Ajman, Sharjah, Fujairah, Al Ain and Ras Al Khaimah. The representative office of the Bank in Singapore has commenced operations from September 2007 and was upgraded to a wholesale bank in August 2009. The Bank has established a representative office in India in September 2009 and in Qatar in November 2009. The representative office in Qatar was upgraded to a branch in May 2011. In December 2012, the Bank established a representative office in Hong Kong.

Up until February 2011, the Bank had a partially owned subsidiary in Libya, First Gulf Libyan Bank (the "Subsidiary"), that carried out commercial banking activities. Effective March 2011, the Bank disassociated itself from the Subsidiary by suspending its management agreement and the entire Bank nominated members in the Subsidiary board resigned. As a result of these changes, the Bank de-recognized the assets, liabilities and non-controlling interest relating to the Subsidiary. As of that date, the investment in the Subsidiary with a net carrying amount of AED 388 million was classified as available for sale investment. During 2012, the Bank's representatives were reinstated to the Board of Directors of the Subsidiary and a revised management agreement was signed, and consequently the Bank regained control over the Subsidiary.

In June 2011, the Bank established "FGB Sukuk Company Limited", a wholly owned subsidiary incorporated in the Cayman Islands for the issuance of Sukuk financing instruments (note 13).

The registered head office of the Bank is at PO Box 6316, Abu Dhabi, United Arab Emirates (U.A.E.). The principal activities of the Bank are described in note 31.

The consolidated financial statements of the Bank were authorised for issue by the Board of Directors on 30 January 2012.

2 SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation
The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standard Board (IASB) and applicable requirements of the Laws in the U.A.E.

The consolidated financial statements have been prepared under the historical cost convention except for investment securities (other than held to maturity investments), derivative financial instruments, investment properties and land included in property and equipment which have been measured at fair value. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and otherwise carried at cost, are adjusted to record changes in fair value attributable to the risks that are being hedged.

The consolidated financial statements of the Bank are prepared in United Arab Emirates Dirhams (AED) which is the functional currency of the Bank. The consolidated balance sheet, consolidated income statement and consolidated statement of cash flows in US Dollar (US$) are presented solely for the convenience of the readers of the consolidated financial statements. The AED amounts have been translated at the rate of AED 3.673 to US$ 1 (2011: AED 3.673 to US$ 1) and all values are rounded to the nearest thousand AED except where otherwise indicated.

2 SIGNIFICANT ACCOUNTING POLICIES *continued*

Changes in accounting policies and disclosures

The accounting policies adopted are consistent with those of the previous financial year, except for the following amendments to IFRS effective as of 1 January 2012:

- IAS 12 *Income Taxes (Amendment) – Deferred Taxes: Recovery of Underlying Assets*
- IFRS 1 *First-Time Adoption of International Financial Reporting Standards (Amendment) - Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters*
- IFRS 7 *Financial Instruments : Disclosures – Enhanced Derecognition Disclosure Requirements*

The adoption of the standards or interpretations is described below:

IAS 12 *Income Taxes (Amendment) - Deferred Taxes: Recovery of Underlying Assets*

The amendment clarified the determination of deferred tax on investment property measured at fair value and introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. It includes the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 should always be measured on a sale basis. The amendment is effective for annual periods beginning on or after 1 January 2012 and it had no effect on the Bank's financial position, performance or its disclosures.

IFRS 1 *First-Time Adoption of International Financial Reporting Standards (Amendment) - Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters*

The IASB provided guidance on how an entity should resume presenting IFRS financial statements when its functional currency ceases to be subject to hyperinflation. The amendment is effective for annual periods beginning on or after 1 July 2011. The amendment had no impact to the Bank.

IFRS 7 *Financial Instruments: Disclosures - Enhanced Derecognition Disclosure Requirements*

The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Bank's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about the entity's continuing involvement in derecognised assets to enable the users to evaluate the nature of, and risks associated with, such involvement. The amendment is effective for annual periods beginning on or after 1 July 2011. The Bank does not have any assets with these characteristics so there has been no effect on the presentation of its financial statements.

Standards issued but not yet effective

Standards issued but not yet effective up to the date of the issuance of the Bank's financial statements are listed below. This listing is of standards and interpretations issued, which the Bank reasonably expects to be applicable at a future date. The Bank intends to adopt those standards when they become applicable.

IFRS 1 *Government Loans - Amendments to IFRS 1*

These amendments require first-time adopters to apply the requirements of IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, prospectively to government loans existing at the date of transition to IFRS. Entities may choose to apply the requirements of IFRS 9 (or IAS 39, as applicable) and IAS 20 to government loans retrospectively if the information needed to do so had been obtained at the time of initially accounting for that loan. The exception would give first-time adopters relief from retrospective measurement of government loans with a below-market rate of interest. The amendment is effective for annual periods on or after 1 January 2013. The amendment has no impact on the Bank.

2 SIGNIFICANT ACCOUNTING POLICIES *continued*

Standards issued but not yet effective *continued*

IFRS 7 *Disclosures - Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7*

These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with IAS 32 Financial Instruments: Presentation. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. These amendments will not impact the Bank's financial position or performance and will become effective for annual periods beginning on or after 1 January 2013.

IFRS 9 *Financial Instruments: Classification and Measurement*

IFRS 9, as issued, reflects the first phase of the IASB's work though the adoption date is subject to the recently issued Exposure Draft on the replacement of IAS 39 and applies to classification and measurement of financial assets and liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but Amendments to IFRS 9 Mandatory Effective Date of IFRS 9 and Transition Disclosures, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the Board will address impairment and hedge accounting. The Bank will quantify the effect of the adoption of the first phase of IFRS 9 in conjunction with the other phases, when issued, to present a comprehensive picture.

IFRS 10 - *Consolidated Financial Statements, IAS 27 Separate Financial Statements*

IFRS 10 replaces the portion of IAS 27 Consolidated and Separate Financial Statements that addresses the accounting for consolidated financial statements. It also addresses the issues raised in SIC-12 Consolidation - Special Purpose Entities.

IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgment to determine which entities are controlled and therefore are required to be consolidated by a parent, compared with the requirements that were in IAS 27. Based on the preliminary analyses performed, IFRS 10 is not expected to have any impact on the currently held investments of the Bank.

This standard becomes effective for annual periods beginning on or after 1 January 2013.

IFRS 11 - *Joint Arrangements*

The standard becomes effective for annual periods beginning on or after 1 January 2013. It replaces IAS 31 Interests in *Joint Ventures* and SIC 13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers*. Because IFRS 11 uses the principle of control in IFRS 10 to define control, the determination of whether joint control exists may change. The adoption of IFRS 11 is not expected to have a significant impact on the accounting treatment of investments currently held by the Bank.

IFRS 12 - *Disclosure of Involvement with Other Entities*

IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required, but has no impact on the Bank's financial position or performance. This standard becomes effective for annual periods beginning on or after 1 January 2013.

IFRS 13 - *Fair Value measurement*

The standard becomes effective for annual periods beginning on or after 1 January 2013. IFRS 13 does not change when an entity is required to use fair value, but rather, provides guidance on how to measure the fair value of financial and non-financial assets and liabilities when required or permitted by IFRS. There are also additional disclosure requirements. Adoption of the standard is not expected to have a material impact on the financial position or performance of the Bank.

2 SIGNIFICANT ACCOUNTING POLICIES *continued*

Standards issued but not yet effective *continued*

IAS 1 *Presentation of Items of Other Comprehensive Income – Amendments to IAS 1*
The amendments to IAS 1 change the grouping of items presented in other comprehensive income (OCI). Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, net gains on hedges of net investments, exchange differences on translation of foreign operations, net movements on cash flow hedges and net losses or gains on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, actuarial gains and losses on defined benefit plans). The amendment affects presentation only and has no impact on the Bank's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

IAS 19 *Employee Benefits (Revised)*
The amendments to IAS 19 remove the option to defer the recognition of actuarial gains and losses, i.e., the corridor mechanism. All changes in the value of defined benefit plans will be recognised in profit or loss and other comprehensive income. The effective date of the standard is 1 January 2013. Adoption of the amendments is not expected to have an impact on the Bank.

IAS 28 *Investments in Associates and Joint Ventures (as revised in 2011)*
As a consequence of the new IFRS 11 Joint Arrangements, and IFRS 12 Disclosure of Interests in Other Entities, IAS 28 Investments in Associates, has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. The revised standard becomes effective for annual periods beginning on or after 1 January 2013.

IAS 32 *Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32*
These amendments clarify the meaning of "currently has a legally enforceable right to set-off". The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. These amendments are not expected to impact the Bank's financial position or performance and become effective for annual periods beginning on or after 1 January 2014.

Annual Improvements May 2012

These improvements, which are effective for annual periods beginning on or after 1 January 2013, will not have an impact on the Bank, but include:

IFRS 1 *First-time Adoption of International Financial Reporting Standards*
This improvement clarifies that an entity that stopped applying IFRS in the past and chooses, or is required, to apply IFRS, has the option to re-apply IFRS 1. If IFRS 1 is not re-applied, an entity must retrospectively restate its financial statements as if it had never stopped applying IFRS.

IAS 1 *Presentation of Financial Statements*
This improvement clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative information is the previous period.

IAS 16 *Property Plant and Equipment*
This improvement clarifies that major spare parts and servicing equipment that meet the definition of property, plant and equipment are not inventory.

IAS 32 *Financial Instruments, Presentation*
This improvement clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 *Income Taxes*.

IAS 34 *Interim Financial Reporting*
The amendment aligns the disclosure requirements for total segment assets with total segment liabilities in interim financial statements. This clarification also ensures that interim disclosures are aligned with annual disclosures.

2 SIGNIFICANT ACCOUNTING POLICIES *continued*

Basis of consolidation
The consolidated financial statements comprise the financial statements of the Bank and those of its following subsidiaries:

	Activity	*Country of incorporation*	*Percentage of holding*	
			2012	*2011*
Mismak Properties Co. LLC (Mismak)	Real estate investments	United Arab Emirates	**100%**	100%
Radman Properties Co. LLC (subsidiary of Mismak)	Real estate investments	United Arab Emirates	**80%**	80%
First Merchant International LLC	Merchant banking services	United Arab Emirates	**100%**	100%
FGB Sukuk Company Limited	Special purpose vehicle	Cayman Islands	**100%**	100%
First Gulf Libyan Bank*	Banking services	Libya	**50%**	50%
First Gulf Properties LLC	Management and brokerage of real estate properties	United Arab Emirates	**100%**	100%

** Please refer to note 1*

Although the Bank owns 50% of the outstanding shares of First Gulf Libyan Bank, the investment has been classified as a subsidiary as the Bank exercises control over the investee because it casts the majority of the votes on the board of directors.

The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies. All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions that are recognised in assets, are eliminated in full.

Subsidiaries are fully consolidated from the date on which control is transferred to the Bank. The Bank exercises control over all of the subsidiaries listed above. Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the date of acquisition or up to the date of disposal, as appropriate. Losses within a subsidiary are attributed to the non-controlling interest even if that results in a deficit balance.

Non-controlling interests represent the portion of the profit and net assets in subsidiaries not held by the Bank and are presented separately in the consolidated income statement and within equity in the consolidated balance sheet, separately from the Bank shareholders' equity.

Due from banks
Due from banks are stated at amortised cost using the effective interest rate less any amounts written off and provision for impairment.

Trading investments
These are initially recognised at cost, being the fair value of the consideration given and subsequently remeasured at fair value. All related realised and unrealised gains or losses are included in the consolidated income statement.

Investments
These are classified as follows:
- Held to maturity
- Available for sale
- Investments carried at fair value through income statement

All investments are initially recognised at cost, being the fair value of the consideration given including acquisition charges (except for investments carried at fair value through the income statement) associated with the investment. Premiums and discounts on investments (excluding those carried at fair value through income statement) are amortised using the effective interest rate method and taken to interest income.

Held to maturity
Investments which have fixed or determinable payments and are intended to be held to maturity, are carried at amortised cost, less provision for impairment in value.

