

**HSBC SUKUK FUND**  
**(Managed by HSBC Saudi Arabia)**  
**FINANCIAL STATEMENTS**  
**For the year ended 31 December 2018**  
**together with the**  
**INDEPENDENT AUDITORS' REPORT**



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Licence No. 46/11/323 issued 11/3/1992

## Independent auditors' report

To the unitholders of HSBC Sukuk Fund

### Opinion

We have audited the financial statements of **HSBC Sukuk Fund** ("the Fund"), managed by HSBC Saudi Arabia ("the Fund Manager"), which comprise of the statement of financial position as at 31 December 2018, the statements of comprehensive income, changes in net assets (equity) attributable to the unitholders and cash flows for the year then ended, and notes to the financial statements, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Fund as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards ("IFRS") as endorsed in the Kingdom of Saudi Arabia and other standards and pronouncements issued by the Saudi Organization for Certified Public Accountants ("SOCPA").

### Basis for opinion

We conducted our audit in accordance with the International Standards on Auditing ("ISA") that are endorsed in the Kingdom of Saudi Arabia. Our responsibilities under those standards are further described in the *Auditors' responsibilities for the audit of the financial statements* section of our report. We are independent of the Fund in accordance with the professional code of conduct and ethics that are endorsed in the Kingdom of Saudi Arabia that are relevant to our audit of the financial statements, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Responsibilities of the Fund Manager and those charged with governance for the financial statements

The Fund Manager is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS that are endorsed in the Kingdom of Saudi Arabia and other standards and pronouncements issued by SOCPA, and compliance with the applicable provisions of the Investment Funds Regulations issued by the Capital Market Authority, the Fund's Terms and Conditions and the Information Memorandum 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.

In preparing the financial statements, the Fund Manager is responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Fund Manager either intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Fund's financial reporting process.

# Independent auditors' report

To the unitholders of HSBC Sukuk Fund (continued)

## Auditors' responsibilities for the audit of the financial statements

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

As part of an audit in accordance with ISA that are endorsed in the Kingdom of Saudi Arabia, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

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

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

**For KPMG Al Fozan & Partners  
Certified Public Accountants**

  
**Dr. Abdullah Hamad Al Fozan**  
License No. 348

28 Rajab 1440H  
Corresponding to: 4 April 2019



**HSBC SUKUK FUND**  
**(An open-ended mutual fund)**  
**STATEMENT OF FINANCIAL POSITION**  
**As at 31 December 2018**  
**(Amounts in US Dollar)**

	<i>Note</i>	<i>31 December 2018</i>	<i>31 December 2017</i>	<i>1 January 2017</i>
<b>ASSETS</b>				
Cash and cash equivalents	<i>10</i>	<b>2,396,907</b>	412,558	184,130
Investments measured at amortised cost	<i>11</i>	<b>2,666,667</b>	2,720,000	2,880,000
Investments at fair value through profit or loss	<i>12</i>	<b>3,334,612</b>	--	--
Investments at fair value through other comprehensive income	<i>13</i>	<b>42,307,200</b>	--	--
Available for sale investments	<i>13</i>	--	50,430,848	51,661,663
Receivables and advances		<b>550,774</b>	405,303	523,837
<b>TOTAL ASSETS</b>		<b>51,256,160</b>	53,968,709	55,249,630
<b>LIABILITIES</b>				
Dividend payable		<b>370,234</b>	355,194	332,013
Accrued expenses	<i>14</i>	<b>101,888</b>	21,508	20,386
<b>TOTAL LIABILITIES</b>		<b>472,122</b>	376,702	352,399
<b>NET ASSETS (EQUITY) ATTRIBUTABLE TO THE UNITHOLDERS</b>				
		<b>50,784,038</b>	53,592,007	54,897,231
<b>Units in issue (numbers)</b>				
		<b>5,289,055</b>	5,464,525	5,533,555
Net asset value (equity) per unit - IFRS	<i>19</i>	<b>9.60</b>	9.81	9.92
Net asset value (equity) per unit - Dealing	<i>19</i>	<b>9.62</b>	9.81	9.92

The accompanying notes (1) to (24) form an integral part of these financial statements.

These financial statements and the accompanying disclosures are approved on behalf of the Fund Board based on the authorization issued on 4 April 2019



**Waleed H Alrashed**  
General Manager Asset Management



**Christie K Moinuddin**  
Chief Financial Officer

**HSBC SUKUK FUND**  
**(An open-ended mutual fund)**  
**STATEMENT OF COMPREHENSIVE INCOME**  
**For the year ended 31 December 2018**  
(Amounts in US Dollar)

	<i>Note</i>	<u><b>2018</b></u>	<u><b>2017</b></u>
<b>INVESTMENT INCOME</b>			
Special commission income from investments at fair value through other comprehensive income		<b>2,042,848</b>	1,451,043
Net unrealized gain on investments at fair value through profit or loss		<b>3,793</b>	--
Net realized loss from investments at fair value through profit or loss		<b>(55,877)</b>	(532,523)
Special commission income from investments measured at amortised cost		<b>65,346</b>	109,876
<b>TOTAL INCOME</b>		<b>2,056,110</b>	1,028,396
<b>EXPENSES</b>			
Management fees	<i>15</i>	<b>543,866</b>	542,742
Allowance for expected credit losses		<b>161,921</b>	--
Exchange loss		<b>7,294</b>	1,796
<b>TOTAL EXPENSES</b>		<b>713,081</b>	544,538
<b>NET INCOME FOR THE YEAR</b>		<b>1,343,029</b>	483,858
<b>OTHER COMPREHENSIVE INCOME</b>			
Net unrealized (loss) / gain on investments at fair value through other comprehensive income		<b>(750,785)</b>	319,579
Movement in fair value / allowance for expected credit losses on investments at fair value through other comprehensive income		<b>162,176</b>	--
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<b>754,420</b>	803,437

The accompanying notes (1) to (24) form an integral part of these financial statements.

