



ARAB BANK AUSTRALIA LIMITED

2017 Annual Report

Arab Bank Australia

This statement outlines the main Corporate Governance practices that were in place throughout the financial year.

Corporate Governance

The Board of Directors has adopted a Corporate Governance Framework which includes the Board's Charter and the Corporate Governance Guidelines.

The Board Charter sets out the key governance principles adopted by the Board for the management of Arab Bank Australia Limited (the "Company" or the "Bank"), and its controlled entities, being the economic entity.

The principles set forth in the Corporate Governance Framework are designed to reflect the full force and intent of the Australian Prudential Regulation Authority's Prudential Standard CPS 510 Governance and to collate the functions and operating principles under which the Board and its Board Committees operate.

The Board regularly reviews its Corporate Governance Framework and practices to ensure adherence to regulatory developments, market best practice and stakeholder expectations.

Role of the Board of Directors

The Board of Directors is responsible to the shareholder, employees and customers for the corporate governance of the economic entity.

The role and responsibilities of the Board of Directors are set out in the Board Charter. The responsibilities include:

- ❖ Corporate governance of the Bank, including the establishment and empowerment of Committees of the Board to assist in its functions;
- ❖ Overseeing the business and affairs of the Bank by:
 - establishing, with management, the overall direction taking into account shareholder objectives, formulating and approving the Bank's strategies and financial objectives to be set out in the annual budgets to be implemented by management;
 - establishing with management and approving the Bank's Risk Appetite;
 - reviewing and approving the ICAAP consistent with the Board determined Risk Appetite;

- ensuring that an appropriate level of capital is maintained commensurate with the level and extent of risks to which the Bank is exposed from its activities and that satisfies the regulatory requirements;
- approving major corporate initiatives;
- approving capital expenditure in excess of limits delegated to management;
- reviewing and approving risk management frameworks and accounting policies, including risk policies and standards, financial statements and reports and overseeing the establishment and ongoing monitoring of the effectiveness of systems of risk and financial management;
- allocating adequate resources to the risk management function and ensuring an appropriate organisational structure, strategic direction and level of staff training are implemented to permit regular risk reviews and reporting of risk issues.
- monitoring the performance of management directly, and through its Committees;
- carrying out the functions specifically reserved for the Board and its Committees under the policies of the Board and consistent with the charters of those Committees;

- ❖ Approval of documents (including reports and statements to the shareholder) required by the Bank's Constitution, the Corporations Act 2001 and other applicable laws and regulations;
- ❖ All aspects of the appointment of the Managing Director, including nomination to the shareholder;
- ❖ Review and approval of the Bank's major human resource policies and overseeing the development strategies for senior and high performing executives including succession planning for the Managing Director and his direct reports, excluding administrative positions;
- ❖ Annual review and approval of the remuneration of employees, including the following:
 - changes in remuneration policy, including superannuation, other benefits and remuneration structure;
 - changes to the Bank's Short Term and Long Term Incentive Schemes;
 - remuneration (including the components comprising the package, such as short term

and long term incentives) for the Managing Director;

- remuneration recommendations from the Managing Director, endorsed by the Board Remuneration Committee (BRemC), for the Managing Director's direct reports (excluding administrative positions), responsible persons, risk and financial control personnel and for all other persons for whom a significant portion of total remuneration is based on performance and whose activities, individually or collectively, may affect the financial soundness of the Bank. This also includes reviewing and approving key performance indicators at the start of the performance period;
- in aggregate, the annual fixed remuneration increase and annual bonus pool provision for the Bank; and
- in aggregate, the outcomes of remuneration review by management for the bonus pool, prior to any payment being made.

The Board reviews the Board Remuneration Committee's recommendations in respect of the overall fees payable to the directors, and will make recommendation to the shareholder for approval.

The Board retains the right to alter the matters reserved for its decision.

Beyond the roles and responsibilities of the Board noted above, the Board delegates to the Managing Director authority for the day-to-day management of the Bank.

In carrying out its role, the Board will operate in a manner reflecting the Bank's values and Codes of Conduct and in accordance with the Board Charter, the Corporate Governance Guidelines, the Bank's Constitution, the Corporations Act 2001 and other applicable laws and regulations.

Independent professional advice

To assist the directors in discharging their duties as directors, each director has the right to seek independent professional advice and with the approval of the Chairman, at the expense of the economic entity. Such advice is to be made available to the entire Board.

Board Composition

The structure of the Board is generally determined on the basis of having a Board of effective composition, size and commitment to adequately discharge its duties and responsibilities, taking into account the requirements set out in CPS 510. This includes:

- ❖ The Bank's Constitution specifies the required number of directors as being at least five and not more than nine directors (or such lower number as the board may determine from time to time), including the Managing Director but not including any alternate directors;
- ❖ The majority of directors are to be non-executive directors. These non-executive directors need not all be independent. They can include Board members or senior management of the parent company or the parent's other subsidiaries, but not executives of the Bank or the Bank's subsidiaries;
- ❖ A minimum of two independent directors are required, in addition to an independent chairperson where the Board has up to seven members. Where the Board has more than seven members, the Board will be required to have at least three independent directors, in addition to an independent chairperson; and
- ❖ At least two of the directors of the Board must be ordinarily resident in Australia, and at least one of those must be independent. The independent directors on the Board of the parent company or its other subsidiaries can also sit as independent directors on the Board of the Bank.

There are currently 7 directors of the Bank, and details of their experience, qualifications, and interests in other organisations, special responsibilities, and attendance at meetings are set out in the Directors' Report.

Membership of the Board consists of:

Non-executive

Independent

Chair: Geoffrey C E Wild AM

Non-executive

Deputy Chair: Randa El Sadek

Non-executive

Independent:

Ian G MacDonald
Leslie E Taylor AM

Non-executive: Therese A S Batshon
 Saleem J S Shadeed

Executive: Joseph Rizk OAM

Independence

The Board regularly assesses the independence of each director, in accordance with the criteria for independence set out in Prudential Standard CPS 510. An independent director is a non-executive director who is free from any business or other association including those arising out of a substantial shareholding, involvement in past management or as a supplier, customer or adviser that could materially interfere with the exercise of their independent judgment.

In addition to being required to conduct themselves in accordance with the ethical policies of the Bank, directors are required to be meticulous in their disclosure of any material contract or relationship in accordance with the Corporations Act 2001 and related Bank policies, and this disclosure extends to the interests of family companies and spouses.

Directors are required to strictly adhere to the constraints on their participation and voting in relation to matters in which they may have an interest in accordance with the Corporations Act 2001 and the Bank's policies.

Each director may from time to time have personal dealings or is involved with other companies or professional firms, which may from time to time have dealings with the Bank. Details of offices held by directors with other organisations are set out in the Directors' Report. Full details of related party dealings are set out in notes to the Bank's accounts as required by law.

All the current non-executive directors of the Bank have been assessed for their independence and their status is set out in the membership table on page 3 after taking into account the criteria referred to above.

Whilst a term of service is a consideration in assessing a director's ability to act in the best interests of the Bank, a term of service on the Board is generally not considered to affect a director's ability to act in the best interests of the Bank. Independence is judged against the ability, integrity and willingness of the director to act. In considering a director's tenure, the Board however ensures that the skill sets of directors remain appropriate.

Director Appointment and Review

The Board has agreed on the criteria which form the basis of selecting candidates for Board appointment.

The Board annually assesses the skills base, experience and qualifications of the existing directors to enable identification of attributes required of directors to ensure it has the expertise required to competently discharge the Board's duties, having regard to the strategic direction of the Bank.

The Board compares the skills base and experience of existing directors with that required for the future strategy of the Bank to enable identification of attributes required in new directors.

After consideration of the results of the performance assessment, the Board will determine its endorsement of the directors to stand for re-appointment at the next Annual General Meeting.

The Board has a policy in place whereby a director's appointment is reviewed, with the shareholder every four years on a rotation basis, to ensure skills remain appropriate (except where succession planning for the Chairman requires an extended term). In accordance with the requirements of Prudential Standard CPS 510, the Board has established this policy for review of directors' tenures to ensure that it remains open to new ideas and independent thinking while retaining adequate expertise. The Board gives consideration to whether directors have served on the Board for a period which could, or could reasonably be perceived to; materially interfere with their ability to act in the interests of the Bank.

The Board has in place a process for annually reviewing its performance, policies and practices, with a view to identifying the quality and effectiveness of the Board, its committees and individual directors, and the processes that support them.

The Board identifies any additional areas where education is required and suggests appropriate development activities for directors after consideration of the results of the annual performance assessment of directors.

Committees

The Board Committees throughout 2017 were:

Board Risk Committee (BRC)
Board Audit Committee (BAC)

Board Remuneration Committee (BRemC)
Board Credit Delegation (BCD)

The Board has approved a Charter and Operating Governance Practices for each of the Board Committees, and reviews the Board Committees on a triennial basis.

Board Risk Committee ("BRC")

Membership of the BRC consists of:

Ian G MacDonald (Chair)
Geoffrey C E Wild AM
Leslie E Taylor AM
Therese A S Batshon
Saleem J S Shadeed

The BRC's primary responsibility is to provide the Board with objective non-executive oversight of the implementation and ongoing operation of the Bank's risk management frameworks (covering credit, liquidity, market and operational risk), compliance matters and any other matters referred to it by the Board.

The Charter of the BRC incorporates the BRC's authority and responsibilities to ensure the BRC can fulfil its purpose and exercise its responsibilities effectively. The Charter of the BRC also incorporates a number of policies and practices to ensure it remains independent and effective. Among these are:

- ❖ The BRC is to be comprised of at least three directors. The directors must be entirely non-executive directors.
- ❖ The Managing Director must not be a member of the BRC.

- ❖ A majority of members must be independent of management and free of any relationship, which could interfere with their independent judgment.
- ❖ The Chair of the BRC is appointed by the Board and must not be the same person as the Chair of the Board. The Chair must be an independent director. The Chairperson of the Board Audit Committee may also chair the Board Risk Committee.
- ❖ The Managing Director, the Executive Manager Finance, Executive Manager Internal Audit, and legal advisors will attend meetings by invitation.
- ❖ A standing invitation is made to all Directors of the Board and the Chief Risk Officer to attend the Committee meetings.
- ❖ The Chief Risk Officer has a direct reporting line to the Board Risk Committee.

Board Audit Committee ("BAC")

Membership of the BAC consists of:

Leslie E Taylor AM (Chair)
Geoffrey C E Wild AM
Ian G MacDonald
Therese A S Batshon
Saleem J S Shadeed

The BAC's primary responsibility is to assist the Board in fulfilling its fiduciary and statutory responsibilities by providing an objective non-executive review of the effectiveness of the external reporting of financial and non-financial information, tax and accounting risks, the internal control framework, Australian Prudential Regulation Authority (APRA) risk management frameworks (covering credit, liquidity, market and operational risk), and the independence and effectiveness of audit activities.

The Charter of the BAC incorporates the BAC's authority and responsibilities to ensure the BAC can fulfil its purpose and exercise its responsibilities effectively. The Charter of the BAC also incorporates a number of policies and practices to ensure it remains independent and effective. Among these are:

- ❖ The BAC is to be comprised of at least three directors. The directors must be entirely non-executive directors with a majority of independent directors and it is preferable to have at least one who has expertise in financial accounting and reporting.
- ❖ The Managing Director must not be a member of the BAC.
- ❖ The Board determines the terms of membership.
- ❖ The Chair of the BAC is appointed by the Board and must not be the same person as the Chair or Deputy Chairman of the Board. The Chair must be an independent director.
- ❖ The Managing Director, the Executive Manager Finance, Executive Manager Internal Audit, the Chief Risk Officer, and legal advisor will attend meetings by invitation.
- ❖ A standing invitation to attend the meetings of the Committee is to be extended to the external auditor.
- ❖ A standing invitation is made to all Directors of the Board to attend the Committee meetings.
- ❖ At least once a year, the BAC Chairman will separately meet the external auditor and the Executive Manager Internal Audit independently of management.

Under Prudential Standard CPS510 Governance, the BAC is responsible for ensuring the adequacy and independence of the external auditor. These responsibilities are fulfilled by a number of specific tasks, including:

- ❖ Nominating the external auditor to the Board for appointment by the shareholder. Deloitte Touché Tohmatsu has been appointed external auditors of the Bank.
- ❖ The external auditor must, in accordance with the Corporations Act 2001, comply with the auditor independence requirements and codes of professional conduct. The BAC will assess on at least an annual basis, the independence, fitness and propriety of the external auditors.
- ❖ Audit fees are reviewed by the BAC each year, to determine that an effective, comprehensive and complete audit can be conducted for that fee.

- ❖ The scope of the audit is agreed between the BAC and the external auditor and is subject to the minimum requirements of the Corporations Act 2001 (which regulates audit requirements), accounting standards and other mandatory professional reporting requirements in Australia.
- ❖ The external audit partner attends the BAC meeting when the annual accounts are reviewed. However, the external auditor may also raise matters directly with the Board.
- ❖ The BAC discusses and receives recommendations from the external auditors on the quality of the Bank's systems, its accounting processes and its financial results. It also receives a report from the auditor on any significant matters raised by the auditor with management.
- ❖ All material accounting matters requiring exercise of judgement by management are specifically reviewed by the BAC and reported on by the BAC to the Board.
- ❖ The policy governing the provision of non-audit services by the external auditors is set out in the BAC Charter and Operational Governance Practices.
- ❖ The Bank requires the partner managing the external audit be changed within a period of 5 years from initial engagement.

The BAC is responsible for the oversight of management in the preparation of the Bank's financial statements and financial disclosures. The BAC relies on the information provided by management and receives reports from the external auditors on an ongoing basis. The Managing Director, together with the Executive Manager Finance declare in writing to the Board that the financial records of the Company for the financial year have been properly maintained and the Company's financial reports for the financial year comply with accounting standards and present a true and fair view of the company's financial condition and operational results. This representation is required annually.

Board Remuneration Committee ("BRemC")

Membership of the BRemC consists of:

Ian G MacDonald (Chair)
Geoffrey C E Wild AM
Randa El Sadek

The purpose of the Remuneration Committee is to assist the Board in fulfilling its responsibilities relating to remuneration and people matters, and compliance with related employment laws and regulations. It does this by ensuring that the Bank has appropriate remuneration and people systems in place by monitoring their effectiveness.

The policy of the Board is that the Remuneration Committee will consist of at least three directors. The directors must be entirely non-executive directors. The Managing Director attends meetings by invitation except when matters affect him personally.

The Charter of the Remuneration Committee incorporates the Remuneration Committee's authority, responsibilities, a number of policies, practices and a work program to ensure the Remuneration Committee can fulfil its purpose and exercise its responsibilities effectively.

Board Credit Delegation (BCD)

The Board delegated to the following Directors the authority to approve credit transactions outside the scope of the delegations to management under the Board's Delegated Authorities:

Geoffrey C E Wild AM
Randa El Sadek
Ian G MacDonald
Therese A S Batshon

Each Delegate has direct access to the Managing Director, the Chief Risk Officer ("CRO") and management on any matters referred to them under the Board Credit Delegation ("BCD"). The Delegates are entitled to rely on management for matters that are the responsibility of management and on the advice of experts advising management, subject to the normal duties of directors.