2 SIGNIFICANT ACCOUNTING POLICIES *continued*

Investments *continued*

Available for sale

After initial recognition, investments which are classified "available for sale" are remeasured at fair value, unless fair value cannot be reliably determined in which case they are measured at cost less impairment. Fair value changes which are not part of an effective hedging relationship are reported as a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as "cumulative changes in fair value" within equity, is included in the consolidated income statement.

Investments carried at fair value through income statement

Investments are classified as fair value through income statement if the fair value of the investment can be reliably measured and the classification as fair value through income statement is as per the documented strategy of the Bank. Investments classified as "Investments at fair value through income statement" upon initial recognition are remeasured at fair value with all changes in fair value being recorded in the consolidated income statement.

Investment in associates

The Bank's investment in associates is accounted for under the equity method of accounting. An associate is an entity in which the Bank has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in the associate is carried in the balance sheet at cost plus post-acquisition changes in the Bank's share of net assets of the associate. Losses in excess of the cost of the investment in an associate are recognised when the Bank has incurred obligations on its behalf. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The Bank's share of the result of operations of associates is included in the consolidated income statement. Unrealised profits and losses from transactions between the Bank and an associate are eliminated to the extent of the Bank's interest in the associate. The reporting dates of associates and the Bank are identical and the associates' accounting policies conform to those used by the Bank for like transactions and events in similar circumstances. After application of the equity method, the Bank determines whether it is necessary to recognise an additional impairment loss on the Bank's investment in associates. The Bank determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case then the Bank calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount in the "share of profits (losses) of associates" in the consolidated income statement.

Repurchase and reverse repurchase agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date ("Repo") are not derecognised. The counterparty liability for amounts received under these agreements is included in due to banks, customers' deposits and term loans in the consolidated balance sheet, as appropriate. The difference between the sale and repurchase price is treated as interest expense which is accrued over the life of the repo agreement using the effective interest rate.

Conversely, securities purchased under agreements to resell at a specified future date ("Reverse Repos") are not recognised on the consolidated balance sheet. The corresponding cash paid, including accrued interest, is included in loans and advances. The difference between the purchase price and resale prices is treated as interest income which is accrued, using the effective interest rate, over the life of the Reverse Repos.

Loans and advances

These are stated at amortised cost, adjusted for effective fair value hedges and stated net of interest suspended less any amounts written off and provision for impairment. Impaired loans are written off only when all possible courses of action to achieve recovery have proved unsuccessful. Amortised cost is calculated using the effective interest rate method.

Islamic financing

Islamic financing comprise principally of floating profit-rate Ijara and Murabaha contracts which are stated at cost less any provisions for impairment.

Impairment and uncollectibility of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, any impairment loss is recognised in the income statement.

Impairment is determined as follows:

(a) for assets carried at amortised cost, impairment is based on estimated cash flows discounted at the original effective interest rate.

(b) for assets carried at fair value, impairment is the difference between cost and fair value.

(c) for assets carried at cost, impairment is based on the present value of future cash flows discounted at the current market rate of return for a similar financial asset.

For available for sale equity investments, reversals of impairment losses are recorded as increases in cumulative changes in fair value through equity.

In addition, a provision is made to cover collective impairment for specific groups of assets carried at amortised cost, where there is a measurable decrease in estimated future cash flows.

Government grants

Government grants are recognised where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the Bank receives non-monetary grants with no conditions attached thereto, the asset and grant are recorded at fair value and the grant is recognised in the consolidated income statement in the period in which it is received. In the case of other non-monetary grants, the grant is set up as deferred income at its fair value and is released to the consolidated income statement over the expected useful life of the relevant asset by equal annual instalments.

Investment properties

Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at fair value which reflects market conditions at the balance sheet date. Gains or losses arising from changes in the fair values of investment properties are included in the consolidated income statement in the year in which they arise.

Investment properties are derecognised when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in the consolidated income statement in the year of retirement or disposal.

Transfers are made to or from investment property only when there is a change in use. For a transfer from properties held for sale, any difference between the fair value of the property at the date of transfer and its previous carrying amount shall be recognised in the consolidated income statement.

Property and equipment

Property and equipment are initially recorded at cost. The carrying amounts are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amount and, where carrying values exceed the recoverable amount, assets are written down. Land is measured at fair value based on valuations performed by independent professional valuers. Valuations are performed frequently to ensure that the fair value of revalued land does not differ materially from its carrying amount.

2 SIGNIFICANT ACCOUNTING POLICIES *continued*

Property and equipment *continued*
Any revaluation surplus is credited to the revaluation reserve included in the equity section of the consolidated statement of financial position, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in the consolidated income statement, in which case the increase is recognised in the consolidated income statement. A revaluation deficit is recognised in the consolidated income statement, except to the extent that it offsets an existing surplus on the same asset recognised in the revaluation reserve.

Depreciation is provided on a straight-line basis on all property and equipment, other than freehold land which is determined to have an indefinite life.

The estimated useful lives of the assets for the calculation of depreciation are as follows:

Buildings	20 years
Motor vehicles	3 years
Furniture, fixtures and equipment	4 years
Computer hardware and software	4 years

Capital work-in progress is initially recorded at cost, and upon completion is transferred to the appropriate category of property and equipment and thereafter depreciated.

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

Deposits
All money market and customer deposits are carried at amortised cost less amounts repaid.

Treasury shares
Own equity instruments which are acquired (treasury shares) are deducted from the equity and accounted for at weighted average cost. No gain or loss is recognised in the consolidated income statement on the purchase, sale, issue or cancelation of the Bank's own equity instruments. Any difference between the carrying amount and the consideration, if reissued, is recognised in share premium. If treasury shares are distributed as part of a bonus share issue, the cost of the shares is charged against retained earnings. Voting rights relating to treasury shares are nullified for the Bank and no dividends are allocated to them respectively.

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

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

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

2 SIGNIFICANT ACCOUNTING POLICIES *continued*

Revenue recognition *continued*
Interest income and expense continued
Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised.

Fee and commission income
The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

Fee income earned from services that are provided over a certain period of time
Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

Fee income from providing transaction services
Fees arising from negotiating or participating in the negotiation of a transaction for a third party – such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

Dividend income
Revenue is recognised when the Bank's right to receive the payment is established.

Net trading income
Results arising from trading activities include all gains and losses from changes in fair value and related interest income or expense and dividends for financial assets and financial liabilities held for trading. This includes any ineffectiveness recorded in hedging transactions.

Rental income
Rental income arising on investment properties is accounted for on a straight-line basis over the lease terms on ongoing leases and is recorded in the income statement in 'Other operating income'.

Income and expense from Islamic financing
Income and expense from Islamic financing is recognised on a time-proportion basis based on principal amounts outstanding.

Foreign currencies
Monetary assets and liabilities in foreign currencies are translated into AED at rates of exchange prevailing at the balance sheet date. Any gains and losses are taken to the consolidated income statement.

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 was determined.

As at the reporting date, the assets and liabilities of foreign operations are translated into the Bank's presentation currency at the rate of exchange ruling at the balance sheet date, and their income statements are translated at the weighted average exchange rates for the year. Exchange differences arising on translation are taken directly to a separate component of equity. On disposal of a foreign operation, the deferred cumulative amount recognised in the equity relating to a particular foreign operation is recognised in the consolidated income statement.

2 SIGNIFICANT ACCOUNTING POLICIES *continued*

Cash and cash equivalents
Cash and cash equivalents comprise cash, balances with U.A.E. Central Bank and due from banks and other financial institutions with original maturities of less than three months.

Employees' pension and end of service benefits
The Bank provides end of service benefits for its employees. The entitlement to these benefits is based upon the employees' length of service and completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

With respect to its UAE national employees, the Bank makes contributions to the relevant government pension scheme calculated as a percentage of the employees' salaries. The Bank's obligations are limited to these contributions, which are expensed when due.

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

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

Derivatives
The Bank enters into derivative financial instruments including forwards, swaps, futures, options and swaptions in the foreign exchange and capital markets. Derivatives are stated at fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the consolidated balance sheet.

Hedges
For the purposes of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (b) cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction.

In relation to fair value hedges which meet the conditions for hedge accounting, any gain or loss from re-measuring the hedging instrument to fair value is recognised immediately in the consolidated income statement. The hedged item is adjusted for fair value changes relating to the risk being hedged and the difference is recognised in the consolidated income statement.

In relation to cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised initially in equity and the ineffective portion is recognised in the consolidated income statement. The gains or losses on effective cash flow hedges recognised initially in equity are either transferred to the consolidated income statement in the period in which the hedged transaction impacts the consolidated income statement or included in the initial measurement of the cost of the related asset or liability.

For hedges which do not qualify for hedge accounting, any gains or losses arising from changes in the fair value of the hedging instrument are taken to the consolidated income statement.

2 SIGNIFICANT ACCOUNTING POLICIES *continued*

Hedges *continued*
Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, in the case of a cash flow hedge, any cumulative gains or losses on the hedging instrument initially recognised in equity remains in equity until the forecasted transaction occurs. Where the hedged transaction is no longer expected to occur, the net cumulative gains or losses initially recognised in equity are transferred to the consolidated income statement.

In the case of a fair value hedge, for hedged items recorded at amortised cost, using the effective interest rate method, the difference between the carrying value of the hedged item on termination and the face value is amortised over the remaining term of the original hedge. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the consolidated income statement.

Trade and settlement date accounting
Purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Bank commits to purchase or sell the asset.

Offsetting
Financial assets and financial liabilities are only offset and the net amount reported in the consolidated balance sheet when there is a legally enforceable right to set off the recognised amounts and the Bank intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

Taxes
Current income tax assets and liabilities for the current period are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date in the countries where the Bank operates and generates taxable income. Taxable profit differs from profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Financial guarantees
Financial guarantees are defined as contracts whereby an entity undertakes to make specific payments for a third party if the latter does not do so. Financial guarantees are reviewed periodically so as to determine the credit risk to which they are exposed and, if appropriate, to consider whether a provision is required. The credit risk is determined by application of criteria similar to those established for quantifying impairment losses on loans and advances. If a specific provision is required for financial guarantees, the related unearned commissions recognised under other liabilities in the consolidated balance sheet are reclassified to the appropriate provision.

De-recognition of financial assets and liabilities
The Bank de-recognises all or part of a financial asset when the contractual rights to the cash flows on the asset expire or when the Bank has transferred the contractual rights to receive the cash flows and substantially all of the risks and rewards linked to the ownership of the asset. The Bank de-recognises all or part of a financial liability when the liability is extinguished in full or in part.

Fair values
For investments and derivatives quoted in an active market, fair value is determined by reference to quoted market prices. Bid prices are used for assets and ask prices are used for liabilities. The fair value of investments in mutual funds, private equity funds or similar investment vehicles are based on the last net asset value published by the fund manager. For other investments, a reasonable estimate of the fair value is determined by reference to the price of recent market transactions involving such investments, current market value of instruments which are substantially the same, or is based on the expected discounted cash flows.

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount payable on demand.

2 SIGNIFICANT ACCOUNTING POLICIES *continued*

Fair values *continued*
The fair value of forward exchange contracts is calculated by reference to forward exchange rates with similar maturities. For other derivatives without quoted prices in an active market, fair value is determined based on quotations received from counter party financial institutions or established third party valuation models.

The fair value of unquoted investments is determined by reference to discounted cash flows, pricing models, net asset base of investee companies or broker over-the-counter quotes.

Significant accounting judgements and estimates
In the process of applying the Bank's accounting policies, management has used its judgements and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgments and estimates are as follows:

Going concern
The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

Classification of investment properties under construction
Management decides on acquisition of a property whether it should be classified as investment property, property and equipment or as properties held for sale.

Properties acquired by the Bank are recorded as investment properties if these were acquired for rental purposes or capital appreciation.

Properties held for own use is recorded as property and equipment.

Properties are recorded as held for sale, at cost, if their carrying amounts will be recovered through a sale transaction.

Classification of investments
Management decides on acquisition of an investment whether it should be classified as held to maturity, held for trading, carried at fair value through income statement, or available for sale.

