

NBAD UAE Islamic Fund

Financial statements

31 December 2012

NBAD UAE Islamic Fund

Financial statements

| <i>Contents</i> | <i>Page</i> |
|---|-------------|
| Independent auditors' report | 1 |
| Statement of financial position | 2 |
| Statement of comprehensive income | 3 |
| Statement of changes in net assets attributable to holders of redeemable units | 4 |
| Statement of cash flows | 5 |
| Notes to the financial statements | 6 |



P O BOX 7613
KPMG Lower Gulf Limited
Abu Dhabi Branch
Abu Dhabi
United Arab Emirates

Telephone +971(2) 4014800
Fax +971(2) 6327612
Website www.ae-kpmg.com

Independent auditors' report

The Unit holders
NBAD UAE Islamic Fund
Abu Dhabi

We have audited the accompanying financial statements of NBAD UAE Islamic Fund ("the Fund"), which comprise the statement of financial position as at 31 December 2012, the statements of comprehensive income, changes in net assets attributable to holders of redeemable units and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

National Bank of Abu Dhabi (the "Fund Manager") is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as the Fund Manager determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

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

Munther Dajani
Registration No. 268

20 JUN 2013

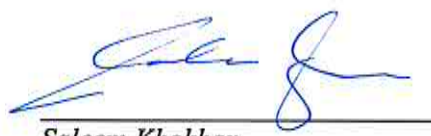
NBAD UAE Islamic Fund

Statement of financial position as at 31 December

| | <i>Note</i> | 2012 AED'000 | 2011 AED'000 |
|---|-------------|-----------------|-----------------|
| Assets | | | |
| Cash at bank | 8 | 745 | 1,289 |
| Financial assets at fair value through profit or loss | 7 | 88,305 | 95,650 |
| Due from brokers | | 21,156 | - |
| Other receivables | | 16 | 23 |
| Total assets | | 110,222 | 96,962 |
| Liabilities | | | |
| Due to related parties | 8 | 13,164 | 527 |
| Other liabilities | | 1,977 | - |
| Total liabilities | | 15,141 | 527 |
| Net assets attributable to holders of redeemable units | 11 | 95,081 | 96,435 |
| Number of units outstanding (thousand units) | | 12,355 | 13,857 |
| Net asset value per unit (AED) | | 7.70 | 6.96 |



Mark Watts
Head of Asset Management Group



Saleem Khokhar
Investment Committee Member

The notes on pages 6 to 28 form an integral part of these financial statements.

The independent auditors' report is set out on page 1.

NBAD UAE Islamic Fund

Statement of comprehensive income for the year ended 31 December

| | <i>Note</i> | 2012 AED'000 | 2011 AED'000 |
|--|-------------|-------------------------------|-------------------------------|
| Dividend income | | 5,057 | 3,876 |
| Other income | 9 | 18 | 39 |
| Net gain / (loss) from financial instruments at fair value through profit or loss | 7 | 7,206 | (20,929) |
| Total income /(loss) | | 12,281 | (17,014) |
| Investment management fees | 8 | (1,949) | (2,238) |
| Other operating expenses | | (541) | (595) |
| Total operating expenses | | (2,490) | (2,833) |
| Increase / (Decrease) in net assets attributable to holders of redeemable units | | 9,791 | (19,847) |

The notes on pages 6 to 28 form an integral part of these financial statements.

The independent auditors' report is set out on page 1.

NBAD UAE Islamic Fund

Statement of changes in net assets attributable to holders of redeemable units
for the year ended 31 December

| | Number of units | Net assets attributable to holders of redeemable units AED'000 |
|---|----------------------------|---|
| Balance at 1 January 2011 | 14,737,808 | 123,061 |
| Issue of units during the year | 85,808 | 665 |
| Redemption of units during the year | (966,885) | (7,444) |
| Decrease in net assets attributable to holders of redeemable units | - | (19,847) |
| Balance at 31 December 2011 | <u>13,856,731</u> | <u>96,435</u> |
| Balance at 1 January 2012 | 13,856,731 | 96,435 |
| Issue of units during the year | 10,899 | 80 |
| Redemption of units during the year | (1,512,904) | (11,225) |
| Increase in net assets attributable to holders of redeemable units | - | 9,791 |
| Balance at 31 December 2012 | <u>12,354,726</u> | <u>95,081</u> |

The notes on pages 6 to 28 form an integral part of these financial statements.

The independent auditors' report is set out on page 1.

NBAD UAE Islamic Fund

Statement of cash flows for the year ended 31 December

| | 2012 AED'000 | 2011 AED'000 |
|--|-------------------|---------------------|
| Cash flows from operating activities | | |
| Profit / (Loss) for the year | 9,791 | (19,847) |
| Changes in: | | |
| Financial instruments at fair value through profit or loss | 7,345 | 25,701 |
| Due from broker | (21,156) | - |
| Prepayments and other receivables | 7 | (23) |
| Due to a related parties | 12,637 | (133) |
| Other liabilities | 1,977 | (213) |
| <i>Cash flows from operating activities</i> | <u>10,601</u> | <u>5,485</u> |
| Cash flows from financing activities | | |
| Proceeds from issue of units | 80 | 665 |
| Payments on redemption of units | (11,225) | (7,444) |
| <i>Cash flows used in financing activities</i> | <u>(11,145)</u> | <u>(6,779)</u> |
| Net decrease in cash and cash equivalents | (544) | (1,294) |
| Cash and cash equivalents at beginning of the year | <u>1,289</u> | <u>2,583</u> |
| Cash and cash equivalents at end of the year | <u><u>745</u></u> | <u><u>1,289</u></u> |

The notes on pages 6 to 28 form an integral part of these financial statements.

