Kuwait Finance House (Bahrain) B.S.C. (c)

INDEPENDENT AUDITOR'S REPORT AND CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2017

Building a better
working world

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF KUWAIT FINANCE HOUSE (BAHRAIN) B.S.C. (c)

We have audited the accompanying consolidated statement of financial position of Kuwait Finance House (Bahrain) B.S.C. (c) [the "Bank"] and its subsidiaries [together the "Group"] as of 31 December 2017, and the related consolidated statements of income, cash flows, changes in owners' equity, and changes in off-balance sheet equity of investment account holders for the year then ended and a summary of significant accounting policies and other explanatory information. These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a Rules and Principles are the responsibility of the Group's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ["AAOIFI"]. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2017, the results of its operations, its cash flows, changes in equity and changes in off-balance sheet equity of investment account holders for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF KUWAIT FINANCE HOUSE (BAHRAIN) B.S.C. (c) (continued)

Other Matters

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain ["CBB"] Rule Book (Volume 2), we report that:

a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; and

b) the financial information contained in the report of the Board of Directors is consistent with the consolidated financial statements.

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6) and CBB directives, or the terms of the Bank's memorandum and articles of association having occurred during the year that might have had a material adverse effect on the business of the Bank or on its financial position; and satisfactory explanations and information have been provided to us by the management in response to all our requests. The Bank has also complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

Ernst + Young

Partner's registration no: 45
23 January 2018
Manama, Kingdom of Bahrain

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2017

	Note	2017 BD 000	2016 BD 000
ASSETS			
Cash and balances with banks and Central Bank of Bahrain	7	**66,962**	56,399
Due from banks	8	**46,107**	88,420
Financing contracts	9	**737,552**	630,391
Investments	10	**7,747**	145,665
Investment in sukuk	11	**157,065**	163,772
Investment in associates	12	**12,599**	129,302
Investment in real estate	13	**-**	301,563
Receivables and other assets	14	**272,856**	63,458
Premises and equipments		**9,437**	8,682
		1,310,325	1,587,652
Assets classified as held for sale	16	**-**	20,272
TOTAL ASSETS		**1,310,325**	1,607,924
LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNERS' EQUITY			
LIABILITIES			
Customers' current accounts		**135,098**	147,630
Due to banks and financial institutions	17	**325,084**	452,960
Customers' murabaha accounts		**73,609**	62,221
Other liabilities	19	**23,101**	41,919
Subordinated wakala payable	20	**94,250**	91,242
		651,142	795,972
Liabilities classified as held for sale	16	**-**	2,117
		651,142	798,089
EQUITY OF INVESTMENT ACCOUNT HOLDERS	21	**477,676**	441,244
OWNERS' EQUITY			
Equity attributable to shareholders of the Parent			
Share capital	22	**132,519**	177,140
Share premium		**-**	71,403
Treasury shares		**-**	(21,923)
Statutory reserve		**19,768**	17,757
General reserve		**-**	28,237
Fair value through equity reserve		**-**	(3,574)
Property fair value reserve		**-**	30,923
Foreign currency translation reserve		**-**	(91)
Proposed dividend		**18,095**	-
Retained earnings		**3,321**	60,403
		173,703	360,275
Non-controlling shareholders		**7,804**	8,316
		181,507	368,591
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNERS' EQUITY		**1,310,325**	1,607,924
OFF-BALANCE SHEET EQUITY OF INVESTMENT ACCOUNT HOLDERS		**135,080**	134,970
CONTINGENT LIABILITIES AND COMMITMENTS	24	**135,078**	154,797

Hamad Abdulmohsen AlMarzouq
Chairman of the Board of Directors

Abdulhakeem Yaqoub Alkhayyat
Managing Director and
Chief Executive Officer

The attached notes 1 to 41 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2017

	Note	*2017* *BD 000*	*2016* *BD 000*
CONTINUING OPERATIONS			
Income from financing contracts	25	**43,310**	37,779
Income from investments	26	**10,268**	4,004
Income from sukuk		**6,979**	4,957
Share of income from associates		**425**	4,281
Revenue from non-banking business entities	28	**5,576**	5,622
OPERATING INCOME		**66,558**	56,643
Direct cost of non-banking business entities	28	**(5,076)**	(4,577)
OPERATING INCOME AFTER DIRECT COSTS		**61,482**	52,066
Return on equity of investment account holders before Group's share as mudarib		**(11,554)**	(5,107)
Group's share as mudarib		**6,311**	1,004
Return on equity of investment account holders	21	**(5,243)**	(4,103)
Profit on due to banks and financial institutions, customers' murabaha accounts and subordinated wakala payable	31	**(11,599)**	(11,391)
NET OPERATING INCOME		**44,640**	36,572
Staff costs		**14,373**	13,882
Depreciation		**1,011**	1,075
Provisions - net	29	**1,243**	7,127
Other expenses	30	**9,681**	8,677
Operating expenses of non-banking business entities	28	**920**	1,420
TOTAL OPERATING EXPENSES		**27,228**	32,181
NET INCOME FOR THE YEAR FROM CONTINUING OPERATIONS		**17,412**	4,391
DISCONTINUED OPERATIONS			
Net results for the year from discontinued operations	16	**2,600**	(3,199)
NET INCOME FOR THE YEAR		**20,012**	1,192
Attributable to:			
Shareholders of the Parent		**20,106**	1,149
Non-controlling shareholders		**(94)**	43
		20,012	1,192

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At 31 December 2017

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Other expenses	30	**9,681**	8,677
Operating expenses of non-banking business entities	28	**920**	1,420
TOTAL OPERATING EXPENSES		**27,228**	32,181
NET INCOME FOR THE YEAR FROM CONTINUING OPERATIONS		**17,412**	4,391
DISCONTINUED OPERATIONS			
Net results for the year from discontinued operations	16	**2,600**	(3,199)
NET INCOME FOR THE YEAR		**20,012**	1,192
Attributable to:			
Shareholders of the Parent		**20,106**	1,149
Non-controlling shareholders		**(94)**	43
		20,012	1,192

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The attached notes 1 to 41 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2017

	Note	2017 BD 000	2016 BD 000
OPERATING ACTIVITIES			
Net income for the year from continuing operations		**17,412**	4,391
Net results for the year from discontinued operations		**2,600**	(3,199)
Net income for the year		**20,012**	1,192
Adjustments for:			
Share of income from associates		**(425)**	(4,281)
Net gain on sale of investments	26	**(8,719)**	(173)
Net gain on sale of investment in real estate	26	**-**	(609)
Net unrealised (gain) loss on investments	26	**(34)**	171
Net unrealised loss on investment in real estate		**309**	1,302
Dividend income	26	**(82)**	(71)
Foreign exchange gain	26	**(380)**	(772)
Rental income	26	**(7)**	(107)
Depreciation		**1,029**	4,451
Provisions - net		**(1,259)**	9,632
Operating income before changes in operating assets and liabilities		**10,444**	10,735
Changes in operating assets and liabilities:			
Mandatory reserve with Central Bank of Bahrain		**(1,145)**	95
Due from banks		**(12,292)**	(11,817)
Financing contracts		**(86,950)**	(95,169)
Receivables and other assets		**11,391**	13,579
Customers' current accounts		**(12,532)**	31,096
Due to banks and financial institutions		**(9,422)**	133,126
Customers' murabaha accounts		**11,388**	14,602
Other liabilities		**(15,537)**	(11,735)
Net cash flows (used in) from operating activities		**(104,655)**	84,512
INVESTING ACTIVITIES			
Sale of investments - net		**14,809**	19,122
Sale (purchase) of investment in sukuk - net		**6,285**	(90,358)
Distributions from investment in associates		**2,962**	6,496
Purchase of investment in real estate - net		**(87)**	(498)
Dividend income		**82**	71
Rental income		**7**	107
Purchase of premises and equipment - net		**(1,022)**	(3,007)
Net cash flows from (used in) investing activities		**23,036**	(68,067)
FINANCING ACTIVITY			
Net movement in equity of investment account holders		**36,432**	(15,456)
Net cash flows from (used in) financing activity		**36,432**	(15,456)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		**(45,187)**	989
Cash and cash equivalents at 1 January		**103,687**	102,698
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	32	**58,500**	103,687