The financial statements and accompanying disclosures in the report are approved on behalf of the Fund Board based on the authorization issued on 28 Rajab 1440H (corresponding to 4 April 2019) by:

  


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**Waleed H AlRashed**  
General Manager Asset Management

  


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**Chistie K Moinuddin**  
Chief Financial Officer

**HSBC SUKUK FUND**  
**(An open-ended mutual fund)**  
**STATEMENT OF CHANGES IN NET ASSETS (EQUITY) ATTRIBUTABLE TO UNITHOLDERS**  
**For the year ended 31 December 2018**  
(Amounts in US Dollar)

	<u>2018</u>	<u>2017</u>
<b>Net assets (equity) attributable to the unitholders as at the beginning of the year (as reported previously)</b>	<b>53,592,007</b>	54,897,231
Impact of adoption of new standard at 1 January 2018 (note 21)	(117,891)	--
Transfer of ECL on investments at FVOCI (note 21)	117,636	--
<b>Net assets (equity) attributable to the unitholders as at the beginning of the year (restated)</b>	<b>53,591,752</b>	54,897,231
Net income for the year	1,343,029	483,858
Unrealised (loss) / gain on investments at fair value through other comprehensive income	(945,298)	319,579
Dividend distributions during the year (Note 22)	(1,485,997)	(1,423,382)
<b><i>Subscriptions and redemptions by the Unitholders:</i></b>		
Proceeds from issuance of units	--	412,741
Payments for redemption of units	(1,719,448)	(1,098,020)
<b>Net change from unit transactions</b>	<b>(1,719,448)</b>	(685,279)
<b>Net assets (equity) attributable to the unitholders as at 31 December</b>	<b>50,784,038</b>	53,592,007

**UNIT TRANSACTIONS**

Transactions in units for the year ended 31 December are summarised as follows:

	<u>2018</u>	<u>2017</u>
	<i>(In numbers)</i>	
<b>Units at the beginning of the year</b>	<b>5,464,525</b>	5,533,555
Units issued during the year	--	41,539
Units redeemed during the year	(175,470)	(110,569)
<b>Net decrease in units</b>	<b>(175,470)</b>	(69,030)
<b>Units as at end of the year</b>	<b>5,289,055</b>	5,464,525

The accompanying notes (1) to (24) form an integral part of these financial statements.

**HSBC SUKUK FUND**  
**(An open-ended mutual fund)**  
**STATEMENT OF CASH FLOWS**  
**For the year ended 31 December 2018**  
(Amounts in US Dollar)

	<u>2018</u>	<u>2017</u>
<b>Cash flow from operating activities</b>		
Net income for the year	1,343,029	483,858
<i>Adjustment for:</i>		
Allowance for expected credit losses	161,921	--
Unrealised gain on investments at fair value through profit or loss	3,793	--
Realised (gain) / loss on sale of investments	55,877	(532,523)
<b>Net changes in operating assets and liability</b>		
Investments at fair value through profit or loss	(3,556,203)	--
Investments at fair value through other comprehensive income	7,178,350	(637,083)
Investments measured at amortised cost	53,078	2,880,000
Receivables and advances	(145,471)	118,534
Accrued expenses	80,380	1,122
<b>Net cash generated from operating activities</b>	5,174,754	2,313,908
<b>Cash flow from financing activities</b>		
Proceeds from issuance of units	--	412,741
Payments for redemption of units	(1,719,448)	(1,098,019)
Dividends paid	(1,470,957)	(1,400,202)
<b>Net cash used in financing activities</b>	(3,190,405)	(2,085,480)
Increase in cash and cash equivalents	1,984,349	228,428
Cash and cash equivalent at the beginning of the year	412,558	184,130
<b>Cash and cash equivalent as at the end of the year</b>	2,396,907	412,558
<b><u>Supplemental information</u></b>		
Special commission income received	2,108,194	1,560,919

The accompanying notes (1) to (24) form an integral part of these financial statements.

**HSBC SUKUK FUND**  
**(An open-ended mutual fund)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**For the year ended 31 December 2018**  
(Amounts in US Dollar)

**1 GENERAL**

HSBC Sukuk Fund (the “Fund”) is an investment fund created through an agreement between HSBC Saudi Arabia (“the Fund Manager”) and investors (“the Unitholders”). The objective of the Fund is to achieve income and capital growth over the medium to long term period, by investing in Sukuk issued globally, along with money market funds and term deposits. The Fund invests primarily in Sukuk (up to 70% of the Fund’s assets) with the balance invested in Shariah compliant money market funds and term deposits. The Fund has no geographic constraints in terms of investment but it focuses on investments in the Gulf Cooperation Council (“GCC”).

The Fund is managed by the Fund Manager who also acts the administrator of the Fund. Albilad Capital is acting as the custodian of the Fund. The Fund is an income-distributing Fund, whereby any income earned by the Fund is distributed to Unitholders at least on semi-annual basis. Any such income distribution by the Fund, however, will solely be at the discretion of the Fund Board of Directors. However, profit, if any, realized, by the Fund, from the sale of any Sukuk at a price higher than its purchase price will not be distributed to Unitholders and would form part of the net asset (equity) value of the Fund.

**2 REGULATING AUTHORITY**

The Fund is governed by the Investment Fund Regulations (“the Regulations”) published by the Capital Market Authority (“the CMA”) on 3 Dhul Hijja 1427H (corresponding to 24 December 2006) detailing requirements for all investment funds operating within the Kingdom of Saudi Arabia. The Regulations were further amended on 16 Sha’aban 1437H (corresponding to 23 May 2016) (“the Amended Regulations”). The Fund Manager believes that the Amended Regulations was effective since 6 Safar 1438H (corresponding to 6 November 2016).

During the year ended 31 December 2018, the Fund Manager has made certain revisions to the terms and conditions of the Fund. The main change in the terms and conditions relate to the change in the custodianship. The Fund updated its terms and conditions which were approved by the CMA on 14 Rajab 1439H (corresponding to 1 April 2018).

**3 SUBSCRIPTION/REDEMPTION (DEALING DAY AND VALUATION DAY)**

The Fund is open for subscriptions/ redemptions of units on Monday (each being a “Dealing Day”). The value of the Fund’s portfolio is determined once weekly on Tuesday (each being a “Valuation Day”). The net asset value of the Fund for the purpose of purchase or sale of units is determined by dividing the net value of assets (fair value of fund assets minus fund liabilities) by the total number of outstanding fund units on the relevant Valuation Day.

**4 BASIS OF PREPARATION**

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as endorsed in the Kingdom of Saudi Arabia and other standards and pronouncements issued by Saudi Organization for Certified Public Accountants (“SOCPA”) and to comply with the applicable provisions of the Investment Fund Regulations issued by the Capital Market Authority, the Fund’s Terms and Conditions and the Information Memorandum.

For all years up to and including the year ended 31 December 2017, the Fund prepared its financial statements in accordance with the generally accepted accounting standards as issued by Saudi Organization of Certified Public Accountants (“SOCPA”). The financial statements for the year ended 31 December 2018 are the first financial statements of the Fund prepared in accordance with IFRS and IFRS 1 “First-time Adoption of International Financial Reporting Standards” has been applied.

An explanation of how the transition to IFRSs has affected the reported financial position, financial performance and cash flows of the Fund is provided in note 20.



**(An open-ended mutual fund)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**For the year ended 31 December 2018**  
(Amounts in US Dollar)

**5 FUNCTIONAL AND PRESENTATION CURRENCY**

These financial statements are presented in United States Dollars (USD), which is also the Fund's functional currency.

**6 BASIS OF MEASUREMENT**

These financial statements have been prepared on a historical cost basis, (except for investments at fair value through profit or loss ("FVTPL") and investments at fair value through other comprehensive income ("FVOCI") which are stated at their fair value) using the accrual basis of accounting.

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

The financial statement accounts in the statement of financial position have been presented in the order of liquidity.