The independent auditors' report is set out on page 1.

NBAD UAE Islamic Fund

Notes to the financial statements

1 Reporting entity

NBAD UAE Islamic Fund (the “Fund”) is an open ended investment fund established in the UAE by National Bank of Abu Dhabi (NBAD) (the “Fund Manager”) and is licensed by the Central Bank of the UAE approval reference number 13/2197/2004 dated 26 December 2004. The Fund is not a separately incorporated entity and its activities are managed by the Fund Manager.

The Fund’s primary / main objective is to invest in a balanced portfolio of equities based on Islamic Shariah law, listed on the financial markets of the UAE or other Middle East and North Africa (MENA) equities markets selected by the Fund Manager, or where appropriate, purchased through ‘over the counter’ arrangements and related securities with a view to achieving capital growth. However the Fund will not concentrate its investment in any country other than the UAE and will follow the guidelines of the Islamic Shariah Law.

The applicable prospectus was revised on 1 November 2007 and the term sheet was revised on 26 July 2012. The revisions are approved by the Securities and Commodities Authority of the UAE. The revised prospectus and term sheet and the financial statements of the Fund as at and for the year ended 31 December 2012 are available upon request from the Fund Manager’s registered office at P.O. Box 4, Abu Dhabi, United Arab Emirates.

2 Basis of preparation

(a) Statement of compliance

The financial statements of the Fund as at and for the year ended 31 December 2012 have been prepared in accordance with International Financial Reporting Standards (IFRSs).

These financial statements were approved on behalf of the Fund Manager on 20 JUN 2013.

(b) Basis of measurement

These financial statements have been prepared on the historical cost basis except for financial instruments at fair value through profit or loss, which are measured at fair value.

(c) Functional and presentation currency

These financial statements are presented in United Arab Emirates Dirham (“AED”), which is the Fund’s functional currency. All financial information presented in AED has been rounded to the nearest thousand.

(d) Use of estimates and judgments

The preparation of the financial statements in conformity with IFRSs requires the Fund Manager to make judgments, 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.

NBAD UAE Islamic Fund

Notes to the financial statements

2 Basis of preparation *(continued)*

(d) Use of estimates and judgments (continued)

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in note 5.

3 Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

(a) Murabaha income

Murabaha income is recognised in statement of comprehensive income on a time apportionment basis, until such time when a reasonable doubt arises with regards to its collectability.

(b) Redemption fees

Redemption fees are charged to holders of redeemable units at the time of redemption of units in the Fund in accordance with the term sheet and are recognised in the statement of comprehensive income in the period during which such redemptions are made.

(c) Dividend income

Dividend income is recognised in the statement of comprehensive income when the right to receive income is established. For quoted equity securities this is usually the ex-dividend date.

(d) Net gain / (loss) from financial instruments at fair value through profit or loss

Net gain / (loss) from financial instruments at fair value through profit or loss includes all realised gain / loss and unrealised fair value changes and foreign exchange differences, but excludes interest and dividend income.

Net realised gain / (loss) from financial instruments at fair value through profit or loss represents the difference between the closing price applicable on the last revaluation date and their sale / settlement price.

The unrealised gain / (loss) represents the difference between the carrying amount of a financial instrument at the beginning of the period, or transaction price when purchased in the current reporting period and its fair value at the end of the period or at the last revaluation date before its sale / settlement.

NBAD UAE Islamic Fund

Notes to the financial statements

3 Significant accounting policies *(continued)*

(e) Expenses

All expenses, including the investment management fees and performance fees are recognised in the statement of comprehensive income on an accrual basis.

(f) Foreign currency transactions

Transactions in foreign currencies are translated into UAE Dirhams at the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into UAE Dirhams at the spot exchange rate at that date.

Foreign currency exchange differences arising on translation are recognised in the statement of comprehensive income. Foreign currency exchange differences relating to investments at fair value through profit or loss are included in net (loss) / gain on investments at fair value through profit or loss.

(g) Financial assets and financial liabilities

i. Recognition and initial measurement

Financial assets and liabilities at fair value through profit or loss are recognised initially on the trade date at which the Fund becomes a party to the contractual provisions of the instrument. Other financial assets and liabilities are recognised on the date they are originated.

Financial assets and financial liabilities at fair value through profit or loss are measured initially at fair value, with transaction costs recognised in the statement of comprehensive income. Financial assets or financial liabilities not at fair value through profit or loss are measured initially at fair value plus transaction costs that are directly attributable to its acquisition or issue.

Subsequent measurement of financial instruments is discussed below in respective notes.

ii. Classification

The Fund has adopted the following classifications for financial assets and financial liabilities:

- Held for trading - equity investments

Financial assets at amortised cost:

- Loans and receivables – cash at bank, due from brokers and certain other receivables.