The attached notes 1 to 41 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

For the year ended 31 December 2017

	Equity attributable to shareholders of the Parent												
	Share capital BD 000	Share premium BD 000	Treasury shares BD 000	Statutory reserve BD 000	General reserve BD 000	Fair value through equity reserve BD 000	Property fair value reserve BD 000	Foreign currency translation reserve BD 000	Retained earnings BD 000	Proposed dividend BD 000	Total BD 000	Non - controlling shareholders BD 000	Total owners' equity BD 000
Balance at 1 January 2017	177,140	71,403	(21,923)	17,757	28,237	(3,574)	30,923	(91)	60,403	-	360,275	8,316	368,591
Net income for the year	-	-	-	-	-	-	-	-	20,106	-	20,106	(94)	20,012
Other comprehensive income for the year (note 23)	-	-	-	-	-	3,231	-	91	-	-	3,322	-	3,322
Total comprehensive income for the year	-	-	-	-	-	3,231	-	91	20,106	-	23,428	(94)	23,334
Cancellation of treasury shares (note 22)	(12,044)	(9,879)	21,923	-	-	-	-	-	-	-	-	-	-
Distributions (note 15)	(32,577)	(61,524)	-	-	(28,237)	77	(30,900)	-	(56,839)	-	(210,000)	-	(210,000)
Net transfer from fair value through equity reserve	-	-	-	-	-	266	-	-	(266)	-	-	-	-
Net transfer from property fair value reserve	-	-	-	-	-	-	(23)	-	23	-	-	-	-
Transfer to statutory reserve	-	-	-	2,011	-	-	-	-	(2,011)	-	-	-	-
Proposed dividend (note 22)	-	-	-	-	-	-	-	-	(18,095)	18,095	-	-	-
Net movement in share of non-controlling shareholders	-	-	-	-	-	-	-	-	-	-	-	(418)	(418)
Balance at 31 December 2017	**132,519**	**-**	**-**	**19,768**	**-**	**-**	**-**	**-**	**3,321**	**18,095**	**173,703**	**7,804**	**181,507**
Balance at 1 January 2016	177,140	71,403	(21,923)	17,642	28,237	(1,876)	31,501	232	58,791	-	361,147	8,264	369,411
Net income for the year	-	-	-	-	-	-	-	-	1,149	-	1,149	43	1,192
Other comprehensive loss for the year (note 23)	-	-	-	-	-	(1,698)	-	(323)	-	-	(2,021)	-	(2,021)
Total comprehensive (loss) income for the year	-	-	-	-	-	(1,698)	-	(323)	1,149	-	(872)	43	(829)
Net transfer from property fair value reserve	-	-	-	-	-	-	(578)	-	578	-	-	-	-
Transfer to statutory reserve	-	-	-	115	-	-	-	-	(115)	-	-	-	-
Net movement in share of non-controlling shareholders	-	-	-	-	-	-	-	-	-	-	-	9	9
Balance at 31 December 2016	177,140	71,403	(21,923)	17,757	28,237	(3,574)	30,923	(91)	60,403	-	360,275	8,316	368,591

The attached notes 1 to 41 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN OFF-BALANCE SHEET EQUITY OF INVESTMENT ACCOUNT HOLDERS

For the year ended 31 December 2017

	Balance at 1 January 2017	***Additional investments***	***Gross income***	***Mudarib share***	***Withdrawals / distributions***	***Balance at 31 December 2017***
	BD 000	***BD 000***	***BD 000***	***BD 000***	***BD 000***	***BD 000***
Murabaha contracts	**134,970**	**107,915**	**8,259**	**(2,692)**	**(113,372)**	**135,080**

	Balance at 1 January 2016	*Additional investments*	*Gross income*	*Mudarib share*	*Withdrawals / distributions*	*Balance at 31 December 2016*
	BD 000	*BD 000*	*BD 000*	*BD 000*	*BD 000*	*BD 000*
Murabaha contracts	135,210	95,695	9,183	(2,760)	(102,358)	134,970

The attached notes 1 to 41 form part of these consolidated financial statements.

1 CORPORATE INFORMATION AND ACTIVITIES

Kuwait Finance House (Bahrain) B.S.C. (c) ("the Bank") is a closed joint stock company incorporated in the Kingdom of Bahrain on 22 January 2002 under the Bahrain Commercial Companies Law No. 21/2001 and is registered with the Ministry of Industry and Commerce under commercial registration (CR) number 48128. The Bank is regulated and supervised by the Central Bank of Bahrain (the "CBB") and has an Islamic retail banking license. The Bank operates under Islamic principles and in accordance with all the relevant regulatory guidelines for Islamic banks issued by the CBB. The address of the Bank's registered office is World Trade Centre, road number 365, Building number 1B, Block 316, P.O. Box 2066, Manama, Kingdom of Bahrain.

The Bank offers a full range of Islamic banking services and products. The activities of the Bank include accepting Shari'a money placements/deposits, managing Shari'a profit sharing investment accounts, offering Shari'a financing contracts, dealing in Shari'a compliant financial instruments as principal/agent, managing Shari'a compliant financial instruments and other activities permitted under the CBB's Regulated Islamic Banking Services as defined in the licensing framework.

The Bank is a subsidiary of Kuwait Finance House K.S.C. (the "Ultimate Parent"), a public company incorporated in the State of Kuwait and listed at the Kuwait Stock Exchange. The Ultimate Parent is regulated and supervised by the Central Bank of Kuwait. The Bank's Shari'a Supervisory Board is entrusted to ensure its adherence to Shari'a rules and principles in its transactions and activities.

The Bank and its subsidiaries (together the "Group") operate in the Kingdom of Bahrain and Hashemite Kingdom of Jordan. The activities of the Bank's key subsidiaries are mentioned in note 5.

The Bank has ten branches (2016: ten), all operating in the Kingdom of Bahrain.

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors passed on 23 January 2018.

2 BASIS OF PREPARATION

2.1 Accounting convention

The consolidated financial statements have been prepared under the historical cost basis, except for investment in real estate, managed funds and equity securities that have been measured at fair value. The consolidated financial statements are presented in Bahraini Dinars ("BD") which is the functional and presentation currency of the Bank. All the values are rounded to the nearest BD thousand, unless otherwise indicated.

2.2 Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with the Financial Accounting Standards ("FAS") issued by the Accounting and Auditing Organization for Islamic Financial Institutions ("AAOIFI"), the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank, the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6) and CBB directives. For matters not covered by FAS, the Group uses the relevant International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB").

2.3 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries as at 31 December each year. The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies.

All intra-group balances, transactions, income and expenses and unrealised gains and losses resulting from intra-group transactions are eliminated in full.

2 BASIS OF PREPARATION (continued)

2.3 Basis of consolidation (continued)

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and continue to be consolidated until the date when such control ceases. Control is achieved where the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired or disposed of during the year, if any, are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate. A change in the Group's ownership of a subsidiary, without a loss of control, is accounted for as an equity transaction.

Share of non-controlling shareholders represents the portion of net income and net assets not held by the Group and are presented separately in the consolidated statement of income and within owners' equity in the consolidated statement of financial position, separately from the equity attributable to shareholders of the Parent. Transactions with the non-controlling interest are handled in the same way as transactions with external parties.

3 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of the Group's consolidated financial statements requires management to make judgments, estimates and assumptions that affect the amounts reported in the consolidated financial statements. The most significant uses of judgments and estimates are as follows:

3.1 Going concern

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

3.2 Fair value of unquoted equity securities and investment in real estate

Fair value is determined for each investment individually in accordance with the valuation policies set out in note 4.25. Where the fair values of the Group's unquoted equity securities cannot be derived from an active market, they are derived using a variety of valuation techniques. Judgment by management is required to establish fair values through the use of appropriate valuation models, consideration of comparable assets, discount rates and the assumptions used to forecast cash flows.

Investment in real estate projects are carried at fair value as determined by independent real estate valuation experts. The determination of the fair value for such assets requires the use of judgment and estimates by the independent valuation experts that are based on local market conditions existing at the date of the consolidated statement of financial position.

3.3 Impairment provisions against financing contracts

The Group reviews its financing contracts at each reporting date to assess whether an impairment provision should be recorded in the consolidated financial statements. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provision required. Such estimates are based on assumptions about factors involving varying degrees of judgment and uncertainty and actual results may differ resulting in future changes to the provisions.

In addition to impairment against individually impaired financing contracts, the Group also makes a collective impairment provision against exposures which, although not specifically identified as requiring an individual impairment, have a greater risk of default than when originally granted. This takes into consideration factors such as any deterioration in country risk, industry, and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

3 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES (continued)

3.4 Impairment of investments at fair value through equity

The Group treats investments carried at fair value through equity as impaired when there is a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires judgment. The Group evaluates factors, such as the historical share price volatility for comparable quoted equities and future cash flows and the discount factors for comparable unquoted equities.

3.5 Liquidity

The Group manages its liquidity through consideration of the maturity profile of its assets, liabilities and equity of investment account holders which is set out in the liquidity risk disclosures in note 37. This requires judgment when determining the maturity of assets and liabilities with no specific maturities.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of the consolidated financial statements are set out below:

4.1 Foreign currency translation

The consolidated financial statements are presented in Bahraini Dinars, which is the Group's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

(i) Transactions and balances

Transactions in foreign currencies are initially recorded in the functional currency using the rate of exchange prevailing at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the date of the consolidated statement of financial position. All differences are taken to the consolidated statement of income with the exception of all monetary items that provide an effective protection for a net investment in a foreign operation. These are recognised in other comprehensive income until the disposal of the net investment, at which time they are recognised in the consolidated statement of income.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial recognition. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined. Exchange gains and losses on non-monetary items classified as "fair value through statement of income" are taken to the consolidated statement of income and for items classified as "fair value through equity" such differences are taken to the consolidated statement of other comprehensive income. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations and translated at closing rate.

(ii) Group companies

As at the reporting date, the assets and liabilities of subsidiaries are translated into the Group's presentation currency (Bahraini Dinars) at the rate of exchange prevailing at the date of the consolidated statement of financial position, and their statements of income are translated at the weighted average exchange rates for the year. Exchange differences arising on translation are recognised in other comprehensive income. On disposal of a foreign subsidiary, the cumulative amount recognised in other comprehensive income relating to that particular foreign subsidiary is recognised in the consolidated statement of income.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.2 Financial instruments - initial recognition and subsequent measurement

Date of recognition

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. All financial assets and liabilities are initially recognised on the trade date, i.e. the date that the Group becomes a party to the contractual provisions of the instrument.

Initial and subsequent measurement of financial instruments

The classification of financial instruments at initial recognition depends on the purpose and the management's intention for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus transaction costs, except in the case of financial assets recorded at fair value through statement of income.

(i) Due from banks

Murabahas are international commodity murabaha transactions. The Bank arranges a murabaha transaction by buying a commodity (which represents the object of the murabaha) and then resells this commodity to the beneficiary murabeh (after computing a profit margin). The sale price (cost plus the profit margin) is paid either lump sum at maturity or in installments by the murabeh over the agreed period.

Murabaha with banks are stated net of deferred profits and provision for impairment, if any. Wakala with banks are stated at cost less provision for impairment, if any.