**7 USE OF CRITICAL JUDGEMENTS AND ESTIMATES**

The preparation of these financial statements in conformity with IFRS requires the use of certain critical accounting judgements, estimates and assumptions that affect the reported amounts of assets and liabilities. It also requires management to exercise its judgment in the process of applying the Fund's accounting policies. Such judgements, estimates and assumptions are continually evaluated and are based on historical experience and other factors, including obtaining professional advices and expectations of future events that are believed to be reasonable under the circumstances.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively. Significant area where management has used estimates, assumptions or exercised judgement are as follow:

***Impairment of financial assets***

The Fund recognises loss allowances for expected credit loss (ECL) on its Murabaha and Sukuk placements.

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

- Financial assets that are determined to have low credit risk at the reporting date; and
- Financial assets on which credit risk has not increased significantly since their initial recognition

The Fund considers a debt security to have low credit risk when their credit risk rating is equivalent to the globally understood definition of 'investment grade' or certain unrated investment with no default in past. 12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

**8 SIGNIFICANT ACCOUNTING POLICIES**

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. Where policies are applicable only after or before 1 January 2018, those policies have been particularly specified.

**HSBC SUKUK FUND**  
**(An open-ended mutual fund)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**For the year ended 31 December 2018**  
(Amounts in US Dollar)

**8 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

***Foreign currency translation***

Transactions in foreign currencies are translated into US Dollars at the exchange rate at the dates of the transactions. Foreign exchange gains and losses arising from translation are included in the statement of comprehensive income.

Monetary assets and liabilities denominated in foreign currencies are retranslated into US Dollars at the exchange rate at the reporting date.

Foreign currency differences arising on retranslation are recognised in profit or loss as net foreign exchange gain / (loss), except for those arising on financial instruments at FVTPL, which are recognised as a component of net gain / (loss) from financial instruments at FVTPL.

***Net Asset Value (Equity)***

Net assets (equity) value per unit, as disclosed in the statement of financial position is calculated by dividing the net assets of the Fund by the numbers of units in issue as at the year end.

***Subscription and redemption of units***

Units subscribed and redeemed are recorded at net asset (equity) value per unit on the Valuation Day for which the subscription request and redemption applications are received.

***Cash and cash equivalents***

Cash and cash equivalents comprise deposits with banks and highly liquid financial assets with maturities of three months or less from the date of acquisition that are subject to an insignificant risk of changes in their fair value and are used by the Fund in the management of short-term commitments, other than cash collateral provided in respect of derivatives and securities borrowing transactions.

***Redeemable units***

The redeemable units are as equity instruments as they meet certain strict criteria. Those criteria include:

- the redeemable units must entitle the holder to a pro-rata share of net assets;
- the redeemable units must be the most subordinated class and class features must be identical;
- there must be no contractual obligations to deliver cash or another financial asset other than the obligation on the issuer to repurchase; and
- the total expected cash flows from the redeemable units over its life must be based substantially on the profit or loss of the issuer.

***Revenue recognition***

***Net gain / (loss) from investments at FVTPL***

Net gain from investments at FVTPL includes all realised and unrealised fair value changes and foreign exchange differences (if any), but excludes interest and dividend income, and dividend expense on securities sold short.

Net realised gain / (loss) from investments at FVTPL is calculated using the weighted average cost method.

***Special commission income***

Special commission income is recognized in statement of comprehensive income on accrual basis using the effective interest rate method.

**HSBC SUKUK FUND**  
**(An open-ended mutual fund)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**For the year ended 31 December 2018**  
(Amounts in US Dollar)

**8 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

***Management fees***

Fund management fees are charged at rates agreed with the Fund Manager. These charges are calculated on each Valuation Day at an annual percentage of the Fund's net assets value. These expenses are charged to the statement of income.

***Zakat and income tax***

Under the current system of taxation in Kingdom of Saudi Arabia the Fund is not liable to pay any tax. Zakat and income tax are considered to be the obligation of the Unitholders and are not provided in the accompanying financial statements. The Value Added Tax (VAT) applicable for fees and expenses are recognized in the statement of comprehensive income.

***Trade date accounting***

All purchases and sales of financial assets are recognized and derecognized on the trade date, i.e. the date that the Fund commits to purchase or sell the assets. Purchases or sales of financial assets require delivery of those assets within the timeframe generally established by regulation or convention in the market place.

***Fair value measurement***

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Fund has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Fund measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an on-going basis. The Fund measures instruments quoted in an active market at a mid-price, because this price provides a reasonable approximation of the exit price.

If there is no quoted price in an active market, then the Fund uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

***Financial assets and financial liabilities***

***Policies applicable before 1 January 2018***

***Investments held for trading***

Investments are classified as "held for trading" if they are purchased for the purpose of resale in the short term. Investments held for trading are initially recorded at cost which includes the purchase price plus all expenditures made by the Fund for the purpose of acquiring the securities. Subsequent to initial recognition, investments held for trading are measured at fair value and resulting gains or losses are recognized in the income statements but excluding dividend income which are separately shown in the income statement. Realized gains or losses at disposal and unrealized gains or losses are determined on average cost basis.

**HSBC SUKUK FUND**  
**(An open-ended mutual fund)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**For the year ended 31 December 2018**  
(Amounts in US Dollar)

**8 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Financial assets and financial liabilities (continued)*

*Available for sale investments*

Investments in available for sale securities are measured and carried in the statement of financial position at fair value. Any changes in fair value, other than impairment losses, are recognized in the statement of changes in net assets attributable to unitholders.

*Held to maturity investments*

Investments that are bought with the intention of being held to maturity are carried at cost (adjusted for any premium or discount on an effective yield basis), less a provision for any permanent diminution in the value of held to maturity investments. Investments transactions are accounted for as at the trade date.

*Policies applicable from 1 January 2018*

*Recognition and initial measurement*

Financial assets and financial liabilities at FVTPL are initially recognised on the trade date, which is the date on which the Fund becomes a party to the contractual provisions of the instrument. Other financial assets and financial liabilities are recognised on the date on which they are originated.

Financial assets at FVTPL are initially recognised at fair value, with transaction costs recognised in profit or loss. Financial assets not at FVTPL are initially recognised at fair value plus transaction costs that are directly attributable to their acquisition or issue.

*Classification*

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

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

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

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

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

On initial recognition of an equity investment that is not held for trading, the Fund may irrevocably elect to present subsequent changes in fair value in other comprehensive income. This election is made on an investment-by-investment basis. All other financial assets are classified as measured at FVTPL.

**HSBC SUKUK FUND**  
**(An open-ended mutual fund)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**For the year ended 31 December 2018**  
(Amounts in US Dollar)

**8 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Business model assessment*

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

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

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

*Assessment whether contractual cash flows are solely payments of principal and interest*

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

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

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

*Assessment whether contractual cash flows are solely payments of principal and interest (continued)*

The Fund holds a portfolio of long-term fixed rate investments for which the Fund has no option to propose to revise the interest rate at periodic reset dates. The Fund has determined that the contractual cash flows of these investments are solely payments of principal and interest because the option varies the interest rate in a way that is consideration for the time value of money, credit risk, other basic lending risks and costs associated with the principal amount outstanding.