Internal control framework

The Board acknowledges that it is responsible for the overall internal control framework but recognises that no cost effective internal control system will preclude all errors and irregularities. The internal control system is based upon well-documented policies and procedures, manuals and guidelines. It is also based upon an organisational structure which provides an appropriate segregation of responsibility given the size of the Company, an internal audit function which provides assurance to the Managing Director and the Board, and the careful selection and training of qualified personnel by Human Resources.

Risk Management

The Board has adopted a structured and disciplined approach to risk management, which includes:

- Establishment of a governance structure;
- Board oversight that there is a sound risk culture;
- Board approval and oversight of the setting of the risk appetite, approval of the Risk Management Strategy and providing management with the appropriate mandates;
- Managing Director direction;
- Dedicated Chief Risk Officer;
- Business Unit Managers' support and adherence to policy and procedures;
- Risk management processes and procedures;
- Audit assurance;
- Board Audit Committee and Board Risk Committee oversight and guidance for management of credit, market, funding, liquidity, operational, business continuity, compliance and security risks; and
- The Board oversees and provides guidance for the management of strategic risk.

Ethical standards

Code of Conduct

The Bank has adopted a Code of Conduct, which sets out the basis for a sound, ethical and impeccable business practice, with which all directors and employees undertake to observe.

The Code requires that all employees and directors act with the highest standard of personal and professional integrity. The Code recognises that the Bank is a fiduciary of public funds and therefore has a commitment to protect the interests of its customers as well as complying with all laws and regulations governing the Bank's business. For this purpose, the Code establishes the sets of standard behaviour required of all employees and directors. Among these are the standards for general responsibilities in relation to ethical conduct, information handling, conflicts of interest, due diligence, gifts and entertainment, fraud, dishonesty, criminal conduct, integrity, whistle blowing, advertising, and information security. In keeping with its responsibility to the shareholder, employees and customers, a set of core values has been adopted, which embrace the principles of customer service, trust, accountability, team work and transparency. To emphasise the importance of the core values, which are regularly communicated to all personnel throughout the organisation.

Conflict of Interest

In addition to the requirements of the Corporations Act 2001 and the Bank's Constitution, the Board has adopted the Bank's Conflict of Interest Policy, which describes the potential conflicts that are required to be addressed and managed by the business. This policy applies to all employees, including directors, and requires the completion of an annual Conflict of Interest Policy declaration.

The policy requires that all employees, including directors, have an obligation to avoid and disclose any financial, business or other relationships, which might conflict with the legitimate business interests of the Bank or the proper performance of their duties. Such a conflict will exist where an employee compromises their ability to act with total objectivity with regard to the Bank's business interests.

Role of the Shareholder

The shareholder of the Company, Arab Bank plc, is responsible for the appointment of the directors, as well as approval of the remuneration for the provision of their services as directors of the Company.

Further, to ensure that the board of directors fulfil their stewardship responsibilities, directors inform the shareholder of all significant events concerning the Bank through the distribution of the Annual Financial Report. The Annual Financial Report includes all information required by the Corporations Act 2001, including information concerning the operations of the economic entity and changes in the state of affairs.

The managers of the Bank are accountable directly to the Managing Director. As a member of the Arab Bank Group, the Bank's management personnel will take into full consideration respective functions of Arab Bank plc to ensure business plans and policies take into account the interests of the Group and achieve standardisation where appropriate. In particular, the credit risk policies of the shareholder are to be appropriately adopted by the Bank through the representation of the nominees of the shareholder in the Board and Committees.

The respective roles that the Board has reserved for itself, and delegated to management, are to be viewed in this context. The Board must ensure that any Group policies followed by the Board give appropriate regard to the Bank's business and its specific requirements.

Subsidiary Board

Arab Australia Capital Markets Pty Ltd, a wholly owned subsidiary of Arab Bank Australia Limited, is comprised of the following directors:

Geoffrey C E Wild AM
Randa El Sadek
Joseph Rizk OAM

Arab Bank Australia Limited and its controlled entities
Directors' report
for the year ended 31 December 2017

The Directors present their report together with the financial report of Arab Bank Australia Limited (the "Company") and the consolidated financial report of the economic entity, being the Company and its controlled entities, for the year ended 31 December 2017, and the auditor's report thereon.

Directors

The directors of the Company at any time during or since the financial year are:

Mr Geoffrey C E Wild AM, Chairman and Non Executive Independent Director

Mr Wild has been a member of the Board since 2 November 1995 and was appointed as Chairman on 19 July 2011. Prior to his appointment as Chairman, he was Deputy Chairman from 9 September 2004. He is a member of the Board Audit Committee, Board Risk Committee, the Board Remuneration Committee and the Board Credit Delegation.

Mr Wild is also the Chairman of WPP Holdings Australia and related entities. Other directorships held are Ooh! Media Limited, IBISWorld Limited and Wild Family Nominees Pty Ltd.

He is a Fellow of the Advertising Institute of Australia (dip), Fellow of the Royal College of Arts (FRCA), Fellow of the Australian Institute of Company Directors, Associate of the Institute of Business Administration, and a Member of the Order of Australia (AM).

Ms Randa El Sadek, Deputy Chair and Non Executive Director

Ms El Sadek is Deputy Chair and has been a Board member since 17 August 2011. Ms El Sadek is a member of the Board Remuneration Committee and the Board Credit Delegation.

Ms El Sadek is Deputy Chief Executive Officer of Arab Bank plc. She holds a Masters in Business Administration.

Mr Leslie E Taylor AM, Non Executive Independent Director

Mr Taylor has been a member of the Board since 25 November 2004 and is Chair of the Board Audit Committee and a member of the Board Risk Committee.

Mr Taylor is a solicitor and a Senior Fellow of the Financial Services Institute of Australia.

He is Chairman of the Whitehouse Institute of Fashion and Design and a director of Ellenborough Securities Pty Limited.

Mr Taylor was made a Member of the Order of Australia (AM) for services to the Financial Sector in 2010.

Mr Ian G MacDonald, Non Executive Independent Director

Mr MacDonald has been a member of the Board since 1 July 2006. He is Chair of the Board Remuneration Committee and Board Risk Committee and a member of the Board Audit Committee and Board Credit Delegation.

He is Chairman of Genworth Mortgage Insurance Australia Limited and a Director of Tasmanian Public Finance Corporation.

Mr MacDonald is a Senior Fellow of the Financial Services Institute of Australasia, and a Member of the Australian Institute of Company Directors.

Arab Bank Australia Limited and its controlled entities
Directors' report
for the year ended 31 December 2017

Ms Therese A Batshon, Non Executive Director

Ms Batshon has been a member of the Board since 18 March 2013. She is also a Member of the Board Audit Committee, Board Risk Committee and Board Credit Delegation.

Ms Batshon is the Senior Vice President and Area Head for Arab Bank plc – Asia Pacific. She has more than 30 years of banking experience across a range of business areas and geographical regions.

She has a Masters Degree in Management Sciences/Administration.

Mr Saleem J S Shadeed, Non Executive Director

Mr Shadeed has been a member of the Board since 22 April 2015.

He is a member of the Board Audit Committee and Board Risk Committee.

Mr Shadeed is Vice President - Credit: International and Subsidiaries Division for Arab Bank plc and has over 20 years of banking experience.

He has a Masters Degree in Business Administration.

Mr Joseph Rizk OAM, Managing Director

Mr Rizk has been Managing Director since 22 December 2010.

He is the President of the Board of Directors for the Westmead Medical Research Foundation, Director of the Westmead Institute for Medical Research, Director of the Lebanese Chamber of Commerce, Director of the Australian Arab Chamber of Commerce and Industry and Chairman of the Italian Opera Foundation Association.

Mr Rizk has over 40 years' experience in Banking including various roles at National Australia Bank Limited before joining the Bank as Chief Banking Officer in 2005. He is a fellow of the Financial Services Institute of Australasia, Fellow of the Australian Institute of Management and a member of the Australian Institute of Company Directors. He is also a panel member of the NSW Language Advisory Panel (Board of Studies, Teaching and Educational Standards NSW).

Directors' Meetings

The number of Directors' meetings held (including meetings of committees of Directors) and number of meetings attended as members by each of the Directors during the financial year were:

Board

Director	Meetings Held	Meetings Attended
Geoffrey C E Wild AM	4	4
Randa El Sadek	4	4
Leslie E Taylor AM	4	4
Ian G MacDonald	4	4
Therese Batshon	4	4
Saleem J S Shadeed	4	4
Joseph Rizk OAM	4	4

Committee Meetings

Director	Risk Committee		Audit Committee		Remuneration Committee	
	Held	Attended	Held	Attended	Held	Attended
Geoffrey C E Wild AM	5	5	4	4	3	3
Randa El Sadek	-	-	-	-	3	3
Leslie E Taylor AM	5	5	4	4	-	-
Ian G MacDonald	5	5	4	4	3	3
Therese Batshon	5	5	4	4	-	-
Saleem J S Shadeed	5	5	4	4	-	-

Company Secretary

Katherine Bayliss was appointed Company Secretary on 9 July 2013 and Executive Manager Finance and Company Secretary on 14 March 2016. She is a fellow of the Association of Chartered Certified Accountants and a Chartered Secretary.

Principal activities

The principal activity of the Company and the economic entity is the provision of general banking services.

Results

The consolidated income before income tax expense was \$87,000 (2016: \$1,399,000).

The consolidated (loss)/income after income tax expense of \$330,000 (2016: \$242,000) was \$(243,000) (2016: \$1,157,000).

Auditor's independence

The lead auditor's independence declaration is set out on page 14 to 16 and forms part of the Directors' report for the year ended 31 December 2017.

Indemnification and insurance of officers and auditors

The Company has agreed to indemnify the directors and officers of the Company and its controlled entities against all liabilities to another person (other than the Company or a related body corporate) that may arise from their position as officers of the Company and its controlled entities, except where the liability arises out of conduct involving a lack of good faith. The Company has, during the year, maintained insurance contracts indemnifying current and former directors and officers of the Company. Disclosure by the Company of the amount of the insurance and the nature of the liabilities covered by the insurance contracts is prohibited under the terms of the contract.

The Company has not entered into any agreement with its current auditors, Deloitte Touché Tohmatsu, which indemnifies them against any claims by third parties arising from their report on the Annual Financial Report.

Since the end of the previous financial year, the Company has paid insurance premiums in respect of directors' and officers' liability and associated legal expenses for current directors and officers, including senior executives of the Company.

Dividends

No dividends have been paid or declared since the start of the financial year.

The directors do not recommend the payment of a final dividend in respect of the financial year ended 31 December 2017 (2016: Nil).

Review of operations

Throughout 2017 the bank continued to execute its strategic plan to diversify its portfolio thereby strengthening its resilience to market cyclical variations. This has resulted in a reduction in the portfolio in 2017. This focus on portfolio quality is reflected in the level of non-performing loans which remain less than 1% of the overall portfolio.

The Bank remains committed to the core pillars of sound banking practice with \$25m of the subordinated debt converted to equity in 2017 which further enhanced our strong capital base. Strong liquidity was also maintained at all times.

The bank continues to focus on operating costs and efficiency whilst maintaining the quality of products and services through the investment in technology and strategic initiatives. The development of an upgraded internet and mobile banking offering are currently underway.

Change in state of affairs

In the opinion of the directors, there were no other significant changes in the state of affairs of the economic entity that occurred during the financial year under review.

Prudential Standard APS 330: Public Disclosure

For detailed disclosures of APS 330, refer to the Company's website <http://www.arabbank.com.au/about/public-disclosures>.

Environmental regulations

The Company and the economic entity are not subject to any particular or significant environmental regulation under a law of the Commonwealth or of a State or Territory.

Events subsequent to balance date

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of the Company and its Subsidiaries, Arab Australia Capital Markets Pty Ltd and the Petra Trusts (referred to as the "Group" or the "Consolidated entities"), the results of those operations, or the state of affairs of the Group in future financial years.

Likely developments

The directors believe, on reasonable grounds, that to include in this report further information regarding likely developments in the operations of the economic entity and the expected results of those operations in future financial years would be likely to result in unreasonable prejudice to the economic entity.

Directors' benefits

Since the end of the previous financial year, no director of the Company has received or become entitled to receive any benefit (other than a benefit included in the aggregate amount of remuneration received or due and receivable by directors shown in the notes to the financial report) because of a contract made by the Company, its controlled entities or a related body corporate with a director or with a firm of which a director is a member, or with an entity in which the director has a substantial interest.

Rounding off

The Company is of a kind referred to in ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191 dated 24 March 2016 and in accordance with that Corporations instrument, amounts in the financial report and directors' report have been rounded off to the nearest thousand dollars, unless otherwise stated.

This report is made with a resolution of the directors:



Joseph Rizk OAM
Director



Leslie E Taylor AM
Director

Dated at Sydney this 23rd day of March 2018

Independent Auditor's Report to the directors of Arab Bank Australia Limited

Report on the Audit of the Financial Report

Opinion

We have audited the financial report of Arab Bank Australia Limited (the "Company") and its subsidiaries (the "Group") which comprises the consolidated Statement of Financial Position as at 31 December 2017, the consolidated Statement of Profit and Loss, the consolidated Statement of Comprehensive Income, the consolidated Statement of Changes in Equity and the consolidated Statement of Cash Flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information, and the directors' declaration.

In our opinion, the accompanying financial report of the Group is in accordance with the *Corporations Act 2001*, including:

- (i) giving a true and fair view of the Group's financial position as at 31 December 2017 and of their financial performance for the year then ended; and
- (ii) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for Opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of our report. We are independent of the Group in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

We confirm that the independence declaration required by the *Corporations Act 2001*, which has been given to the directors of the Company, would be in the same terms if given to the directors as at the time of this auditor's report.

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

Other Information

The directors are responsible for the other information. The other information comprises the information included in the Group's Annual Report for the year ended 31 December 2017, but does not include the financial report and our auditor's report thereon.

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

In connection with our audit of the financial report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the Financial Report

The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the financial report, the directors are responsible for assessing the ability of the Group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Report

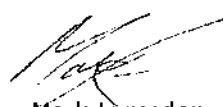
Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that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

As part of an audit in accordance with the Australian Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial report or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the financial report. We are responsible for the direction, supervision and performance of the Group's audit. We remain solely responsible for our audit opinion.

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

Deloitte. Touche. Tohmatsu.
DELOITTE TOUCHE TOHMATSU


Mark Lumsden
Partner
Chartered Accountants
Sydney, 23 March 2018

The Board of Directors
Arab Bank Australia Limited
Level 7, 20 Bridge Street
SYDNEY NSW 2000

23 March 2018

Dear Board Members

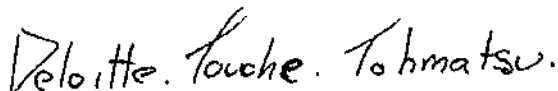
Arab Bank Australia Limited

In accordance with section 307C of the Corporations Act 2001, I am pleased to provide the following declaration of independence to the directors of Arab Bank Australia Limited.

As lead audit partner for the audit of the financial statements of Arab Bank Australia Limited for the financial year ended 31 December 2017, I declare that to the best of my knowledge and belief, there have been no contraventions of:

- (i) the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and
- (ii) any applicable code of professional conduct in relation to the audit.