(ii) Financing contracts

(a) Murabaha

Murabaha represents the sale of goods at cost plus an agreed profit. Murabaha receivables are stated net of deferred profits, any amounts written off and provision for impairment, if any. Promise made in the murabaha to the purchase orderer is not obligatory upon the customer.

(b) Ijarah Muntahia Bittamleek

Ijarah Muntahia Bittamleek mainly comprise of land and buildings and certain other assets. Ijarah Muntahia Bittamleek is a lease whereby the legal title of the leased asset passes to the lessee at the end of the ijarah (lease term), provided that all ijarah installments are settled.

Assets under Ijarah Muntahia Bittamleek are initially recognised at cost and subsequently depreciated at rates calculated to write off the cost of each asset over its useful life to its residual value.

(c) Musharaka

Musharaka represents a partnership between the Group and a customer whereby each party contributes to the capital in equal or varying proportions to establish a new project or share in an existing one, and whereby each of the parties becomes an owner of the capital on a permanent or declining basis and shall have a share of profits or losses. These are stated at the fair value of consideration given less any amounts written off and provision for impairment, if any.

(iii) Investments

Investments are classified as follows:

- Investments at fair value through statement of income;
- Investments at fair value through equity; and
- Investments at amortised cost.

(a) Investments at fair value through statement of income

Investments at fair value through statement of income include investments held for trading and investments designated upon initial recognition as investments at fair value through statement of income.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.2 Financial instruments - initial recognition and subsequent measurement (continued)

(iii) Investments (continued)

(a) Investments at fair value through statement of income (continued)
An investment is classified as held for trading if acquired or originated principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin. Any investments that form part of a portfolio where there is an actual pattern of short-term profit taking are also classified as 'held for trading'.

The Group also utilises the exemption available in accordance with IAS 28 and FAS 24 as applicable to venture capital organisations and classifies such investments in joint ventures and associates as "investments at fair value through statement of income". Financial assets carried at fair value through statement of income are recognised at fair value, with transaction costs recognised in the consolidated statement of income.

Investments classified as 'fair value through statement of income' are subsequently measured at fair value. The unrealised gains and losses arising from the remeasurement to fair value are included in the consolidated statement of income.

(b) Investments at fair value through equity
Investments at fair value through equity are those which are designated as such or are not classified as carried at fair value through statement of income or at amortised cost. These include investments in equity securities and managed funds.

Investments at fair value through equity are subsequently measured at fair value. Unrealised gains and losses are recognised in statement of comprehensive income. When the investment is disposed of or determined to be impaired, the cumulative gain or loss, previously transferred to the fair value through equity reserve, is recognised in the consolidated statement of income. Where the Group holds more than one investment in the same security they are deemed to be disposed of on a weighted average basis.

(c) Investments at amortised cost
Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as such when the Group has the positive intention and ability to hold them to maturity. After initial measurement, these investments are measured at amortised cost, less impairment. The losses arising from impairment are recognised in the consolidated statement of income under 'provisions'.

(iv) Equity of investment account holders
Equity of investment account holders is invested in due from banks, sukuk and financing contracts. No priority is granted to any party for the purpose of distribution of profits. According to the terms of acceptance of the investment account holders funds, 100% of these funds are invested after deductions of mandatory reserve and sufficient operational cash requirements.

Equity of investment account holders is carried at fair value of consideration received less amounts settled. Expenses are allocated to investment accounts in proportion of average equity of investment account holders to average assets, however, investment related expenses and assets are excluded.

Income is allocated proportionately between equity of investment account holders and owners' equity on the basis of the average balances outstanding during the year and share of the funds invested.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.3 Derecognition of financial assets and financial liabilities

(i) Financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired; or
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either: (a) has transferred substantially all the risks and rewards of the assets, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset.

(ii) Financial liabilities

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

4.4 Impairment of financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in profit or principal repayments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

(i) Financial assets carried at amortised cost

For financial assets carried at amortised cost, the Group first assesses whether objective evidence of impairment exists for individually significant financial assets, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in the collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of a provision account and the amount of the loss is recognised in the consolidated statement of income.

Financing contracts together with the associated provisions are written off when there is no realistic prospect of future recovery and collateral has been realised or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced in the consolidated statement of income.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.4 Impairment of financial assets (continued)

(i) Financial assets carried at amortised cost (continued)
The present value of the estimated future cash flows is discounted at the financial asset's original effective profit rate. If a financial asset has a variable profit rate, the discount rate for measuring any impairment loss is the current effective profit rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs of obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal credit grading system which considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(ii) Investments at fair value through equity
For investments at fair value through equity, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as "fair value through equity", objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss measured as the difference between the acquisition cost and the current fair value less any impairment loss on that investment previously recognised in the consolidated statement of comprehensive income is removed from fair value through equity reserve and recognised in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income; increases in their fair value subsequent to impairment are recognised directly in equity.

4.5 Offsetting financial instruments
Financial assets and financial liabilities are only offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable or religious right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

4.6 Development properties
Development properties consist of cost of land being developed for sale in the ordinary course of business and costs incurred in bringing such land to its saleable condition and is stated at the lower of cost and net realisable value.

Net realisable value is based on estimated selling price less any further costs expected to be incurred on completion and sale.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.7 Recognition of income and expense

(i) Income recognition

(a) Murabaha
Where the income is quantifiable and contractually determined at the commencement of the contract, income is recognised on a time-apportioned basis over the period of the contract based on the principal amounts outstanding. Accrual of income is suspended when the Group believes that the recovery of these amounts may be doubtful.

(b) Ijarah Muntahia Bittamleek
Ijarah income is recognised on a time-apportioned basis, net of depreciation, over the lease term. Accrual of income is suspended when the Group believes that the recovery of these amounts may be doubtful.

(c) Musharaka
Income on musharaka contracts is recognised when the right to receive payment is established or on distribution by the musharek.

(d) Dividends
Dividends from investments in equity securities are recognised when the right to receive the payment is established.

(e) Fees and commission income
Fees and commission income is recognised when earned.

(f) Revenue from sale of real estate
Revenue on sale of real estate is recognised when all of the following conditions are met:

- A sale is consummated and contracts are signed;
- The buyer's investment, as of the date of financial statements, is adequate (25% and above) to demonstrate a commitment to pay for the property; and
- The Group has transferred to the buyer the risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property.

Where property is under development and agreement has been reached to sell such property when construction is complete, the Group considers whether the contract comprises:

- contract to construct a property; or
- contract for the sale of a completed property.

Where a contract is determined to be a construction contract, revenue is recognised using the percentage of completion method as construction progresses. The percentage of work complete is measured based on the costs incurred up until the end of the reporting period as a proportion of total costs expected to be incurred.

Where the contract is judged to be for the sale of a completed property, revenue is recognised when the significant risks and rewards of ownership of the property are transferred to the buyer.

(g) Service income
Revenue from rendering of services is recognised when the services are rendered.

(h) Revenue from sale of goods
Revenue from sales of goods is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.7 Recognition of income and expense (continued)

(i) Income recognition (continued)

(i) Group's share as a mudarib
The Group's share as a mudarib for managing the equity of investment account holders is accrued based on the terms and conditions of the related mudaraba agreements whereas, for off balance sheet equity of investment account holders, mudarib share is recognised when distributed.

(ii) Expense recognition

(a) Profit on due to banks, financial institutions and customers' murabaha accounts
Profit on these is accrued on a time-apportioned basis over the period of the contract based on the principal amounts outstanding.

(b) Return on equity of investment account holders
Return on equity of investment account holders is based on the income generated from jointly financed assets after deducting mudarib share and is accrued based on the terms and conditions of the underlying mudaraba agreement. Investors' share of income represents income generated from assets financed by investment account holders net of allocated operating expenses excluding investment related expenses. The Group's share of profit is deducted from the investors' share of income before distribution to investors.

4.8 Investment in associates
An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in the associate is carried in the consolidated statement of financial position at cost plus post acquisition changes in the Group's share of net assets of the associate. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised nor individually tested for impairment.

After application of the equity method, the Group determines whether it is necessary to recognise any impairment loss with respect to the Group's net investment in the associate. The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount in the consolidated statement of income.

The consolidated statement of income reflects the share of the results of operations of the associate. Where there has been an income or expense recognised in the other comprehensive income of the associate, the Group recognises its share of any such income or expense, when applicable, in the consolidated statement of comprehensive income. Gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of stake in the associate.

The reporting dates of the associates and the Group are identical and their accounting policies conform to those used by the Group for like transactions and events in similar circumstances. In case of any difference in the associates' accounting policies, their results are adjusted to bring them in line with the Group accounting policies.

Upon loss of significant influence over the associate, the Group measures and recognises any retaining investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retaining investment and proceeds from disposal is recognised in the consolidated statement of income.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.9 Investment in joint ventures

The Group has arrangements with other parties which represent joint ventures. These take the form of agreements to share control.

The reporting dates of the joint ventures and the Group are identical and their accounting policies conform to those used by the Group for like transactions and events in similar circumstances. In case of any difference in the joint ventures' accounting policies, their results are adjusted to bring them in line with the Group accounting policies.

Where the joint venture is established through a stake in a company (a jointly controlled entity), the Group recognises its stake in the entity's assets and liabilities using the equity method of accounting. Under the equity method, the investment in a joint venture is carried in the consolidated statement of financial position at cost plus post acquisition changes in the Group's share of its net assets, less distributions received and less impairment in value of individual investments.

4.10 Investment in real estate

Properties held to earn rental income, for capital appreciation or both are classified as investment in real estate. Investments in real estate are measured initially at cost, including transaction costs. Subsequent to initial recognition, investments in real estate are stated at fair value, which reflects market conditions at the date of the consolidated statement of financial position. The Group engages independent valuation specialists to determine fair value as at the year end.