For those deemed to be held to maturity, management ensures that the requirements of IAS 39 are met and in particular the Bank has the intention and ability to hold these to maturity.

The Bank classifies investments as trading if they are acquired primarily for the purpose of making a short term profit by the dealers.

Classification of investments as fair value through income statement depends on how management monitors the performance of these investments. When they are not classified as held for trading but have readily available reliable fair values and the changes in fair values are reported as part of profit or loss in the management accounts, they are classified as fair value through income statement.

All other investments are classified as available for sale.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES *continued*

Significant accounting judgements and estimates *continued*
Impairment of investments
The Bank treats available for sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires judgement for which management takes into consideration, amongst other factors, share price volatility and the underlying asset base of the investee companies.

Impairment losses on loans and advances
The Bank reviews its problem loans and advances on a quarterly basis to assess whether a provision for impairment should be recorded in the consolidated income statement. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

Collective impairment provisions on loans and advances
In addition to specific provisions against individually significant loans and advances, the Bank also makes a collective impairment provision against loans and advances which although not specifically identified as requiring a specific provision have a greater risk of default than when originally granted. The amount of the provision is based on the guidelines issued by the Central Bank of the UAE.

3 CASH AND BALANCES WITH U.A.E. CENTRAL BANK

	2012	*2011*
	AED 000	*AED 000*
Cash on hand	**312,431**	285,399
Balances with U.A.E. Central Bank	**12,531,905**	9,301,371
	12,844,336	9,586,770

Balances with U.A.E. Central Bank include AED 3,463,744 thousand (2011: AED 2,390,473 thousand) representing mandatory cash reserve deposits and AED 7,000,000 thousand (2011: AED 6,000,000 thousand) representing certificates of deposit. These are not available for use in the Bank's day-to-day operations.

4 LOANS AND ADVANCES

The composition of loans and advances portfolio is as follows:

	2012	*2011*
	AED 000	*AED 000*
Economic Sector		
Agriculture	**97,681**	110,190
Energy	**2,654,012**	1,367,416
Trading	**8,882,169**	7,654,632
Construction	**4,594,686**	4,740,364
Transport	**776,824**	906,138
Personal – Retail loans and credit cards	**27,739,675**	24,595,008
Personal – Retail mortgages	**1,906,686**	3,188,113
Personal – Retail mortgages - National Housing Loans (note 11)	**12,514,612**	10,369,369
Personal - Others	**2,822,194**	6,006,511
Government	**502,082**	338,857
Share financing	**2,664,954**	3,289,929
Real estate	**19,844,429**	19,521,812
Services	**17,673,798**	14,300,076
Public sector	**10,644,509**	9,206,874
Manufacturing	**5,077,919**	2,746,165
Total	**118,396,230**	108,341,454
Less provision for impaired loans and advances	**(3,751,751)**	(3,621,655)
Total	**114,644,479**	104,719,799
Representing:		
Conventional loans and advances	**109,395,525**	99,287,907
Islamic financing	**5,248,954**	5,431,892
Total	**114,644,479**	104,719,799

Loans and advances to customers are stated net of provision for impairment. The movements in the provision during the year were as follows:

	2012	*2011*
	AED 000	*AED 000*
At 1 January	**3,621,655**	3,294,783
Amounts written off	**(1,426,947)**	(1,132,968)
Recoveries (note 25)	**(158,600)**	(41,465)
Charge for the year (note 25)	**1,811,728**	1,594,556
Notional interest on impaired loans and advances (note 21)	**(96,085)**	(93,251)
At 31 December	**3,751,751**	3,621,655

At 31 December 2012, the provision for impaired loans and advances includes an amount of AED 149 million (2011: AED 62 million) in respect of loans and advances to subsidiaries of Dubai Holding of AED 456 million (2011: AED 621 million), which are in the process of being restructured. At 31 December 2012, other balances in accounts classified as impaired amounted to AED 3,449 million (2011: AED 3,681 million).

4 LOANS AND ADVANCES *continued*

In certain cases, the Bank continues to carry classified doubtful debts and delinquent accounts on its books even after making 100% provision for impairment. Where appropriate, interest is recorded and suspended on these accounts for legal considerations. Interest income on impaired loans is recognized in accordance with IAS 39: Financial Instruments: Recognition and Measurement. The notional interest on impaired loans and advances charged during the year amounted to AED 96,085 thousand (2011: AED 93,251 thousand).

During 2012, National Housing Loans increased by AED 2,979,555 thousand (2011: AED 2,850,112 thousand), which was partially offset by the waiver of AED 834,312 thousand (2011: AED 824,657 thousand) representing a discount of 25% (2011: 25%) granted to nearly 1,673 borrowers (2011: 1,700 borrowers) on the completion of their houses as directed by the Private Housing Loans Authority for Nationals. The amount waived was reduced from the corresponding Abu Dhabi Government deposit (note 11). This is a non-cash transaction which has been excluded from the statement of cash flows.

5 INVESTMENTS

	2012	*2011*
	AED 000	*AED 000*
Carried at fair value through income statement		
Investments in managed funds	**168,258**	152,932
Investments in equities - Quoted	**149,120**	197,153
- Unquoted	**19,178**	19,178
Debt securities	**159,765**	133,895
	496,321	503,158
Available for sale investments		
Investments in equities - Quoted	**28,599**	-
-Unquoted	**70,632**	464,887
Investments in private equity funds	**1,398,028**	1,379,359
Debt securities - Quoted	**4,008,194**	2,299,673
- Unquoted	**13,053**	138,210
Structured debt notes - Unquoted	**1,193,725**	485,460
	6,712,231	4,767,589
Held to maturity investments		
Debt securities - Quoted	**9,061,135**	11,172,251
- Unquoted	**1,008,579**	2,346,458
	10,069,714	13,518,709
Total	**17,278,266**	18,789,456
Analysis of debt securities:		
Fixed rate	**12,197,235**	14,113,062
Floating rate	**3,247,216**	2,462,885
	15,444,451	16,575,947

Geographic analysis of investments is as follows:

Within U.A.E.	**9,783,025**	8,429,634
Outside U.A.E.	**7,495,241**	10,359,822
	17,278,266	18,789,456

5 INVESTMENTS *continued*

Investments in managed funds represent investments made in managed hedge funds which invest in equities, debt securities and derivatives with the objective of generating superior returns on a risk-adjusted basis using a diversified portfolio approach.

Investments in private equity funds represent investments made in funds and limited partnerships to fund primary investment commitments in target companies with the objective of generating returns outperforming the public equity markets.

Investments in equities amounting to AED 5,697 thousand (2011: AED 23,123 thousand) are held in the name of third parties with the beneficial interest assigned to the Bank.

Debt securities represent bonds with maturities ranging up to 10 years from the balance sheet date. Of the debt securities at 31 December 2012, 55% (2011: 69%) comprise bonds which are either guaranteed by governments or issued by entities owned by governments.

At 31 December 2012, the Bank's largest holding of debt securities issued by a single issuer accounted for 12% (2011: 33%) of total debt securities.

At 31 December 2012, debt securities with a carrying value of AED 3,090,579 thousand (2011: AED 10,803,862 thousand) were pledged under repurchase agreements with overseas financial institutions and banks with a principal value of AED 2,987,738 thousand (2011: AED 10,355,860 thousand).

The fair value of held to maturity investments at 31 December 2012 amounted to AED 10,464,545 thousand (2011: AED 13,533,939 thousand).

All unquoted available for sale equities are recorded at fair value except for investments amounting to AED 2,272 thousand (2011: AED 2,453 thousand) which are recorded at cost since their fair values cannot be reliably estimated. There is no active market for these investments and the Bank intends to hold them for the long term.

During 2008, the Bank entered into an exchange agreement (the "Agreement") in respect of an investment it held in a quoted equity, whereby the rights and benefits to the investment were transferred to the counterparty of the Agreement in exchange for the payment of interest at the rate of EURIBOR plus 0.5% for the duration of the agreement of 5 years. Under the agreement, any appreciation or decline in value of the investment at maturity or termination of the agreement, if earlier, would be ceded to the counterparty. Accordingly, the investment in the quoted equity was de-recognised and the balance outstanding from the third party representing the value of the investment of Euro 260 million (equivalent to AED 1,406 million at the inception of the agreement) was recorded under other assets.

During 2011, the Bank, being the registered holder of the equity investment, participated in a rights issue offering by the investee, on behalf of the counterparty to the Agreement and purchased an additional investment with a total value of AED 128 million. During 2012, the Bank and the third party decided to unwind the originally signed agreement. The third party will return a specific number of shares to the Bank over a specified period of time. As a result, the Bank acquired certain number of shares during the year. The carrying amount of the interest bearing asset amounted to AED 689 million as at 31 December 2012 (2011: AED 1,358 million).

6 INVESTMENT IN ASSOCIATES

The Bank has the following investments in associates:

	Percentage of holding	
	2012	*2011*
First Gulf Financial Services LLC	**45%**	45%
Green Emirates Properties PJSC	**40%**	40%
Aseel Finance PJSC	**40%**	40%
Midmak Properties LLC	**16%**	16%

First Gulf Financial Services LLC ("FGFS"), is a limited liability company which is incorporated in the Emirate of Abu Dhabi and provides equity brokerage services in the United Arab Emirates.

Green Emirates Properties PJSC is a private joint stock company incorporated in the Emirate of Abu Dhabi and engaged mainly in the management and brokerage of real estate properties in United Arab Emirates and overseas.

Aseel Finance PJSC is a private joint stock company which is incorporated in the Emirate of Abu Dhabi and provides Islamic financial services.

Midmak Properties LLC ("Midmak") is a limited liability company incorporated in the Emirate of Abu Dhabi. Midmak is involved in real estate activities. Although the Bank owns 16% of the outstanding shares of Midmak, the investment has been classified as an associate as the Bank exercises significant influence due to representation of the Board of Directors.

Summarised financial information on investment in associates is set out below:

	2012	*2011*
	AED 000	*AED 000*
Share of associates' balance sheet		
Assets	**905,306**	1,087,086
Liabilities	**512,341**	643,276
Net assets	**392,965**	443,810
Carrying amount of investment in associates	**392,965**	443,810
Share of associates' revenue, profit and losses:		
Revenue	**73,045**	50,138
Profit (loss) for the year	**43,084**	(7,570)

As of 31 December 2012, the Bank's share of contingent liabilities of associates amounted to AED 330,008 thousand (2011: AED 332,692 thousand).

7 INVESTMENT PROPERTIES

	2012	2011
	AED 000	AED 000
Balance at 1 January	**7,537,900**	7,049,254
Additions	**532,539**	661,250
Disposals	**(360,887)**	(116,465)
Gain (loss) from fair value adjustment (note 23)	**62,260**	(56,139)
At 31 December	**7,771,812**	7,537,900

Investment properties are stated at fair value which represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation. As of 31 December 2011 and 2012, all investment properties were valued by independent professional valuers. The fair value of the properties has been determined either based on transactions observable in the market or based on a valuation model.

The property rental income earned by the Bank from its investment properties (note 23), that are leased out under operating leases, amounted to AED 67,284 thousand (2011: AED 51,438 thousand).

8 OTHER ASSETS

	2012	2011
	AED 000	AED 000
Interest receivable	**1,018,427**	921,020
Prepayments	**55,939**	40,133
Positive fair value of derivatives (note 30)	**678,263**	602,480
Receivable under equity swap (note 5)	**689,209**	1,357,808
Receivable from sale of investment properties	**27,788**	48,567
Others	**677,401**	587,011
Total	**3,147,027**	3,557,019

Receivable under equity exchange includes an interest bearing receivable arising from an equity exchange entered into by the Bank during 2008 (note 5).