Financial liabilities at amortised cost:

- Other liabilities – balances due to related parties, other liabilities and net assets attributable to holders of redeemable units

NBAD UAE Islamic Fund

Notes to the financial statements

3 Significant accounting policies *(continued)*

(g) Financial assets and financial liabilities (continued)

ii. Classification (continued)

A financial instrument is classified as held for trading, if:

- it is acquired or incurred principally for the purpose of selling or repurchasing in the near term; or
- on initial recognition it is part of a portfolio that is managed together and for which there is evidence of a recent pattern of short-term profit taking.

Note 6 provides a reconciliation of line items in the statement of financial position to the categories of financial instruments, as defined by IAS 39.

iii. Derecognition

The Fund derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Fund neither transfers nor retains substantially all the risks and rewards of ownership and does not retain control of the financial asset. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Fund is recognised as a separate asset or liability in the statement of financial position.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised), and the consideration received (including any new asset obtained less any new liability assumed) is recognised in the statement of comprehensive income.

The Fund enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised.

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

iv. Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Fund has a legal right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRSs, for example, for gains and losses arising from a group of similar transactions, such as gains and losses from financial instruments at fair value through profit or loss.

NBAD UAE Islamic Fund

Notes to the financial statements

3 Significant accounting policies *(continued)*

(g) Financial assets and financial liabilities (continued)

v. Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective profit method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

The effective profit rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, when appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective profit rate, the Fund estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

vi. Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Fund measures the fair value of financial assets using quoted bid prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Fund establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, reference to the index that is considered to be the best representative of the instrument and discounted cash flow analyses. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Fund, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e. the fair value of the consideration given or received.

Assets are measured at a bid price and liabilities are measured at an asking price.

All changes in fair value, other than dividend income, are recognised in the statement of comprehensive income as net gain or loss from financial instruments at fair value through profit or loss.

NBAD UAE Islamic Fund

Notes to the financial statements

3 Significant accounting policies *(continued)*

(g) Financial assets and financial liabilities (continued)

vii. Identification and measurement of impairment

At each reporting date the Fund assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is (are) impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired can include significant financial difficulty of the banker or issuer, default or delinquency by a banker or issuer, indications that a banker or issuer will enter bankruptcy or other observable data relating to a group of assets such as adverse changes in the payment status of bankers or issuers in the group, or economic conditions that correlate with defaults in the group.

Impairment losses on financial assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective profit rate. Impairment losses are recognised in the statement of comprehensive income and reflected in an allowance account against loans and receivables. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through the statement of comprehensive income.

The Fund writes off financial assets carried at amortised cost when they are determined to be uncollectible.

(h) Cash and cash equivalents

Cash and cash equivalents for the purpose of cash flow comprise deposits with bank with original maturities of less than three months.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(i) Net asset value per unit

The net asset value per unit disclosed in the statement of financial position is calculated in accordance with the Fund's Prospectus by dividing the net assets attributable to holders of redeemable units included in the financial position by the number of units outstanding at the reporting date.

NBAD UAE Islamic Fund

Notes to the financial statements

3 Significant accounting policies *(continued)*

(j) Redeemable units

Redeemable units are classified as financial liabilities and are measured at the present value of the redemption amounts. In accordance with the Fund's prospectus, the redemption amounts of the redeemable units are based on last published net asset value. The net assets value includes Fund's underlying investments, calculated using the closing prices. On the other hand, in accordance with the Fund's accounting policies, financial assets are measured at a bid price and financial liabilities are measured at the asking price. The differences in the measurement bases of the Fund's underlying investments and the redemptions amounts of the redeemable units have been adjusted through net gain / loss from financial assets at fair value through profit and loss.

(k) Provisions

A provision is recognised if, as a result of a past event, the Fund has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where the effect of time value of money is material, provisions are determined by discounting the expected future cash flows, that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(l) New standards issued not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for annual periods beginning after 1 January 2012, and have not been applied in preparing these financial statements:

- (i) IFRS -9 Financial Instruments:* In November 2009 the IASB's issued IFRS 9 as a comprehensive project to replace IAS 39, deals with classification and measurement of financial assets. The requirements of this standard represent a significant change from the existing requirements in IAS 39 in respect of financial assets. The standard contains two primary measurement categories for financial assets: amortised cost and fair value. The standard eliminates the existing IAS 39 categories of held to maturity, available-for-sale and loans and receivable.

Gains and losses on remeasurement of financial assets measured at fair value will be recognized in profit or loss, except that for an investment in an equity instrument which is not held-for-trading, IFRS 9 (2010) added guidance to IFRS 9 (2009) on the classification and measurement of financial liabilities, and this guidance is consistent with the guidance in IAS 39 with few exceptions.

IFRS 9 (2010) also added the requirements of IAS 39 for derecognition of financial assets and liabilities to IFRS 9 without change.

The IASB has deferred the mandatory effective date of the existing chapters of IFRS 9 Financial Instruments (2009) and IFRS 9 (2010) to annual periods beginning on or after January 1, 2015. The early adoption of either standard continues to be permitted. The Fund is currently in process of evaluating the potential effect of this standard and has no intention of early adoption of this standard.