Yours sincerely



DELOITTE TOUCHE TOHMATSU



Mark Lumsden
Partner
Chartered Accountants

Arab Bank Australia Limited and its controlled entities
Financial Statements
for the year ended 31 December 2017

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Arab Bank Australia Limited and its controlled entities

Statement of Profit or Loss

for the year ended 31 December 2017

	Note	Consolidated		Company	
		2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Interest income	4	39,723	43,361	39,723	43,357
Interest expense	4	19,201	22,658	19,209	22,662
Net interest income		20,522	20,703	20,514	20,695
Non-interest income	4	3,313	5,904	3,313	5,904
Operating Income		23,835	26,607	23,827	26,599
Loan impairment (reversals)/charges	7	(338)	1,448	(338)	1,448
Operating expenses	4	24,086	23,760	24,086	23,760
Income before income tax expense		87	1,399	79	1,391
Income tax expense	5(a)	330	242	328	240
Net (loss)/income		(243)	1,157	(249)	1,151

The Statement of Profit or Loss is to be read in conjunction with the notes to the financial statements set out on pages 24 to 66.

Arab Bank Australia Limited and its controlled entities
Statement of Comprehensive Income
for the year ended 31 December 2017

	Note	2017 \$'000	Consolidated 2016 \$'000	2017 \$'000	Company 2016 \$'000
(Loss)/Profit for the period		(243)	1,157	(249)	1,151
Other comprehensive Income					
Items that may be reclassified subsequently to the Statement of Profit or Loss					
Effective portion of changes in fair value of cash flow hedge	15	60	(327)	60	(327)
Gain on cash flow hedging instruments	15	-	2,728	-	2,728
Other comprehensive income before income tax		60	2,401	60	2,401
Income tax expense charged directly to other comprehensive income	5(a)	(18)	(720)	(18)	(720)
Other comprehensive income for the period, net of income tax		42	1,681	42	1,681
Total comprehensive(loss)/ income for the period		(201)	2,838	(207)	2,832
Total comprehensive (loss)/income attributable to owners of the Company		(201)	2,838	(207)	2,832

The Statement of Comprehensive Income is to be read in conjunction with the notes to the financial statements set out on pages 24 to 66.

Arab Bank Australia Limited and its controlled entities
Statement of Financial Position
for the year ended 31 December 2017

		Consolidated		Company	
		2017	2016	2017	2016
		\$'000	\$'000	\$'000	\$'000
Assets					
Cash	17	19,457	3,235	19,457	3,235
Receivables from other financial institutions	18	42,807	91,183	42,807	91,183
Loans and advances to customers, net	6	606,014	676,806	606,014	676,806
Financial assets – at amortised cost	8	290,025	256,891	290,025	256,891
Shares in controlled entities	22	-	-	70	70
Property and equipment	23	725	586	725	586
Intangible assets	19	1,232	1,541	1,232	1,541
Deferred tax assets	5(b)	10,307	10,654	10,349	10,662
Other assets	20	2,141	2,306	2,141	2,306
Total assets		972,708	1,043,202	972,820	1,043,280
Liabilities					
Deposits	11	759,922	826,411	759,922	826,411
Payables to other financial institutions	10	32,904	36,642	33,216	36,945
Derivative liabilities	9	402	63	402	63
Subordinated debt	12	25,006	50,006	25,006	50,006
Provisions for employee entitlements	24	1,754	1,683	1,754	1,683
Other liabilities	21	1,627	2,103	1,632	2,077
Total liabilities		821,615	916,908	821,932	917,185
Net assets		151,093	126,294	150,888	126,095
Equity					
Share capital	14	94,314	69,314	94,314	69,314
Reserves	15	6,141	6,099	6,141	6,099
Retained earnings	16	50,638	50,881	50,433	50,682
Total equity		151,093	126,294	150,888	126,095

The Statement of Financial Position is to be read in conjunction with the notes to the financial statements set out on pages 24 to 66.

Arab Bank Australia Limited and its controlled entities
Statement of Changes in Equity
for the year ended 31 December 2017

Consolidated
For the year ended 31 December 2017

	Note	Share capital \$'000	Hedging reserve \$'000	General reserve for credit losses \$'000	Retained earnings \$'000	Total \$'000
Balance as at 1 January 2017		69,314	(44)	6,143	50,881	126,294
Issuance of share Capital		25,000	-	-	-	25,000
(Loss)/Profit for the period	16	-	-	-	(243)	(243)
Other comprehensive income, net of income tax	15	-	-	-	-	-
Effective portion of changes in fair value of cash flow hedges, net of tax	15	-	42	-	-	42
Total comprehensive (loss)/income for the period	15	-	42	-	(243)	(201)
Balance as at 31 December 2017		94,314	(2)	6,143	50,638	151,093

Company
For the year ended 31 December 2017

Balance as at 1 January 2017		69,314	(44)	6,143	50,682	126,095
Issuance of share capital		25,000	-	-	-	25,000
(Loss)/Profit for the period	16	-	-	-	(249)	(249)
Other comprehensive income, net of income tax	15	-	-	-	-	-
Effective portion of changes in fair value of cash flow hedges, net of tax	15	-	42	-	-	42
Total comprehensive (loss)/income for the period	15	-	42	-	(249)	(207)
Balance as at 31 December 2017		94,314	(2)	6,143	50,433	150,888

The Statement of Changes in Equity is to be read in conjunction with the notes to the financial statements set out on pages 24 to 66.

Arab Bank Australia Limited and its controlled entities
Statement of Changes in Equity
for the year ended 31 December 2017

Consolidated
For the year ended 31 December 2016

	Note	Share capital \$'000	Hedging reserve \$'000	General reserve for credit losses \$'000	Retained earnings \$'000	Total \$'000
Balance as at 1 January 2016		62,500	(1,725)	6,327	49,540	116,642
Issuance of share Capital		6,814	-	-	-	6,814
Profit for the period	16	-	-	-	1,157	1,157
Other comprehensive income, net of income tax	15	-	-	-	-	-
Effective portion of changes in fair value of cash flow hedges, net of tax	15	-	(229)	-	-	(229)
Gains on cash flow hedging instruments, net of tax		-	1,910	-	-	1,910
Total comprehensive income for the period	15	-	1,681	-	1,157	2,838
Transfer from credit reserve to retained earnings	15	-	-	(184)	184	-
Balance as at 31 December 2016		69,314	(44)	6,143	50,881	126,294

Company
For the year ended 31 December 2016

Balance as at 1 January 2016		62,500	(1,725)	6,327	49,347	116,449
Issuance of share capital		6,814	-	-	-	6,814
Profit for the period	16	-	-	-	1,151	1,151
Other comprehensive income, net of income tax	15	-	-	-	-	-
Effective portion of changes in fair value of cash flow hedges, net of tax	15	-	(229)	-	-	(229)
Gains on cash flow hedging instruments, net of tax		-	1,910	-	-	1,910
Total comprehensive income for the period	15	-	1,681	-	1,151	2,832
Transfer from credit reserve to retained earnings	15	-	-	(184)	184	-
Balance as at 31 December 2016		69,314	(44)	6,143	50,682	126,095

The Statement of Changes in Equity is to be read in conjunction with the notes to the financial statements set out on pages 24 to 66.

Arab Bank Australia Limited and its controlled entities

Statement of Cash Flows

for the year ended 31 December 2017

	Note	Consolidated		Company	
		2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
<i>Cash flows from operating activities</i>					
Decrease of loans, advances and bills discounted issued or extended		71,035	73,372	71,035	73,372
Deposits (paid)/received		(65,208)	14,336	(65,208)	14,336
Interest received		40,099	43,872	40,099	43,872
Fees, commission and other non-interest received		3,090	3,192	3,090	3,192
Insurance claims received		249	2,577	249	2,577
Interest paid		(20,424)	(29,119)	(20,432)	(29,123)
Amounts paid to employees and suppliers		(23,653)	(23,037)	(23,637)	(23,037)
Net cash from operating activities	17(b)	5,188	85,193	5,196	85,189
<i>Cash flows from investing activities</i>					
Net purchase of financial assets at amortised cost		(33,029)	(72,437)	(33,029)	(72,437)
Purchase of property and equipment		(415)	(876)	(415)	(876)
Proceeds from sale of property and equipment		-	51	-	51
Net cash used in investing activities		(33,444)	(73,262)	(33,444)	(73,262)
<i>Cash flows from financing activities</i>					
Net (payments)/receipts on dues to other financial institutions		(3,894)	981	(3,902)	985
Issuance of share capital		-	6,814	-	6,814
Net cash (used in)/from financing activities		(3,894)	7,795	(3,902)	7,799
Net (decrease)/increase in cash and cash equivalents		(32,150)	19,726	(32,150)	19,726
Cash and cash equivalents at the beginning of the financial year		94,367	74,641	94,367	74,641
Cash and cash equivalents at the end of the financial year	17(a)	62,217	94,367	62,217	94,367

The Statement of Cash Flows is to be read in conjunction with the notes to the financial statements set out on pages 24 to 66.

Basis of Financial Statements Preparation

This section outlines the Group's (definition is set out in Note 1 general information) accounting policies that relate to the financial statements and the notes to the accounts. Where a particular accounting policy relates to a specific balance or transaction, such accounting policy is contained in the relevant note. This section also describes the new accounting standards, amendments and interpretations that are effective in 2017 or later years and how these are expected to impact the Group's consolidated financial statements.

1. General information

Arab Bank Australia Limited (referred to as the "Bank" or "Company") is a Company domiciled in Australia. The address of the Company's registered office and principal place of business is Level 7, 20 Bridge Street, Sydney, NSW, 2000.

The Company established the Petra Trusts (referred to as the "Trust") which is a Residential Mortgage Backed Internal Securitisation Trust. The Company acts as subscriber, manager and administrator of the Trust. Perpetual Corporate Trust Limited is the Trustee. The Trust is a wholly owned entity of the Company since inception. Refer to Note 13 for further details.

The consolidated financial statements for the year ended 31 December 2017, comprise the Company and its Subsidiaries, Arab Australia Capital Markets Pty Ltd and the Trust. Arab Bank plc is the ultimate controlling entity.

The Group is a for-profit entity and primarily involved in corporate and retail banking.

2. Summary of significant accounting policies

(a) Statement of compliance

The financial statements of the Company and the Group are general purpose financial statements which have been prepared in accordance with Australian Accounting Standards adopted by the Australian Accounting Standards Board (AASB) and the Corporations Act 2001. The financial statements of the Company and the Group comply with International Financial Reporting Standards (IFRS) adopted by the International Accounting Standards Board (IASB).

The consolidated financial statements were authorised for issue by the Board of Directors on 23rd March 2018.

(b) Significant accounting policies

The consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments which are measured at fair value.

The Group's accounting policies which relate to a specific account balance or transaction are disclosed within the relevant notes. Whereas accounting policies which have an impact on the financial statements as a whole are set out below.

(c) Functional and presentation currency

These consolidated financial statements are presented in Australian dollars, which is the Group's functional currency.

The Company is of a kind referred to in ASIC Corporations (Rounding in Financial/Directors' Reports) instrument 2016/191 dated 24 March 2016 and in accordance with that instrument, all financial information presented in Australian dollars has been rounded to the nearest thousand unless otherwise stated.

2. Summary of significant accounting policies (continued)

(d) Use of estimates and judgements

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

The following are the critical judgements that management have made in the process of applying the Group's accounting policies and that have the most significant effect in the amounts recognised in the consolidated financial statements:

Note 7 – Provisions for impairment
Note 25 – Fair value of financial instruments
Note 5 – Income tax - deferred tax assets

(e) Basis of consolidation

The consolidated financial statements include the financial statements of the Bank and all entities controlled by the Bank. The Bank controls another entity when it has:

- power over the relevant activities of the entity;
- exposure to, or rights to, variable returns from its involvement with the entity; and
- the ability to use its power over the entity to affect the Bank's returns from the entity.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary.

All balances and transactions between Group entities have been eliminated on consolidation.

(f) Foreign currency transactions

Transactions in foreign currencies are translated to Australian Dollars at the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Statement of Profit or Loss.

3. Application of new and revised Accounting Standards

I. New and revised AASBs affecting amounts reported and/or disclosures in the financial statements

In the current year, the Group has applied the following amendments to AASBs issued by the Australian Accounting Standards Board (AASB) that are mandatorily effective for an accounting period that begins on or after 1 January 2017, and therefore relevant for the current year end and the Group's operations.

- ***AASB 2016-1 Amendments to Australian Accounting Standards – Recognition of Deferred Tax Assets for Unrealised Losses***

The amendments clarify the following:

- Decreases below cost in the carrying amount of a fixed-rate debt instrument measured at fair value for which the tax base remains at cost give rise to a deductible temporary difference, irrespective of whether the debt instruments' holder expects to recover the carrying amount of the debt instrument by sale or by use, or whether it is probable that the issuer will pay all the contractual cash flows.
- When an entity assesses whether taxable profits will be available against which it can utilise a deductible temporary difference, and the tax law restricts the utilisation of losses to deduction against income of a specific type (e.g. capital losses can only be offset against capital gains), an entity assesses a deductible temporary difference in combination with other deductible temporary difference of that type, but separately from other types of deductible temporary difference.
- The estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this.

I. New and revised AASBs affecting amounts reported and/or disclosures in the financial statements (continued)

- In evaluating whether sufficient future taxable profits are available, an entity should compare the deductible temporary differences with future taxable profits excluding tax deductions resulting from the reversal of those deductible temporary differences.

The application of these amendments does not have a material impact on the Group's consolidation financial statements as the Bank already assesses the sufficiency of future taxable profits in a way that is consistent with these amendments.

- **AASB 2016-2 Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 107**

- The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities.

The application of these amendments does not have a material impact on the Group's consolidated financial statements.

II. Standards and interpretations in issue but not yet adopted

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning on or after 1 January 2017, and have not been applied in preparing these consolidated financial statements. The impact of the changes to Australian Accounting Standards and Interpretations which are applicable to the Group is set out below.

Impact of changes to Australian Accounting Standards and Interpretations

Adoption of the following amendments will result in changes to the Group's accounting policies on recognition and measurement:

- **AASB 9 'Financial Instruments', and the relevant amending standards**

AASB 9 issued in December 2009 introduced new requirements for the classification and measurement of financial assets. AASB 9 was subsequently amended in December 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition, and in December 2013 to include the new requirements for general hedge accounting. Another revised version of the standard was issued in December 2014 mainly to include a) impairment requirements for financial assets and b) limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' (FVTOCI) measurement category for certain simple debt instruments. This will become mandatory beginning 1st January 2018.

Key requirements of AASB 9 are:

Classification and measurement

- All recognised financial assets that are within the scope of AASB 9 are required to be subsequently measured at amortised cost or fair value or fair value through other comprehensive income with the approach that classifies the financial assets based on a business model for managing financial assets and whether the contractual cash flows represent solely payments of principal and interest.
- With regard to the measurement of financial liabilities designated as at fair value through profit or loss, AASB 9 requires that the amount of change in fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Under AASB 139, the entire amount of the change in fair value of the financial liability designated as fair value through profit or loss is presented in profit or loss.