9 PROPERTY AND EQUIPMENT

	Land AED 000	Buildings AED 000	Capital work-in progress AED 000	Motor vehicles AED 000	Furniture, fixtures and equipment AED 000	Computer hardware and software AED 000	Total AED 000
2012							
Cost or valuation:							
At 1 January 2012	264,018	341,245	31,765	1,685	102,151	162,329	903,193
Attributable to reconsolidation of subsidiary	-	8,985	-	662	4,222	3,753	17,622
Additions during the year	-	7,277	7,830	-	7,595	32,860	55,562
Transfers	-	39,595	(39,595)	-	-	-	-
Cost of disposals	-	-	-	-	(1,249)	(605)	(1,854)
At 31 December 2012	**264,018**	**397,102**	**-**	**2,347**	**112,719**	**198,337**	**974,523**
Depreciation:							
At 1 January 2012	-	84,828	-	606	81,444	116,052	282,930
Attributable to reconsolidation of subsidiary	-	2,732	-	194	1,204	1,595	5,725
Provided during the year	-	21,072	-	502	15,851	24,571	61,996
Disposals	-	-	-	-	(1,194)	(577)	(1,771)
At 31 December 2012	**-**	**108,632**	**-**	**1,302**	**97,305**	**141,641**	**348,880**
Net book value:							
At 31 December 2012	**264,018**	**288,470**	**-**	**1,045**	**15,414**	**56,696**	**625,643**
2011							
Cost or valuation:							
At 1 January 2011	253,665	340,297	14,529	1,739	89,683	147,885	847,798
Additions during the year	10,353	11,199	17,236	1,222	16,169	22,351	78,530
Cost of disposals	-	-	-	(500)	(1,451)	(3,488)	(5,439)
Attributable to deconsolidation of subsidiary	-	(10,251)	-	(776)	(2,250)	(4,419)	(17,696)
At 31 December 2011	264,018	341,245	31,765	1,685	102,151	162,329	903,193
Depreciation:							
At 1 January 2011	-	68,026	-	1,044	58,073	94,985	222,128
Provided during the year	-	18,759	-	285	25,214	25,735	69,993
Disposals	-	-	-	(500)	(1,294)	(3,423)	(5,217)
Attributable to deconsolidation of subsidiary	-	(1,957)	-	(223)	(549)	(1,245)	(3,974)
At 31 December 2011	-	84,828	-	606	81,444	116,052	282,930
Net book value:							
At 31 December 2011	264,018	256,417	31,765	1,079	20,707	46,277	620,263

10 DUE TO BANKS

	2012	2011
	AED 000	AED 000
Current and demand deposits	**35,681**	75,326
Deposits maturing within one year	**3,883,817**	8,172,010
Total	**3,919,498**	8,247,336

As of 31 December 2012, deposits maturing within one year amounted to nil (2011: AED 3,539,583 thousand) from banks held against the sale of debt securities with arrangements to repurchase them at a fixed future date.

11 CUSTOMERS' DEPOSITS

	2012	2011
	AED 000	AED 000
Current accounts	**13,694,403**	7,819,256
Saving accounts	**1,460,641**	1,172,633
Time deposits	**88,030,522**	80,091,121
Call and other deposits	**16,119,068**	14,390,723
Total	**119,304,634**	103,473,733

As of 31 December 2012, time deposits include deposits of AED 2,462,132 thousand (2011: AED 6,284,059 thousand) from overseas financial institutions held against the sale of debt securities with arrangements to repurchase them at a fixed future date.

In December 2006, the Bank received an initial deposit of AED 5 billion from the Government of Abu Dhabi (the "Government") to fund an interest-free housing loans scheme for UAE Nationals, which is recorded in call and other deposits. The scheme is being administered by the Bank based on various terms and conditions agreed with the Government. As of 31 December 2012, the Government time deposit amounted to AED 12,845 million (2011: AED 10,700 million) and housing loans (note 4) amounting to AED 12,515 million (2011: AED 10,369 million) were disbursed by the Bank. Interest is payable on this Government deposit at market rates based on the principal amount net of loan disbursements made.

During the year, the Abu Dhabi Government deposit increased by AED 2,978,698 thousand (2011: AED 2,771,065 thousand). The increase was partially offset by the waiver of AED 834,312 thousand (2011: AED 824,657 thousand) representing a discount of 25% (2011: 25%) granted to nearly 1,673 borrowers (2011: 1,700 borrowers) as further discussed in note 4. This is a non-cash transaction which has been excluded from the statement of cash flows.

As of 31 December 2012, the top 5 depositors accounted for 27 % of total customer deposits (2011: 27%).

12 TERM LOANS

	2012	2011
	AED 000	AED 000
Syndicated loan 1	**-**	3,030,225
Syndicated loan 2	**3,305,700**	-
Bank loans	**1,469,200**	2,111,975
Euro Medium Term Note	**2,387,450**	1,724,268
Federal Government loan	**4,510,087**	4,510,087
Medium term bonds	**1,202,728**	785,951
Repurchase agreements	**525,606**	532,218
	13,400,771	12,694,724

Syndicated Loan 1:
During 2007, the Bank obtained a loan of US$ 825 million (equivalent to AED 3,030 million) from a syndicate comprising of several foreign and local banks. The loan has been repaid in full on 29 November 2012.

Syndicated Loan 2:
On 6 December 2012, the Bank obtained a loan of US$ 900 million (equivalent to AED 3,306 million) from a syndicate comprising of several foreign and local banks. The loan is repayable in full in December 2015. The loan accrues interest at the rate of LIBOR plus a margin of 1.30% per annum plus a mandatory cost, if any, calculated by the facility agent as the weighted average of the lenders' additional cost rates. The loan is subject to various terms, covenants and conditions. Specifically, the Bank should ensure that its capital adequacy ratio shall not at any time be less than the Basel II minimum capital requirements as implemented in the U.A.E. under the guidelines of the Central Bank.

Bank Loans:
Bank loans comprise of several borrowings obtained from other commercial banks as follows:

Loan no.	*Year obtained*	*Loan amount US$ 000*	*Loan amount AED 000*	*Maturity*	*Interest*
1	2011	200,000	734,600	July 2013	Libor + 150 bps
2	2012	200,000	734,600	April 2014	Libor + 150 bps
		400,000	1,469,200		

During the year, bank loans amounting to US$ 375,000 thousand (AED 1,377,375 thousand) were repaid in full. Two bank loans amounting to US$ 150,000 thousand each (AED 550,950 thousand) were repaid on 26 April 2012 and 31 May 2012 respectively, and a further bank loan of US$ 75,000 thousand (AED 275,475 thousand) was repaid on 8 June 2012.

Euro Medium Term Note:
During 2009, the Bank issued a 3 year Euro Medium Term Note (EMTN) of US$ 500 million (equivalent to AED 1,837 million). The notes have been repaid in full on 26 November 2012.

On 9 October 2012, the Bank issued another Euro Medium Term Note (EMTN) of US$ 650 million (equivalent to AED 2,387 million) under the same EMTN programme. The notes are due in October 2017 and carry a coupon rate of 2.862% per annum payable semi-annually in arrears.

12 TERM LOANS *continued*

Federal Government Loan:
As of 31 December 2008, customer deposits included deposits of AED 4,510,087 thousand placed by the U.A.E. Federal Government (the "Lender") for a period of 3-5 years. During 2009, these deposits were re-categorised as a subordinated loan. The loan is eligible as Tier 2 Capital for the purposes of calculation of capital adequacy ratio as per the Basel II guidelines implemented by the Central Bank of the UAE.

As per the terms, the loan is subordinated to all creditors other than junior creditors and the equity shareholders of the Bank. The loan bears a fixed interest rate of 4% per annum for first two years and steps up to 4.5% per annum and 5% per annum in the third and fourth years and from fifth year onwards at 5.25% p.a. Interest is payable on a quarterly basis. The loan matures on 31 December 2016.

The agreement contains certain conditions relating to the Bank's minimum Tier 1 Capital requirement and also stipulates that the Lender has the right at its sole discretion to convert the loan amount together with accrued interest into share capital in case of breach of agreement by the Bank.

The Bank has the option at any time during the option period to repay the loan in whole or in part subject to meeting certain conditions.

Medium Term Bonds:
On 16 February 2011, the Bank issued 5 year bonds of CHF 200 million (equivalent of AED 801 million). The bonds are due in February 2016 and carry a coupon rate of 3% per annum payable annually in arrears.

On 27 November 2012, the Bank issued CHF 100 million bonds (equivalent of AED 401 million). The bonds are due in January 2016 and carry a coupon at the rate of 3 months CHF LIBOR plus a margin of 1.15% per annum payable quarterly in arrears.

Repurchase Agreements:
During 2010, the Bank entered into several transactions with a foreign bank to obtain financing against the sale of debt securities amounting to AED 532,218 thousand with arrangements to repurchase them at a fixed future date. The amount and maturity of outstanding transactions are as follows:

No.	*Amount US$ 000*	*Amount AED 000*	*Maturity*
1	18,000	66,114	1-August-2013
2	54,900	201,648	8-April-2014
3	13,500	49,585	8-October-2014
4	40,500	148,756	25-October-2017
5	7,200	26,446	1-August-2018
6	9,000	33,057	8-April-2019
	143,100	**525,606**	

The Bank has not had any defaults of principal, interest or other breaches with regard to all borrowings during the year ended 31 December 2012 and the year ended 31 December 2011.

13 SUKUK FINANCING INSTRUMENTS

In August 2011, the Bank raised financing by way of a sukuk issued by FGB Sukuk Company Limited (a special purpose vehicle) amounting to US$ 650 million (equivalent to AED 2,387 million) and maturing in August 2016 (the Sukuk). The Sukuk carries a fixed profit rate of 3.797 percent per annum payable semi annually and is listed on the London Stock Exchange. The Sukuk was the inaugural issuance under the US$ 3.5 billion trust certificate issuance programme. Pursuant to the sukuk structure, FGB Sukuk Company Limited (as Rab-ul-Maal and Trustee) will receive certain payments from the Bank (as mudareb of certain mudaraba assets and wakeel of certain wakala assets). FGB Sukuk Company Limited will use such amounts received from the Bank to discharge its payment obligations under the Sukuk. Such payment obligations of the Bank rank pari passu with all other senior unsecured obligations of the Bank.

On 18 January 2012, the Bank issued its second tranche of trust certificates amounting to US$ 500 million (equivalent to AED 1,836 million) due in January 2017 under the same trust certificate issuance program. The Sukuk carries a fixed profit rate of 4.046 percent per annum payable semi annually and is listed on the London Stock Exchange.

14 OTHER LIABILITIES

	2012 ***AED 000***	*2011* *AED 000*
Interest payable	**677,614**	449,549
Accrued expenses	**196,507**	182,077
Provisions for staff benefits (note 15)	**251,689**	226,554
Accounts payable and sundry creditors	**1,014,498**	815,046
Advances received on sale of investment properties	**956,802**	1,148,180
Payable in respect of acquisition of investment properties	**229,227**	231,356
Negative fair value of derivatives (note 30)	**852,009**	742,369
Others	**143,320**	114,847
Total	**4,321,666**	3,909,978

15 PROVISION FOR STAFF BENEFITS

The movement in the provision was as follows:

	2012 ***AED 000***	*2011* *AED 000*
At 1 January	**226,554**	214,834
Arising during the year	**182,549**	161,895
Utilised	**(157,414)**	(150,175)
At 31 December	**251,689**	226,554

16 SHARE CAPITAL

	Authorized, issued and fully paid	
	2012	*2011*
	AED 000	*AED 000*
Ordinary shares of AED 1 each	**3,000,000**	1,500,000

In its meeting held on 30 January 2012, the Board of Directors of the Bank resolved to distribute 1,500 million shares amounting to AED 1,500 million to shareholders of the Bank as bonus shares. The resolution was approved by the shareholders of the Bank in the Annual General Meeting held on 29 February 2012.

17 TREASURY SHARES

During 2008, the Bank received an approval from the Securities & Commodities Authority of the United Arab Emirates to buy back up to 137.5 million of its own shares. As part of the scheme, the Bank accumulated a total of 75 million shares as at 31 December 2010.

In its meeting held on 6 January 2011, the Board of Directors of the Bank resolved to propose the distribution of the 75 million shares acquired until 31 December 2010 and pay dividends on those, to the shareholders and the holders of the Bank's mandatory convertible bonds of the Bank, on their conversion. The proposal was subsequently approved by the shareholders in their ordinary General Assembly held on 9 March 2011.