Unrealised gains arising from a change in the fair value of investment in real estate are recognised directly in the consolidated statement of changes in owners' equity under "Property fair value reserve" for the period in which they arise.

Unrealised losses resulting from re-measurement at fair value of investment in real estate are adjusted in equity against the property fair value reserve, to the extent of the available credit balance of this reserve. In case such losses exceed the available balance, the unrealised losses are recognised in the consolidated statement of income. In case there are unrealised losses relating to investment in real estate that have been recognised in the consolidated statement of income in a previous financial period, the unrealised gains relating to the current financial period are recognised in the consolidated statement of income to the extent of crediting back such previous losses in the consolidated statement of income.

Realised gains or losses resulting from the sale of any investment in real estate are measured as the difference between the carrying value and the net cash or cash equivalent proceeds from the sale for each investment separately. The resulting gain or loss together with the available balance in the property fair value reserve is recognised in the consolidated statement of income for the current financial period.

Investment in real estate under construction is measured at cost until the construction is completed. Once the construction is completed and the property is ready for its intended use, it is measured at its fair value.

Investments in real estate are derecognised when they have been disposed of or permanently withdrawn from use and no future economic benefit is expected from their disposal. Any gains or losses on the retirement or disposal of these real estate investments are recognised in the consolidated statement of income in the year of retirement or disposal.

Transfers are made to investment in real estate when, and only when, there is a change in use, evidenced by the end of owner occupation or commencement of an operating lease. Transfers are made from investment in real estate when, and only when, there is a change in use, evidenced by commencement of owner occupation or commencement of development with a view to sale.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.11 Premises and equipment

Premises and equipment are stated at cost excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value, if any.

Depreciation is calculated using the straight-line method to write down the cost of premises and equipment to their residual values over their estimated useful lives. Land is not depreciated. The estimated useful lives are as follows:

	Years
Premises	20
Telecom equipment	10 - 25
Hardware, software and equipment	1.5 - 7
Motor vehicles and office furniture	5 - 7

An item of premises and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in the consolidated statement of income in the year the asset is derecognised.

4.12 Intangible assets

Intangible assets include the value of license rights. Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is its fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less accumulated amortisation and any accumulated impairment losses.

Intangible assets with finite useful lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset maybe impaired. The amortisation period and the amortisation method are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite useful lives is recognised in the consolidated statement of income. Amortisation of license rights is calculated using the straight-line method to write down the cost of these intangible assets to their residual values over their estimated useful lives of 4 - 25 years.

4.13 Impairment of non-financial assets

The Group assesses at each reporting date or more frequently whether there is an indication that a non-financial asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If any such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. Impairment losses relating to goodwill cannot be reversed for subsequent increase in its recoverable amount in future periods.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.14 Financial guarantees

In the ordinary course of business, the Group provides financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recorded in the consolidated statement of financial position at fair value in 'other liabilities' being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is recognised in the consolidated statement of income under 'provisions'. The premium received is recognised in the consolidated statement of income on a straight line basis over the life of the guarantee.

4.15 Treasury shares

Own equity instruments that are reacquired (treasury shares) are recognised at cost and deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments. Any difference between the carrying amount and the consideration, if reissued, is recognised in share premium.

4.16 Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) arising from a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of obligation.

4.17 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Chief Operating Decision Maker (CODM). CODM is a person or group that allocates resources to and assesses the performance of the operating segments of the entity. The Group has determined the Managing Director and Chief Executive Officer as its CODM.

4.18 Cash and cash equivalents

Cash and cash equivalents comprise of cash and balances with banks and the Central Bank of Bahrain (excluding mandatory reserve) and due from banks with original maturity of 90 days or less.

4.19 Employees' end of service benefits

Provision is made for leaving indemnity payable under the Bahraini Labor Law applicable to non-Bahraini employees' accumulated periods of service at the consolidated statement of financial position date.

Bahraini employees of the Group are covered by contributions made to the Social Insurance Organisation ("SIO") as a percentage of the employees' salaries. The Group's obligations are limited to these contributions, which are expensed when due. For Bahrainis with basic salaries above a certain threshold, the Bank recognises leaving indemnity in line with the requirements of Bahrain Labour Law.

4.20 Off-balance sheet equity of investment account holders

Off-balance sheet equity of investment account holders represents funds received by the Bank on the basis of mudaraba to be invested in specified products as directed by the investment account holders. The assets funded by these funds are managed in a fiduciary capacity by the Bank for which the Bank earns mudarib share which is disclosed as part of 'income from retail and corporate banking activities'. These assets are not included in the consolidated statement of financial position as the Group does not have the right to use or dispose of them except within the conditions laid down in the underlying mudaraba contract.

4.21 Earnings prohibited by Shari'a

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is transferred to charity.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.22 Inventories

Inventories are carried at the lower of cost and net realisable value. When inventories become old or obsolete, an estimate is made of their net realisable value. For individually significant amounts this estimation is performed on an individual basis. Amounts which are not individually significant, but which are old or obsolete, are assessed collectively and an allowance applied according to the inventory type and the degree of ageing or obsolescence, based on historical selling prices.

4.23 Assets classified as held for sale

The Group classifies assets as held for sale if their carrying amounts will be recovered principally through a sale rather than through continuing use. Such assets classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

The criteria for held for sale classification is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Actions required to complete the sale should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. Management must be committed to the plan, expected within one year from the date of the classification.

Property, plant and equipment and intangible assets are not depreciated or amortised once classified as held for sale.

Assets and liabilities classified as held for sale are presented separately in the statement of financial position.

Results from discontinued operations are presented as a single amount in the consolidated statement of income.

Assets which ceases to be classified as held for sale are consolidated on a line by line basis. Prior period balances are re-presented.

4.24 Repossessed assets

Repossessed assets are assets acquired in settlement of financing contracts with customers. These assets are carried at the lower of carrying amount and fair value less costs to sell and reported within "receivables and other assets" in the consolidated statement of financial position.

4.25 Fair value of financial instruments

The Group measures financial instruments and non-financial assets such as investment in real estate, at fair value at the date of statement of financial position. Fair values of financial instruments are disclosed in note 35.

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 to the Group.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.25 Fair value of financial instruments (continued)

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 Group 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. Observable data used alongwith the Group's approach to determining fair values of financial instruments and quantitative disclosure are disclosed in note 36.

4.26 Taxation

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on overseas operations is provided for in accordance with the fiscal regulations of the respective countries in which the Group operates and is included in the accompanying consolidated statement of income under "other operating expenses".

4.27 Zakah

In accordance with the instructions of the Shari'a Supervisory Board of the Bank, payment of Zakah is the responsibility of the shareholders of the Bank. Accordingly, no Zakah has been charged to these consolidated financial statements.

4.28 New standards, amendments and interpretations

FAS 30 – Impairment, credit losses and onerous commitments

In November 2017, AAOIFI issued FAS 30 - "Impairment, credit losses and onerous commitments" which is effective from the financial periods beginning on or after 1 January 2020, with early adoption permitted. This standard supersedes the earlier FAS 11 - "Provisions and Reserves". The Group considers it as a significant project and therefore has set up an implementation team with members from its Risk Management, Financial Control, IT, and respective business units to achieve a successful and robust implementation. The Group will early adopt FAS 30 during 2018 and currently is in the final phase of implementation, whereby parallel run exercise is under process together with various level of validations.

Credit losses approach

The Group will recognize credit loss provisions based on a forward looking Expected Credit Loss (ECL) approach on all established receivables and off-balance sheet exposures including guarantees, letters of credit and other similar positions which are subject to credit risk.

The Group will categorize its assets subject to credit losses into the following three stages in accordance with the FAS 30 methodology:

⇨ Stage 1 – Performing receivables: receivables that are not significantly deteriorated in credit quality since origination. The impairment provision will be recorded based on 12 months ECL.

⇨ Stage 2 – Underperforming receivables: receivables that have significantly deteriorated in credit quality since origination. The credit losses will be recorded based on life time ECL.

⇨ Stage 3 – Impaired receivables: For receivables that are impaired, the Group will recognize the impairment provision based on life time ECL.

The Group will also consider the forward-looking information in its assessment of significant deterioration in credit risk since origination as well as the measurement of ECLs. The forward-looking information will include the elements such as macroeconomic factors (e.g., equity prices and oil prices) and economic forecasts obtained through external sources.

To evaluate a range of possible outcomes, the Group intends to formulate various scenarios. For each scenario, the Group will derive an ECL and apply a probability weighted approach to determine the impairment provision in accordance with the accounting standards requirements.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.28 New standards, amendments and interpretations (continued)

Impairment approach
The Group will recognize impairment losses on all other financing, investment assets and exposures subject to risks other than credit risk (excluding investments carried at fair value through income statement and inventories).

The impairment losses will be measured by which the carrying amount of an asset exceeds its recoverable amount. The recoverable amount will be the higher of its fair value less costs of disposal and its value in use.

Net realizable value approach
The Group will recognize impairment on inventories recognized as a result of financial transactions which are based on a trade based structure e.g. deferred payment sales including Murabaha, installment sales, Salam or Istisna'a.

Subsequent to the initial recognition, all inventories will be measured at the lower of cost and net realizable value. The net realizable value, is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale, considering the factors specific to the Group.

Provision for onerous contract or commitment to acquire an asset
The Group will recognize provision when the Group is obligated to acquire an asset under a future commitment or contracts permissible to be entered in the future, and it is expected that the obligation under the contract or commitment is higher than the economic benefits expected to flow through acquisition of such asset. In such situation, the Group will create a provision on this account reflecting the expected losses arising on such transaction.