3. Application of new and revised Accounting Standards (continued)

II. Standards and interpretations in issue not yet adopted (continued)

Impact of changes to Australian Accounting Standards and Interpretations (continued)

Impairment

- In relation to the impairment of financial assets, AASB 9 requires an expected credit loss model, as opposed to an incurred credit loss model under AASB 139. AASB 9 requires more timely recognition of expected credit losses using a three stage approach where:
 - Financial assets where there has been no significant increase in credit risk since origination, a provision equivalent to 12 months expected credit losses is recognised.
 - For financial assets where there has been a significant increase in credit risk or where the asset is credit impaired, a provision equivalent to full lifetime expected loss is required.
- Expected credit losses are probability weighted amounts considering a range of possible outcomes, time value of money, past events, current conditions and forecasts of economic conditions.

Hedging

- The new general hedge accounting requirements retain the three types of hedge accounting mechanisms currently available in AASB 139. Under AASB 9, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. Moreover, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about an entity's risk management activities have also been introduced.

In 2011 the Group early adopted AASB 9 "Financial Instruments" (2010), which was subsequently revised in December 2013 and December 2014. The Group elected an accounting policy choice under AASB 9 to continue to apply the impairment requirements for financial assets and hedge accounting requirements under AASB 139 "Financial Instruments: Recognition and measurement".

Work is in progress to implement the remaining AASB 9's requirements. The directors of the Company anticipate that full adoption of AASB 9 may have increased volatility in respect of the Group's profit and loss provisioning and minor impact on hedge accounting. The estimated impact on provision is less than \$1M.

• **AASB 15 'Revenue from Contracts with Customers'**

- AASB 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. AASB 15 will supersede the current revenue recognition guidance including AASB 118 'Revenue', AASB 111 'Construction Contracts' and the related Interpretations when it becomes effective on 1 January 2018.

The core principle of AASB 15 is that an entity should recognise revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

- Under AASB 15, an entity recognises revenue when (or as) a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer.

The directors of the Company anticipate the impact to be in the income recognition for head start home loans as discounts to interest rates needed to be recognised over the expected life of the loan. The expected impact is not material as head start home loans comprise only 2% of the total lending portfolio and as such contribute an immaterial portion to revenue on a consolidated basis.

3. Application of new and revised Accounting Standards (continued)

II. Standards and interpretations in issue not yet adopted (continued)

Impact of changes to Australian Accounting Standards and Interpretations (continued)

- **AASB 16 Leases**

The new standard will be effective for annual periods beginning on or after 1 January 2019.

AASB 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors.

The accounting model for lessees will require lessees to recognise all leases on balance sheet, except for short-term leases and leases of low value assets.

The Group, as a lessee, engages only in operating leases and has entered into commercial property leases, leases on motor vehicles and items of office equipment. As at 31 December 2017, the Group does not intend to early adopt the standard and as such any impact on the consolidated financial statements are yet to be assessed.

III. New Standards and Interpretations not applicable for the Group but are relevant for the period

- AASB 2016-4 'Amendments to Australian Accounting Standards- Recoverable Amount of Non-Cash Generating Specialised Assets of Not-for-Profit Entities' is not applicable to the Group as the Group is a for-profit entity.
- AASB 2016-7 'Amendments to Australian Accounting Standards- Deferral of AASB 15 for Not-for-Profit Entities' is not applicable as the Group is a for-profit entity.
- AASB 2017-2 'Amendments to Australian Accounting Standards- Further Annual improvements 2014-2016' does not apply as the Company does not hold any interests in entities classified as held for sale or discontinued operations.

Performance for the year

This section shows the results and performance of the Group in more detail including the key areas of operating income and expenses and income tax (refer to Notes 4 and 5).

4. Operating profit and expenses

Operating income

Recognition and measurement

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The principal sources of revenue are interest income, fees and commissions.

Interest income

Interest income is recognised on a time proportion basis using the effective interest rate on the financial asset. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument (or when appropriate, a shorter period) to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and commissions paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

Interest continues to be accrued on loans, advances and other receivables when an impairment assessment has concluded that the interest is not recoverable, and an equal and offsetting specific provision for impaired interest is also accrued.

There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably.

Interest expense

Interest expense is recognised on a time proportion basis using the effective interest rate of the financial liability. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial instrument (or where appropriate, a shorter period) to the amount of the financial liability.

Interest income and interest expense presented in the Statement of Profit or Loss include interest on financial assets and liabilities measured at amortised cost calculated on an effective interest basis.

Lending fees

Fees and direct costs relating to loan origination, financing or restructuring and to loan commitments are deferred and amortised to non interest income over the expected life of the loan using the effective interest rate method. Fees received for commitments which are not expected to result in a loan are included in credit related fees and commissions and amortised on a straight-line basis over the commitment period. Where fees are received on an ongoing basis and represent the recoupment of the costs of maintaining and administering existing loans, these fees are taken to income and classified as fees and commission income when the service has been provided.

Commission and other fees

When commission charges and fees relate to specific transactions or events, they are recognised as income in the period in which they are received. However, when they are charged for services provided over a period, they are taken to income on an accrual basis.

Trading gains and losses

Trading gains and losses comprise gains or losses related to trading assets and liabilities, and include all realised and unrealised fair value changes and foreign exchange differences.

4. Operating profit and expenses (continued)

Profit before income tax has been determined as follows:

	Consolidated		Company	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Interest income				
Cash and liquid assets	113	56	113	56
Receivables from other financial institutions ¹	733	961	733	957
Loans and advances to customers ²	33,061	37,446	33,061	37,446
Financial assets – at amortised cost	5,816	4,898	5,816	4,898
Total interest income	39,723	43,361	39,723	43,357

¹Receivables from other financial institutions includes \$233 (2016: \$234) received from the Arab Bank plc group.

²Loans and advances to customers includes \$NIL (2016: \$1,533) received from related parties.

Interest expense				
Deposits ²	17,885	20,264	17,893	20,268
Subordinated debt ³	940	1,617	940	1,617
Payables to other financial institutions ¹	301	407	301	407
Total interest rate swaps	75	370	75	370
Total interest expense	19,201	22,658	19,209	22,662

¹Payables to other financial institutions include \$9,355 (2016: \$4,221) paid to Arab Bank plc group.

²Deposits include \$28,305 (2016: \$17,377) paid to related parties.

³The subordinated debt represents total amount of interest paid to Arab Bank plc.

Net interest income	20,522	20,703	20,514	20,695
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Non-interest income/(expense)				
Insurance claims received*	249	2,439	249	2,439
Commission and other fees	1,860	2,180	1,860	2,180
Foreign exchange earnings	721	826	721	826
Cost of forward exchange contracts	(9)	(163)	(9)	(163)
Profit/(Loss) on disposal of property and equipment	(9)	31	(9)	31
Gain on sale of securities	8	564	8	564
Other income**	493	27	493	27
Total non-interest income	3,313	5,904	3,313	5,904

Operating income	23,835	26,607	23,827	26,599
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*Recoveries of defence costs in relation to bad debts written off in previous years.

** 2017 includes \$385k of GST claimed for prior years following the adoption of an apportionment methodology.

Operating expenses

Recognition and measurement

Operating expenses are recognised as the relevant service is rendered, or the related liability is incurred.

Salary and staff costs are recognised over the period in which the employees render the service. Refer to Note 24 Provision for employee entitlements for more information on staff provisions.

4. Operating profit and expenses (continued)

Lease payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Depreciation and amortisation - refer to Note 23 Property and equipment for further details on depreciation and Note 19 Intangible assets for amortisation of intangibles.

Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except:

- where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or
- for receivables and payables which are recognised inclusive of GST.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of other assets or other liabilities.

Cash flows are included in the cash flow statement on a gross basis. The GST component of cash flows arising from investing and financing activities which is recoverable from, or payable to, the taxation authority is classified within operating cash flows.

	Consolidated		Company	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Staff				
Salaries	11,236	11,162	11,236	11,162
Superannuation	1,107	1,190	1,107	1,190
Provision for employee entitlements	71	217	71	217
Training and education	171	161	171	161
Other	952	848	952	848
	13,537	13,578	13,537	13,578
Occupancy				
Rent	2,378	2,303	2,378	2,303
Other	756	695	756	695
	3,134	2,998	3,134	2,998
Depreciation and amortisation				
Amortisation of software	548	604	548	604
Fixture and fittings	204	232	204	232
Property and equipment	342	158	342	158
	1,094	994	1,094	994
Office expenses				
Marketing and communications	952	929	952	929
Postage and stationery	278	311	278	311
Subscriptions	296	251	296	251
Business Travel	374	290	374	290
Entertainment	159	226	159	226
Communications	8	12	8	12
Other	180	209	180	209
	2,247	2,228	2,247	2,228
Other				
Information system expenses	2,304	2,330	2,304	2,330
Service and consultation fees	1,791	1,560	1,791	1,560
Other	(21)	72	(21)	72
	4,074	3,962	4,074	3,962
Total operating expenses	24,086	23,760	24,086	23,760

5. Income tax

Recognition and measurement

Income tax on the profit for the year comprises current and deferred tax. Income tax is recognised in the Statement of Profit or Loss except to the extent that it relates to items recognised directly in the Statement of Other Comprehensive Income or in the Statement of Changes in Equity.

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

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date.

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

Tax consolidation

The Company entered into a tax sharing agreement with its 100% owned subsidiaries. The Company along with the Trust and Arab Australia Capital Markets Pty Ltd form the tax consolidated group. Under the terms of the agreement, all members of the tax-consolidated group are taxed as a single entity and the Head Company is Arab Bank Australia Limited.

(a) Income Tax Expense

Recognised in the Statement of Profit or Loss

	Note	Consolidated 2017 \$'000	Consolidated 2016 \$'000	Company 2017 \$'000	Company 2016 \$'000
Current tax expense					
Current year		-	779	33	777
		-	779	33	777
Deferred tax expense					
Effect of a write down/(increase) in DTA due to reversal/ (increase) in provisions		350	(305)	350	(305)
Effect of movement in other temporary differences		(20)	(334)	(55)	(334)
Effect of concession (research and development)		-	102	-	102
		330	(537)	295	(537)
Total income tax expense in the Statement of Profit or Loss		330	242	328	240
Recognised in other comprehensive income					
Movement in cash flow hedge reserve	15	18	(98)	18	(98)
Gains on cash flow hedging instruments		-	818	-	818
		18	720	18	720

*At the balance sheet date, the Company has unutilised tax losses of \$25.6m (2016: \$24.7m) available to offset against future profits. A deferred tax asset has not been recognised for the additional tax losses generated in 2017 due to the quantum of tax losses brought forward. The asset will be recovered if taxable profits arise that could be offset against the deferred tax asset when it reverses.

5. Income tax (continued)

Reconciliation between tax expense and pre-tax accounting profit:

	Consolidated		Company	
	2017	2016	2017	2016
	\$'000	\$'000	\$'000	\$'000
(Loss)/Profit for the year	(243)	1,157	(249)	1,151
Total income tax expense	330	242	328	240
Profit excluding income tax	87	1,399	79	1,391
Income tax expense using the Company's domestic tax rate of 30% (2016: 30%)	26	420	24	418
Non-deductible expenses	34	32	34	32
Effect of unused tax losses not recognised as deferred tax assets	270	-	270	-
Effect of concession (research and development)	-	102	-	102
Research and Development tax offset	-	(312)	-	(312)
Total income tax expense	330	242	328	240

(b) Deferred tax assets and liabilities

Deferred tax assets arising from:

Provision for employee entitlements	526	505	526	505
Property and equipment	411	438	411	438
Derivative liability	1	19	1	19
Doubtful debts	1,013	1,363	1,013	1,363
Tax loss carry forward	7,412	7,412	7,420	7,420
Research and development tax offset	740	740	740	740
Other	212	189	246	189
Deferred tax assets	10,315	10,666	10,357	10,674
Other	(8)	(12)	(8)	(12)
Total deferred tax liabilities	(8)	(12)	(8)	(12)
Net tax assets	10,307	10,654	10,349	10,662

The recognition of deferred tax asset relies on an assessment of the profitability and sufficient future taxable profits. With the recent history of tax losses incurred in the 2012 to 2015 financial years, the most significant judgements relate to expected future profitability and the assumptions and the key drivers on which forecasts are based.

(c) Movement in temporary differences during the year:

Balance as at 1 January	10,654	11,618	10,662	11,623
Provision for employee benefits	21	65	21	65
Property and equipment	(27)	(29)	(27)	(29)
Derivative liability*	(18)	(720)	(18)	(720)
Movement in provisions	(350)	305	(350)	305
Other assets	4	2	4	2
Movement in tax losses	-	(882)	-	(879)
Other liabilities	23	(17)	57	(17)
Research and development tax offset	-	312	-	312
Balance as at 31 December	10,307	10,654	10,349	10,662

*\$60,000 (2016: \$2,401,000) of the gross movement in derivative assets and liabilities was recognised in other comprehensive income. Refer to Note 15.

5. Income tax (continued)

(c) Movement in temporary differences during the year (continued)

Deductible temporary differences and unused tax losses for which no deferred tax assets have been recognised are attributable to the following:

	Consolidated		Company	
	2017	2016	2017	2016
	\$'000	\$'000	\$'000	\$'000
Capital losses	1,020	1,020	1,020	1,020
Tax losses (revenue in nature)	900	-	900	-

Lending

The lending assets of the Group are discussed in this section. Further information is provided on loans and other receivables and impairment relating to these financial assets. (Refer Notes 6 to 7)

6. Loans and advances to customers

Recognition and measurement

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables' and are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the effect of discounting is immaterial.

All loans are subject to continuous management review, to assess whether there is any objective evidence that any loan or group of loans is impaired. The table below presents loans and advances to customers by purpose.

Commercial loans*	189,533	233,135	189,533	233,135
Housing loans – other**	265,627	287,345	265,627	287,345
Housing loans – owner occupied**	133,102	131,256	133,102	131,256
Overdrafts	21,129	29,613	21,129	29,613
Gross loans and advances to customers	609,391	681,349	609,391	681,349
Less:				
Provisions for impairment				
Specific provision	(1,157)	(1,663)	(1,157)	(1,663)
Collective provision	(2,220)	(2,880)	(2,220)	(2,880)
Provisions for impairment	(3,377)	(4,543)	(3,377)	(4,543)
Net loans and advances to customers	606,014	676,806	606,014	676,806
Current	169,180	192,284	169,180	192,284
Non-Current	436,834	484,522	436,834	484,522
	606,014	676,806	606,014	676,806

* This category includes capitalised commission received from customers in advance of \$335k (2016: \$318k) which is amortised using the effective interest method.

** Includes \$34,594k (2016: \$35,905k) of securitised loans. Refer to Note 13 for further details.

7. Provision for impairment

Recognition and measurement

The Group assesses at each balance sheet date whether there is objective evidence that financial assets excluding derivative assets are impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the balance sheet date ('a loss event') and that loss event or events has had an impact on the estimated future cash flows of the financial asset or portfolio that can be reliably estimated. If any such indication exists, the asset's carrying amount is written down to the asset's estimated recoverable amount.

Loans and advances and financial assets at amortised cost

The Group assesses at each reporting date, whether there is any objective evidence that individual loans and advances and financial assets held at amortised cost or groups of these financial assets are impaired.