18 CAPITAL NOTES

Following approval of the Extraordinary General Assembly meeting held on 25 February 2009, the Board of Directors resolved on 26 February 2009 to issue capital notes (the "Notes") to the Department of Finance, Government of Abu Dhabi amounting to AED 4 billion. The Notes are subject amongst other terms, to the following:

- The Notes have a par value of AED 10 million each;
- The Notes are perpetual securities in respect of which there is no fixed redemption date;
- The Notes constitute direct, unsecured and subordinated obligations of the Bank;
- The Notes holder is entitled to a non-cumulative semi-annual fixed interest coupon at the rate of 6% per annum until February 2014 and floating interest rate of EIBOR plus 2.3% per annum thereafter. The Bank may at its sole discretion elect not to make an interest coupon payment. Any interest payment made will be reflected in the statement of changes in equity. During the year, interest payments amounted to AED 240 million (2011: AED 240 million).

19 APPROPRIATIONS

Legal reserve
In accordance with the U.A.E. Commercial Companies Law No. 8 of 1984 (as amended) and the Articles of Association of the Bank, 10% of profit for the year of the Bank shall be transferred to the legal reserve until it reaches 50% of the nominal value of the paid up share capital. The early conversion of the mandatory convertible bonds during 2011 resulted in an increase to the legal reserve by AED 3,475 million (note 20). As the legal reserve exceeds 50% of the share capital, no further transfers from the net profit are made to the legal reserve. The legal reserve is not available for distribution.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2012

19 APPROPRIATIONS *continued*

Special reserve
As required by Article 82 of Union Law No 10 of 1980, 10% of the profit for the year shall be transferred to the special reserve. The Bank may resolve to discontinue such annual transfers when the reserve equals 50% of the nominal value of the paid up share capital. The special reserve is not available for distribution.

General reserve
Transfers to the general reserve are made upon the recommendation of the Board of Directors. This reserve may only be used for the purposes recommended by the Board of Directors and approved by the shareholders.

No transfers are proposed by the Board of Directors (2011: AED nil) from the profit for the year to the general reserve.

Dividends

	2012	*2011*
	AED 000	*AED 000*
Cash dividends proposed in respect of 2012: 0.83 fils (2011: Declared AED 1)	**2,500,000**	1,500,000
Bonus shares proposed in respect of 2012: nil (2011: Declared AED 1)	**-**	1,500,000
Dividend on ordinary shares paid during the year	**1,479,818**	864,830

20 MANDATORY CONVERTIBLE BONDS

During 2011, the Board of Directors of the Bank approved a plan to early convert the mandatory convertible bonds. The Bank obtained the approval of all the bondholders and, as a result, early converted the bonds during February 2011. The conversion resulted in the following:

- The share capital of the Bank increased by AED 125 million, representing the par value of AED 1 for 125 million newly issued shares.
- The legal reserve of the Bank increased by AED 3,475 million, representing the share premium on those additional new shares.

The Board of Directors resolved to pay interest of AED 81,462 thousand in two phases as follows: AED 59,490 thousand until 22 January 2011 and AED 21,972 thousand for the period from 23 January 2011 until the bonds converted on 20 February 2011.

21 INTEREST INCOME AND INCOME FROM ISLAMIC FINANCING

	2012	*2011*
	AED 000	*AED 000*
Interest income		
Loans and advances	**6,600,365**	6,248,111
Deposits with banks and financial institutions	**172,145**	115,310
Investment securities	**487,319**	305,188
Notional interest on impaired loans and advances (note 4)	**96,085**	93,251
Total	**7,355,914**	6,761,860
Income from Islamic financing	**288,574**	311,477
Interest income and income from Islamic financing	**7,644,488**	7,073,337

22 INTEREST EXPENSE AND ISLAMIC FINANCING EXPENSE

	2012 AED 000	2011 AED 000
Interest expense		
Customers' deposits	**1,349,852**	1,464,233
Bank deposits	**50,343**	47,941
Term loans	**367,383**	342,953
Total	**1,767,578**	1,855,127
Islamic financing expense	**356,526**	139,319
Interest expense and Islamic financing expense	**2,124,104**	1,994,446

23 OTHER OPERATING INCOME

	2012 AED 000	2011 AED 000
Investment income:		
Gains on disposal of available for sale investments	**51,766**	58,229
Gains on disposal of investments carried at fair value through income statement	**15,298**	18,921
Change in fair value of investments carried at fair value through income statement	**456**	(23,660)
Other investment income	**9,855**	9,683
Total investment income	**77,375**	63,173
Commission income	**502,107**	460,696
Fee income	**475,773**	486,564
Fees and commissions on credit cards	**299,133**	253,938
Brokerage and fund management fee income	**22,885**	11,021
Foreign exchange income	**79,045**	68,727
Derivative income (loss)	**40,445**	(25,805)
Gain (loss) on revaluation of investment properties (note 7)	**62,260**	(56,139)
(Loss) gain on sale of investment properties	**(10,095)**	13,863
Loss on sale of property and equipment	**(42)**	(29)
Rental income (note 7)	**67,284**	51,438
Other income	**90,133**	84,114
Total	**1,706,303**	1,411,561

24 GENERAL AND ADMINISTRATIVE EXPENSES

	2012 AED 000	2011 AED 000
Staff costs	**685,486**	570,822
Depreciation (note 9)	**61,996**	69,993
Other general and administrative expenses	**678,413**	581,666
Total	**1,425,895**	1,222,481
Number of employees	**1,112**	930

25 PROVISION FOR IMPAIRMENT OF LOANS AND ADVANCES

	2012 AED 000	2011 AED 000
Provision for impaired loans and advances (note 4)	**1,811,728**	1,594,556
Recoveries (note 4)	**(158,600)**	(41,465)
	1,653,128	1,553,091

26 BASIC AND DILUTED EARNINGS PER SHARE

Basic earnings per share amounts for the year are calculated by dividing profit for the year attributable to ordinary equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share amounts are calculated by dividing the net profit attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the year, adjusted for the effects of dilutive instruments.

The following reflects the income and share data used in the earnings per share computations:

	2012	2011
Profit for the year attributable to ordinary equity holders (AED 000)	**4,154,345**	3,707,275
Deduct: Interest on mandatory convertible bonds (AED 000)	**-**	(28,724)
Deduct: Interest on capital notes (AED 000)	**(156,973)**	(240,000)
Profit attributable to ordinary equity holders (AED 000)	**3,997,372**	3,438,551
Weighted average number of ordinary shares in issue (000's)	**3,000,000**	2,986,027
Basic and diluted earnings per share (AED)	**1.33**	1.15

Shares related to mandatory convertible bonds are included in the weighted average number of ordinary shares from the date the related bonds were issued. Treasury shares are excluded from the date they were purchased.

27 CASH AND CASH EQUIVALENTS

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

	2012	2011
	AED 000	AED 000
Cash and balances with U.A.E. Central Bank	**12,844,336**	9,586,770
Due from banks and financial institutions	**18,329,081**	12,225,320
	31,173,417	21,812,090
Less: Balances with U.A.E. Central Bank maturing after three months of placement	**7,000,000**	6,000,000
Less: Due from banks and financial institutions maturing after three months of placement	**3,389,272**	5,560,935
Cash and cash equivalents	**20,784,145**	10,251,155

Geographic analysis of due from banks and financial institutions is as follows:

Within U.A.E	**6,464,070**	5,050,815
Outside U.A.E	**11,865,011**	7,174,505
	18,329,081	12,225,320

28 RELATED PARTY TRANSACTIONS

In the ordinary course of its activities, the Bank enters into transactions with related parties, comprising directors, major shareholders, key management and their related concerns, at commercial interest and commission rates. The Bank obtains collateral, including charges over real estate properties and securities, the extent of which is dependent on the Bank's assessment of the credit risk of the related party. All loans and advances to related parties are performing advances and are free of any provision for impaired loans and advances.

The following transactions have been entered into with related parties:

	2012	2011
	AED 000	AED 000
Board members, key management personnel and associated companies		
Loans and advances	**6,368,904**	12,496,815
Customers' deposits	**3,823,330**	4,455,742
Commitments and contingent liabilities	**875,672**	3,152,485
Interest and commission income	**316,355**	747,152
Interest expense and Islamic financing expense	**85,643**	128,919
Associates		
Loans and advances to customers	**876,290**	977,090
Customers' deposits	**95,046**	477,802
Commitments and contingent liabilities	**756,263**	762,973
Interest and commission income	**44,315**	40,296
Interest expense and Islamic financing expense	**3,314**	4,412

28 RELATED PARTY TRANSACTIONS *continued*

	2012	2011
	AED 000	AED 000
Compensation of key management personnel:		
Short term employee benefits	**89,569**	76,696
Post employment benefits	**12,617**	9,199

In addition to amounts disclosed above, Board of Directors remuneration amounting to AED 28,000 thousand (2011: AED 28,000 thousand) has been included in the consolidated statement of comprehensive income and is subject to the approval of the shareholders at the forthcoming Annual General Meeting.

29 COMMITMENTS AND CONTINGENT LIABILITIES

The Bank has the following commitments and contingent liabilities at 31 December:

	2012	2011
	AED 000	AED 000
Contingent liabilities:		
Acceptances	**4,456,375**	2,320,093
Letters of credit	**25,696,127**	21,785,762
Guarantees	**43,541,455**	43,247,654
	73,693,957	67,353,509
Commitments:		
Commitments to extend credit maturing within one year	**2,943,782**	2,071,904
Commitments for future capital expenditure	**1,430,169**	1,905,625
Commitments for future private equity investments	**517,583**	639,808
	4,891,534	4,617,337
Total commitments and contingent liabilities	**78,585,491**	71,970,846

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

Letters of credit, guarantees and acceptances commit the Bank to make payments on behalf of customers in the event of a specific act such as the export or import of goods or upon the failure of the customer to perform under the terms of a contract. These contracts would have market risk if issued or extended at a fixed rate of interest. However, these contracts are primarily made at a floating rate.

Commitments to extend credit represent contractual irrevocable commitments to make loans and revolving credits. Commitments generally have fixed expiry dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

30 DERIVATIVES

The table below shows the positive and negative fair values of derivative financial instruments, together with the notional amounts analysed by term to maturity. The notional amount is the amount of a derivative's underlying asset and liabilities, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at year end and are neither indicative of the market risk nor credit risk.

	Positive fair value AED 000	*Negative fair value AED 000*	*Notional amount Total AED 000*	***Notional amounts by term to maturity*** *Within 3 months AED 000*	*3-12 months AED 000*	*1-5 years AED 000*	*More than 5 years AED 000*
At 31 December 2012							
Derivatives held for trading:							
Forward foreign exchange contracts	**65,472**	**61,078**	**26,016,703**	**13,442,784**	**12,119,781**	**454,138**	**-**
Interest rate swaps, caps and collars	**453,488**	**553,282**	**13,997,867**	**2,022,851**	**256,994**	**4,476,343**	**7,241,679**
Credit default swaps	**102**	**-**	**73,460**	**73,460**	**-**	**-**	**-**
Commodity linked swaps	**-**	**31,605**	**734,600**	**-**	**-**	**734,600**	**-**
Equity swaps	**-**	**-**	**158,434**	**-**	**-**	**-**	**158,434**
Swaptions	**12,421**	**12,421**	**1,469,200**	**-**	**-**	**-**	**1,469,200**
Options	**10,578**	**11,875**	**6,603,216**	**950,560**	**2,261,951**	**3,390,705**	**-**
Futures	**1,322**	**-**	**1,209,222**	**1,174,169**	**35,053**	**-**	**-**
	543,383	**670,261**	**50,262,702**	**17,663,824**	**14,673,779**	**9,055,786**	**8,869,313**
Derivatives held as a fair value hedge:							
Interest rate swaps	**3,920**	**131,670**	**2,714,659**	**200,000**	**-**	**400,000**	**2,114,659**
Cross currency swaps	**130,960**	**50,078**	**2,037,269**	**-**	**-**	**1,661,711**	**375,558**
	134,880	**181,748**	**4,751,928**	**200,000**	**-**	**2,061,711**	**2,490,217**
Total	**678,263**	**852,009**	**55,014,630**	**17,863,824**	**14,673,779**	**11,117,497**	**11,359,530**
At 31 December 2011							
Derivatives held for trading:							
Forward foreign exchange contracts	50,768	45,459	12,954,483	10,062,047	2,218,691	673,745	-
Interest rate swaps, caps and collars	442,705	600,551	19,121,379	734,600	1,157,585	4,471,324	12,757,870
Credit default swaps	345	1,771	173,460	-	100,000	73,460	-
Commodity linked swaps	-	32,280	734,600	-	-	734,600	-
Equity swaps	-	-	157,633	-	-	-	157,633
Options	8,741	10,677	1,778,693	895,913	344,776	538,004	-
Futures	439	-	211,442	211,442	-	-	-
	502,998	690,738	35,131,690	11,904,002	3,821,052	6,491,133	12,915,503
Derivatives held as a fair value hedge:							
Interest rate swaps	4,013	51,631	600,000	-	-	600,000	-
Cross currency swaps	95,469	-	1,471,646	-	-	1,096,088	375,558
Total	602,480	742,369	37,203,336	11,904,002	3,821,052	8,187,221	13,291,061

Derivative product types

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

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency. For currency swaps, fixed or floating interest payments as well as notional amounts are exchanged in different currencies.