NBAD UAE Islamic Fund

Notes to the financial statements

3 Significant accounting policies *(continued)*

(l) New standards issued not yet adopted (continued)

- (ii)* Presentation of items of the other comprehensive income (Amendments to IAS 1 Presentation of Financial Statements) introduces changes to the presentation of items of other comprehensive income. The amendments require that an entity present separately the items of other comprehensive income that would be reclassified to profit and loss in future if certain conditions are met from those that would never be reclassified to profit and loss. It also changes the title of the statement of comprehensive income to that statement of profit and loss and other comprehensive income. However, an entity is allowed to use other titles. The effective date is 1 July 2012 and the amendments may be early applied. The standard is not expected to have a material effect on the Fund's financial statements.
- (iii)* IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. It explains how to measure fair value when it is required by other IFRSs. It does not introduce new fair value measurements, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards. The standard is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The Fund is currently in the process of evaluating the potential effect of this standard.

4 Financial risk management

Introduction and overview

The Fund has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk
- Operational risk

This note presents information about the Fund's exposure to each of the above risks, the Fund's objectives, policies and processes for measuring and managing risk, and the Fund's management of capital.

Risk management framework

The Advisory Board and Investment Committee have the overall responsibility for the establishment and oversight of the Fund's risk management framework.

The Fund is managed by the Fund Manager on the basis of the Funds investment objectives and guidelines, subject to the supervision of the Investment Committee, on a day to day basis. The Advisory Board reviews the activities and performance of the Fund (including Fund's investment strategies as set out in the Investment process) and makes appropriate recommendations to the Fund Manager.

The Fund's risk management policies are established to identify and analyse the risks faced by the Fund, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly, on an ongoing basis, to reflect changes in market conditions, products and services offered. Details of the nature of the Fund's investment portfolio at the reporting date are disclosed in relevant risk notes.

NBAD UAE Islamic Fund

Notes to the financial statements

4 Financial risk management (*continued*)

(a) Credit risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Fund, resulting in a financial loss to the Fund. It arises principally from cash at bank, due from brokers and certain other receivables. For risk management reporting purposes, the Fund considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

Management of credit risk

Credit risk is monitored on a regular basis by the Fund Manager, Investment committee and Advisory board in accordance with policies and procedures in place. The Investment Committee's main objectives include: (i) to determine the investment strategies and tactics to be adopted to manage the Funds in accordance with the investment objectives and guidelines as set out in the prospectus and term sheet; and (ii) to review the Fund's performance and discuss the various strategies adopted at the sectoral and occasionally at the stock level. The Fund Advisory Board's main objectives are to protect the interests of the investors. It also has a responsibility to consider the investment strategies adopted for the individual Funds and to review the performance of each Fund at a strategic level. Additionally the Advisory Board also considers events and actions that may have given rise to a conflict of interest and advise the Fund Manager on possible remedies, if appropriate. Where the credit risk is not in accordance with the investment policy or guidelines of the Fund, the Fund Manager is obliged to rebalance the portfolio as soon as is reasonably practicable after each determination that the portfolio is not in compliance with the stated investment parameters.

Exposure to credit risk

The Fund's maximum credit risk exposure at the statement of financial position date is represented by the respective carrying amounts of the financial assets in the statement of financial position.

Balances due from brokers

Balances due from brokers result from margin accounts and sale transactions awaiting settlement. Credit risk relating to unsettled transactions is considered small due to the short settlement period involved and the reputable brokers engaged by the Fund Manager. The Fund Manager monitors the internal controls, credit ratings and financial position of the brokers on a quarterly basis.

Majority of the Fund's transactions for sale and purchase of securities are made through Abu Dhabi Financial Services LLC ("ADFS") which is a subsidiary of the Fund Manager. (*Refer note 8*)

Cash at bank

The Fund's bank balances are with the Fund Manager.

Concentration of credit risk

There were no significant concentrations of credit risk to any individual issuer or group of issuers at 31 December 2012 or 31 December 2011 except in connection with the bank balances held with the Fund Manager.

Settlement risk

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

NBAD UAE Islamic Fund

Notes to the financial statements

4 Financial risk management *(continued)*

(a) Credit risk (continued)

Settlement risk (continued)

For the majority of transactions the Fund mitigates this risk by conducting settlements through a broker to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval and limit monitoring process.

Past due and impaired assets

No financial assets carried at amortised cost were past due or impaired at 31 December 2012 (31 December 2011: nil).

(b) Liquidity risk

Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations arising from its financial liabilities that are settled by delivering cash or another financial asset, or that such obligations will have to be settled in a manner disadvantageous to the Fund.

It arises principally from due to related parties and net assets attributable to holders of redeemable units.

Management of liquidity risk

The Fund's approach to manage the risk is to have sufficient liquidity to meet its liabilities, including anticipated redemptions of units, as and when due, without incurring unacceptable losses or risking damage to the Fund's reputation.

The Fund's liquidity risk is managed on a daily basis by the Fund Manager in accordance with policies and procedures in place. The Fund's overall liquidity risks are monitored on a weekly basis by the Investment Committee and the Advisory Board.