Expected impact
The Group has reviewed its receivables and assets and is expecting the following impact from the early adoption of FAS 30 on January 1, 2018:

According to transitional provisions for initial application of FAS 30, the Group is allowed to recognize any difference between previous carrying amount under FAS 11 and the carrying amount of losses that is attributable to the shareholders at the beginning of the annual reporting period (that includes the date of initial application) in opening retained earnings, and the cumulative charge attributable to shareholders, including unrestricted investment account holders, related to previous periods shall be adjusted with an allocation from the respective Investment Risk Reserve (and from the respective Profit Equalization Reserve in case of a shortfall) with due Shari'ah approvals. In case of any remaining shortfall, a temporary transfer with Shari'ah approval may be made from shareholders' equity.

The Group does not expect any significant impact on opening retained earnings on the date of initial application. Similarly, Tier 1 ratio is not expected to be impacted by FAS 30.

The new standard also introduces disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Group's disclosures about its financial instruments particularly in the year of the adoption.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.28 New standards, amendments and interpretations (continued)

Governance and controls

The Group has a centrally managed FAS 30 implementation project and includes subject matter experts on methodology, data sourcing and modelling, IT processing and reporting. The Group's work to date has covered performing and developing an impairment methodology to support the calculation of the ECL provision. Specifically, during 2017 the Group developed its approach for assessing significant increase in credit risk ("SICR"), incorporating forward looking information, including macro-economic factors and preparing the required IT systems and process architecture. The Group has performed a full end to end parallel run based on 31 December 2017 data to assess procedural readiness. Overall governance of the implementation project is through the Steering Committee and includes representation from Financial Control, Risk Management and IT. The Group is in the process of enhancing its governance framework to implement appropriate validations and controls over new key processes and significant areas of judgment such as SICR determining and applying forward looking information in multiple economic scenarios and computation of ECL.

The assessment above is a point in time estimate and is not a forecast. The actual effect of the implementation of FAS 30 on the Group could vary from this estimate. The Group continues to refine models, methodologies and controls, and monitor developments in regulatory rule-making in advance of FAS 30 early adoption on 1 January 2018. All estimates are based on the Group's current interpretation of the requirements of FAS 30, reflecting industry guidance and discussions to date.

5 LIST OF KEY SUBSIDIARIES

Key subsidiaries, all of which have 31 December as their year end, are listed below.

Subsidiary	*Year of incorporation*	*Country of incorporation*	*Ownership %*	
			2017	*2016*
Kuwait Finance House - Jordan The company and its subsidiaries are engaged in investment advisory and investments in private equities and real estate development.	2007	Hashemite Kingdom of Jordan	**100.00**	100.00
Ishbiliya Village W.L.L. The principal activity of the company is to invest in and develop real estate projects and consequently buying, selling and marketing of such properties.	2005	Kingdom of Bahrain	**100.00**	100.00

6 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

The Group's financial instruments have been classified in accordance with their measurement basis as follows:

At 31 December 2017	*Financial assets at fair value through statement of income*	*Financial assets at fair value through equity*	*Financial assets at cost/ amortised cost*	*Financial liabilities at cost/ amortised cost*	*Total*
	BD 000	*BD 000*	*BD 000*	*BD 000*	*BD 000*
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	-	-	66,962	-	66,962
Due from banks	-	-	46,107	-	46,107
Financing contracts	-	-	737,552	-	737,552
Investments	3,125	4,622	-	-	7,747
Investment in sukuk	-	-	157,065	-	157,065
Receivables and other assets	-	-	231,277	-	231,277
	3,125	4,622	1,238,963	-	1,246,710
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS					
Customers' current accounts	-	-	-	135,098	135,098
Due to banks and financial institutions	-	-	-	325,084	325,084
Customers' murabaha accounts	-	-	-	73,609	73,609
Other liabilities	-	-	-	21,632	21,632
Subordinated wakala payable	-	-	-	94,250	94,250
Equity of investment account holders	-	-	-	477,676	477,676
	-	-	-	1,127,349	1,127,349

At 31 December 2016	*Financial assets at fair value through statement of income*	*Financial assets at fair value through equity*	*Financial assets at cost/ amortised cost*	*Financial liabilities at cost/ amortised cost*	*Total*
	BD 000	*BD 000*	*BD 000*	*BD 000*	*BD 000*
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	-	-	56,399	-	56,399
Due from banks	-	-	88,420	-	88,420
Financing contracts with customers	-	-	630,391	-	630,391
Investments	140,566	5,099	-	-	145,665
Investment in sukuk	-	-	163,772	-	163,772
Receivables and other assets	-	-	10,421	-	10,421
	140,566	5,099	949,403	-	1,095,068
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS					
Customers' current accounts	-	-	-	147,630	147,630
Due to banks and financial institutions	-	-	-	452,960	452,960
Customers' murabaha accounts	-	-	-	62,221	62,221
Other liabilities	-	-	-	31,633	31,633
Subordinated wakala payable	-	-	-	91,242	91,242
Equity of investment account holders	-	-	-	441,244	441,244
	-	-	-	1,226,930	1,226,930

7 CASH AND BALANCES WITH BANKS AND CENTRAL BANK OF BAHRAIN

	Note	2017 BD 000	2016 BD 000
Cash		**9,795**	8,142
Balances with banks		**19,573**	9,449
Balance with CBB		**7,134**	9,493
CBB mandatory reserve	7.1	**30,460**	29,315
	7.2	**66,962**	56,399

7.1 This mandatory reserve is not available for use in the Group's day to day operations.

7.2 This balance includes BD 27,516 thousand (2016: BD 26,388 thousand) financed by investment account holders' funds.

8 DUE FROM BANKS

	2017 BD 000	2016 BD 000
Murabaha	**27,370**	53,552
Wakala	**18,850**	34,981
	46,220	88,533
Impairment provision	**(113)**	(113)
	46,107	88,420

This balance includes BD 18,395 thousand (2016: BD 44,652 thousand) financed by investment account holders' funds. These carry profit rates ranging from 0.60% to 3.44% per annum (2016: 0.15% to 2.95% per annum).

9 FINANCING CONTRACTS WITH CUSTOMERS

	Self financed		*Financed through investment account holders' funds*		*Total*	
	2017 BD 000	2016 BD 000	**2017 BD 000**	2016 BD 000	**2017 BD 000**	2016 BD 000
Murabaha	**182,962**	185,888	**182,039**	122,951	**365,001**	308,839
Deferred profits	**(15,003)**	(13,408)	**(15,191)**	(10,074)	**(30,194)**	(23,482)
Individual impairment provision	**(8,039)**	(4,230)	**(8,141)**	(3,178)	**(16,180)**	(7,408)
	159,920	168,250	**158,707**	109,699	**318,627**	277,949
Ijarah Muntahia Bittamleek (note 9.1)	**211,210**	192,038	**222,667**	190,753	**433,877**	382,791
Individual impairment provision	**(3,762)**	(2,408)	**(4,047)**	(2,438)	**(7,809)**	(4,846)
	207,448	189,630	**218,620**	188,315	**426,068**	377,945
Musharaka	**291**	342	**-**	-	**291**	342
	291	342	**-**	-	**291**	342
	367,659	358,222	**377,327**	298,014	**744,986**	656,236
Collective impairment provision					**(7,434)**	(25,845)
					737,552	630,391

9 FINANCING CONTRACTS WITH CUSTOMERS (continued)

9.1 These mainly comprise of land and building and are presented net of accumulated depreciation amounting to BD 93,600 thousand (2016: BD 80,787 thousand).

9.2 During the year, the Bank took possession of properties with a carrying value of BD 2,876 thousand (2016 : 1,030 thousand) as part of financing settlement and were classified as repossessed assets in the receivables and other assets.

9.3 The following is a reconciliation of the individual and collective impairment provisions for losses on financing contracts with customers:

	Individual impairment 2017 BD 000	***Collective impairment 2017 BD 000***	***Total 2017 BD 000***	*Individual impairment 2016 BD 000*	*Collective impairment 2016 BD 000*	*Total 2016 BD 000*
At 1 January	**12,254**	**25,845**	**38,099**	12,756	25,098	37,854
Charge / transfers	**16,074**	**1,264**	**17,338**	1,386	1,151	2,537
Reversals / transfers	**(1,749)**	**(19,675)**	**(21,424)**	(1,650)	(404)	(2,054)
Net provisions (reversals)	**14,325**	**(18,411)**	**(4,086)**	(264)	747	483
Write-offs	**(2,590)**	**-**	**(2,590)**	(238)	-	(238)
At 31 December	**23,989**	**7,434**	**31,423**	12,254	25,845	38,099

10 INVESTMENTS

The Group's investments are classified as follows:

	Note	***2017 BD 000***	*2016 BD 000*
Investments at fair value through statement of income	10.1	**3,125**	140,566
Investments at fair value through equity	10.2	**4,622**	5,099
		7,747	145,665

10.1 Carried at fair value through statement of income

		2017 BD 000	*2016 BD 000*
Held for trading		**1,742**	1,086
Designated at fair value upon initial recognition	10.1.1	**1,383**	139,480
		3,125	140,566

10.1.1 Designated at fair value upon initial recognition

		2017 BD 000	*2016 BD 000*
Unquoted equity securities	10.1.1.1	**-**	138,270
Managed funds - at Net Asset Value		**1,383**	1,210
		1,383	139,480

10.1.1.1 During the year, as per the capital optimization plan, Group's certain investments have been transferred to a nominated entity of the Ultimate Parent. Refer note 15 for details.