Credit default swaps transfer the credit exposure of debt securities between parties. The buyer of a credit default swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. Accordingly, the risk of default is transferred from the holder of the debt security to the seller of the swap.

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

30 DERIVATIVES *continued*

Derivative product types continued

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Bank. The Bank enters into derivative contracts with a number of financial institutions of good credit rating.

Derivatives held for trading purposes

Most of the Bank's derivative trading activities relate to offering products to customers at competitive prices in order to enable them to transfer, modify or reduce current and expected risks and manage their market positions with the expectation of making profit from favourable movements in prices or rates.

Derivatives held for hedging purposes

As part of its asset and liability management the Bank uses derivatives for hedging purposes in order to reduce its exposure to interest rate risks.

The total loss on interest rate swaps held as fair value hedges amounted to AED 120,059 thousand (2011: gain of AED 92,953 thousand). A corresponding loss / gain has been adjusted against the carrying value of the related hedged asset.

31 SEGMENTAL INFORMATION

A segment represents a distinguishable component of the Bank that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Operating segment information

For management purposes the Bank is organised into five operating segments:

Corporate banking - Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers and high net worth individuals.

Treasury, including investment operations - Principally providing money market, trading and treasury services, as well as the management of the Bank's funding operations by use of government securities and placements and deposits with other banks.

Retail banking - Principally handling individual customers' deposits, and providing consumer type loans, overdrafts, credit cards facilities and funds transfer facilities.

Real estate activities – Principally the acquisition, leasing, brokerage, management and resale of properties carried out through its subsidiaries and associate companies.

Other operations comprising mainly the Head Office including unallocated costs, subsidiaries and associates other than above categories.

31 SEGMENTAL INFORMATION *continued*

Operating segmental information for the year ended 31 December 2012 was as follows:

	Corporate banking AED 000	*Treasury AED 000*	*Retail banking AED 000*	*Real estate AED 000*	*Other operations AED 000*	*Total AED 000*
Assets	**68,110,862**	**44,728,622**	**41,191,577**	**9,403,617**	**11,598,931**	**175,033,609**
Liabilities	**98,271,120**	**5,292,473**	**26,766,312**	**1,386,108**	**13,454,506**	**145,170,519**
Operating income excluding associates	**2,744,286**	**810,403**	**2,967,982**	**201,102**	**502,914**	**7,226,687**
Net interest income and income from Islamic financing	**1,981,037**	**665,745**	**2,526,238**	**-**	**347,364**	**5,520,384**
Share of profit from associates	**-**	**-**	**-**	**25,435**	**17,649**	**43,084**
Provision for impairment of loans and advances	**(577,608)**	**-**	**(508,903)**	**-**	**(566,617)**	**(1,653,128)**
Profit attributable to equity holders of the Bank	**1,836,778**	**741,420**	**1,767,200**	**189,250**	**(380,303)**	**4,154,345**
Other segment information						
Investment in associates	**-**	**-**	**-**	**139,328**	**253,637**	**392,965**
Capital expenditure	**-**	**-**	**-**	**532,551**	**55,550**	**588,101**
Depreciation	**-**	**-**	**-**	**3,373**	**58,623**	**61,996**

Operating segment information for the year ended 31 December 2011 was as follows:

	Corporate banking AED 000	*Treasury AED 000*	*Retail banking AED 000*	*Real estate AED 000*	*Other operations AED 000*	*Total AED 000*
Assets	64,064,723	37,925,241	37,256,940	7,930,275	10,303,158	157,480,337
Liabilities	85,024,629	15,266,336	19,535,131	1,562,133	9,324,992	130,713,221
Operating income excluding associates	2,631,516	564,702	2,914,321	88,320	291,593	6,490,452
Net interest income and income from Islamic financing	1,971,347	504,952	2,377,956	-	224,636	5,078,891
Share of losses of associates	-	-	-	(23,226)	15,656	(7,570)
Provision for impairment of loans and advances	(674,725)	(86)	(681,065)	-	(197,215)	(1,553,091)
Profit attributable to equity holders of the Bank	1,671,868	509,321	1,626,502	43,831	(144,247)	3,707,275
Other segment information						
Investment in associates	-	-	-	195,356	248,454	443,810
Capital expenditure	-	-	-	676,627	63,153	739,780
Depreciation	-	-	-	10,016	59,977	69,993

The Bank's operations in UAE contribute the majority of its revenues. Also, the Bank's non-current assets in UAE represent a significant portion of its total non-current assets.

32 RISK MANAGEMENT

32.1 Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to operating risks.

Risk management structure

In line with the best practice followed in world class financial institutions the overall risk management responsibility lies with the Board of Directors of the Bank under which there is a Risk and Compliance Committee (RCMC) comprising of three board members and the Chief Risk Officer who take the responsibility for identifying and controlling the risks.

Board of Directors

The overall risk management responsibility lies with the Board of Directors of the Bank. They provide the direction, strategy and oversee all the activities through various committees.

Audit Committee

The Audit Committee comprises two independent members who represent the Board of Directors of the Bank. The committee has the overall responsibility of assessing the internal audit findings, directing implementation of audit recommendations and overseeing the internal audit activities undertaken within the internal control environment and regulatory compliance framework of the Bank. Duties and responsibilities of the Audit Committee are governed by a formally approved Audit Committee Charter which is in line with best practice and control governance.

Risk & Compliance Management Committee (RCMC)

The RCMC comprises two independent members who represent the Board of Directors of the Bank. The objective of RCMC is to assist the Board of Directors in fulfilling its corporate governance and oversight responsibilities by establishing, monitoring and reviewing internal control, compliance and risk management processes and systems within the Bank.

Asset Liability Committee (ALC)

Asset Liability Management (ALM) process is an act of planning, acquiring, and directing the flow of funds through an organization. The ultimate objective of this process is to generate adequate and stable earnings and to steadily build an organization's equity over time, while taking measured business risks. The bank has a well defined ALM policy duly describing the objective, role and function of Asset Liability Committee (ALCO). This process revolves around ALCO, the body within the Bank that holds the responsibility to make strategic decisions to manage balance sheet related risks. The ALCO consisting of the bank's senior management including the Managing Director (MD) and Chief Executive Officer (CEO) meets at least once a month.

Credit Committee

All the business proposals of clients are approved through a committee empowered by the Executive Committee of the bank through the CEO. The Bank has a Credit Committee which approves all the funded and non funded limits. The committee consists of senior management personnel including the CEO. The approval process and the authorities vested with the committee members are well defined in a credit policy manual. The policy manual enumerates various procedures to be followed by a relationship manager in bringing a relationship to the Bank. Various aspects of the credit approval process have been defined in the policy which enables efficient approval of the proposals.

32 RISK MANAGEMENT *continued*

32.1 Introduction *continued*

Risk management structure *continued*

Investment and Management Committee (IMCO)
Investment and Management Committee (IMCO) is a management level committee with representations from investment, financial control and risk management functions. This committee is entrusted with the responsibility of approving limits for investments and in approving individual investment proposals within those limits. It ensures that the investment decisions conform to the guidelines laid down in the investment policy of the Bank and are within overall limits prescribed by the Board of Directors. The committee meets to discuss new proposals for investments as well as analyse the performance of existing investments. The committee also sets guidelines for investments.

Risk Management Unit (RMU)
RMU is an independent unit reporting to the CEO and the RCMC. RMU is responsible for identifying, measuring, monitoring and controlling the risks arising out of various activities in the Bank by the different business units. The process is through partnering with the units in identifying and addressing the risks by setting limits and reporting on the utilization thereof.

RMU also monitors compliance with the regulatory procedures and anti-money laundering monitoring procedures of the Bank.

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

Internal Audit
Risk management processes throughout the Bank are audited annually by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee. The Head of Internal Audit has direct reporting lines to the Audit Committee in securing his independence and objectivity in all audit engagements undertaken within the Bank.

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

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the RCMC, and the head of each business division. The report includes aggregate credit exposure, limit exceptions and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the provision for credit losses on a quarterly basis. RCMC receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

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

32 RISK MANAGEMENT *continued*

32.1 Introduction *continued*

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

The risk profile is assessed before entering into hedge transactions, which are authorized by the appropriate level of seniority within the Bank. The effectiveness of hedges is assessed by the RMU. The effectiveness of all the hedge relationships is monitored by the RMU monthly. In situations of ineffectiveness, the Bank will enter into a new hedge relationship to mitigate risk on a continuous basis.

The Bank actively uses collateral to reduce its credit risks.

Risk concentration
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 the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographic location.

The Bank seeks to manage its credit risk exposure through diversification of lending activities to avoid undue concentrations of risks with individuals or groups of customers in specific industries or businesses.

Details of the composition of the loans and advances portfolio are provided in note 4. Information on credit risk relating to investments is provided in note 32.2.

32.2 Credit risk
Credit risk 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. The Bank attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties. 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 has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Derivative financial instruments
Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the balance sheet.

Credit-related commitments risks
The Bank makes available to its customers guarantees which may require that the Bank makes payments on their behalf. Such payments are collected from customers based on the terms of the letters of guarantee. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

32 RISK MANAGEMENT *continued*

32.2 Credit risk *continued*

Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Notes	***Gross maximum exposure 2012 AED 000***	*Gross maximum exposure 2011 AED 000*
Balances with U.A.E. Central Bank	3	**12,531,905**	9,301,371
Due from banks and financial institutions	27	**18,329,081**	12,225,320
Loans and advances	4	**114,644,479**	104,719,799
Investments	5	**15,444,451**	16,575,947
Other assets	8	**3,091,088**	3,516,886
Total		**164,041,004**	146,339,323
Derivatives held for trading			
Forward foreign exchange contracts	30	**65,472**	50,768
Interest rate swaps, caps and collars	30	**453,488**	442,705
Credit default swaps	30	**102**	345
Equity swaps	30	**-**	-
Swaptions	30	**12,421**	-
Options	30	**10,578**	8,741
Futures	30	**1,322**	439
		543,383	502,998
Derivatives held as a fair value hedge:			
Interest rate swaps	30	**3,920**	4,013
Cross currency swaps	30	**130,960**	95,469
Total		**134,880**	99,482
Contingent liabilities	29	**73,693,957**	67,353,509
Commitments	29	**2,943,782**	2,071,904
Total		**76,637,739**	69,425,413
Total credit risk exposure		**241,357,006**	216,367,216

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

32 RISK MANAGEMENT *continued*

32.2 Credit risk *continued*

Credit risk concentration

Concentration of risk is managed by customer/counterparty, by geographical region and by industry sector. The funded and non funded credit exposure to the top 5 borrowers as of 31 December 2012 was AED 20,693,105 thousand (2011: AED 21,635,329 thousand) before taking account of collateral or other credit enhancements and AED 14,277,312 thousand (2011: AED 13,756,283 thousand), net of such protection.