The Fund's term sheet provides for the weekly redemption of units and it is therefore exposed to the liquidity risk of meeting unit holders' redemptions at any time. The Fund's redemption policy only allows for redemptions on the last day of each week and unit holders must provide at least 2 days prior notice.

The Fund's financial instrument includes bank balances and listed equity securities which are considered to be readily realisable as they are actively traded on major UAE stock exchanges. Also, the term sheet of the Fund allows up to 25% of the Fund's total assets to be held in the form of cash or cash equivalents in order to meet redemptions.

The Fund's fair value through profit or loss investments includes shares which are not traded actively in the market and are considered to be illiquid. As a result the Fund may not be able to liquidate some of its investment in due time in order to meet liquidity. These securities comprise 0.60 % (2011: 0.56%) of the total investment. These securities may take more than twelve months to realise from the reporting date.

NBAD UAE Islamic Fund

Notes to the financial statements

4 Financial risk management (continued)

(b) Liquidity risk (continued)

Maturity analysis for financial liabilities

Residual contractual maturities of the financial liabilities at reporting dates are as follows. The tables below show the contractual undiscounted cash flows of the Fund's financial liabilities:

| | Less than 1 month AED'000 | Gross/ Carrying amount AED'000 |
|--|--|---|
| 31 December 2012 | | |
| Due to related parties | 13,164 | 13,164 |
| Other liabilities | 1,977 | 1,977 |
| Net assets attributable to holders of Redeemable units | 95,081 | 95,081 |
| | <u>110,222</u> | <u>110,222</u> |
| 31 December 2011 | | |
| Due to related parties | 527 | 527 |
| Other liabilities | - | - |
| Net assets attributable to holders of redeemable units | 96,435 | 96,435 |
| | <u>96,962</u> | <u>96,962</u> |

The previous table shows the discounted cash flows of the Fund's financial liabilities on the basis of their earliest possible contractual maturity. The carrying amounts are similar to the gross amounts.

The Fund's expected cash flows on these instruments do not vary significantly from this analysis except for net assets attributable to the holders of redeemable units, which the Fund has the contractual obligation to redeem within the 2 days of notice. Historical experience indicates that these units are held by unit holders based on medium or long term basis, however redemption levels are very difficult to predict as they vastly fluctuate with the changing market conditions and investor needs or objectives.

NBAD UAE Islamic Fund

Notes to the financial statements

4 Financial risk management *(continued)*

(c) Market risk

Market risk is the risk that changes in market prices, such as interest rates, equity prices, and foreign exchange rates will affect the Fund'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 Fund's strategy on the management of the market risk is driven by its investment objectives and guidelines. The Fund's primary investment objective is to invest in a balanced portfolio of equities based on Islamic Shariah law, listed in Dubai, Abu Dhabi and other Arab equities markets. The Fund's market risk is managed on a daily basis by the Fund Manager in accordance with the policies and procedures in place. The Fund's overall market positions are monitored by the Advisory Board and Investment Committee on periodic basis.

When considered necessary or appropriate, the Fund Manager may hedge currency and/or other portfolio related risks in accordance with the investment objectives and guidelines.

Exposure to currency risk

The Fund may invest in financial instruments and enter into transactions denominated in currencies other than its functional currency ("AED"). Consequently, the Fund is exposed to risks that the exchange rate of its currency relative to other foreign currencies may change in a manner that has an adverse effect on the value if that portion of the Fund's assets or liabilities denominated in currencies other than the AED.

The exchange rate of AED and all other Arab currencies, in which the Fund invests, is pegged against US Dollar and hence the Fund's exposure to currency risk is limited to that extent.

Since the majority of the assets and liabilities are in AED or in foreign currencies pegged with the AED, the management estimates that any reasonable possible changes in exchange rates would not have a significant impact on the Fund's financial statements.

Exposure to interest rate risk

Interest rate risk is the risk that arises from timing difference in the maturity and re-pricing of Fund's interest bearing assets and liabilities.

The majority of Fund's financial assets and liabilities are non-interest bearing. Interest bearing financial assets and liabilities mature or re-price in the short term, i.e. no longer than twelve months. As a result the Fund is subject to limited exposure to fair value or cash flow interest rate risk due to fluctuations in the prevailing levels of market interest rate; hence the management estimates that any reasonable possible changes in interest rates movements would not have a significant impact on the Fund's financial statements.

NBAD UAE Islamic Fund

Notes to the financial statements

4 Financial risk management *(continued)*

(c) Market risk (continued)

Exposure to interest rate risk (continued)

Bank balances placed with the Fund Manager are at floating rates, with re-pricing on quarterly basis. All other financial assets and liabilities are non-interest bearing.

Other price risk

Other price risk is the risk that the fair value of the financial instrument will fluctuate as a result of changes in market prices (other than those arising from currency risk), whether caused by factors specific to an individual investment, its issuer or all factors affecting all instruments traded in the market. As the majority of the Fund's financial instruments are carried at fair value with fair value changes recognised in the statement of comprehensive income, all changes in market conditions will directly affect net investment income.

Price risk is managed by the Fund Manager by constructing a diversified portfolio of instruments, in different industry sectors and traded on different markets. Under normal circumstances the Fund invests in the trading instruments in accordance with the investment guidelines.