10 INVESTMENTS (continued)

10.2 Carried at fair value through equity

	2017 BD 000	2016 BD 000
Quoted equity securities	1,349	1,349
Unquoted equity securities	5,254	5,254
	6,603	6,603
Reclassification to income statement on impairment	3,034	-
Impairment provisions	(5,015)	(1,504)
	4,622	5,099

10.2.1 Movement in impairment provisions relating to investments:

	2017 BD 000	2016 BD 000
At 1 January	1,504	1,436
Charge / reclassification to income statement for the year	3,511	68
At 31 December	5,015	1,504

10.2.2 The movement of investments carried at fair value through equity during the year is as follows:

	2017 BD 000	2016 BD 000
At 1 January	5,099	6,614
Impairment provisions	(3,511)	(68)
Fair value changes	-	(1,447)
Reclassification to income statement on impairment	3,034	-
At 31 December	4,622	5,099

10.3 Composition of investment portfolio:

The industry and geographic composition of the Group's investment portfolio is as follows:

	Middle East	Total	
		2017	2016
	BD 000	BD 000	BD 000
Real estate development	-	-	138,309
Banking and financial services	6,442	6,442	7,013
Others	1,305	1,305	343
	7,747	7,747	145,665

11 INVESTMENT IN SUKUK

	Note	2017 BD 000	2016 BD 000
Quoted sukuk			
Government		65,479	34,878
Unquoted sukuk			
Government		70,700	108,085
Others		20,886	20,809
	11.1	157,065	163,772

11.1 Investment in sukuk includes an amount of BD 54,438 thousand (2016: BD 72,190 thousand) financed by investment account holders' funds. Fair value of investment in sukuk as at 31 December 2017 amounted to BD 158,346 thousand (2016: BD 166,569 thousand).

12 INVESTMENT IN ASSOCIATES

The Group has the following associates as at 31 December 2017:

Name of the associates	*Nature of business*	*Country of incorporation*	*Holding*
Deera Investment and Real Estate Development Company	Real estate project development and property management.	Hashemite Kingdom of Jordan	28.0%
Energy Central B.S.C. (c)	Providing district cooling, sea water desalination, waste water treatment and related services.	Kingdom of Bahrain	33.5%

The following table illustrates the summarised financial information of associates:

	2017 BD 000	*2016* BD 000
Current assets	**6,619**	226,040
Non-current assets	**49,432**	412,058
Current liabilities	**(6,018)**	(119,905)
Non-current liabilities	**(8,291)**	(41,293)
Total net assets	**41,742**	476,900
Commitments	**-**	4,646

Total income and net profit of associates for the year:

	2017 BD 000	*2016* BD 000
Total income	**2,328**	136,281
Net profit	**287**	14,888

The movement of the Group's investment in associates is as follows:

	Note	*2017* BD 000	*2016* BD 000
At 1 January		**129,302**	130,340
Investments during the year		**1,323**	1,755
Disposals during the year	12.1	**(115,156)**	-
Distributions from the associates		**(2,962)**	(6,496)
Share of income from associates		**425**	4,281
Share of other comprehensive loss	23	**197**	(251)
Provision for impairment	29	**(757)**	-
Other movements		**227**	(327)
At 31 December		**12,599**	129,302

The quoted value of the investment in associates for which quoted prices are available is BD 5,182 thousand (2016: BD 21,133 thousand). However, the quoted price does not represent the fair value as the shares are not actively traded. The fair value based on internal models approximates their carrying value.

12.1 During the year, as per the capital optimization plan, Group's certain investments in joint ventures and associates have been transferred to a nominated entity of the Ultimate Parent. Refer note 15 for details.

13 INVESTMENT IN REAL ESTATE

		2017 BD 000	2016 BD 000
Cost			
At 1 January		**299,378**	298,027
Additions during the year		**69**	1,865
Disposals during the year	13.2	**(299,447)**	(514)
At 31 December		**-**	299,378
Fair value adjustment			
At 1 January		**2,185**	3,731
Fair value adjustments		**(309)**	(1,302)
Relating to disposals	13.2	**(1,876)**	(244)
At 31 December		**-**	2,185
Total	13.1	**-**	301,563

13.1 Investment in real estate, held in the Kingdom of Bahrain, at 31 December consists of the following:

	2017 BD 000	2016 BD 000
Buildings	-	37,075
Lands	-	264,488
	-	301,563

Rental income included in the consolidated statement of income from investment in real estate amounted to BD 1,767 thousand (2016: BD 3,369 thousand).

Direct operating expenses (including repairs and maintenance) amounting to BD 1,273 thousand (2016: BD 1,570 thousand) arising from investment in real estate that generated rental income during the year are included in the consolidated statement of income under other expenses.

BD 82 thousand (2016: BD 64 thousand) direct operating expenses (including repairs and maintenance) arising from investment in real estate that did not generate rental income during the year are included in the consolidated statement of income under other expenses.

Investment in real estate includes the Bank's share of nil (2016: BD 13,744 thousand) which are jointly owned with third parties and are subject to normal conditions applicable to joint ownership.

13.2 During the year, as per the capital optimization plan, Group's investment in real estate has been transferred to a nominated entity of the Ultimate Parent. Refer note 15 for details.

14 RECEIVABLES AND OTHER ASSETS

	Note	*2017* *BD 000*	*2016* *BD 000*
Land and development cost	14.1	**37,717**	43,183
Fees receivable		**2,416**	1,654
Project expenses receivable		**1,150**	1,582
Inventories		**796**	9,799
Profit receivable		**2,375**	1,909
Repossessed assets		**7,023**	4,147
Trade receivables of subsidiaries		**4,387**	4,483
Prepaid expenses		**1,870**	1,735
Receivables relating to disposal of investments		**223,663**	2,099
Receivables from corporate customers		**1,442**	1,471
Other assets		**1,589**	2,357
Gross receivables and other assets		**284,428**	74,419
Impairment provisions	14.2	**(11,572)**	(10,961)
		272,856	63,458

14.1 Land and development cost

	2017 *BD 000*	*2016* *BD 000*
Land	**28,700**	31,922
Development cost	**9,017**	11,261
	37,717	43,183

This development cost represents construction, consultancy and profit paid on financing, capitalised relating to various real estate projects being undertaken by the Group.

14.2 Movement in impairment provisions relating to receivables and other assets.

	Note	*2017* *BD 000*	*2016* *BD 000*
At 1 January		**10,961**	18,513
Charge (reversal) for the year	14.2.1	**1,061**	(1,689)
Disposals / settlements		**(450)**	(5,863)
At 31 December		**11,572**	10,961

14.2.1 Charge for the year

		2017 *BD 000*	*2016* *BD 000*
Provisions against receivables and other assets	29	**1,061**	(1,536)
Non-banking business entities	28.2	**-**	(153)
		1,061	(1,689)

15 TRANSFER OF ASSETS TO THE ULTIMATE PARENT

During the year, the Ultimate Parent approved a capital optimization plan for the Bank pursuant to which certain assets have been transferred to a nominated entity of the Ultimate Parent. The transferred assets included investments of BD 134,855 thousand, investment in real estate of BD 302,528 thousand and investment in joint ventures and associates of BD 109,300 thousand.

The transfer of assets is settled through adjustment of interbank borrowing from the Ultimate Parent of BD 118,466 thousand, distribution to the Ultimate Parent of BD 210,000 thousand and by way of recognising a receivable of BD 222,000 thousand from the nominated entity. The receivable is expected to be settled through realisation of assets transferred. The Ultimate Parent has also provided a letter of guarantee for settlement of receivable. The Bank will continue to advise for the management and realisation of assets transferred.

16 DISCONTINUED OPERATIONS

On 14 December 2017, the Group signed the share sale agreement for the transfer of ownership and control of a wholly owned subsidiary, Mena Telecom W.L.L. ("Mena"). During December 2016, the Group has classified Mena as held for sale and decided to sell its equity stake. Mena is engaged in providing telecommunication services under licenses issued by the Telecommunications Regulatory Authority of the Kingdom of Bahrain.

The results of Mena, included in the consolidated statement of income, based on the most recent management accounts are as follows:

	2017	*2016*
	BD 000	*BD 000*
Revenue	**10,433**	10,901
Cost of sales	**(2,516)**	(2,641)
Operating income	**7,917**	8,260
Operating expenses	**(7,819)**	(8,801)
Reversals (provisions) - net	**2,502**	(2,658)
	2,600	(3,199)

The major classes of assets and liabilities of Mena, classified as held for sale as at 31 December, are as follows:

	2017	*2016*
	BD 000	*BD 000*
ASSETS		
Equipment and furniture	-	13,436
Intangible assets	-	3,179
Inventories	-	708
Accounts receivable and other assets	-	2,717
Cash and bank balances	-	232
	-	20,272
LIABILITIES		
Accounts payable and accruals	-	2,117

The net cash flows received by Mena are as follows:

	2017	*2016*
	BD 000	*BD 000*
Net cash flows from operating activities	**3,124**	2,785
Net cash flows from investing activities	**(1,519)**	(1,857)
	1,605	928

17 DUE TO BANKS AND FINANCIAL INSTITUTIONS

	2017	*2016*
	BD 000	*BD 000*
Due to banks		
Murabaha payables	**90,849**	74,505
Wakala payables	**72,321**	202,072
Current accounts	**590**	740
Due to financial institutions		
Murabaha payables	**66,537**	81,393
Wakala payables	**94,787**	94,250
	325,084	452,960

18 ASSETS UNDER MANAGEMENT

At 31 December 2017, assets managed in a fiduciary capacity amounted to BD 609,857 thousand (2016: BD 41,904 thousand).