*Reclassifications*

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

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**8 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

***Derecognition***

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

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognized) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized in OCI is recognized in profit or loss. Transactions in which the Fund neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Fund continues to recognize the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

***Offsetting***

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Fund currently has a legally enforceable right to set off the amounts and it intends either to settle them 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 IFRS, or for gains and losses arising from a Fund of similar transactions such as in the Fund's trading activity.

***Measurement of ECL***

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- Financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the Fund in accordance with the contract and the cash flows that the Fund expects to receive); and
- Financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;

***Presentation of allowance for ECL in the statement of financial position***

Loss allowances for ECL are presented in the statement of financial position for financial assets measured at amortized cost and investments at fair value through other comprehensive income as a deduction from the gross carrying amount of the assets.

For debt instrument measured FVOCI, no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the allowance is disclosed and is recognised in the fair value reserve. Impairment losses are recognised in profit and loss and changes between the amortised cost of the assets and their fair value are recognised in OCI.

***Significant increase in credit risk***

To determine whether the risk of default on a financial instrument has increased significantly since initial recognition, the Fund considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Fund's historical experience and expert credit assessment and including an assessment of the change in probability of default (PD) as at the reporting date with the PD at the time of initial recognition of the exposure.

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**8 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Definition of default*

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

- the investee is unlikely to pay its credit obligations to the Fund in full, without recourse by the Fund to actions such as realizing security (if any is held); or
- the investee is past due more than 10 days on any material credit obligation to the Fund.

In assessing whether a investee is in default. The Fund considers indicators that are:

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

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

**9 STANDARDS ISSUED BUT NOT YET EFFECTIVE**

A number of amendments and standards are effective for the year beginning on or after 1 January 2019 and earlier application is permitted; however, the Fund has not early applied these new amendments and standards in preparing these financial statements as these do not have material impact on the Fund's financial statements.

**10 CASH AND CASH EQUIVALENTS**

Cash and cash equivalents balance consist of cash in bank that has investment grade credit ratings, as rated by the international rating agencies.

	<b>31 December 2018</b>	31 December 2017	1 January 2017
Bank balance – current account	<b>2,396,907</b>	412,558	184,130
Total	<b>2,396,907</b>	412,558	184,130

The bank balance is placed with a local Saudi bank, having sound credit rating.

**11 INVESTMENTS MEASURED AT AMORTISED COST**

	<b>31 December 2018</b>	31 December 2017	1 January 2017
Murabaha placements with banks	<b>2,666,667</b>	2,720,000	2,880,000
Allowance for expected credit losses	--	--	--
Total	<b>2,666,667</b>	2,720,000	2,880,000

Counterparties with whom the Fund has made placements have credit ratings of investment grade as issued by rating agencies. The average effective special commission rate on money market placements as at the year end is 3.15% p.a. (31 December 2017: 1.53% p.a. and 1 January 2017: 3.13% p.a.).

The methodology and assumptions applied by the Fund in estimating the ECL on the short term Murabaha placements are based on using the Moody's rating scales which are then adjusted for country specific data, forward looking estimates and macroeconomic variables such as expected GDP growth, to determine the ECL as at the end of the reporting year.

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**11 INVESTMENTS MEASURED AT AMORTISED COST (CONTIUED)**

The movement of the allowance for expected credit losses for placements is summarized as follows:

	<i>31 December</i> <i>2018</i>	<i>31 December</i> <i>2017</i>	<i>1 January</i> <i>2017</i>
Balance at the beginning of the year	--	--	--
Effect of the adoption of IFRS 9	<b>255</b>	--	--
Reversal for the year	<b>(255)</b>	--	--
Balance at the end of the year	<u>--</u>	<u>--</u>	<u>--</u>

**12 INVESTMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS**

Investments comprise the following exposure as at reporting date:

	<b>31 December 2018</b>	
	<b>Cost</b>	<b>Market value</b>
<b>Mutual Fund</b>		
HSBC Saudi Riyal Murabaha Fund (ART)	<u>3,331,246</u>	<u>3,334,612</u>
<b>Total</b>	<u>3,331,246</u>	<u>3,334,612</u>

As at 31 December 2017 and 1 January 2017, the Fund held no investments at fair value through profit or loss.

**13 INVESTMENTS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME / AVAILABLE FOR SALE INVESTMENTS**

	<i>31 December</i> <i>2018</i>	<i>31 December</i> <i>2017</i>	<i>1 January</i> <i>2017</i>
Investments at FVOCI	<b>42,587,012</b>	--	--
Allowance for expected credit losses	<b>(279,812)</b>	--	--
	<u>42,307,200</u>	--	--
Available for sale investments – Sukuks	--	41,797,494	37,346,731
Available for sale investments – Murabaha placements	--	8,633,354	14,314,932
	<u>42,307,200</u>	<u>50,430,848</u>	<u>51,661,663</u>



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**14 INVESTMENTS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (FVOCI) / AVAILABLE FOR SALE INVESTMENTS**

Fair value through other comprehensive income (FVOCI) comprise Debt Securities – Sukuks and are summarized as follows:

Face Value	Counterparty	Maturity	Current		31 December 2018		31 December 2017		1 January 2017	
			Rate	Cost	Market Value	Cost	Market Value	Cost	Market Value	
4,450,000	Emaar Sukuk Limited	18-Jul-2019	6.40	<b>4,876,038</b>	<b>4,508,740</b>	4,101,550	3,914,748	2,574,850	2,497,938	
4,000,000	Turkiye Finans	24-Apr-2019	5.375	<b>2,489,690</b>	<b>2,454,288</b>	2,054,500	2,038,900	--	--	
3,610,000	Dar Al Arkan International Sukuk Company	28-May-2019	--	--	--	1,212,750	1,212,750	--	--	
3,535,000	Saudi Electricity Global Sukuk IV Noor Sukuk Company	03-Apr-2022	4.211	<b>3,569,031</b>	<b>3,577,137</b>	3,569,031	3,700,332	3,569,031	3,728,347	
3,600,000	Limited	28-Apr-2020	2.788	<b>3,582,275</b>	<b>3,536,424</b>	1,544,575	1,534,740	--	--	
3,050,000	Sukuk Funding Limited	31-May-2023	4.348	--	--	3,151,775	3,115,087	--	--	
2,500,000	Dubai Islamic Bank Tier 1 Sukuk Ltd	Perpetual	6.25	<b>1,537,050</b>	<b>1,501,875</b>	1,025,000	1,017,500	--	--	
2,500,000	Abu Dhabi Islamic Bank	Perpetual	6.375	--	--	868,050	868,063	--	--	
2,500,000	Emirates Islamic Bank Sukuk Ltd.	31-May-2021	3.542	<b>2,526,758</b>	<b>2,478,825</b>	2,526,758	2,529,475	1,414,000	1,409,310	
2,400,000	Almarai Company* Sharjah Islamic Bank	Perpetual	4.4337	--	--	2,403,764	2,404,000	1,599,851	1,600,000	
2,400,000	Sukuk III Ltd.	17-Mar-2020	2.843	<b>2,395,200</b>	<b>2,365,092</b>	2,395,200	2,384,028	--	--	
2,050,000	Perusahaan Penerbit SBSN Indonesia	21-Nov-2018	--	--	--	2,114,575	2,091,000	2,114,575	2,132,000	
1,860,000	Adib Sukuk Company Limited	14-Feb-2022	3.664	<b>1,891,155</b>	<b>1,820,066</b>	1,891,155	1,878,926	--	--	
1,333,333	Najran Cement Company* Dar-Al-Arkan International Sukuk Company	11-Jun-2020	--	<b>1,333,298</b>	<b>1,333,333</b>	1,333,298	1,333,333	1,333,298	1,333,333	
1,100,000	Sukuk	10-Apr-2022	6.875	<b>4,598,300</b>	<b>4,462,725</b>	--	--	--	--	
800,000	Savola Group Company*	22-Jan-2020	3.1875	<b>752,170</b>	<b>786,517</b>	752,170	773,801	752,170	761,084	
580,000	DP World	31-May-2023	3.908	--	--	595,950	594,500	--	--	
500,000	Alpha Star Holding	9-Apr-2019	4.97	<b>510,571</b>	<b>499,115</b>	2,348,625	2,310,142	--	--	
200,000	APICORP Sukuk Ltd Bahrain Mumtalakat	1-Nov-2022	3.141	<b>200,000</b>	<b>193,998</b>	200,000	199,238	--	--	
1,520,000	Holding Co.	25-Nov-2021	4.00	<b>1,455,300</b>	<b>1,447,002</b>	--	--	--	--	
580,000	AHB Sukuk Co. Ltd	19-Sep-2023	4.375	<b>580,000</b>	<b>584,802</b>	--	--	--	--	
1,200,000	Dubai Islamic Bank Tier 1 Sukuk Ltd	Perpetual	6.75	<b>1,224,000</b>	<b>1,233,000</b>	--	--	--	--	
1,500,000	Garuda Indonesia Global Sukuk	03-Jun-2020	5.95	<b>1,462,500</b>	<b>1,442,370</b>	--	--	--	--	
1,500,000	NMC Healthcare Sukuk	21-Nov-2023	5.95	<b>1,508,400</b>	<b>1,518,660</b>	--	--	--	--	
6,000,000	Arab National Bank	07-Oct-2025	-	<b>1,586,337</b>	<b>1,587,795</b>	--	--	--	--	
10,000,000	Bank Albilad	30-Aug-2026	4.21	<b>2,666,224</b>	<b>2,666,935</b>	--	--	--	--	
2,600,000	Noor Tier 1 Sukuk Ltd	Perpetual	2.788	<b>2,593,500</b>	<b>2,588,313</b>	--	--	--	--	
2,400,000	Fawaz Abdulaziz Al Hokair Company*	24-Jun-2019	--	--	--	2,399,488	2,400,000	2,399,488	2,400,000	
2,000,000	Dubai Islamic Bank Sukuk	30-Mar-2021	--	--	--	2,021,000	2,019,690	--	--	
1,550,000	Oman Sovereign Sukuk	1-Jun-2024	--	--	--	1,527,525	1,551,744	--	--	
1,150,000	Turkiye FinansKatilim Bankasi Sukuk	02-May-2018	--	--	--	1,167,953	1,150,184	1,167,953	1,149,586	
775,000	EIB Sukuk Company Limited	11-Jun-2018	--	--	--	796,313	775,314	796,313	787,594	
3,934,000	FGB Sukuk Company Limited	18-Jan-2017	--	--	--	--	--	4,067,773	3,997,928	
2,400,000	Majid Al-Futtaim Sukuk Limited	7-Feb-2017	--	--	--	--	--	2,509,700	2,412,000	
2,100,000	SOQ Sukuk AQ.S.C.	18-Jan-2023	--	--	--	--	--	2,158,800	2,144,070	
2,080,000	DP World Sukuk Limited	2-July-2017	--	--	--	--	--	2,196,480	2,129,920	
2,050,000	Dubai Islamic Bank Sukuk Limited	30-May-2017	--	--	--	--	--	2,132,547	2,077,982	
1,650,000	EIB Sukuk Company Limited	18-Jan-2017	--	--	--	--	--	1,741,045	1,654,125	
1,515,000	Saudi Electricity Global Sukuk Company	03-Apr-2017	--	--	--	--	--	1,532,423	1,518,984	
1,500,000	Qatar Islamic Bank Sukuk Funding Ltd	10-Oct-2017	--	--	--	--	--	1,526,900	1,505,775	
1,400,000	Tamweel Funding Ltd	18-Jan-2017	--	--	--	--	--	1,508,250	1,403,010	
700,000	Banque Saudi Fransi	22-May-2017	--	--	--	--	--	720,300	703,745	
	<b>Total</b>			<b>43,337,797</b>	<b>42,587,012</b>	42,001,005	41,797,494	37,815,747	37,346,731	

\*with floating rate

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**13 INVESTMENTS FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (FVOCI) / AVAILABLE FOR SALE INVESTMENTS [CONTINUED]**

The methodology and assumptions applied by the Fund in estimating the ECL on Sukuk placements are based on using the Moody's rating scales which are then adjusted for country specific data based on where Sukuk placements' underlying assets are, forward looking estimates and macroeconomic variables such as expected GDP growth, to determine the ECL as at the end of the reporting year.

The movement of the allowance for expected credit losses for sukuks is summarized as follows:

	<i>31 December</i> <u>2018</u>	<i>31 December</i> <u>2017</u>	<i>1 January</i> <u>2017</u>
Balance at the beginning of the year	--	--	--
Effect of the adoption of IFRS 9	<b>117,636</b>	--	--
Charge for the year	<b>162,176</b>	--	--
Balance at the end of the year	<b>279,812</b>	--	--

**14 ACCRUED EXPENSES**

Accrued expenses include management fee payable (inclusive of VAT) to the Fund Manager.

**15 TRANSACTIONS WITH 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. The related parties of the Fund include the Fund Manager, the Fund Board and other funds being managed by the Fund Manager. In the ordinary course of its activities, the Fund transacts business with the Fund Manager.

Related 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. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties of the Fund comprise HSBC Saudi Arabia (being the Fund Manager, custodian and administrator of the Fund), the Fund Board and The Saudi British Bank ("SABB") (being significant shareholder of the Fund Manager).