As per the term sheet of the Fund, the policy for concentration of its investment portfolio profile is as follows:

- Upto 50% of its total assets may be in MENA equities;
- Investment in any particular company shall not exceed the lower of 10% of that company's then total market capitalisation or any restrictions on investment prescribed by applicable law and/or the relevant company's Articles of Association;
- Except as required to reflect market weighing of a stock, investment in equities or liquid tradable securities of any company is not to exceed 25% of the Fund's total assets at the time of investment. No use of derivatives is allowed; and
- Investments in third party collective investment schemes must be limited to 15% of the Fund's NAV and must not exceed 5% of the net asset value of any of the collective investment schemes the Fund is invested in.

Internal procedures require the Fund Manager to manage price risk on a daily basis. Internal procedures and systems help the Fund Manager to keep a check and control of any kind of price risk on an ongoing basis. Any deviation from the permitted guidelines needs to be corrected in the best possible manner within a reasonable time frame from the equity perspective. The Fund's procedures require price risk to be monitored on a monthly basis by the Advisory Board and Investment Committee.

Where the other price risk is not in accordance with the investment policy or guidelines of the Fund, the Fund Manager is obliged to rebalance the portfolio as soon as is reasonably practicable after each determination that the portfolio is not in compliance with the stated investment parameters.

NBAD UAE Islamic Fund

Notes to the financial statements

4 Financial risk management (continued)

(c) Market risk (continued)

Other price risk (continued)

The Fund Manager monitors concentration of risk based on counterparties and industries. The Fund's equity investments are concentrated in the following industries:

| | 2012 AED'000 | 2011 AED'000 |
|------------------------|-----------------|-----------------|
| Banking | 25,091 | 23,365 |
| Real Estate | 15,000 | 23,076 |
| Finance and Investment | 533 | 1,325 |
| Telecom | 37,340 | 36,510 |
| Others | 10,341 | 11,374 |
| | <u>88,305</u> | <u>95,650</u> |

The Fund had the following individual significant concentration in its portfolio of investments at fair value through profit or loss:

| | 2012 % | 2011 % |
|-----------------------------------|-----------|-----------|
| Emaar Properties Company P.J.S.C. | 17 | 24 |
| Etisalat P.J.S.C. | 25 | 20 |
| Dubai Islamic Bank P.J.S.C. | 18 | 12 |
| Du | 11 | 14 |
| | <u>11</u> | <u>14</u> |

The Fund estimates the future reasonably possible market price fluctuations for equity investments on an individual investment basis.

The table below sets out the effect on the Fund's statement of comprehensive income and net assets attributable to holders of redeemable units of a reasonably possible strengthening in the individual equity market prices of 1% at 31 December. The analysis assumes that all other variables, in particular interest and foreign currency rates remain constant.

| <i>Effect in AED thousand</i> | 2012 | 2011 |
|--|-------------|-------------|
| Investments at fair value through profit or loss | <u>883</u> | <u>951</u> |
| <i>Effect in % of net assets</i> | | |
| Investments at fair value through profit or loss | <u>0.93</u> | <u>0.99</u> |

NBAD UAE Islamic Fund

Notes to the financial statements

4 Financial risk management *(continued)*

(c) Market risk (continued)

A weakening of market prices would have resulted in an equal but opposite effect to the amounts shown above.

As at the reporting date the Fund had investments in inactive securities, the fair value of which is measured using a valuation technique. Although the management believes that its estimates of fair value are appropriate, the use of different methodologies or assumptions could lead to different measurement of fair value. Maximum exposure against these securities amounted AED 533 thousand (2011: AED 533 thousand).

(d) Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the processes, technology and infrastructure supporting the Fund's operations either internally within the Fund or externally at the Fund's service providers, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of investment management behaviour.

Operational risks arise from all of the Fund's activities. The Fund's objective is to manage operational risk so as to balance limiting of financial losses and damage to its reputation whilst achieving its investment objective of generating returns to investors.

The primary responsibility for the development and implementation of controls over operational risk rests with the Fund Manager. This responsibility is supported by the development of overall standards for the management of operational risk, which encompasses the controls and processes at the service providers and the establishment of service levels with the service providers, in the following areas:

- requirements for appropriate segregation of duties between various functions, roles and responsibilities;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified;
- contingency plans;
- ethical and business standards; and
- risk mitigation, including insurance where this is effective.

Compliance with policies and procedures is supported by periodic reviews undertaken by the Fund Manager's Group internal audit department. The results of these reviews are discussed with the management, with summaries submitted to the Audit Committee and senior management of the Fund Manager.

As at the reporting date the Fund has not breached any investment guidelines by investing in the shares of prohibited activities. However, any such investment by the Fund is subsequently dealt with as per the requirements of the term sheet and under guidance of Islamic Shariah consultant.

NBAD UAE Islamic Fund

Notes to the financial statements

4 Financial risk management *(continued)*

(d) Operational risk (continued)

The directors' assessment over the adequacy of the controls and processes in place at the service providers with respect to operational risks is carried out via regular discussions with the service providers.