The distribution of the Bank's financial assets by geographic region and industry sector is as follows:

	2012 AED 000	*2011 AED 000*
Geographic region		
UAE	**134,477,889**	122,479,496
Other Arab countries	**9,982,822**	3,028,614
Europe	**6,833,806**	7,114,204
USA	**2,468,539**	6,994,229
Rest of the world	**10,277,948**	6,722,780
Financial assets subject to credit risk	**164,041,004**	146,339,323
Other assets	**10,992,605**	11,141,014
Total assets	**175,033,609**	157,480,337
Industry sector		
Commercial and business	**78,455,000**	72,162,149
Personal	**41,191,577**	37,256,940
Government	**16,551,305**	15,838,757
Banks and financial institutions	**25,497,589**	18,579,245
Others	**2,345,533**	2,502,232
Financial assets subject to credit risk	**164,041,004**	146,339,323
Other assets	**10,992,605**	11,141,014
Total assets	**175,033,609**	157,480,337

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For repurchase and reverse repurchase transactions, cash or securities,
- For commercial lending, charges over real estate properties, inventory, trade receivables and securities,
- For personal lending, assignment of salaries in favour of the Bank.

The Bank also obtains guarantees from parent companies for loans to their subsidiaries, but the benefits are not included in the above table.

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

32 RISK MANAGEMENT *continued*

32.2 Credit risk *continued*

Collateral and other credit enhancements *continued*
It is the Bank's policy to dispose of repossessed assets, other than investment properties, in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Bank does not occupy repossessed properties for business use.

The Bank also makes use of master netting agreements with counterparties.

At 31 December 2012, the fair value of collateral that the Bank holds relating to loans individually determined to be impaired amounts to AED 562,314 thousand (2011: AED 698,194 thousand). The collateral consists of cash, securities, letters of guarantee and properties.

Credit quality per class of financial assets
The credit quality of financial assets is managed by the Bank using internal credit ratings. The table below shows the credit quality by class of asset, based on the Bank's credit rating system. The amounts presented are gross of impairment provisions.

	Neither past due nor impaired			
	Pass grade AED 000	*Watch grade AED 000*	*Past due or individually impaired AED 000*	*Total AED 000*
2012				
Cash and balances with U.A.E. Central Bank	**12,531,905**	**-**	**-**	**12,531,905**
Due from banks and financial institutions	**18,329,081**	**-**	**-**	**18,329,081**
Loans and advances	**103,944,292**	**7,444,901**	**7,007,037**	**118,396,230**
Other assets	**3,091,088**	**-**	**-**	**3,091,088**
Investments	**15,444,451**	**-**	**-**	**15,444,451**
Total	**153,340,817**	**7,444,901**	**7,007,037**	**167,792,755**
2011				
Cash and balances with U.A.E. Central Bank	9,301,371	-	-	9,301,371
Due from banks and financial institutions	12,225,320	-	-	12,225,320
Loans and advances	95,861,867	5,990,862	6,488,725	108,341,454
Other assets	3,516,886	-	-	3,516,886
Investments	16,575,947	-	-	16,575,947
Total	137,481,391	5,990,862	6,488,725	149,960,978

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31 December 2012

32 RISK MANAGEMENT *continued*

32.2 Credit risk *continued*

Credit quality per class of financial assets *continued*
Past due loans and advances include those that are only past due by a few days. An analysis of past due loans, by age, is provided below.

Aging analysis of past due but not impaired loans

	Less than 30 days AED 000	*31 to 60 days AED 000*	*61-90 days AED 000*	*More than 91 days AED 000*	*Total AED 000*
31 December 2012					
Past due but not impaired loans and advances	**2,023,599**	**633,045**	**444,738**	**536,487**	**3,637,869**
Past due and impaired loans and advances					**7,543,523**
Less:					
Past due but not impaired loans and advances					**(3,637,869)**
Impaired loans and advances (note 4):					
Loans and advances under restructuring					**456,459**
Other loans and advances					**3,449,195**
					3,905,654
Impaired loans, excluding loans and advances under restructuring					**3,449,195**
31 December 2011					
Past due but not impaired loans and advances	1,412,058	509,653	265,159	316,053	2,502,923
Past due and impaired loans and advances					6,804,777
Less:					
Past due but not impaired loans and advances					(2,502,923)
Impaired loans and advances (note 4):					
Loans and advances under restructuring					620,727
Other loans and advances					3,681,128
					4,301,855
Impaired loans, excluding loans and advances under restructuring					3,681,128

See note 4 for more detailed information with respect to the provision for impairment losses on loans and advances.

Renegotiated loans
The total carrying amount of loans and advances whose terms have been renegotiated as of 31 December 2012 amounted to AED 3,801,472 thousand (2011: AED 5,444,285 thousand).

Impairment assessment
The Bank uses an incurred loss model for the recognition of losses on impaired financial assets. This means that losses can only be recognised when objective evidence of a specific loss event has been observed. Triggering events include the following:

- Significant financial difficulty of the borrower;
- A breach of contract such as default of payment;
- If it becomes probable that the customer will enter bankruptcy or other financial reorganization; and
- Observable data that suggests that there is a decrease in the estimated future cash flows from the loans.

32 RISK MANAGEMENT *continued*

32.3 Liquidity risk and funding management

Liquidity risk is the risk that an institution will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. To guard against this risk, management has diversified funding sources and assets are managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents, and readily marketable securities. In addition the Bank also has committed lines of credit that it can access to meet liquidity needs and the Bank also maintains mandatory cash reserve deposits with the Central Bank of U.A.E. equal to 1% of customer time deposits and 14% of customer current, call and savings accounts.

Analysis of financial assets and financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial assets and liabilities at 31 December 2012 based on contractual maturities.

	Less than 3 months AED 000	*3 months to 1 year AED 000*	*1 year to 5 years AED 000*	*Over 5 years AED 000*	*Total AED 000*
ASSETS					
Cash and balances with UAE Central Bank	**5,844,336**	**7,000,000**	**-**	**-**	**12,844,336**
Due from banks and financial institutions	**17,908,523**	**420,558**	**-**	**-**	**18,329,081**
Loans and advances, net	**31,704,743**	**14,546,090**	**35,945,340**	**32,448,306**	**114,644,479**
Investments	**2,882,227**	**1,203,447**	**8,675,361**	**4,517,231**	**17,278,266**
Other assets	**3,147,027**	**-**	**-**	**-**	**3,147,027**
Financial assets	**61,486,856**	**23,170,095**	**44,620,701**	**36,965,537**	**166,243,189**
Non-financial assets					**8,790,420**
Total assets					**175,033,609**
LIABILITIES					
Due to banks	**3,182,645**	**736,853**	**-**	**-**	**3,919,498**
Customers' deposits	**62,525,258**	**39,625,408**	**4,309,192**	**12,844,776**	**119,304,634**
Term loans	**-**	**800,714**	**12,540,554**	**59,503**	**13,400,771**
Sukuk financing instruments	**-**	**-**	**4,223,950**	**-**	**4,223,950**
Other liabilities	**4,321,666**	**-**	**-**	**-**	**4,321,666**
Total liabilities	**70,029,569**	**41,162,975**	**21,073,696**	**12,904,279**	**145,170,519**

The maturity profile of the financial assets and liabilities at 31 December 2011 was as follows:

	Less than 3 months AED 000	*3 months to 1 year AED 000*	*1 year to 5 years AED 000*	*Over 5 years AED 000*	*Total AED 000*
ASSETS					
Cash and balances with UAE Central Bank	3,586,770	6,000,000	-	-	9,586,770
Due from banks and financial institutions	10,443,915	1,781,405	-	-	12,225,320
Loans and advances, net	28,477,719	10,264,436	31,127,360	34,850,284	104,719,799
Investments	6,374,904	230,398	6,336,573	5,847,581	18,789,456
Other assets	3,557,019	-	-	-	3,557,019
Financial assets	52,440,327	18,276,239	37,463,933	40,697,865	148,878,364
Non-financial assets					8,601,973
Total assets					157,480,337
LIABILITIES					
Due to banks	8,176,740	70,596	-	-	8,247,336
Customers' deposits	71,328,046	18,523,914	2,696,382	10,925,391	103,473,733
Term loans	-	6,138,479	6,347,986	208,259	12,694,724
Sukuk financing instruments	-	-	2,387,450	-	2,387,450
Other liabilities	3,909,978	-	-	-	3,909,978
Total liabilities	83,414,764	24,732,989	11,431,818	11,133,650	130,713,221

32 RISK MANAGEMENT *continued*

32.3 Liquidity risk and funding management *continued*

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2012 and 2011 based on contractual undiscounted repayment obligations, including cash flows pertaining to principal repayment and interest payable to maturity.

	Less than 3 months AED 000	*3 months to 1 year AED 000*	*1 year to 5 years AED 000*	*Over 5 years AED 000*	*Total AED 000*
2012					
LIABILITIES					
Due to banks	**3,185,019**	**742,855**	**-**	**-**	**3,927,874**
Customers' deposits	**62,801,407**	**40,407,217**	**4,411,348**	**12,876,472**	**120,496,444**
Term loans	**97,379**	**1,100,247**	**13,665,369**	**61,133**	**14,924,128**
Sukuk financing instruments	**82,478**	**82,478**	**4,755,971**	**-**	**4,920,927**
Other liabilities	**4,321,666**	**-**	**-**	**-**	**4,321,666**
Total liabilities	**70,487,949**	**42,332,797**	**22,832,688**	**12,937,605**	**148,591,039**
2011					
LIABILITIES					
Due to banks	8,183,850	70,815	-	-	8,254,665
Customers' deposits	71,591,554	18,947,333	2,718,763	10,956,215	104,213,865
Term loans	94,126	6,436,091	7,342,858	215,220	14,088,295
Sukuk financing instruments	45,326	90,651	2,704,730	-	2,840,707
Other liabilities	3,909,978	-	-	-	3,909,978
Total liabilities	83,824,834	25,544,890	12,766,351	11,171,435	133,307,510

The disclosed financial instruments in the above table are the gross undiscounted cash flows. However, those amounts may be settled gross or net. The following table shows the reconciliation of the carrying amounts of derivatives and their future cash flows.

	Less than 3 months AED 000	*3 months to 1 year AED 000*	*1 year to 5 years AED 000*	*Over 5 years AED 000*	*Total AED 000*
2012					
Inflows	**124,181**	**98,960**	**624,335**	**353,358**	**1,200,834**
Outflows	**(113,944)**	**(152,705)**	**(768,934)**	**(330,985)**	**(1,366,568)**
Net	**10,237**	**(53,745)**	**(144,599)**	**22,373**	**(165,734)**
2011					
Inflows	106,836	118,968	778,143	634,863	1,638,810
Outflows	(105,246)	(175,233)	(830,036)	(659,310)	(1,769,825)
Net	1,590	(56,265)	(51,893)	(24,447)	(131,015)

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments.

	Less than 3 months AED 000	3 months to 1 year AED 000	1 to 5 years AED 000	Over 5 years AED 000	Total AED 000
2012					
Contingent liabilities	**49,357,195**	**11,869,365**	**12,467,397**	**-**	**73,693,957**
Commitments	**232,675**	**4,166,272**	**492,587**	**-**	**4,891,534**
Total	**49,589,870**	**16,035,637**	**12,959,984**	**-**	**78,585,491**
2011					
Contingent liabilities	43,132,884	9,762,257	14,458,368	-	67,353,509
Commitments	532,529	3,560,889	523,919	-	4,617,337
Total	43,665,413	13,323,146	14,982,287	-	71,970,846

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

32 RISK MANAGEMENT *continued*

32.4 Market risk

Market risk is the risk that the fair value and future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates, and equity prices.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. Effective hedging strategies are in place to ensure that interest rate fluctuations do not cause significant changes in future cash flows or fair value of financial instruments.