Objective evidence that an individual asset or a group of these assets are impaired includes, but is not limited to, observable data from the following loss events:

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

If there is objective evidence that an impairment loss on loans and advances or held to maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the asset's recoverable amount. Loans and advances to customers are presented net of provisions for loan impairment. The Group has assessed provisions individually and collectively.

Specific provision

Individually assessed provisions are made against financial assets that are individually significant or which have been individually assessed as impaired. The provisions are established based primarily on estimates of the realisable value of collateral taken and are measured as the difference between a financial asset's carrying amount and the net value of the expected future cash flows.

Collective provision

All other loans and advances to customers that do not have an individually assessed provision are assessed collectively for impairment. Collective provisions are maintained to reduce the carrying amount of the portfolios of similar loans and advances to their estimated recoverable amount at the balance sheet date.

This is calculated taking into consideration historical loss data, current available information for assets with similar risk characteristics, evidence of indicators of impairment, and a qualitative assessment of changes in the environment. In addition, management considers overall indicators of portfolio performance, quality and economic conditions.

An impairment loss is recognised when the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the Statement of Profit or Loss.

7. Provision for impairment (continued)

Recognition and measurement (continued)

Non-financial assets

The carrying amounts of the Group's non-financial assets are assessed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

The recoverable amount of other assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the expected future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

A previously recognised impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. This would not exceed the carrying amount net of amortisation or depreciation, if no impairment loss had been recognised in prior years.

	Consolidated		Company	
	2017	2016	2017	2016
	\$'000	\$'000	\$'000	\$'000
Specific provisions				
Opening balance	1,663	1,081	1,663	1,081
Specific loan impairment charges*	1,229	1,234	1,229	1,234
Recoveries and write backs	(907)	(71)	(907)	(71)
Bad debt write offs**	(828)	(581)	(828)	(581)
Closing balance	1,157	1,663	1,157	1,663
Collective provisions				
Opening balance	2,880	2,447	2,880	2,447
Collective loan impairment charges (net of release)	(660)	433	(660)	433
Closing balance	2,220	2,880	2,220	2,880
Total provisions for impairment	3,377	4,543	3,377	4,543

*Total charge for debt provisions net of recoveries on loans previously written off and write backs is \$1,079k (2016: \$1,448k).

**Bad debt written off during the year.

Included in interest income is \$51k (2016: \$65k) relating to income on impaired loans and advances to customers. This is fully provided for in the specific provision.

Treasury and Investments

This section covers the financial instruments of the Group including derivatives and other financial assets at amortised cost (refer Notes 8 to 9).

I. Non-derivative financial instruments

In 2011 the Group early adopted AASB 9 "Financial Instruments" (2010), which was subsequently revised in December 2013 and December 2014. The Group elected an accounting policy choice under AASB 9 to continue to apply the impairment requirements for financial assets and hedge accounting requirements under AASB 139 "Financial Instruments: Recognition and measurement".

Recognition and measurement

The Group initially recognises financial assets on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

Financial assets are initially measured at fair value. If the financial asset is not subsequently measured at fair value through profit or loss, then the initial measurement includes transaction costs that are directly attributable to the asset's acquisition or origination. The Group subsequently measures financial assets at either amortised cost or fair value.

Premiums or discounts are amortised using the effective interest method. Any allocations resulting from the decline in value of these investments leading to the inability to recover the investment or part thereof are recorded, and any impairment is recognised in the consolidated Statement of Profit or Loss.

Derecognition

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in such transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

The Group derecognises a financial liability when its contractual obligations are discharged or expire.

Amortised Cost

On initial recognition, a financial asset is classified as measured at: amortised cost, fair value through other comprehensive income (FVTOCI) or fair value through profit and loss (FVTPL)

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

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

Financial asset categories in the Statement of Financial Position measured at amortised cost are receivables from other financial institutions, selected bonds and floating rate notes (financial assets at amortised cost) and financial liabilities include the subordinated debt.

Fair Value through Other Comprehensive Income

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

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

On initial recognition of an equity investment that is not held for trading, the Company may irrevocable elect to present subsequent changes in fair value in other comprehensive income. This election is made on an investment-by-investment basis.

Financial assets at fair value through profit or loss – designated

Such financial assets are those initially designated at fair value through profit or loss if such designation eliminates or significantly reduces a measurement or recognition inconsistency (accounting mismatch) that would otherwise arise. Financial assets may be designated at fair value through profit or loss if they make part of a group of financial assets or financial liabilities or both, that are managed and their performance is evaluated on a fair value basis in accordance with a documented investment policy.

Financial assets designated at fair value through profit or loss are initially recognised at their fair value and are stated subsequently at fair value, while transaction costs are expensed in the Statement of Profit or Loss. Changes in fair value of these financial assets are included in the Statement of Profit or Loss in the period in which the change occurs.

Gains and losses from the changes in the foreign exchange rates of monetary assets denominated in foreign currencies are recorded within non-interest income.

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except when the Group changes its business model for managing financial assets.

Offsetting

Financial assets and liabilities are offset and the net amount presented in the Statement of Financial Position when, and only when, the Group has a legal right to offset the amounts and intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

II. II. Derivative financial instruments, including hedge accounting

The Group holds derivative financial instruments that include foreign exchange contracts, forward rate agreements, futures and cross currency and interest rate swaps. Derivative financial instruments are used as part of the Group's trading activities and to hedge certain assets and liabilities.

8. Other financial assets – at amortised cost

Recognition and measurement

Financial assets are measured at amortised cost only if:

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

The Group has held bank acceptances, bonds and floating rate notes which it classifies as financial assets at amortised cost.

	Consolidated		Company	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Floating rate notes	255,025	201,148	255,025	201,148
Investment in bonds	-	20,743	-	20,743
Bank acceptances	35,000	35,000	35,000	35,000
	290,025	256,891	290,025	256,891
Current	123,089	100,331	123,089	100,331
Non-current	166,936	156,560	166,936	156,560
	290,025	256,891	290,025	256,891

9. Derivative assets and liabilities

Each derivative is classified as “held for hedging”, or as “other” derivatives. Derivatives classified as held for “hedging” are derivative transactions entered into in order to manage the risks arising from non-traded assets, liabilities and commitments in Australia.

Derivatives transacted for hedging purposes

The Company enters into derivative transactions which are designated and qualify as cash flow hedges, for recognised assets, liabilities or forecast transactions. The Company adopted hedge accounting on 1 July 2008.

Derivatives for risk management

The Company enters into interest rate swaps for risk management. These derivatives are not designated as cash flow hedges. The movement in fair value of these derivatives is recognised in the Statement of Profit or Loss.

Trading derivatives

The Company enters into interest rate swaps and foreign exchange agreements for the purpose of trading.

Cash flow hedges

The Company uses interest rate swaps to protect against changes in cash flows of certain variable rate deposits and lending. For the year ended 31 December 2017 the Company did not recognise a loss (2016: \$NIL), as there is no ineffective portion of the cash flow hedges.

The effective portion of gains or losses on derivative contracts designated as cash flow hedges are initially recorded in the Hedging Reserve (Note 15) but are reclassified to current period earnings when the hedged cash flow occurs. Refer to Recognition and measurement section below for details.

During the prior year ended 31 December 2016 the Company terminated two swaps with a combined fair value of \$2,735k due to the sale of securities.

Recognition and measurement

The Group initially recognises derivative financial instruments at the fair value of consideration given or received. They are subsequently remeasured to fair value. A positive revaluation amount of a contract is reported as an asset and a negative revaluation amount of a contract as a liability.

Interest rate swap receipts and payments are recognised within net interest income using the effective interest method. Revaluation gains and losses are recognised within other operating income unless designated in an effective cash flow hedge relationship.

The Group designates certain derivatives held for risk management as hedging instruments in qualifying hedge relationships. On initial designation of the hedge, the Group formally documents the relationship between the hedging instrument and hedged item, including the risk management strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship.

The Group applies hedge accounting and the changes in fair value of these derivatives are accounted for as described below:

Cash flow hedges

Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in profit or loss.

A fair value gain or loss represents the amount by which changes in the fair value of the expected cash flow of the hedging derivative differ from the fair value of the changes in the cash flow of the hedged item.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a financial asset the amount recognised in equity is transferred to profit or loss and other comprehensive income in the same period that the hedged item affects profit or loss.

9. Derivative assets and liabilities (continued)

If the derivative hedging instrument is designated as a cash flow hedge subsequent to the deal date, the effective portion of movements in fair values post designation are recognised in equity. Movements in fair value prior to designation are recognised in the Statement of Profit or Loss. An amount equal to the effective portion of the fair value at designation is amortised to the Statement of Profit or Loss and other comprehensive income in accordance with the expected future cash flows of the derivative hedging instrument.

	Consolidated and Company 2017			Consolidated and Company 2016		
	Notional value \$'000	Fair value asset \$'000	Fair value liability \$'000	Notional value \$'000	Fair value asset \$'000	Fair value liability \$'000
Interest rate swaps	10,000	-	(2)	10,000	-	(63)
Total derivative liabilities held for hedging	10,000	-	(2)	10,000	-	(63)
Forward exchange contracts	21,000	-	(400)	180	-	-
Total derivative liabilities	31,000	-	(402)	10,180	-	(63)

The fair value of derivative contracts (foreign exchange contracts) was obtained from observable market data. The carrying value of derivatives liabilities approximates its fair value.

The Company uses a third party application to perform mark-to-market of its derivatives portfolio (interest rate swaps) at the end of each month. The application uses regression analysis to perform valuation and test the effectiveness of the hedges. From current year, the data used to perform the valuations is adjusted for credit risk.

The following table details the notional principal amounts and remaining terms of interest rate swaps outstanding at the end of the reporting period.

	Average contracted fixed interest rate		Notional principal value		Fair value	
	2017 %	2016 %	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Less than 1 year	2.5	-	10,000	-	2	-
1 to 2 years	-	2.5	-	10,000	-	63
2 to 5 years	-	-	-	-	-	-
More than 5 years	-	-	-	-	-	-
Total			10,000	10,000	2	63

The interest rate swaps are reset on a periodical basis. The floating rate on the interest rate swaps is linked to market based interest rate. The Group settles the difference between the fixed and floating interest rate on a net basis.

All interest rate swap contracts exchanging floating rate interest amounts for fixed rate interest amounts are designated as cash flow hedges in order to reduce the Group's cash flow exposure resulting from variable interest rates.

Forward exchange contracts settle on a short term basis.

Funding and Capital

This section focuses on the Group's funding and capital structure. It covers payables to other financial institutions, deposits, subordinated debt, securitisation, share capital, reserves and retained earnings (refer Notes 10 to 16).

10. Payables to other financial institutions

Recognition and measurement

Payables due to other financial institutions include deposits, vostro balances, repurchase agreements and settlement account balances due to other banks. They are brought to account at fair value plus directly attributable transaction costs at inception. Payables due to other financial institutions are subsequently carried at amortised cost. Interest expense is charged to the Statement of Profit or Loss using the effective interest method.

	Consolidated		Company	
	2017	2016	2017	2016
	\$'000	\$'000	\$'000	\$'000
Australia – Authorised deposit-taking institutions and central bank*	23,204	9,774	23,204	9,774
Overseas				
Arab Bank plc group	6,577	18,007	6,577	18,007
Foreign banks	2,236	8,008	2,236	8,008
Related parties	887	853	1,199	1,156
	32,904	36,642	33,216	36,945

*Payables to ADIs includes a repurchase agreement with the Reserve Bank of Australia (RBA) amounting to \$19,668k (2016:\$Nil). On 5th October 2017, the Company established a repurchase agreement facility with the Reserve Bank of Australia to support market and trading activity. Where the Company transacts in repurchase agreements (i.e. securities sold subject to repurchase agreements), the securities are retained in their respective balance sheet categories. The counterparty liability is included in payables due to the other financial institutions.

All payables to other financial institutions are current and due within one year.

11. Deposits

Recognition and measurement

Deposits and other public borrowings include certificates of deposits, term deposits, savings deposits, cheque and other demand deposits. They are brought to account at fair value plus directly attributable transaction costs at inception. Deposits and other public borrowings are subsequently stated at amortised cost. Interest expense is charged to the Statement of Profit or Loss using the effective yield method.

	Consolidated		Company	
	2017	2016	2017	2016
	\$'000	\$'000	\$'000	\$'000
Current	26,844	16,872	26,844	16,872
At call	309,623	318,709	309,623	318,709
Term	422,572	489,622	422,572	489,622
Savings	883	1,208	883	1,208
	759,922	826,411	759,922	826,411
Current	749,862	814,985	749,862	814,985
Non-Current	10,060	11,426	10,060	11,426
	759,922	826,411	759,922	826,411

12. Subordinated debt

Recognition and measurement

The instrument is classified as debt within the Statement of Financial Position and is carried at amortised cost. The related interest expense is recognised in the Statement of Profit and Loss.

	Consolidated		Company	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Subordinated debt	25,006	50,006	25,006	50,006

The rights of the lender are subordinated to all other unsubordinated creditors. The debt matures on 31 December 2032 and is a non-redeemable facility whereby the Company has contractual obligations to pay interest at market rates on a monthly basis to the holder of the instrument, Arab Bank plc, the ultimate controlling entity of the Group.

On 14th August 2017, \$25,000,000 of the subordinated debt was capitalised into ordinary share capital.

13. Securitisation

Securitisation is a funding, liquidity and capital management tool. It provides the Company with the option to sell mortgage backed securities and increase the Group's funding capacity.

The Company packaged equitable interests in residential mortgage backed loans and transferred these loans to the Petra Trusts (the "Trust") which was established to house these loans. The Trust issued floating rate notes backed by the same loans and sold them back to the Company. The transfer does not qualify for derecognition and accordingly the loans continue to be presented in the Statement of Financial Position of the Company. The Company retains the risks and rewards of the loans as being the sole unit holder and beneficiary of the Trust.

On 18 September 2014, the Trust issued one Participation Unit and ten Residential Units at \$10 each, to the Company. The Trust also issued Class A and B Notes of \$33.8m and \$6.6m, respectively which were purchased by the Company. The proceeds from the note issue were used to purchase residential mortgage loans of \$38.1m from the Company. Both Class A and B Notes qualify for repurchase with the Reserve Bank of Australia.

The Trust is wholly owned by the Company and forms part of the consolidated group.

Costs incurred which are directly attributable to the establishment of the Trust as described above as well as costs incurred by the Company which are directly related to the issue of a pool of mortgage loans by the Trust are amortised over 3 years, which is the expected life of the pool of loans.

The table below presents assets securitised by the Group:

	2017 \$'000	2016 \$'000
Residential mortgage loans (Note 6)	34,594	35,905
Cash and receivables from other financial institutions (Note 17(a))*	5,997	4,797
Total securitised assets	40,591	40,702

*Cash and receivables from other financial institutions are held by the Trustee, which have not yet been distributed to the note holder.

Any credit, market and liquidity risks arising from the internal securitisation transactions are captured and monitored in the Group's risk management framework and processes.

14. Share capital

Recognition and measurement

Ordinary shares are classified as equity. Ordinary share capital is the amount of paid up capital from the issue of ordinary shares.