In the ordinary course of its activities, the Fund transacts business with related parties. Related party transactions are governed by limits set by the regulations issued by CMA. All the related party transactions are undertaken at mutually agreed prices and approved by the Fund Manager. The transactions were carried out on the basis of approved terms and conditions of the Fund.

The Fund Manager charges to the Fund on each Valuation Day, management fees at a rate of 1.00% of Net assets value (2017: 1.00% of Net assets value). All Fees and expenses related to the management of the Fund including but not limited to custody, administration, audit, regulatory and index fees, etc., are included in the management fee.

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**15 TRANSACTIONS WITH RELATED PARTIES (CONTINUED)**

Subscription fee up to 1% is considered in the financial statement of the fund as this is recognized as fund's income. The Fund does not charge any redemption fees on redemption of units.

During the year, the Fund entered into the following transactions with related parties in the ordinary course of business.

Related party	Nature of transactions	Amount of transaction during the year		Closing balance	
		<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
HSBC Saudi Arabia (Fund Manager)	Fund management fee	543,866	542,742	101,888	17,616
SABB (Shareholder)	Cash and cash equivalents	--	--	2,396,907	412,558

Board member compensation and other expenses during the year has been borne and paid by HSBC Saudi Arabia ("the Fund Manager").

HSBC Multi-assets Defensive Fund, HSBC Multi-assets Balanced Fund and HSBC Multi-assets Growth Fund managed by the Fund Manager have outstanding number of 800,000 units (31 December 2017: 800,000 units), 1,333,013 units (31 December 2017: 1,333,013 units) and 187,893 units (31 December 2017: 187,893 units) respectively of the fund.

Cash and cash equivalents is deposited in a current account maintained with SABB under the name of the Fund Manager. No interest is receivable on this balance.

**16 CLASSIFICATION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES**

The table below sets out the classifications of the carrying amounts of the Fund's financial assets and financial liabilities into categories of financial instruments:

<u>31 December 2018</u>	<i>Amortized cost</i>	<i>FVTPL</i>	<i>FVOCI</i>
Cash and cash equivalents	2,396,907	--	--
Investments measured at amortised cost	2,666,667	--	--
Investments at fair value through profit or loss	--	3,334,612	--
Investments at fair value through other	--	--	42,307,200
Receivables and advances	550,774	--	--
<b>Total financial assets</b>	<b>5,614,348</b>	<b>3,334,612</b>	<b>42,307,200</b>
Dividend payable	370,234	--	--
Accrued expenses	101,888	--	--
<b>Total financial liabilities</b>	<b>472,122</b>	<b>--</b>	<b>--</b>

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**16 CLASSIFICATION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)**

<u>31 December 2017</u>	<i>Loans and receivables / Amortized cost</i>	<u>AFS</u>
Cash and cash equivalents	412,558	--
Investments measured at amortised cost	2,720,000	--
Available for sale investments	--	50,430,848
Receivables and advances	405,303	--
Total financial assets	<u>3,537,861</u>	<u>50,430,848</u>
Dividend payable	355,194	--
Accrued expenses	21,508	--
Total financial liabilities	<u>376,702</u>	<u>--</u>
	<i>Loans and receivables / Amortized cost</i>	<u>AFS</u>
<u>1 January 2017</u>		
Cash and cash equivalents	184,130	--
Investments measured at amortised cost	2,880,000	--
Available for sale investments	--	51,661,663
Receivables and advances	523,837	--
Total financial assets	<u>3,587,967</u>	<u>51,661,663</u>
Dividend payable	332,013	--
Accrued expenses	20,386	--
Total financial liabilities	<u>352,399</u>	<u>--</u>

**17 FINANCIAL RISK MANAGEMENT**

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

- credit risk;
- liquidity risk;
- market risks; and
- operational risk

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

***Risk management framework***

The Fund maintains positions in non-derivative financial instruments in accordance with its investment management strategy. The Fund's investment portfolio comprises investments measured at amortised cost, FVTPL and FVOCI.

The Fund's investment manager has been given discretionary authority to manage the assets in line with the Fund's investment objectives. Compliance with the target asset allocations and the composition of the portfolio are monitored by the Fund Board. In instances where the portfolio has diverged from target asset allocations, the Fund's investment manager is obliged to take actions to rebalance the portfolio in line with the established targets, within prescribed time limits.

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**17 FINANCIAL RISK MANAGEMENT (CONTINUED)**

***Credit risk***

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

The Fund is exposed to credit risk on its cash and cash equivalents, investments measured at amortised cost, investments at FVTPL and investments at FVOCI and receivables. The Fund Manager seeks to limit its credit risk by monitoring credit exposure and by dealing with reputed counterparties.

The Fund's policy over credit risk is to minimize its exposure to counterparties with perceived higher risk of default by dealing only with counterparties that meet the certain credit standards.

Credit risk is monitored on a regular basis by the Fund Manager to ensure it is in line with the investment guidelines of the Fund Board.

The table below shows the maximum exposure to credit risk for the component of the statement of financial position:

	<b>31 December 2018</b>	31 December 2017	1 January 2017
Cash and cash equivalents	<b>2,396,907</b>	412,558	184,130
Investments measured at amortised cost	<b>2,666,667</b>	2,720,000	2,880,000
Investments at FVTPL	<b>3,334,612</b>	--	--
Investment at FVOCI / AFS	<b>42,587,012</b>	50,430,848	51,661,663
Receivables and advances	<b>550,774</b>	405,303	523,837
<b><i>Total exposure to credit risk</i></b>	<b>51,535,927</b>	53,968,709	55,249,630

The Fund does not have a formal internal grading mechanism. Credit risk is managed and controlled by monitoring credit exposures, limiting transactions with specific counterparties and continually assessing the creditworthiness of counterparties. Credit risks are generally managed on the basis of external credit ratings of the counterparties.

***Analysis of credit quality***

The Fund has murabaha and sukuk placements with counterparties having following credit quality:

	<b>31 December 2018</b>	31 December 2017
A1	<b>2,478,825</b>	--
A2	<b>10,304,676</b>	3,700,332
A3	<b>13,823,530</b>	7,057,957
Aa3	<b>193,998</b>	199,238
B1	<b>4,462,725</b>	1,212,750
Ba1	<b>1,518,660</b>	--
Ba2	<b>499,115</b>	--
Ba3	<b>1,447,002</b>	--
Baa1	--	2,720,000
Baa2	--	5,261,330
Baa3	<b>6,963,028</b>	6,005,748
Unrated	<b>895,453</b>	24,273,493
<b>Total</b>	<b>42,587,012</b>	50,430,848

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**17 FINANCIAL RISK MANAGEMENT (CONTINUED)**

Amounts arising from ECL

Impairment on investments at amortized cost, and FVOCI have been measured on a 12-month and lifetime expected loss basis and reflect the maturities of the exposures. The Fund considers that these exposures have low credit risk based on the external credit ratings of the counterparties.