Substantially all of the securities of the Fund are held with reputable brokers. Bankruptcy or insolvency of the custodians may cause the Fund's rights with respect to the securities held by the custodian to be delayed or limited. The Fund Manager monitors the credit ratings, internal control and financial position of its custodians on a periodic basis.

(e) Capital management

The Fund's capital is represented by the number of units outstanding. The objective of the Fund is to invest the subscriptions amounts in a portfolio with a view to both achieving capital growth and provide attractive returns over medium term, while reducing directional downward risk in underlying market.

The Fund aims to deliver this objective mainly through investing in a balanced portfolio as per the Fund investment guidelines while maintaining sufficient liquidity to meet unit holder's redemptions. The Fund has complied with the externally imposed requirements including SCA and UAE Central Bank rules and regulations.

5 Use of estimates and judgments

Key sources of estimation uncertainty and critical accounting judgments in applying the Fund's accounting policies:

(a) Fair values of financial instruments

The Fund's financial instruments include investments which are measured at fair value in the statement of financial position and it is usually possible to determine their fair values within a reasonable range of estimates i.e. quoted market prices are readily available.

For certain other financial instruments the carrying amounts approximate fair value due to the immediate or short term nature of the financial instruments.

Availability of observable market prices reduces the need for management judgment and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial market.

Valuation models that employ significant inputs require a higher degree of management judgment and estimation in the determination of fair value. Management judgment and estimation are usually required for selection of the appropriate valuation model to be used.

The Fund has an established control framework with respect to the measurement of fair values. Specific controls include: verification of observable pricing inputs; calibration or back testing of models, review and changes to models, analysis and investigation of significant daily valuation movements; and reporting of significant valuation issues to the Advisory Board and Investment Committee.

NBAD UAE Islamic Fund

Notes to the financial statements

5 Use of estimates and judgments *(continued)*

Key sources of estimation uncertainty and critical accounting judgments in applying the Fund's accounting policies: (continued)

(a) Fair values of financial instruments (continued)

The Fund's accounting policies on fair value measurements for financial instruments are discussed in notes 3(g) and 6.

(b) Contingent liability arising from litigations

Due to the nature of its operations, the Fund may be involved in litigations arising in the ordinary course of business. Provision for contingent liabilities arising from litigations is based on the probability of outflow of economic resources and reliability of estimating such outflow. Such matters are subject to many uncertainties and the outcome of individual matters is not predictable with assurance.

(c) Financial asset and liability classification

The Fund's accounting policies provide scope for financial assets and liabilities to be designated on inception into different accounting categories in certain circumstances.

In classifying financial assets as fair value through profit or loss, the Fund has determined it meets the description as set out in notes 3(g) and 6.

NBAD UAE Islamic Fund

Notes to the financial statements

6 Financial assets and liabilities

Accounting classifications and fair values

The table below provides reconciliation of the line items in the Fund's statement of financial position to the categories of financial instruments as at:

| | At fair value through profit or loss AED'000 | Other amortised cost AED'000 | Carrying amount AED'000 |
|---|---|---------------------------------------|-------------------------------|
| 31 December 2012 | | | |
| Cash at bank | - | 745 | 745 |
| Financial assets at fair value through profit or loss | 88,305 | - | 88,305 |
| Due from brokers | - | 21,156 | 21,156 |
| Other receivables | - | 16 | 16 |
| | <u>88,305</u> | <u>21,917</u> | <u>110,222</u> |
| Due to a related parties | - | 13,164 | 13,164 |
| Other liabilities | - | 1,977 | 1,977 |
| Net assets attributable to holders of redeemable units | - | 95,081 | 95,081 |
| | <u>-</u> | <u>110,222</u> | <u>110,222</u> |
| 31 December 2011 | | | |
| Cash at bank | - | 1,289 | 1,289 |
| Financial assets at fair value through profit or loss | 95,650 | - | 95,650 |
| Other receivables | - | 23 | 23 |
| | <u>95,650</u> | <u>1,312</u> | <u>96,962</u> |
| Due to a related party | - | 527 | 527 |
| Other liabilities | - | - | - |
| Net assets attributable to holders of redeemable units | - | 96,435 | 96,435 |
| | <u>-</u> | <u>96,962</u> | <u>96,962</u> |

The financial instruments not accounted for at fair value through profit or loss are short-term financial assets and liabilities whose carrying amounts approximates their fair value.

NBAD UAE Islamic Fund

Notes to the financial statements

6 Financial assets and liabilities (*continued*)

Accounting classifications and fair values (*continued*)

All financial assets and liabilities are measured at amortised cost except for held for trading investments which are measured at fair value either by reference to published price quotations in an active market or by using some valuation technique.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction. Consequently, differences can arise between book values and the fair value estimates. Underlying the definition of fair value is the presumption that the Fund is a going concern without any intention or requirement to materially curtail the scale of its operation or to undertake a transaction on adverse terms.

For investment in shares that are inactive as at the reporting date the Fund determines fair value using valuation techniques. The valuation techniques include comparison to similar instruments, if any, for which market observable prices exist or mark to that index which is considered to offer closest prices. The objective of using a valuation technique is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

The Fund measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.

Level 2: Valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques for which all significant inputs are directly or indirectly observable from market data.

Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

NBAD UAE Islamic Fund

Notes to the financial statements

6 Financial assets and liabilities (continued)

Accounting classifications and fair values (continued)

| | Level 1 AED'000 | Level 2 AED'000 | Level 3 AED'000 | Total AED'000 |
|--|--------------------|--------------------|--------------------|------------------|
| 31 December 2012 | | | | |
| Financial assets at fair value through profit and loss | 87,772 | - | 533 | 88,305 |
| Total | 87,772 | - | 533 | 88,305 |
| 31 December 2011 | | | | |
| Financial assets at fair value through profit and loss | 95,117 | - | 533 | 95,650 |
| Total | 95,117 | - | 533 | 95,650 |

The table below shows a reconciliation from the beginning balances to the ending balances for fair value measurements in level 3 of the fair value hierarchy :

| | 2012 AED'000 | 2011 AED'000 |
|--|-----------------|-----------------|
| Balance as at 1 January | 533 | 1,463 |
| Loss recognised in the statement of comprehensive income | - | (930) |
| Balance as at 31 December | 533 | 533 |

7 Net gain / (loss) on investments at fair value through profit or loss

| | 2012 AED'000 | 2011 AED'000 |
|--------------------------|-----------------|-----------------|
| Realised gain / (loss) | 315 | (2,640) |
| Unrealised gain / (loss) | 6,891 | (18,289) |
| | 7,206 | (20,929) |

As at reporting date all of the Funds investments at fair value through profit or loss are in equity securities.

NBAD UAE Islamic Fund

Notes to the financial statements

8 Related parties

Identity of related parties

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. Related parties comprise members of the Advisory Board and Investment Committee and the Fund Manager and the entities controlled by them. In the ordinary course of business, the Fund renders and receives services from such related parties at agreed rates, terms and conditions set out by the Fund Manager.

Terms and conditions

Key terms and conditions are shown below:

Brokerage ADFS, a wholly owned subsidiary of NBAD, provides brokerage services to the Fund at prevailing market rates.

Banking services NBAD provides banking services at rates agreed with the Fund.

Others The Fund Manager is entitled to the following fees as set out in the offering terms sheet:

- Management fees of 2%;
- Performance fees at 10% per annum charged by the Fund Manager on the increase in the Fund's NAV above the "Hurdle Rate". The Hurdle Rate is calculated as an increase of 2% per quarter over the last highest NAV of the Fund on which performance fees have been charged.

Balances

Balances with related parties at the reporting dates are shown below:

| | 2012 AED'000 | 2011 AED'000 |
|--|-----------------|-----------------|
| Number of units held by related parties (in thousands) | 34 | 34 |
| Cash at bank | 745 | 1,289 |
| Due from broker | 7,428 | - |

Due to related parties

| | | |
|--|---------------|------------|
| Management fees payable to the Fund Manager | - | 509 |
| Administration fee payable to Custody department | 16 | 18 |
| Due to broker | 13,148 | - |
| | <u>13,164</u> | <u>527</u> |

NBAD UAE Islamic Fund

Notes to the financial statements

8 Related parties *(continued)*

Investments at fair value through profit or loss include equity investments amounting to AED 21,717 thousand (31 December 2011: AED 19,399 thousand) held by a related party on behalf of the Fund.

Transactions

Transactions with related parties during the year included in the statement of comprehensive income are shown below:

| | 2012 AED'000 | 2011 AED'000 |
|----------------------------|-----------------|-----------------|
| Brokerage expense | (95) | (27) |
| Investment management fees | <u>(1,949)</u> | <u>(2,238)</u> |

In accordance with article 16.2 of the term sheet, a management fee of 2% per annum of the Fund's NAV is payable quarterly to the Fund Manager, calculated and accrued on a weekly basis.

The Fund is managed by the Fund Manager and has no key management personnel.

9 Other income

| | 2012 AED'000 | 2011 AED'000 |
|----------------|-----------------|-----------------|
| Redemption fee | 4 | 4 |
| Other | <u>14</u> | <u>35</u> |
| | <u>18</u> | <u>39</u> |

Other income mainly represents rebate obtained from brokers.

10 Units of the Fund

The initial offering of units was at a price of AED 10 per unit (par value). Subsequent to the initial offering, the subscription price for units is based on the Net Asset Value (NAV) per unit on the last business day of each week.

NBAD UAE Islamic Fund

Notes to the financial statements

11 Reconciliation of net asset and net asset value per shares

| | 2012 AED'000 | 2011 AED'000 |
|--|-----------------|-----------------|
| Net asset as per prospectus | 95,350 | 96,723 |
| Adjustment from closing prices to bid prices | (269) | (288) |
| Net assets as per financial reporting | 95,081 | 96,435 |

In accordance with the Fund's prospectus unaudited net asset value is weekly reported to the holders of redeemable units. Unaudited net assets value includes investments at fair value through profit or loss calculated using quoted closing prices without adjustment for financial assets disposal costs or unit encashment charges.

For financial statement reporting purposes, audited net assets value is calculated using quoted bid prices for financial assets.

12 Comparative figures

Comparative figures have been reclassified, where applicable, to conform to the presentation adopted in the current year.