19 OTHER LIABILITIES

	2017 BD 000	2016 BD 000
Pay orders issued but not presented	**2,320**	4,130
Payable on account of financing contracts	**851**	1,227
Staff related accruals	**4,393**	3,678
Profit payable on due to banks, financial institutions and customers' murabaha accounts	**4,616**	4,870
Profit payable on equity of investment account holders	**1,160**	1,318
Trade payables of subsidiaries	**2,042**	2,960
Advance from customers	**1,469**	10,286
Contingencies and others	**6,250**	13,450
	23,101	41,919

20 SUBORDINATED WAKALA PAYABLE

The subordinated wakala payable carries a profit equivalent to a rate of 1% over the six month USD LIBOR. The facility has been approved by CBB to be recognised as Tier II capital and is unsecured and sub-ordinate to the claim of all creditors and will expire in 2022. Starting from 2017, the Bank has started to amortise this Tier II Capital in accordance with the relevant guidelines and regulation for capital adequacy purposes.

During the year, an amount of BD 2,962 thousand (2016: BD 3,519 thousand) has been charged to the consolidated statement of income in respect of subordinated wakala payable.

21 EQUITY OF INVESTMENT ACCOUNT HOLDERS

The mudarib share on investment accounts ranges from 30% to 85% (2015: 30% to 85%) depending on the investment period and in the case of saving accounts, where there is no restriction on cash withdrawal, the mudarib share ranges from 85% to 95% (2016: 85% to 95%). The rate of return to investment account holders, as at 31 December 2017 and 2016, for various types of investment accounts, denominated in BD and USD, is as follows:

	2017 Rate of return %	2016 Rate of return %
Investment accounts - denominated in BD		
Saving accounts	**0.14**	0.25
VIP saving accounts	**0.41**	0.30
One month investment accounts	**1.20**	1.20
Three months investment accounts	**1.40**	1.40
Six months investment accounts	**1.65**	1.65
Nine months investment accounts	**1.80**	1.80
One year investment accounts	**1.90 / 2.00**	1.90 / 2.00
Investment accounts - denominated in USD		
Saving accounts	**0.14**	0.20
VIP saving accounts	**0.30**	0.30
One month investment accounts	**0.85 / 0.95**	0.95
Three months investment accounts	**1.20**	1.20
Six months investment accounts	**1.40**	1.40
Nine months investment accounts	**1.50**	1.50
One year investment accounts	**1.65**	1.65

21 EQUITY OF INVESTMENT ACCOUNT HOLDERS (continued)

21.1 Investment accounts by type

	2017 *BD 000*	*2016* *BD 000*
Saving accounts	**184,071**	169,875
VIP saving accounts	**22,285**	20,938
One month investment accounts	**67,108**	66,190
Three months investment accounts	**67,828**	76,546
Six months investment accounts	**47,175**	46,684
Nine months investment accounts	**2,767**	110
One year and above investment accounts	**86,442**	60,901
	477,676	441,244

22 SHARE CAPITAL AND RESERVES

Share capital

	Note	*2017* *BD 000*	*2016* *BD 000*
Authorised:			
3,500,000 thousand (2016 : 3,500,000 thousand) ordinary shares of BD 0.1 each		**350,000**	350,000
Issued and fully paid up:			
As at the beginning and end of the year			
1,325,187 thousand (2016 : 1,771,405 thousand) shares	16	**132,519**	177,140

Nature and purpose of reserves

Share premium
Amounts collected in excess of the par value of the issued share capital during any new issue of shares, net of issue expenses, are treated as share premium. This amount is not available for distribution, but can be utilised as stipulated by the Bahrain Commercial Companies Law ("BCCL").

Treasury shares
The amount of consideration paid including all directly attributable costs incurred in connection with the acquisition of treasury shares are recognised in equity. During the year, treasury shares of the Bank were cancelled with corresponding impact in the share capital and share premium reserve.

Statutory reserve
As required by Bahrain Commercial Companies Law ("BCCL") and the Bank's articles of association, 10% of the net income for the year has been transferred to the statutory reserve. However, as allowed under BCCL the Bank may resolve to discontinue such annual transfers when the reserve totals 50% of paid up share capital. The reserve is not distributable except in such circumstances as stipulated in the BCCL and following the approval of the CBB.

General reserve
The general reserve is established in accordance with the articles of association of the Bank and is distributable following a resolution of shareholders at a general meeting and the approval of CBB. The Bank may transfer any amount to the general reserve, as approved by the shareholders at a general meeting, out of the net income for the year after appropriating statutory reserve.

22 SHARE CAPITAL AND RESERVES (continued)

Fair value through equity reserve
Unrealised gains and losses resulting from investments carried at fair value through equity, if not determined to be impaired, recorded in the fair value through equity reserve and not available for distribution. Upon disposal of such assets, the related cumulative gains or losses are transferred to retained earnings and become available for distribution.

Property fair value reserve
Unrealised gains on investment in real estate are recognised in the property fair value reserve in owners' equity and are not available for distribution. Any unrealised loss on investment in real estate is first adjusted against any unrealised gain lying in this reserve and the remainder is taken to the consolidated statement of income. Upon disposal of such assets, the related cumulative gains or losses are transferred to retained earnings and become available for distribution.

Foreign currency translation reserve
The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries.

Retained earnings
Retained earnings is the cumulative amount of annual earnings not paid out as dividends. Included in retained earnings is a non-distributable reserve amounting to BD 1,502 thousand (2016: BD 1,575 thousand) relating to subsidiaries of the Bank.

Proposed dividend
Proposed dividend is shown seperately within equity till it is approved by the Annual General Meeting. The Board of Directors of the Bank have proposed a dividend of BD 18,095 thousand for the year ended 31 December 2017 (2016 : nil). This proposal is subject to the approval of the Annual General Meeting of the Bank and completion of legal formalities.

23 TOTAL COMPREHENSIVE INCOME

	2017	*2016*
	BD 000	*BD 000*
Net income for the year	**20,012**	1,192
Other comprehensive income (loss)		
Fair value adjustments against fair value through equity investments	**-**	(1,447)
Reclassification to income statement on impairment of equity investment	**3,034**	-
Net movement in foreign currency translation reserve	**91**	(323)
Share of other comprehensive income (loss) of associates	**197**	(251)
Total other comprehensive income (loss) for the year	**3,322**	(2,021)
Total comprehensive income (loss) for the year	**23,334**	(829)
Adjustment attributable to non-controlling shareholders	**94**	(43)
	23,428	(872)

24 CONTINGENT LIABILITIES AND COMMITMENTS

		2017	*2016*
	Note	***BD 000***	*BD 000*
Contingent liabilities			
Letters of credit		**25,536**	9,096
Guarantees		**11,076**	14,524
		36,612	23,620
Irrevocable commitments to extend credit			
Original term to maturity of one year or less		**97,949**	131,077
Development cost commitment	24.1	**517**	100
		135,078	154,797

24 CONTINGENT LIABILITIES AND COMMITMENTS (continued)

24.1 This represent payments to be made to contractors and consultants for a development project in progress.

Operating lease commitments

At 31 December 2017, the Group had commitments in respect of non-cancellable operating leases amounting to BD 1,424 thousand (2016: BD 1,801 thousand) relating to leasehold premises. Of the commitments in respect of operating leases, BD 1,130 thousand (2016: BD 1,140 thousand) are due within one year, BD 250 thousand (2016: BD 446 thousand) are due in one to five years and the remaining over five years.

25 INCOME FROM FINANCING CONTRACTS

	Note	***2017 BD 000***	*2016 BD 000*
Murabaha		**16,922**	14,123
Ijarah Muntahia Bittamleek	25.1	**21,384**	18,570
Musharaka		**26**	18
Due from banks		**972**	1,082
Income from financing contracts		**39,304**	33,793
Mudarib share from off balance sheet equity of investment account holders		**2,692**	2,760
Fees and commission income		**1,314**	1,226
		43,310	37,779

25.1 This is presented net of depreciation on Ijarah Muntahia Bittamleek assets amounting to BD 40,589 thousand (2016: BD 37,238 thousand).

26 INCOME FROM INVESTMENTS

		2017 BD 000	*2016 BD 000*
Net unrealised loss on investments	26.1	**34**	(171)
Net gain on sale of investments		**8,719**	173
Net gain on sale of investment in real estate		**-**	609
Dividend income		**82**	71
Fee income		**1,029**	1,198
Foreign exchange		**380**	772
Rental income		**7**	107
Other income		**17**	1,245
		10,268	4,004

26.1 This represents fair value changes recognized during the year based on the recent net asset values "NAV's" of the funds and fair value of investments.

27 INCOME AND EXPENSE RELATING TO FINANCING CONTRACTS AND SUKUK

	2017 BD 000	*2016 BD 000*
Income from financing contracts	**39,304**	33,793
Income from sukuk	**6,979**	4,957
	46,283	38,750
Less: Profit on due to banks and financial institutions, customers' murabaha accounts and subordinated wakala payable	**11,599**	11,391
Less: Return on equity of investment account holders	**5,243**	4,103
	16,842	15,494
	29,441	23,256

28 NON-BANKING BUSINESS ENTITIES

	Note	*2017* *BD 000*	*2016* *BD 000*
Revenue	28.1	**5,576**	5,622
Less:			
Direct cost		**5,076**	4,577
Operating expenses	28.2	**920**	1,420
		(420)	(375)

29.1 This includes unreaslied fair value losses amounting to BD 309 thousand (2016 : BD 1,302 thousand) on account of investment in real estate.