	Consolidated		Company	
	2017	2016	2017	2016
	\$'000	\$'000	\$'000	\$'000
Opening balance	69,314	62,500	69,314	62,500
Issue of ordinary shares *	25,000	6,814	25,000	6,814
Closing balance	94,314	69,314	94,314	69,314

*On 14 August 2017, the Company issued an additional 25,000,000 (2016: 6,814,274) fully paid \$1 ordinary shares to its parent entity, Arab Bank plc.

At 31 December 2017 the share capital comprised 94.3m ordinary shares (2016: 69.3m). All issued shares are fully owned and paid by Arab Bank plc who is entitled to receive dividends if declared. The Company does not have authorised capital or par value in respect of its issued shares. All shares rank equally with regard to the Company's residual assets. No dividend has been declared since the start of the financial year (2016: \$nil).

15. Reserves

Recognition and measurement

APRA Prudential Standard APS 220 "Credit Quality" requires a reserve to be held to cover credit losses estimated but not certain to arise in the future over the full life of all individual facilities. The general reserve for credit losses (GRCL) is calculated using a prudential expected loss methodology that differs to the incurred credit loss methodology used for AASB 139 "Financial Instruments: Recognition and Measurement" credit loss provisions. The GRCL represents an appropriation of retained profits to non-distributable reserves when the regulatory reserve is greater than the accounting provision. The purpose of the GRCL is to provide the Group with freely available capital which can be used to meet credit losses that may subsequently materialise.

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions.

	Consolidated		Company	
	2017	2016	2017	2016
	\$'000	\$'000	\$'000	\$'000
Opening balance	(44)	(1,725)	(44)	(1,725)
Effective portion of changes in fair value of cash flow hedges	60	(327)	60	(327)
Gain on disposal of cash flow hedging instruments	-	2,728	-	2,728
Tax on cash flow hedging instruments (Note 5)	(18)	(720)	(18)	(720)
Closing balance	(2)	(44)	(2)	(44)

General reserve for credit losses

Opening balance	6,143	6,327	6,143	6,327
Transfer to retained earnings	-	(184)	-	(184)
Closing balance	6,143	6,143	6,143	6,143
Total reserves	6,141	6,099	6,141	6,099

16. Retained earnings

	Consolidated		Company	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Opening balance	50,881	49,540	50,682	49,347
Transfers from general reserve for credit loss	-	184	-	184
Net (loss)/profit	(243)	1,157	(249)	1,151
Closing balance	50,638	50,881	50,433	50,682

Operating assets and liabilities

This section outlines the operating assets and liabilities of the Group. Further information is provided on reconciliation of cash flow statement, receivables from other financial institutions, intangible assets, other assets and other liabilities (refer Notes 17 to 21).

17. Notes to the Statement of Cash flows

Recognition and measurement of Cash and Cash equivalents

Cash and cash equivalents comprise the net amount of short-term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of change in value. They are held for the purposes of meeting short-term cash commitments (rather than for investment or other purposes). For the purposes of the cash flow statement, cash and cash equivalents includes cash and liquid assets and amounts due from other banks (including repurchase agreements), that are readily convertible to known amounts of cash within three months.

Cash and cash equivalents are carried at amortised cost in the Statements of Financial Position.

(a) Reconciliation of cash

For the purposes of the Statement of Cash Flows, cash includes cash on hand, cash at bank and short term deposits at call, net of outstanding bank overdrafts. Cash as at the end of the financial year as shown in the Statement of Cash Flows is reconciled to the related items in the Statement of Financial Position as follows:

Cash	19,457	3,235	19,457	3,235
Receivables from other financial institutions*	42,760	91,132	42,760	91,132
	62,217	94,367	62,217	94,367

*Receivables are net of accrued interest. \$5,997k (2016: \$4,797k) is securitised assets. Refer to Note 13 for further details.

17. Notes to the Statement of Cash Flows (continued)

(b) Reconciliation of net profit to net cash provided by operating activities

	Consolidated		Company	
	2017	2016	2017	2016
	\$'000	\$'000	\$'000	\$'000
(Loss)/Profit for the period	(243)	1,157	(249)	1,151
Add/(less) items classified as investing/financing activities:				
Loss/(Profit) on disposal of property and equipment	9	(31)	9	(31)
Add/(less) non-cash items:				
Depreciation	546	390	546	390
Amortisation of intangibles	548	604	548	604
Amortisation of mortgage establishment fees	17	(116)	17	(116)
(Decrease)/Increase in provisions for doubtful debts	(338)	1,448	(338)	1,448
Change in hedging revaluations	399	(195)	399	(195)
Changes in assets and liabilities:				
Change in loans, advances and bills discounted issued or extended	71,035	73,372	71,035	73,372
Change in deposits	(65,208)	14,336	(65,208)	14,336
Change in prepayments	(258)	(382)	(258)	(382)
Change in interest receivable	(23)	717	(23)	717
Change in interest payable	(1,222)	(6,463)	(1,218)	(6,461)
Change in other liabilities	(474)	(106)	(422)	(106)
Change in deferred tax balance	329	245	287	245
Change in employee provisions	71	217	71	217
Net cash provided by operating activities	5,188	85,193	5,196	85,189

(c) Net reporting of certain cash flows

Cash flows arising from the following activities have been presented on a net basis in the Statement of Cash Flows:

- (i) money market trading activities and retail lending activities;
- (ii) customer deposits to and withdrawals from savings, money market and other deposit accounts;
- (iii) balances due to and from other financial institutions;
- (iv) statutory deposits; and
- (v) investment securities.

18. Receivables from other financial institutions

Australia – Authorised deposit-taking institutions				
Local banks	39,904	62,008	39,904	62,008
Overseas				
Arab Bank plc group	163	2,031	163	2,031
Related parties	6	7	6	7
Foreign banks	2,734	27,137	2,734	27,137
	42,807	91,183	42,807	91,183

All receivables from other financial institutions are current and readily convertible to cash.

19. Intangible assets

Recognition and measurement

The Group capitalises certain computer software costs and recognises them as intangible assets where they are clearly identifiable, can be reliably measured and will lead to future economic benefits that the Group controls.

The Group carries capitalised software assets at cost less amortisation and any impairment losses. The Group amortises these assets on a straight-line basis at a rate applicable to the expected useful life of the asset, but usually not exceeding 5 years.

Intangible assets are assessed annually for impairment and whenever there is an indication that the asset may be impaired.

Cost	Consolidated		Company	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Opening balance	9,074	8,514	9,074	8,514
Acquisitions	248	650	248	650
Disposals	(82)	-	(82)	-
Reclassification*	-	(90)	-	(90)
Closing balance	9,240	9,074	9,240	9,074
Amortisation				
Opening balance	7,533	7,034	7,533	7,034
Amortisation for period	548	604	548	604
Disposals	(73)	-	(73)	-
Reclassification*	-	(105)	-	(105)
Closing balance	8,008	7,533	8,008	7,533
Carrying amounts	1,232	1,541	1,232	1,541

*Following a review in the prior year, reclassification adjustments were posted between categories of property, equipment and intangible assets to reflect the most appropriate categorisation of the underlying assets.

Intangible assets comprise computer software only. Costs relating to current software implementation projects not yet available for use are included in other assets (Note 20).

20. Other assets

Expenses paid in advance	1,527	1,269	1,527	1,269
Refundable deposits*	338	251	338	251
Other, including software implementation project costs**	276	786	276	786
	2,141	2,306	2,141	2,306

*Refundable deposits include the funds pledged as a security for operational transactions.

**Included in other assets is \$253k (2016: \$746k) of capitalised expenditure which will be transferred to Property and Equipment and Intangible Assets once they are installed and available for use. These costs relate to projects in progress and are expected to transfer out of other assets within twelve months.

All other assets are current and due within one year.

21. Other liabilities

Recognition and measurement

Other liabilities comprise all other financial liabilities, interest, fees and other unrealised expenses payable and securities purchased but not delivered. These liabilities are recorded at cost.

	Consolidated		Company	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Accrued expenses	1,399	1,450	1,399	1,450
Other	228	653	233	627
	1,627	2,103	1,632	2,077

*All other liabilities are current and due within one year.

Other information/disclosures

This section covers all other disclosures including shares in controlled entities, property and equipment, provision for employee entitlements, fair value of financial instruments, risk management, commitment for expenditures, auditor's remuneration, related parties, contingent liabilities and financial reporting by segments.

The note on fair value of financial instruments discusses the Group's methodology on the measurement of fair value. The note on risk management outlines the risks that the Group is exposed to and how these are managed and mitigated.

22. Shares in controlled entities

Recognition and measurement

Equity contributions to the controlled entities are carried in the Bank's financial statements at the lower of cost of acquisition or recoverable amount.

Details of the controlled entity are:

	Country of Incorporation	Interest %	Company	
			2017 \$'000	2016 \$'000
Arab Australia Capital Markets Pty Ltd	Australia	100	70	70
Petra Trusts	Australia	100	-	-

Arab Australia Capital Markets Pty Ltd is a wholly owned Subsidiary and has not traded or employed any staff during the year. Its total assets and liabilities for the year ended 31 December 2017 are \$315,380 (2016: \$307,078) and \$41,663 (2016: \$39,173), respectively.

Petra Trusts is 100% owned entity, the purpose of which is to provide a contingency liquidity reserve facility.

23. Property and equipment

Recognition and measurement

Items of Property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the asset.

23. Property and equipment (continued)

Depreciation

Items of Property and equipment are depreciated at appropriate rates to recognise the cost of each asset during its effective working life using the straight-line method. The estimated useful lives of property and equipment are as follows:

Equipment	- 3 to 5 years
Furniture	- 6 years
Motor Vehicles	- 5 years
Leasehold Improvements	- Life of Leasehold

Depreciation rates for property and equipment are reviewed periodically to ensure they appropriately reflect residual values and estimated useful lives.

	Consolidated			Company		
	Property & equipment \$'000	Fixtures & fittings \$'000	Total \$'000	Property & equipment \$'000	Fixtures & fittings \$'000	Total \$'000
Cost						
Balance at 1 January 2016	2,000	3,337	5,337	2,000	3,337	5,337
Acquisitions	51	36	87	51	36	87
Disposals	(148)	-	(148)	(148)	-	(148)
Reclassification*	(232)	306	74	(232)	306	74
Balance at 31 December 2016	1,671	3,679	5,350	1,671	3,679	5,350
Acquisitions	668	17	685	668	17	685
Disposals	(311)	(38)	(349)	(311)	(38)	(349)
Reclassification*	-	-	-	-	-	-
Balance at 31 December 2017	2,028	3,658	5,686	2,028	3,658	5,686
Accumulated depreciation						
Balance at 1 January 2016	1,650	2,752	4,402	1,650	2,752	4,402
Depreciation for the year	158	232	390	158	232	390
Disposals	(128)	-	(128)	(128)	-	(128)
Reclassification*	(213)	313	100	(213)	313	100
Balance at 31 December 2016	1,467	3,297	4,764	1,467	3,297	4,764
Depreciation for the year	342	204	546	342	204	546
Disposals	(311)	(38)	(349)	(311)	(38)	(349)
Reclassification*	-	-	-	-	-	-
Balance at 31 December 2017	1,498	3,463	4,961	1,498	3,463	4,961
Carrying amount						
31 December 2016	204	382	586	204	382	586
31 December 2017	530	195	725	530	195	725

*Following a review in the prior year, reclassification adjustments were posted between categories of property, equipment and intangible assets to reflect the most appropriate categorisation of the underlying assets.

Assets not yet available for use are held in other assets until they can be transferred to property and equipment. Refer to Note 20 for additional information.

As at 31 December 2017 there were no impairment losses in items of property and equipment. Refer to Note 7 for related accounting policy on assessment of impairment.

The cost of property and equipment which is fully depreciated and in use is \$10,490k (2016: \$10,043k).

Notes to the financial statements

For the year ended 31 December 2017

24. Provision for employee entitlements

Recognition and measurement

Long service leave

The Group's net obligation in respect of long-term service benefits is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The obligation is calculated using estimated future service costs and is discounted to its present value.

Wages, salaries, annual leave and non-monetary benefits

Liabilities for annual leave which are expected to be settled within 12 months of the reporting date represent obligations resulting from employee's services provided to reporting date, are calculated at undiscounted amounts based on remuneration wage and salary rates that the consolidated entity expects to pay as at reporting date including related on-costs such as workers compensation insurance and payroll tax. Non-accumulating non-monetary benefits such as medical care and cars are expensed based on the net marginal cost to the consolidated entity as the benefits are taken by the employees.

31 December 2017	Consolidated and Company		Total \$'000
	Long service leave \$'000	Annual leave \$'000	
Balance as at 1 January 2017	936	747	1,683
Provisions made during the year	149	777	926
Provisions used during the year	(54)	(801)	(855)
Balance as at 31 December 2017	1,031	723	1,754
31 December 2016			
Balance as at 1 January 2016	720	746	1,466
Provisions made during the year	306	792	1,098
Provisions used during the year	(90)	(791)	(881)
Balance as at 31 December 2016	936	747	1,683

25. Fair value of financial instruments

Fair value is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market prices are used to determine fair value where an active market exists. For financial instruments where there are no readily available quoted market prices, valuation methods based on market conditions are used.

	2017		2016	
	Consolidated and Company		Consolidated and Company	
	Carrying	Fair	Carrying	Fair
	Value	Value	value	Value
	\$'000	\$'000	\$'000	\$'000
Assets				
Cash	19,457	19,457	3,235	3,235
Receivables from other financial institutions	42,807	42,807	91,183	91,183
Loans, advances and other receivables	606,014	611,107	676,806	679,893
Other financial assets – at amortised cost	290,025	290,580	256,891	256,948
Other financial assets	1,888	1,888	1,560	1,560
Total financial assets measured at fair value	960,191	965,839	1,029,675	1,032,819
Liabilities				
Payables to other financial institutions	32,904	32,904	36,642	36,642
Deposits	759,922	760,774	826,411	827,830
Subordinated debt	25,006	25,006	50,006	50,006
Other financial liabilities	1,627	1,627	2,103	2,103
Total financial liabilities measured at fair value	819,459	820,311	915,162	916,581

Cash and liquid assets

The carrying values of cash and liquid assets and receivables from other financial institutions approximate their fair value as they are short term in nature or are receivable on demand.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are carried at fair value determined using quoted market prices.

Loans, advances and other receivables

The fair value of impaired loans was calculated by discounting expected cash flows using a rate that includes a premium for the uncertainty of the flows.

For variable rate loans, excluding impaired loans, the carrying amount is a reasonable estimate of fair value. The fair value for fixed rate loans was calculated by utilising discounted cash flow models (i.e. the net present value of the portfolio future principal and interest cash flows), based on the maturity of the loans. The discount rates applied were based on the current benchmark rate, including an add-on of the existing credit margin of the lending portfolio, offered for the average remaining term of the portfolio. These rates vary based on the term of the loan offered and interest rate environment during the period.

The carrying value of loans, advances and other receivables is net of accumulated collective and individually assessed provisions for impairment.

Financial assets – at amortised cost

The fair values for financial assets at amortised cost investments are determined using quoted market prices or dealer quotes for the same as similar securities or where a market price is not readily available, estimated discounted values of future cash flows.

25. Fair value of financial instruments (continued)

Payables to other financial institutions

The carrying value of payables due to other financial institutions and bank acceptances approximate their fair value as they are short term in nature and reprice frequently.