12-month probabilities of default are based on Moody's transition matrix for the period 1983-2016. Loss given default parameters generally reflect an assumed recovery rate of 50%. However, if the asset were credit-impaired, then the estimate of loss would be based on a specific assessment of expected cash shortfalls and on the original effective interest rate.

The Fund has recorded expected credit loss amounting to USD 279,812 as at 31 December 2018 (1 January 2018: USD 117,891).

**Liquidity risk**

Liquidity risk is the risk that the Fund will encounter difficulty in releasing funds to meet commitments associated with financial liabilities.

The Fund's terms and conditions provide for the subscriptions and redemptions of units throughout the week and it is, therefore, exposed to the liquidity risk of meeting unitholder redemptions.

The Fund Manager monitors the liquidity requirements on a regular basis and seeks to ensure that sufficient funds are available to meet any commitments as they arise.

**Market risk**

Market risk is the risk that changes in market prices – such as interest rates, foreign exchange rates, and credit spreads – will affect the Fund's income or the fair value of its holdings in financial instruments.

The Fund's strategy for the management of market risk is driven by the Fund's investment objective as per Fund's terms and conditions. The Fund's market risk is managed on a timely basis by the investment manager in accordance with the policies and procedures in place. The Fund's market positions are monitored on a timely basis by the Fund Manager.

Commission rate risk

Commission rate risk arises from the possibility that the changes in commission rates will affect either the fair values or the future cash flows of financial instruments. The Fund Manager monitors positions daily to ensure maintenance of positions within established gap limits, if any.

A summary of the Fund's commission rate gap position, analysed by the earlier of contractual re- pricing or maturity date, is as follows:

<b><u>31 December 2018</u></b>	<b><i>Less than 1 month</i></b>	<b><i>1 to 3 months</i></b>	<b><i>More than 3 months</i></b>	<b><i>Total</i></b>
<b><u>ASSETS</u></b>				
Investments at amortized cost	2,666,667	--	--	2,666,667
Investments at FVOCI - Gross	3,334,612	2,953,403	36,298,997	42,587,012
<b>Total commission-bearing assets</b>	<b>6,001,279</b>	<b>2,953,403</b>	<b>36,298,997</b>	<b>45,253,679</b>
<b><u>LIABILITIES</u></b>				
<b>Total commission-bearing liabilities</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>--</b>
<b>Total commission rate gap</b>	<b>6,001,279</b>	<b>2,953,403</b>	<b>36,298,997</b>	<b>45,253,679</b>

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**17 FINANCIAL RISK MANAGEMENT (CONTINUED)**

*Commission rate risk (continued)*

<u>31 December 2017</u>	<i>Less than 1 month</i>	<i>1 to 3 months</i>	<i>More than 3 months</i>	<i>Total</i>
<b><u>ASSETS</u></b>				
Investments at amortized cost	2,720,000	--	--	2,720,000
Available for sale investments	775,314	--	49,655,434	50,430,848
Total commission-bearing assets	3,495,314	--	49,655,434	53,150,848
<b><u>LIABILITIES</u></b>				
Total commission-bearing liabilities	--	--	--	--
Total commission rate gap	3,495,314	--	49,655,434	53,150,848
<u>1 January 2018</u>	<i>Less than 1 month</i>	<i>1 to 3 months</i>	<i>More than 3 months</i>	<i>Total</i>
<b><u>ASSETS</u></b>				
Investments at amortized cost	2,880,000	--	--	2,880,000
Available for sale investments	--	--	51,661,663	51,661,663
Total commission-bearing assets	2,880,000	--	51,661,663	54,541,663
<b><u>LIABILITIES</u></b>				
Total commission-bearing liabilities	--	--	--	--
Total commission rate gap	51,661,663	--	51,661,663	54,541,663

*Currency risk*

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Fund's functional currency is US Dollar (USD) and there are no foreign currency exposures as at 31 December 2018 except for investment at FVTPL which is in Saudi Arabian Riyal (SR). SR is already pegged with USD at a fixed rate and accordingly, foreign exchange gains / losses are not significant.

Sensitivity analysis

The sensitivity analysis reflects how net assets attributable to the Unitholders would have been affected by changes in relevant risk variable that were reasonably possible at the reporting date.

Management has determined that a fluctuation in commission rates of 10 basis points is reasonably possible, considering the economic environment in which the Fund operates. The table below sets out the effect on the Fund's net assets attributable to the Unitholders of a reasonably possible increase of 10 basis points in commission rates at 31 December. The impact of such an increase or reduction has been estimated by calculating the fair value changes of the fixed-interest debt securities and other fixed-interest-bearing assets, less liabilities. The impact is primarily from the decrease in the fair value of fixed income securities. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

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**17 FINANCIAL RISK MANAGEMENT (CONTINUED)**

<u>Effect on net assets in USD</u>	<b>2018</b>	2017
Net assets (equity) attributable to the Unitholders	<b>41,455</b>	38,904

A reduction in commission rates of the same amount would have resulted in an equal but opposite effect to the amounts shown above.

***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 activities with financial instruments, 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 behavior.

The Fund's objective is to manage operational risk so as to balance limiting of financial losses and damage to its reputation with achieving its investment objective of generating returns to unitholders.

The primary responsibility for the development and implementation of control over operational risks rests with the Risk Management Team. This responsibility is supported by the development of overall standard 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:

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

**18 FAIR VALUES OF FINANCIAL INSTRUMENTS**

The Fund measures certain financial instruments at fair value at each reporting date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Fund. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. The Fund uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. Changes in assumptions about these factors could affect the fair value of financial instruments.



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**18 FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)**

Valuation models

The fair values of financial instruments that are traded in active markets are based on prices obtained directly from an exchange on which the instruments are traded or obtained from a broker that provides an unadjusted quoted price from an active market for identical instruments. For all other financial instruments, the Fund determines fair values using other valuation techniques.

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

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: Inputs that are quoted market prices (unadjusted) in active markets for identical instruments.

Level 2: Inputs other than quoted prices included within Level 1 that are observable 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 in which all significant inputs are directly or indirectly observable from market data.

Level 3: Inputs that are unobservable. This category includes all instruments for which 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 but for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair value hierarchy – Financial instruments

The table below analyses financial instruments at the reporting date by the level in the fair value hierarchy into which the fair value measurement is categorized. The amounts are based on the values recognised in the statement of financial position. All fair value measurements below are recurring.