The following table estimates the sensitivity to a reasonable possible change in interest rates on the Bank's income statement. The sensitivity of the income statement is the effect of the assumed changes (whether increase or decrease) in interest rates on the net interest income for one year, based on the floating rate financial assets and financial liabilities, denominated in various currencies, held at 31 December 2012 and 2011, with all other variables held constant.

Currency	*AED*	*USD*	*EUR*	*GBP*	*Others*
Assumed change in interest rates	0.50%	0.50%	0.50%	0.50%	0.50%
Impact on net interest income from increase in interest rates:					
2012 (AED 000)	**(73,130)**	**58,354**	**(3,679)**	**(1,139)**	**(18,733)**
2011 (AED 000)	(6,052)	30,189	(2,539)	(364)	(7,535)
Impact on net interest income from decrease in interest rates:					
2012 (AED 000)	**73,130**	**(58,354)**	**3,679**	**1,139**	**18,733**
2011 (AED 000)	6,052	(30,189)	2,539	364	7,535

(Amounts in brackets reflect decreases in net interest income)

The sensitivity of equity is calculated by revaluing fixed rate available for sale financial assets, including the effect of any associated hedges, and swaps designated as cash flow hedges, for the effects of the assumed changes in interest rates. At 31 December 2012 and 2011, the effect of the assumed changes in interest rates on equity is as follows:

Currency	*USD*
Assumed change in interest rates	0.50%
Impact on equity from increase in interest rates:	
2012 (AED 000)	**(61,680)**
2011 (AED 000)	(42,391)
Impact on equity from decrease in interest rates:	
2012 (AED 000)	**64,264**
2011 (AED 000)	43,736

32 RISK MANAGEMENT *continued*

32.4 Market risk *continued*

Currency risk

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

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2012 and 2011 on its monetary assets and liabilities and its forecast cash flows. The analysis estimates the effect of a reasonably possible movement of AED against other currencies, with all other variables held constant on the consolidated income statement.

Currency	USD	EUR	GBP	Libyan Dinar
Assumed change in exchange rates	1%	1%	1%	1%
Impact on operating income from increase in exchange rates:				
2012 (AED 000)	**(65,926)**	**531**	**(8)**	**(3,731)**
2011 (AED 000)	(12,289)	(84)	5	(3,781)
Impact on operating income from decrease in exchange rates:				
2012 (AED 000)	**65,926**	**(531)**	**8**	**3,731**
2011 (AED 000)	12,289	84	(5)	3,781

(Amounts in brackets reflect decreases in operating income)

At 31 December 2012 and 2011, the effect of the assumed changes in exchange rates on equity is insignificant.

Equity price risk

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Bank's investment portfolio.

The following table estimates the sensitivity to a possible change in equity markets on the Bank's income statement. The sensitivity of the income statement is the effect of the assumed change in the reference equity benchmark on the fair value of investments carried at fair value through the income statement.

	Assumed level of change %	***Impact on net income 2012 AED 000***	*Impact on net income 2011 AED 000*
Investments carried at fair value through the income statement			
Reference equity benchmarks:			
Abu Dhabi Securities Exchange Index	5%	**1,578**	4,918
Dubai Financial Market Index	5%	**452**	844
Net asset value of managed funds	5%	**8,413**	7,647
Other equity exchanges	5%	**5,373**	4,043
Unquoted	5%	**1,012**	1,011

32 RISK MANAGEMENT *continued*

32.4 Market risk *continued*

Equity price risk *continued*

The effect on equity (as a result of a change in the fair value of equity instruments held as available for sale at 31 December 2012 and 2011) due to a reasonably possible change in equity indices, with all other variables held constant, is as follows:

	Assumed level of change %	***Impact on equity 2012 AED 000***	*Impact on equity 2011 AED 000*
Available for sale investments			
Reference equity benchmarks:			
Net asset value of private equity funds	5%	**69,901**	68,968
Others	5%	**1,430**	-

Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

The effect on profit for one year, assuming 10% of repayable financial instruments were to prepay at the beginning of the year, with all other variables held constant, is estimated at AED 369,555 thousand (2011: AED 413,308 thousand).

Operational risk

Operational risk is the risk of direct or indirect loss arising from inadequate or failed internal processes, systems failure, human error, fraud or external events. When required controls fail, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. While the Bank cannot expect to eliminate all operational risks, through a control framework and by continuous monitoring and responding to potential risks, the Bank is able to manage these risks. Controls include effective segregation of duties, appropriate access, authorisation and reconciliation procedures, staff training and robust assessment processes. The processes are reviewed by risk management and internal audit on an ongoing basis.

33 FAIR VALUE OF FINANCIAL INSTRUMENTS

While the Bank prepares its financial statements under the historical cost convention modified for measurement to fair value of investment securities (other than held to maturity investments and certain unquoted investments), investment properties and derivative financial instruments, in the opinion of management, the estimated carrying values and fair values of those financial assets and liabilities, other than the Government deposit referred to in note 11, that are not carried at fair value in the financial statements are not materially different, since assets and liabilities are either short term in nature or in the case of deposits and performing loans and advances, frequently re-priced. For impaired loans and advances, expected cash flows, including anticipated realisation of collateral, were discounted using the original interest rates, considering the time of collection and a provision for the uncertainty of the cash flows.

The carrying value of unquoted investments stated at cost and fair value of held to maturity investments are disclosed in note 5. The fair value of the Government deposit cannot be reliably estimated as this is dependent on the amounts and timing of future loan disbursement under the housing loans scheme. Details of the Government deposit are disclosed in note 11.

33 FAIR VALUE OF FINANCIAL INSTRUMENTS *continued*

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

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

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

	Level 1 2012 AED 000	***Level 2 2012 AED 000***	***Level 3 2012 AED 000***	***Total 2012 AED 000***
FINANCIAL ASSETS				
INVESTMENTS				
Carried at fair value through income statement				
Investments in managed funds	**-**	**168,258**	**-**	**168,258**
Investments in equities - Quoted	**148,064**	**-**	**1,056**	**149,120**
- Unquoted	**-**	**-**	**19,178**	**19,178**
Debt securities	**159,765**	**-**	**-**	**159,765**
Available for sale investments				
Investments in equities - Quoted	**28,599**	**-**	**-**	**28,599**
- Unquoted	**-**	**2,247**	**68,385**	**70,632**
Investments in private equity funds	**-**	**-**	**1,398,028**	**1,398,028**
Debt securities - Quoted	**4,008,194**	**-**	**-**	**4,008,194**
- Unquoted	**-**	**13,053**	**-**	**13,053**
Structured debt notes - Unquoted	**-**	**1,193,725**	**-**	**1,193,725**
	4,344,622	**1,377,283**	**1,486,647**	**7,208,552**
DERIVATIVES - Positive fair value				
Derivatives held for trading				
Forward foreign exchange contracts	**-**	**65,472**	**-**	**65,472**
Interest rate swaps, caps and collars	**48**	**453,440**	**-**	**453,488**
Swaptions	**-**	**12,421**	**-**	**12,421**
Credit default swaps	**-**	**102**	**-**	**102**
Options	**-**	**10,578**	**-**	**10,578**
Futures	**1,322**	**-**	**-**	**1,322**
Derivatives held as fair value hedge				
Interest rate swaps	**-**	**3,920**	**-**	**3,920**
Cross currency swaps	**-**	**130,960**	**-**	**130,960**
	1,370	**676,893**	**-**	**678,263**
DERIVATIVES - Negative fair value				
Derivatives held for trading				
Forward foreign exchange contracts	**-**	**61,078**	**-**	**61,078**
Interest rate swaps, caps and collars	**73**	**553,209**	**-**	**553,282**
Swaptions	**-**	**12,421**	**-**	**12,421**
Options	**-**	**11,875**	**-**	**11,875**
Commodity linked swaps	**-**	**31,605**	**-**	**31,605**
Derivatives held as fair value hedge				
Interest rate swaps	**-**	**131,670**	**-**	**131,670**
Cross currency swaps	**-**	**50,078**	**-**	**50,078**
	73	**851,936**	**-**	**852,009**

33 FAIR VALUE OF FINANCIAL INSTRUMENTS *continued*

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

	Level 1 2011 AED 000	*Level 2 2011 AED 000*	*Level 3 2011 AED 000*	*Total 2011 AED 000*
FINANCIAL ASSETS				
INVESTMENTS				
Carried at fair value through income statement				
Investments in managed funds	-	152,932	-	152,932
Investments in equities - Quoted	196,105	-	1,048	197,153
- Unquoted			19,178	19,178
Debt securities	133,895	-	-	133,895
Available for sale investments				
Investments in equities - Unquoted	-	390,762	74,125	464,887
Investments in private equity funds	-	-	1,379,359	1,379,359
Debt securities	2,299,673	138,210	-	2,437,883
Structured debt notes - Unquoted	-	485,460	-	485,460
	2,629,673	1,167,364	1,473,710	5,270,747
DERIVATIVES - Positive fair value				
Derivatives held for trading				
Forward foreign exchange contracts	-	50,768	-	50,768
Interest rate swaps, caps and collars	-	442,705	-	442,705
Credit default swaps	-	345	-	345
Options	-	8,741	-	8,741
Futures	439	-	-	439
Derivatives held as fair value hedge				
Interest rate swaps	-	4,013	-	4,013
Cross currency swaps	-	95,469	-	95,469
	439	602,041	-	602,480
DERIVATIVES - Negative fair value				
Derivatives held for trading				
Forward foreign exchange contracts	-	45,459	-	45,459
Interest rate swaps, caps and collars	-	600,551	-	600,551
Credit default swaps	-	1,771	-	1,771
Options	-	10,677	-	10,677
Commodity linked swaps	-	32,280	-	32,280
Derivatives held as fair value hedge				
Interest rate swaps	-	51,631	-	51,631
	-	742,369	-	742,369

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

33 FAIR VALUE OF FINANCIAL INSTRUMENTS *continued*

Investments carried at fair value through income statement
Investments carried at fair value through income statement are listed equities in local as well as international exchanges, and hedged funds. Equity valuations are based on market prices as quoted in the exchange while funds are valued on the basis on Net Asset Value (NAV) statements received from fund managers.

Available for sale investments
AFS investments, revaluation gain / loss of which is recognized through equity, comprises long term strategic investments in companies, private equity funds and Eurodollar or AED denominated debt securities. For companies and funds, the financial statements provide the valuations of these investments which are arrived primarily by discounted cash flow analysis. For debt securities, the applied valuation is quoted prices by key market players.

Derivatives
Derivatives are mainly interest rate and currency swaps, asset swaps, options on equities, swaptions and FX forward contracts. The valuation techniques used are models which use observable market data like FX forward rates, interest rate curves of different currencies, the deduced zero curves and forward rates and volatilities of the underlying factors.

Transfers between categories

During the reporting periods ending 31 December 2012, there were no transfers between Level 1 and Level 2 fair value measurements.

The following table shows a reconciliation of the opening and closing amount of Level 3 financial assets recorded at fair value:

	2012 AED 000	*2011 AED 000*
At 1 January	**94,352**	96,987
Total (loss) gain recorded in equity	**(682)**	1,367
Transfer from level 2	**-**	1,048
Disposals	**(5,050)**	(5,050)
At 31 December	**88,620**	94,352

34 CAPITAL ADEQUACY

Capital management
The primary objective of the Bank's capital management is to ensure that the Bank maintains healthy capital ratios in order to support its business, to maximise shareholders' value and to ensure that the Bank complies with externally imposed capital requirements.

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

34 CAPITAL ADEQUACY *continued*

Capital management *continued*

The capital adequacy ratio calculated in accordance with the guidelines of the U.A.E. Central Bank is as follows:

	2012	*2011*
	AED 000	*AED 000*
Total capital base	**30,530,040**	29,285,238
Risk weighted assets:		
Balance sheet items	**112,308,673**	105,758,055
Off-balance sheet exposures	**31,138,455**	30,221,769
Total risk weighted assets	**143,447,128**	135,979,824
Total assets ratio (%)	**21.3%**	21.5%