Deposits

The fair value of non-interest bearing, call and variable rate deposits, and fixed rate deposits repricing within six months, is the carrying value as at year end. Discounted cash flow models based upon current market rates for debt with similar characteristics and maturities, were used to calculate the fair value of other term deposits.

Subordinated debt

The fair values of subordinated debt issues were calculated based on discounted cash flows, utilising a yield curve appropriate to the expected remaining maturity of the instrument. The carrying value of subordinated debt approximates its fair value.

Fair value hierarchy

The table below analyses financial instruments by their position in the fair value hierarchy.

The different levels have been defined as follows:

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

Level 2: inputs other than quoted prices included within Level 1 are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

There is no transfer between levels 1, 2 and 3 during the year.

31 December 2017	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Assets				
Cash	19,457	-	-	19,457
Receivables from other financial institutions	-	42,807	-	42,807
Other financial assets – at amortised cost	-	290,580	-	290,580
Loans and advances and other receivables	-	-	611,107	611,107
Other financial assets	-	1,888	-	1,888
Total financial assets	19,457	335,275	611,107	965,839
Liabilities				
Payables to other financial institutions	-	32,904	-	32,904
Deposits	-	760,774	-	760,774
Subordinated debt	-	-	25,006	25,006
Derivative liabilities	-	402	-	402
Other financial liabilities	-	1,627	-	1,627
Total financial liabilities	-	795,707	25,006	820,713

25. Fair value of financial instruments (continued)
Fair value hierarchy (continued)

31 December 2016	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Assets				
Cash	3,235	-	-	3,235
Receivables from other financial institutions	-	91,183	-	91,183
Other financial assets – at amortised cost	-	256,948	-	256,948
Loans and advances and other receivables	-	-	679,893	679,893
Other financial assets	-	1,560	-	1,560
Total financial assets	3,235	349,691	679,893	1,032,819
Liabilities				
Payables to other financial institutions	-	36,642	-	36,642
Deposits	-	827,830	-	827,830
Subordinated debt	-	-	50,006	50,006
Derivative liabilities	-	63	-	63
Other financial liabilities	-	2,103	-	2,103
Total financial liabilities	-	866,638	50,006	916,644

26. Risk management

(a) Introduction and overview

The Group is exposed to a number of risks, which it manages at different organisational levels. The main categories of risk are:

- **Credit risk:** The risk that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms.
- **Liquidity risk:** The risk that the Group will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.
- **Market risk:** The risk that changes in market prices, such as interest rates and foreign exchange rates will affect the Group's income or the value of holdings.
- **Interest rate risk:** The risk of loss from fluctuations in the future cash flows of financial instrument fair values due to a change in market interest rates.
- **Operational risks:** The risks of losses owing to deficient or erroneous internal procedures, human or system errors or external events.

There is no material difference between the Company and the Group risk disclosures. This note presents information about the Group's exposure to each of the above risks, the objectives, policies and processes for measuring and managing each of these risks, and management of capital.

26. Risk management (continued)

Risk management framework

Risk Management governance originates at Board level, and cascades through the Chief Executive Officer and business units through the Risk Appetite Statement, policies and delegated authorities. The framework is designed to ensure Board level oversight and a clear segregation of duties between those who originate and those who approve risk exposures.

The Board Risk Committee oversees the Risk Management Framework. This includes the management of material risks such as credit, market, liquidity and funding, operational, insurance, compliance (including regulatory), and reputational risks assumed by the Bank in carrying on its business. The Committee reviews regular reports from management on the measurement of risk and the adequacy and effectiveness of the Bank's risk management and internal control systems. The Board Risk Committee helps formulate the Bank's Risk Appetite and Internal Capital Adequacy Assessment Process for consideration by the Board and makes recommendations to the Board on the risk management framework that is consistent with the approved risk appetite.

Strategic risks are governed by the Board, with input from the Board sub-committees. Tax and accounting risks are governed by the Board Risk Committee.

The Board Audit Committee (BAC) assists the Board in fulfilling their fiduciary and statutory responsibilities by providing an objective non-executive review of the effectiveness of the external reporting of financial and non-financial information, the internal control framework, APRA risk management framework, and the independence and effectiveness of audit activities and any other matter referred to it by the Board.

In addition, the Managing Director has established Executive Committees to manage key risks of the Bank, including the following:

- Executive Committee (EXCO);
- Asset & Liability Committee (ALCO);
- Executive Credit Committee (ECC);
- Operational Risk and Compliance Committee (ORC); and
- Strategic Technology Enterprise Projects (STEP) Committee.

The Board reviews the Charter of each of the above Executive Committees.

(b) Credit risk

Credit risk arises principally from the Group's loans and advances to customers and banks and investment securities. Approval for loans and advances to customers requires a recommender and approver and for larger balances additional sign offs are required.

The portfolio is closely monitored by the Lending Officers and any significant arrears are overseen on a continual basis by the Senior Recoveries Manager.

The Board of Directors has delegated responsibility for the management of credit risk to the Board Risk Committee ("BRC"). The Board has delegated credit approval authority to nominated Directors with BRC being advised of any decisions taken.

The status and grading of all balances is reported to the Global Credit Department of the parent, Arab Bank plc on a monthly basis in addition to regular reporting to key management of the Bank and Executive Credit Committee.

26. Risk management (continued)

(b) Credit risk (continued)

The below table presents the maximum exposure to credit risk of balance sheet items (excluding trading assets) combined with the credit quality for each class of financial asset as at the reporting date.

Items categorised in the following table as watch list are subject to a review every 3 months.

	Loans and advances to customers		Receivables from other financial institutions		Financial assets – at amortised cost	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Carrying amount	606,014	676,806	42,807	91,183	290,025	256,891
Non-performing loans						
Non-performing loans	5,693	5,807	-	-	-	-
Less: specific provision (Note 7)	(1,157)	(1,663)	-	-	-	-
Non-performing loans, net of provision for impairment	4,536	4,144	-	-	-	-
Past due but performing						
0-30 days	43,061	51,809	-	-	-	-
30-60 days	1,540	1,104	-	-	-	-
60-90 days	2,124	1,244	-	-	-	-
90-120 days	-	-	-	-	-	-
Over 120 days	-	118	-	-	-	-
Past due but performing	46,725	54,275	-	-	-	-
Neither past due nor non performing	556,973	621,267	42,807	91,183	290,025	256,891
Carrying Amount	608,234	679,686	42,807	91,183	290,025	256,891
Less: collective provision (Note 7)	(2,220)	(2,880)	-	-	-	-
Total carrying amount	606,014	676,806	42,807	91,183	290,025	256,891

Receivables from other financial institutions

Receivables are held with banks and financial institution counter parties, which are rated B+ to AA-, based on Standard and Poors (S&P) ratings revised.

Financial assets at amortised cost

Floating Rate Notes and Bank Acceptances are held with financial institutions which are rated BBB to AAA, based on Standard and Poors (S&P) ratings revised.

Non-performing loans

Non-performing loans are loans for which the Group determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan. Refer to Note 7 for further details taken into consideration when assessing for evidence of impairment.

Provisions for impairment

The Group creates specific provisions that represent its estimate of incurred losses on individual balances. This is assessed in accordance with the process detailed in Note 7. The Group considers the value of security held and any other assets held by the borrower in assessing the estimated loss.

The Group also creates a collective provision for future anticipated losses based on the current portfolio. The collective provision is calculated in accordance with Note 7.

26. Risk management (continued)

(b) Credit risk (continued)

Past due but performing loans

Past due but performing loans are balances where the contractual interest or principal payments are past due, but the Group holds adequate security, or collateral, and the stage of collection is sufficient for the loan not to be impaired. If a relationship group has a loan past due for 90 days all related loans and balances are classified as past due in accordance with APRA guidance.

Write off policy

Loan balance write offs are approved when they are deemed not collectible. This determination is reached following a review of the value of security held, any other assets held by the borrower and the individual financial position of the borrower.

Collateral

Collateral is held against loans and advances to customers in the form of mortgage interests over property, other registered security over assets and guarantees. The fair value of the collateral is assessed at the time of initial borrowing and periodically reassessed including when the loan or advance becomes impaired.

At balance sheet date, the Group's loan portfolio is secured as follows:

Carrying amount of loans and balances by security type (loan to valuation ratio – LVR at origination)

	Loans and advances to customers	
	2017	2016
	\$'000	\$'000
Cash	46	99
Commercial – LVR < 65%	195,243	260,323
Commercial – LVR > 65%	1,574	1,832
Residential – LVR < 60%	73,078	69,257
Residential – LVR > 60% < 80%	326,490	328,777
Residential – LVR > 80% < 90%	5,166	10,637
Residential – LVR > 90% < 100%	3,939	4,171
Taxi plates	3,832	6,204
Unsecured	23	49
Total	609,391	681,349
Less specific provision	(1,157)	(1,663)
Less collective provision	(2,220)	(2,880)
Carrying amount of loans and balances	606,014	676,806

The Group monitors concentrations of credit risk by industry. An analysis of concentration of credit risk at the reporting date is shown below.

Concentration by economic sector:

Property and business services	238,407	283,271
Construction	122,791	139,356
Retail and wholesale trade	82,624	79,576
Transport and storage	37,525	48,098
Cultural, recreational, personal and other services	43,404	49,668
Health and community services	21,630	19,668
Manufacturing	20,938	24,278
Finance and insurance	15,076	10,891
Other commercial and industrial	26,996	26,543
Gross loans and advances to customers	609,391	681,349
Specific provisions	(1,157)	(1,663)
Collective provisions	(2,220)	(2,880)
Net loans and advances to customers	606,014	676,806

The above analysis complies with the Australian and New Zealand standard industrial classification codes (ANZSIC).

26. Risk management (continued)

(b) Credit risk (continued)

Derivative exposures

The Group did not hold any derivative assets as at 31 December 2017 (2016:\$ Nil).

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

For certain types of transactions the Group mitigates this risk by conducting settlements through a settlement/clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Transactions and trades are conducted within the approved counterparty and transaction limits and monitored by the Market and Liquidity Risk. Significant limits are subject to approval by the Board Credit delegates. All limits recorded against financial institutions are endorsed by the Arab Bank plc's Financial Institutions Division.

(c) Liquidity risk

Treasury maintains information about the projected cash flows from future business to ensure that sufficient liquidity is maintained in order for the Group to meet its obligations. In addition, the Group and its ultimate controlling entity, Arab Bank plc continue to adopt a more conservative approach than required by APRA to ensure that the Group continues to meet its obligations.

The Group maintains a portfolio of high quality liquid assets, largely consisting of investment securities and bonds. The Group also maintains loans and advances to banks and other inter-bank facilities for liquidity purposes.

The liquidity position is monitored and reported daily to the Bank's Treasury, key management of the business and the Global Treasury department of the parent, Arab Bank plc. In addition, the liquidity position is reported to APRA and ALCO on a regular basis.

Regular liquidity stress testing is conducted under a variety of scenarios covering both predictable and more severe market conditions. All liquidity policies and procedures are subject to review by ALCO and approval by the Board Risk Committee. A summary report including any exceptions and remedial action taken is submitted regularly to ALCO.

The Group has internal securitisation vehicle in place - Petra Trusts, which was established to hold mortgage backed loans in exchange for floating rate notes which can be repurchased to the Reserve Bank. The purpose of this internal securitisation is to provide a contingency liquidity reserve facility to meet any potential liquidity crisis that the Group may face due to internal or external factors.

The Group's liquidity remains strong and at 31 December 2017 its liquidity ratio exceeded APRA's minimum requirements and satisfied Arab Bank plc's requirements.

26. Risk management (continued)

(c) Liquidity risk (continued)

The tables below for 2017 and 2016 break down the financial liabilities of the Group by contractual maturity. The Group's expected cash flows on these instruments vary significantly from this analysis. For example, from past experience deposits from customers are expected to remain stable or increase in balance.

	Carrying Amount	Less than 1 month	1-3 months	3 months to 1 year	1-3 years	More than 3 years	Total*
31 December 2017							
\$'000s							
Liabilities							
Payables to other financial institutions	32,904	30,895	1,003	1,008	-	-	32,906
Deposits	759,922	418,174	200,314	134,181	9,043	1,379	763,091
Derivatives	402	155	267	-	-	-	422
Subordinated debt	25,006	46	138	414	1,658	31,031	33,287
Other financial liabilities	1,627	1,627	-	-	-	-	1,627
Total financial liabilities	819,861	450,897	201,722	135,603	10,701	32,410	831,333

31 December 2016 **\$'000s**

Liabilities							
Payables to other financial institutions	36,642	32,126	3,011	1,531	-	-	36,668
Deposits	826,411	438,048	203,380	177,675	9,898	1,981	830,982
Derivatives	63	19	-	55	20	-	94
Subordinated debt	50,006	94	172	790	3,240	62,963	67,259
Other financial liabilities	2,103	2,103	-	-	-	-	2,103
Total financial liabilities	915,225	472,390	206,563	180,051	13,158	64,944	937,106

*The table above has been drawn up based on the undiscounted contractual maturities of the financial liabilities. The difference in the total amount against the carrying amount of total liabilities is the interest that will be settled throughout the term of the financial liabilities.

Notes to the financial statements

For the year ended 31 December 2017

26. Risk management (continued)

(d) Market risk

Market risk is the risk that changes in market prices, such as interest rate and foreign exchange rates will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks

The Group separates exposure to market risk into either trading or non-trading portfolios. Trading portfolios include those positions arising from transactions entered into in order to profit from market movements. Residual risk arises from facilitating customer transactions and actively extending these positions for trading purposes.

Non-trading portfolios arise primarily from the interest rate management of the Group's retail and commercial banking assets and liabilities.

All foreign exchange risk within the Group is managed centrally by Treasury. The foreign exchange position is treated as part of the Group's trading portfolios for risk management purposes.

Overall authority for market risk is vested in the Asset and Liability Committee (ALCO). Market and Liquidity Risk is responsible for the development of detailed risk management policies (subject to the review and approval of ALCO and the Board) and for the day-to-day operations.

The management of market risk is principally undertaken using risk limits approved by ALCO and the Board. Limits are set for portfolios, products and risk types, with market liquidity being a key factor in determining the level of limits set.

Interest Rate Risk

The primary form of interest rate risk for the Group is considered to be repricing risk, which arises from the timing differences in the maturity (for fixed rate) and repricing data (for variable rate) assets and liabilities. This is monitored and managed using the Basis point present value (BPV) methodology and is reported to Treasury, to Global Treasury department of the parent, Arab Bank plc, weekly and to ALCO on a monthly basis.

The Basis Point Valuation (PV01) reporting measures the impact of a one basis point move in interest rates and quantifies the expected financial impact to the Group. The Board of Directors assigns a limit, endorsed by the Global Treasury department of the parent for an acceptable level of financial impact in this scenario. Any breaches of limits are notified immediately to the key management and ALCO.

The table below shows the effect on the Statement of Profit or Loss and Statement of Changes in Equity if there was a movement of 200 basis points in interest from the rates at the reporting date:

	Increase of 2%		Decrease of 2%	
	Profit/(loss)	Shareholder's Equity Increase/(Decrease)	Profit/(Loss)	Shareholder's Equity Increase/(Decrease)
	\$	\$	\$	\$
31 December 2017	2,170,188	(2,374)	3,302,544	(2,398)
31 December 2016	2,504,528	133,000	3,481,250	(260,000)

Non-trading portfolios are exposed to the risk of loss from fluctuations in the fair value of interest rate swaps due to a change in market interest rates unless held to maturity.