The table below presents the financial instruments measured at their fair values as of reporting date based on the fair value hierarchy:

	<b>31 December 2018</b>				
	<b>Carrying value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Cash and cash equivalents	<b>2,396,907</b>	--	--	<b>2,396,907</b>	<b>2,396,907</b>
Investments measured at amortised cost	<b>2,666,667</b>	--	--	<b>2,666,667</b>	<b>2,666,667</b>
Investments at FVTPL	<b>3,334,612</b>	<b>3,334,612</b>	--	--	<b>3,334,612</b>
Investment at FVOCI	<b>42,307,200</b>	<b>32,593,894</b>	--	<b>9,713,306</b>	<b>42,307,200</b>
<b>Total</b>	<b>50,705,386</b>	<b>35,928,506</b>	--	<b>14,776,880</b>	<b>50,705,386</b>

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**18 FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)**

	31 December 2017				
	Carrying value	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	412,558	--	--	412,558	412,558
Investments measured at amortised cost	2,720,000	--	--	2,720,000	2,720,000
Available for sale	50,430,848	50,430,848	--	--	50,430,848
<b>Total</b>	<b>53,563,406</b>	<b>50,430,848</b>	<b>--</b>	<b>3,132,558</b>	<b>53,563,406</b>

  

	1 January 2017				
	Carrying value	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	184,130	--	--	184,130	184,130
Investments measured at amortised cost	2,880,000	--	--	2,880,000	2,880,000
Available for sale	51,661,663	51,661,663	--	--	51,661,663
<b>Total</b>	<b>54,725,793</b>	<b>51,661,663</b>	<b>--</b>	<b>3,064,130</b>	<b>54,725,793</b>

During the year, there has been no transfer within the levels has taken place.

Financial instruments such as cash in bank, Murabaha placements, other receivables and accrued expenses are short-term financial assets and financial liabilities whose carrying amounts approximate fair value, because of their short-term nature and the high credit quality of counterparties.

**19 LAST VALUATION DAY**

The Capital Market Authority (CMA), through its circular dated 10 Rabi Al Thani 1439H (corresponding to 28 December 2017), has approved the Dual NAV approach for investment funds. In accordance with the circular, IFRS 9 will be applied for accounting and reporting purposes and dealing NAV will remain unaffected until further notice.

The last valuation day of the year was 31 December 2018 (2017: 31 December 2017) and in lieu of the above circular from CMA, the dealing net assets (equity) value on this day was SR 9.62 per unit (2017: USD 9.81). The IFRS net assets (equity) value per unit on 31 December 2018 was SR 9.60 (2017: USD 9.81).

**20 EXPLANATION OF TRANSITION TO IFRS**

As stated in note 4, these are the Fund's first financial statements prepared in accordance with IFRSs as endorsed in the Kingdom of Saudi Arabia and other standards and pronouncements issued by SOCPA.

The accounting policies set out in note 8 have been applied in preparing the financial statements for the year ended 31 December 2018, the comparative information presented in these financial statements for the year ended 31 December 2017 and in the preparation of an opening IFRS statement of financial position at 1 January 2017 (the Fund's date of transition) except for IFRS 9 as disclosed in note 21, hence no further reconciliation statements have been provided.

The transition from previous GAAP i.e. generally accepted accounting standards in the Kingdom of Saudi Arabia as issued by SOCPA to IFRSs as endorsed in the Kingdom of Saudi Arabia has no significant impact on the Fund's financial position, comprehensive income, and statement of changes in net assets (equity) attributable to the Unitholders and cash flows.

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**21 IMPACT OF CHANGE IN ACCOUNTING POLICIES**

*Adoption of IFRS 9 “Financial Instruments” (IFRS 9)*

The Fund has adopted IFRS 9 with date of transition of 1 January 2018, opting to apply exemption allowed under IFRS 1 “First-time Adoption of International Financial Reporting Standards” from retrospective application. Accordingly, comparative information has been presented under the previous GAAP.

The assessment relating to determination of business model within which a financial instrument is held and classification and measurements of all of the Fund’s financial instruments have been made based on the facts and circumstances that existed at the date of transition.

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

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets resulting from the adoption of IFRS 9 are recognized in net assets (equity) attributable to the Unitholders as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.
- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application:
  - The determination of the business model within which a financial asset is held.
  - The revocation of previous designations of certain financial assets as measured at FVTPL.

The following table and the accompanying notes below explain the original measurement categories under previous GAAP and the new measurement categories under IFRS 9 for each class of the Fund’s financial assets and financial liabilities as at 1 January 2018.

The effect of adopting IFRS 9 on the carrying amounts of financial assets at 1 January 2018 relates solely to the new impairment requirements.

	<i>Classification under previous GAAP</i>	<i>New classification under IFRS 9</i>	<i>Original carrying value under previous GAAP</i>	<i>New carrying value under IFRS 9</i>
Cash and cash equivalents	Loans and receivables	Amortised cost	412,558	412,558
Murabaha placements	Loans and receivables	Amortised cost	2,720,000	2,719,745
Available for sale investments	Available for sale (AFS)	Investments at FVOCI (Debt)	50,430,848	50,313,212

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**21 IMPACT OF CHANGE IN ACCOUNTING POLICIES (CONTINUED)**

Reconciliation of carrying amounts under previous GAAP to carrying amounts under IFRS 9 at the adoption of IFRS 9

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

	<i>Carrying amount as at 31 December 2017</i>	<i>Re- classification</i>	<i>Re- measurement</i>	<i>IFRS 9 carrying amount as at 1 January 2018</i>
Cash and cash equivalent	412,558	--	--	412,558
Investments measured at amortised cost	2,720,000	--	(255)	2,719,745
Investments at FVOCI / AFS	50,430,848	--	(117,636)	50,313,212

As at 1 January 2018, re-measurement pertains to first time adoption of expected credit loss recorded in investments measured at amortised cost and investments at FVOCI.

**Impact on net assets (equity) attributable to Unitholders**

	<i>Net assets (equity) value</i>
Closing balance under previous GAAP (31 December 2017)	53,592,007
Recognition of expected credit losses under IFRS 9	(117,891)
Transfer of ECL on investments at FVOCI	117,636
<b>Opening balance under IFRS 9 (1 January 2018)</b>	<b><u>53,591,752</u></b>

**22 DIVIDEND DISTRIBUTIONS**

As per the terms and conditions of the Fund, the Fund Board made the following distributions out of the Fund during the year:

	<u>31 December 2018</u>	<u>31 December 2017</u>
1 <sup>st</sup> Interim dividend at the rate of 0.07 USD per unit (2017: 0.065 USD per unit)	<b>372,528</b>	355,104
2 <sup>nd</sup> Interim dividend at the rate of 0.07 USD per unit (2017: 0.065 USD per unit)	<b>371,617</b>	356,496
3 <sup>rd</sup> Interim dividend at the rate of 0.07 USD per unit (2017: 0.065 USD per unit)	<b>371,618</b>	356,588
4 <sup>th</sup> Interim dividend at the rate of 0.07 USD per unit (2017: 0.065 USD per unit)	<b>370,234</b>	355,194
<b>Total</b>	<b><u>1,485,997</u></b>	<b><u>1,423,382</u></b>

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**23 SUBSEQUENT EVENT**

There were no events subsequent to the statement of financial position date which require adjustments of or disclosure in the financial statements or notes thereto.

**24 APPROVAL OF FINANCIAL STATEMENTS**

These financial statements were approved by the Fund Board on 28 Rajab 1440H (corresponding to 4 April 2019).