26. Risk management (continued)

(d) Market risk (continued)

Interest Rate Risk (continued)

The following tables represent the earlier of contractual repricing or maturity date as at 31 December 2017 and the prior year. The table is illustrative only and is based on simplified scenarios. Actions that would have been taken to mitigate the interest rate risk are not incorporated. In reality, the Group seeks to proactively change the interest rate risk profile to minimise losses and optimise net revenues. This analysis also makes simplifying projections, including that all positions run to maturity.

	Weighted Average Effective Interest	Carrying amount	Less than 1 month	1-3 months	3 months to 1 year	1-3 years	More than 3 years	Carrying amount
31 December 2017								
\$'000s								
Cash	-	19,457	19,457	-	-	-	-	19,457
Receivables from other financial institutions	1.06%	42,807	42,807	-	-	-	-	42,807
Loans and advances to customers, net	5.17%	606,014	449,186	18,035	65,765	69,898	3,130	606,014
Financial assets at amortised cost	2.11%	290,025	129,278	160,747	-	-	-	290,025
Total financial assets		958,303	640,728	178,782	65,765	69,898	3,130	958,303
Payables to other financial institutions	0.47%	32,904	32,904	-	-	-	-	32,904
Deposits	2.23%	759,922	428,385	189,341	132,472	8,723	1,001	759,922
Subordinated debt	2.32%	25,006	25,006	-	-	-	-	25,006
Total financial liabilities		817,832	486,295	189,341	132,472	8,723	1,001	817,832
Effect of derivatives		(10,000)	(10,000)	-	-	-	-	(10,000)
		130,471	144,433	(10,559)	(66,707)	61,175	2,129	130,471
31 December 2016								
\$'000s								
Cash	-	3,235	3,235	-	-	-	-	3,235
Receivables from other financial institutions	1.47%	91,183	91,183	-	-	-	-	91,183
Loans and advances to customers, net	5.09%	676,806	550,267	958	31,620	88,648	5,313	676,806
Financial assets at amortised cost	2.43%	256,891	45,920	180,422	10,029	-	20,520	256,891
Total financial assets		1,028,115	690,605	181,380	41,649	88,648	25,833	1,028,115
Payables to other financial institutions	0.03%	36,642	34,392	500	1,750	-	-	36,642
Deposits	2.49%	826,411	438,034	202,044	175,762	9,487	1,084	826,411
Subordinated debt	3.24%	50,006	50,006	-	-	-	-	50,006
Total financial liabilities		913,059	522,432	202,544	177,512	9,487	1,084	913,059
Effect of derivatives		(10,000)	-	-	(10,000)	-	-	(10,000)
		105,056	168,173	(21,164)	(145,863)	79,161	24,749	105,056

26. Risk management (continued)

(d) Market risk (continued)

Foreign Exchange risk - trading portfolios

The principal risk to which foreign exchange trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows of fair values of financial instruments because of a change in the foreign exchange rates. The Group trades predominately spot positions and some forward positions. Stop loss and total exposure limits are in place. A valuation of the trading book is undertaken on a daily basis and breaches of limits are notified to ALCO.

The details of the net foreign currency position are as follows:

	2017		2016	
	Base currency	AUD	Base currency	AUD
	'000	'000	'000	'000
USD	(79)	(101)	36	49
GBP	24	42	4	7
EUR	(7)	(11)	(2)	(2)
JPY	-	-	-	-
CHF	1	2	2	2
Other currencies*	149	60	51	40
Total		(8)		96

*Various foreign currencies translated to AUD.

Sensitivity analysis

The sensitivity analysis shows the effect on the Statement of Profit or Loss if there was a movement of 20% in foreign exchange rates from the rates at the reporting date.

	Increase of 20%	Decrease of 20%
	Profit/(loss)	Profit/(loss)
	\$	\$
31 December 2017	1,429	(2,143)
31 December 2016	(15,840)	23,761

The foreign currency sensitivities set out above are illustrative only and are based on simplified scenarios. The figures represent the effect of the pro forma movements in foreign exchange rates and the Group's current foreign exchange risk profile. The projection above also assumes that foreign exchange rates all move by the same amount and, therefore, does not reflect the potential impact of some rates changing whilst others remain unchanged. This effect does not incorporate actions that would have been taken to mitigate the impact of this foreign exchange risk. In reality, the Group seeks to proactively change the foreign exchange risk profile to minimise losses and optimise net revenues.

26. Risk management (continued)

(e) Operational risk

All business entities are subject to risk from the general business environment. Possible causes of risk are the Group's processes, personnel, technology and infrastructure or external factors such as legal and regulatory requirements.

The Group aims to manage this risk in a cost effective manner which does not restrict initiative or creativity. The operational risks of the Group and controls are monitored by ORC which meets on a regular basis.

Incidents which resulted or could have resulted in a loss to the Group (excluding minor office errors) are recorded in the Incident Management System and reported to ORC.

The Group requires a minimum level of controls for all departments and is supported by periodic reviews undertaken by Internal Audit. A summary of testing and recommendations for improving controls is submitted to the manager of the business unit, senior management of the Group and BAC.

The Group uses the Operational Risk Management Framework (ORMF) to describe its approach to identifying, assessing, controlling, and monitoring operational risk.

The ORMF consists of six modules:

- 1) Governance – to provide a clear structure and defined roles and responsibilities that support proactive oversight and monitoring of operational risk.
- 2) Risk and Control Self Assessment – to identify the business-as-usual operational risks that currently exist within the business or could be expected to occur within the next 12 months.
- 3) Control Self Assessment – to perform a test of key controls to validate the effectiveness of controls as identified in the Risk & Control Self Assessment.
- 4) Key Risk Indicators – to provide management with early warning indicators of changes to the organisation's risk profile.
- 5) Action Management – to develop remedial actions where the level of risk is above the Group's risk appetite.
- 6) Incident Management – to identify, assess, quantify, escalate, record, manage and report risk incidents that have occurred.

The Group implements the ORMF in accordance with the Three Lines of Defence approach to risk management, as follows:

- 1st Line (Business Units): Business line managers have primary responsibility for the day-to-day management of operational risk and bear the consequences of operational risk losses;
- 2nd Line (Operational Risk Management Team): Formulate high level operational risk policies and risk appetite, and provide oversight, challenge, and support to optimise the risk/reward trade-off; and
- 3rd Line (Internal Audit): Provide assurance to the Board of the overall effectiveness of internal controls.

26. Risk management (continued)

(f) Capital management

Regulatory capital

The Group's regulator, Australian Prudential Regulation Authority (APRA), sets and monitors capital requirements for the Group.

In implementing current capital requirements, APRA requires the Group to maintain a prescribed ratio of total capital to risk weighted assets. The risk weighting used for assets are as prescribed by APRA. The Group's and the parent's, Arab Bank plc, policy is to maintain a capital adequacy higher than required by the regulator. The Group's policy is to maintain a strong capital base to maintain investor, creditor and market confidence and to sustain future development of the business.

There have been no material changes to the Group's management of capital during the period. The Group adopted the mandatory capital requirements under Basel III from 1 January 2013. Under Basel III, the Bank is required to maintain a minimum Tier 1 capital, comprising common equity and retained earnings; and Tier 2 comprising subordinated debt and general reserve for credit losses.

The Group's regulatory capital is analysed into two tiers:

- Tier 1 capital, includes ordinary share capital, retained earnings and any other regulatory adjustments related to items that are included in equity but are treated differently for capital adequacy purposes.
- Tier 2 capital, includes subordinated debt and the general reserve for credit losses.

The Group has complied with all externally imposed capital requirements throughout the period under the Basel III.

Regulatory capital is managed on the Basel III standardised methodology. Capital adequacy is measured by means of a risk based capital ratio. The capital ratios reflect capital as a percentage of total risk weighted assets (RWA). RWA represents an allocation of risks associated with the Group's on and off balance sheet assets and other related exposures.

The Group's capital position is monitored on a continuous basis and reported monthly to ALCO. Capital forecasts are conducted periodically and a detailed capital and strategy plan is presented to the Board annually.

The Group's capital ratios throughout the 2017 and 2016 financial year were in compliance with both regulatory minimum capital requirements and the Board approved minimums.

The Group is required to inform the regulator immediately of any breach or potential breach of its minimum prudential capital adequacy requirements, including details of remedial action taken or planned to be taken.

26. Risk management (continued)

(f) Capital management (continued)

The Group's regulatory capital position at 31 December was as follows:

	2017	2016
	\$'000	\$'000
Common equity Tier 1 / Tier 1 capital		
Ordinary share capital	94,314	69,314
Retained earnings	50,638	50,881
Less intangible assets and deferred tax assets	(11,606)	(11,909)
Total	133,346	108,286
Tier 2 capital		
General reserve for credit losses	6,143	6,143
Subordinated debt	25,000	50,000
Total	31,143	56,143
Total regulatory capital	164,489	164,429
Risk-weighted assets	612,259	681,428
Capital ratios		
Total regulatory capital expressed as a percentage of risk weighted assets	26.87%	24.13%
Total common equity tier 1 / tier 1 capital expressed as a percentage of risk-weighted assets	21.78%	15.89%

27. Commitments for expenditure

Recognition and measurement

An operating lease is a lease whereby substantially all of the risks and rewards incidental to legal ownership of the leased assets remain with the lessor. As a lessee, the Group engages only in operating leases and has entered into commercial property leases, leases on motor vehicles and items of office equipment. The leases have various terms and some property leases include optional renewal periods in the contracts.

There are no restrictions placed upon the lessee by entering these leases. Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

	Consolidated		Company	
	2017	2016	2017	2016
	\$'000	\$'000	\$'000	\$'000
Future operating lease rentals not provided for and payable:				
Not later than one year	2,447	2,812	2,447	2,812
Later than one year but not later than two years	2,270	825	2,270	825
Later than two years but not later than five years	4,490	1,021	4,490	1,021
Total	9,207	4,658	9,207	4,658

The consolidated entity leases branches, head office building and equipment.

28. Auditor's remuneration

	Consolidated		Company	
	2017	2016	2017	2016
	\$	\$	\$	\$
Audit services:				
Audit of the financial report*	283,500	275,250	283,500	275,250
	283,500	275,250	283,500	275,250
Non-audit services				
Other services	79,000	73,932	79,000	73,932
	79,000	73,932	79,000	73,932
Total	362,500	349,182	362,500	349,182

*excluding disbursements

The Board Audit and Risk Committees have considered the non-audit services provided by Deloitte Touche Tohmatsu for the years ended 31 December 2017 and 2016 and is satisfied that the provision of these services is compatible with, and did not compromise the auditor independence requirements of the Corporations Act 2001 and the level of fees were compatible with maintaining auditor's independence.

29. Related parties

In addition to their salaries, the consolidated entity also provides non-cash benefits to directors and executive officers, and contributes to a superannuation fund on their behalf.

Key management personnel compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity directly or indirectly, including any Director of the entity. Key management personnel of Arab Bank Australia Limited and its controlled entities are:

Mr Geoffrey C E Wild AM	Chairman and Non Executive Independent Director
Ms Randa El Sadek	Deputy Chairman and Non Executive Director
Mr Ian G MacDonald	Non Executive Independent Director
Mr Leslie Taylor AM	Non Executive Independent Director
Mr Saleem J S Shadeed	Non Executive Director
Ms Therese A S Batshon	Non Executive Director
Mr Joseph Rizk OAM	Managing Director
Ms Katherine Bayliss	Executive Manager Finance and Company Secretary
Ms Helen Michael	Chief Operating Officer
Mr James Gow	Chief Risk Officer

The key management personnel compensation included in "staff expenses" (see Note 4) are as follows:

	Consolidated		Company	
	2017	2016	2017	2016
	\$	\$	\$	\$
Short-term employee benefits*	1,923,200	1,855,213	1,923,200	1,855,213
Other long-term benefits	19,276	30,203	19,276	30,203
Post-employment benefits	204,905	166,792	204,905	166,792
	2,147,381	2,052,208	2,147,381	2,052,208

*Included in short term employee benefits is \$100,283 (2016: \$122,813) of annual leave for key management. Short term employee benefits are expected to be settled wholly within 12 months.

29. Related parties (continued)

Transactions within the Arab Bank plc group

During the financial year, the Company engaged in banking transactions with Arab Bank plc, and its wholly owned subsidiaries. All transactions were on normal terms and conditions. Balances with these companies are disclosed in the relevant notes to the financial statements.

The Company also reimbursed Arab Bank plc for software and third party costs. These services are also provided on normal commercial terms and conditions.

Transactions with key management personnel and other related parties

As at 31 December 2017, the Company had total loans to key management of \$NIL (2016: \$9,598) and deposits received from key management of \$1,093,429 (2016: \$1,188,812) which were under normal terms and conditions.

There were no other transactions and contracts with directors apart from the amounts disclosed above.

Ultimate controlling entity

The ultimate controlling entity of Arab Bank Australia Limited is Arab Bank plc, a company incorporated in Jordan.

30. Contingent liabilities

Recognition and measurement

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the amount of the obligation under the contract, as determined in accordance with AASB 137 'Provisions, Contingent Liabilities and Contingent Assets'. Financial guarantees and other contingent liabilities are accounted for as off balance sheet items.

Loan assets under committed lending facilities are not recognised until the related facilities are drawn.

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business.

Details of financial instruments with off-balance sheet risk are as follows:

	Consolidated		Company	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
	Face value		Face value	
Credit risk related instruments				
Letters of credit confirmed in the normal course of business	176	182	176	182
Letters of Guarantee given in the normal course of business	3,680	4,068	3,680	4,068
Commitments to extend credit	96,471	124,487	96,471	124,487

Letters of guarantee given in the normal course of business include guarantees for NIL (2015: \$99,000) which are cross guaranteed by Arab Bank plc.


31. Subsequent events

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of the Group, the results of those operations, or the state of affairs of the Group in future financial years.

In the opinion of the directors of Arab Bank Australia Limited:

1. The financial statements and notes, set out on pages 18 to 65, are in accordance with the Corporations Act 2001, including:
 - (a) giving a true and fair view of the financial position of the Company and consolidated entities as at 31 December 2017 and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date; and
 - (b) complying with Accounting Standards and the Corporations Regulations 2001; and
2. There are reasonable grounds to believe that the Company and consolidated entities will be able to pay its debts as and when they become due and payable.
3. The directors have been given the declarations required by section 295A of the Corporations Act 2001 from the Chief Executive Officer and Chief Financial Officer for the financial year ended 31 December 2017.
4. The directors draw attention to note 2(a) to the consolidated financial statements which includes a statement of compliance with International Financial Reporting Standards.

Signed in accordance with a resolution of the directors:



Joseph Rizk OAM
Director



Geoffrey C E Wild AM
Chairman

Dated at Sydney this 23rd day March 2018

arabbank.com.au

Arab Bank Australia Limited ABN 37 002 950 745
Australian Financial Services Licence/Australian Credit Licence 234563.

Arab Bank Australia