28.2 Operating expenses

	Note	*2017* *BD 000*	*2016* *BD 000*
Staff costs		**251**	673
Depreciation		**18**	23
Provisions - net	14.2.1	**-**	(153)
Other expenses		**651**	877
		920	1,420

29 PROVISIONS - NET

	Note	*2017* *BD 000*	*2016* *BD 000*
Due from banks	8	**-**	113
Financing contracts	9.3	**(4,086)**	483
Investments	29.1	**3,511**	68
Investment in associates	12	**757**	-
Receivables and other assets	14.2.1	**1,061**	(1,536)
Others		**-**	7,999
		1,243	7,127

29.1 This includes impairment provision of BD 276 thousand (2016 : BD 68 thousand) (note 10.2.1) recognised against investments carried at fair value through equity and BD 3,235 thousand (2016 : nil) on account of reclassification of available for sale reserve to consolidated statement of income.

30 OTHER EXPENSES

	2017 *BD 000*	*2016* *BD 000*
Business development	**1,633**	1,562
Technology and communication	**2,937**	2,407
Legal, consulting and outsourcing	**860**	632
Premises - rentals and maintenance	**2,330**	2,269
Administration, selling and others	**1,921**	1,807
	9,681	8,677

31 PROFIT ON DUE TO BANKS AND FINANCIAL INSTITUTIONS, CUSTOMERS' MURABAHA ACCOUNTS AND SUBORDINATED WAKALA PAYABLE

	2017	*2016*
	BD 000	*BD 000*
Due to banks	**4,356**	4,176
Due to financial institutions	**2,978**	2,710
Customers' murabaha accounts	**1,303**	986
Subordinated wakala payable (note 20)	**2,962**	3,519
	11,599	11,391

32 CASH AND CASH EQUIVALENTS

Cash and cash equivalents for the purpose of the consolidated statement of cash flows comprise of the following amounts:

	2017	*2016*
	BD 000	*BD 000*
Cash	**9,795**	8,142
Balances with banks	**19,573**	9,449
Balances with CBB excluding mandatory reserve	**7,134**	9,493
Due from banks with original maturity of less than ninety days	**21,998**	76,603
	58,500	103,687

33 RELATED PARTY TRANSACTIONS AND BALANCES

Related parties represent associated companies, the parent and its major shareholders, directors and key management personnel of the Bank, the Bank's Shari'a Supervisory Board and entities controlled, jointly controlled or significantly influenced by such parties. Transactions with related parties arise from the ordinary course of business. Pricing policies and terms of these transactions are approved by the Group's management. Outstanding balances at the year end, excluding financing contracts, are unsecured.

The following table provides the total amount of transactions that have been entered into with related parties for the relevant financial year:

	Associated companies BD 000	*Parent BD 000*	*Directors and key management personnel BD 000*	*Other related parties BD 000*	*Total 2017 BD 000*	*Total 2016 BD 000*
Cash & Balances with Banks	-	1,529	-	20	1,549	295
Financing contracts *	-	-	5,057	63,976	69,033	73,890
Investment in sukuk	-	-	-	20,886	20,886	20,809
Fees receivable	-	-	-	762	762	790
Receivables and other assets	-	-	-	222,000	222,000	436
Due to banks and financial institutions	-	50,266	-	27,825	78,091	212,308
Customers' current accounts	-	225	448	2,783	3,456	12,534
Subordinated wakala payable	-	94,250	-	-	94,250	91,242
Equity of investment account holders	-	-	1,681	10,153	11,834	13,532
Letters of credit	-	-	-	20	20	20
Commitments to extend credit	-	-	-	5,521	5,521	85
Off balance sheet equity of investment account holders						
- Funds extended to related parties	-	-	-	135,080	135,080	134,970
- Funds received from related parties	-	-	-	4,550	4,550	6,100
Assets under management	-	-	-	554,245	554,245	-

* includes balances amounting to BD 17,046 thousand (2016: BD 1,345 thousand) which are past due and impaired

33 RELATED PARTY TRANSACTIONS AND BALANCES (continued)

The income and expenses in respect of related parties included in the consolidated financial statements are as follows:

	Associated companies BD 000	*Parent BD 000*	*Directors and key management personnel BD 000*	*Other related parties BD 000*	*Total 2017 BD 000*	*Total 2016 BD 000*
Income from financing contracts	**493**	**-**	**189**	**2,910**	**3,592**	3,631
Income from investment in sukuk	**-**	**-**	**-**	**1,271**	**1,271**	1,274
Fee income	**-**	**-**	**-**	**798**	**798**	886
Profit on due to banks and financial institutions	**-**	**2,322**	**-**	**554**	**2,876**	3,214
Profit on subordinated wakala payable	**-**	**2,962**	**-**	**-**	**2,962**	3,519
Profit on equity investment account holders	**-**	**-**	**15**	**768**	**783**	525
Staff costs	**-**	**-**	**5,498**	**128**	**5,626**	5,569
Other expenses	**-**	**-**	**-**	**1,120**	**1,120**	1,377
Mudarib share of off-balance sheet equity of investment account holders	**-**	**-**	**-**	**2,692**	**2,692**	2,760

Compensation of key management personnel, included in the consolidated statement of income, is as follows:

	2017 BD 000	*2016 BD 000*
Short term employee benefits	**5,202**	5,191
Long term employee benefits	**296**	250

Directors' remuneration and attendance fee for the year ended 31 December 2017 amounted to BD 198 thousand and BD 120 thousand respectively (2016: BD 103 thousand and BD 191 thousand respectively).

34 SEGMENT INFORMATION

For management purposes, the Group is organised into the following segments.

Retail & Corporate Banking Group	Principally engaged in Shari'a compliant profit sharing investment arrangements, providing Shari'a compliant financing contracts and other facilities to corporate, retail and institutional customers.
Investment Banking Group	Principally engaged in investment banking activities, including private equity, real estate investments, treasury and other activities.

No operating segments have been aggregated to form the above reportable segments.

Management monitors the operating results of its segments separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on segment profit (as reported in internal management reports) which is measured using the same measurement principles as are used in the preparation of these consolidated financial statements.

Group revenues for the current and prior year does not include significant revenues (i.e. more than 10% of the Group's total revenue) from any single external customer.

The following table presents operating income, net income, total assets and total liabilities of the Group's segments for the year ended 31 December 2017:

	Retail & Corporate Group BD 000	*Investment Banking Group BD 000*	*Total BD 000*
Operating income	50,289	11,193	61,482
Net income for the year from continuing operations	11,580	5,832	17,412
Net results for the year from discontinued operations	-	2,600	2,600
Net income for the year			20,012
Segment assets	979,451	330,874	1,310,325
Segment liabilities and equity of investment account holders	722,664	406,154	1,128,818

The following table shows the distribution of the Group's net income and total assets by geographical segments, based on the location in which the transactions and assets are recorded, for the year ended 31 December 2017.

	Bahrain BD 000	*Other countries BD 000*	*Total BD 000*
Operating income	60,448	1,034	61,482
Segment assets	1,250,508	59,817	1,310,325

Other countries mainly represent State of Kuwait and Hashemite Kingdom of Jordan.

34 SEGMENT INFORMATION (continued)

The following table presents operating income, net income, total assets and total liabilities of the Group's segments for the year ended 31 December 2016:

	Retail & Corporate Group BD 000	*Investment Banking Group BD 000*	*Total BD 000*
Operating income	42,736	9,330	52,066
Net income for the year from continuing operations	3,613	778	4,391
Net results for the year from discontinued operations	-	(3,199)	(3,199)
Net income for the year			1,192
Segment assets	918,317	669,335	1,587,652
Assets classified as held for sale	-	20,272	20,272
Total assets			1,607,924
Segment liabilities and equity of investment account holders	700,314	536,902	1,237,216
Liabilities classified as held for sale	-	2,117	2,117
Total liabilities and equity for investment account holders			1,239,333

The following table shows the distribution of the Group's net income and total assets by geographical segments, based on the location in which the transactions and assets are recorded, for the year ended 31 December 2016.

	Bahrain BD 000	*Other countries BD 000*	*Total BD 000*
Operating income	50,072	1,994	52,066
Segment assets	1,517,142	70,510	1,587,652
Assets classified as held for sale	20,272	-	20,272
Total assets			1,607,924

Other countries mainly represent State of Kuwait and Hashemite Kingdom of Jordan.

35 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the value representing the estimate of the amount of cash or cash equivalent that would be received for an asset sold or the amount of cash or cash equivalent paid for a liability extinguished or transferred in an orderly transaction between a willing buyer and a willing seller at the measurement date.

At 31 December 2017 and 2016, the fair value of financial instruments approximate their carrying values.

Financial instruments recorded at fair value

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

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

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

	Level 1 2017 BD 000	***Level 2 2017 BD 000***	***Level 3 2017 BD 000***	***Total 2017 BD 000***
Investments at fair value through statement of income				
Investments held for trading	**1,742**	**-**	**-**	**1,742**
Unquoted equity securities	**-**	**-**	**-**	**-**
Managed funds	**-**	**1,383**	**-**	**1,383**
Investments at fair value through equity				
Quoted equity securities	**382**	**-**	**-**	**382**
Unquoted equity securities	**-**	**-**	**4,240**	**4,240**
	2,124	**1,383**	**4,240**	**7,747**

	Level 1 2016 BD 000	*Level 2 2016 BD 000*	*Level 3 2016 BD 000*	*Total 2016 BD 000*
Investments at fair value through statement of income				
Investments held for trading	1,086	-	-	1,086
Unquoted equity securities	-	-	138,270	138,270
Managed funds	-	1,210	-	1,210
Investments at fair value through equity				
Quoted equity securities	502	-	-	502
Unquoted equity securities	-	-	4,597	4,597
	1,588	1,210	142,867	145,665

During the year ended 31 December 2017, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

35 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

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

	Unquoted equity securities 2017 BD 000	***Managed funds 2017 BD 000***	*Unquoted equity securities 2016 BD 000*	*Managed funds 2016 BD 000*
Balance at 1 January	**142,867**	-	159,965	-
Investments made during the year	-	-		-
Provisions / unrealised fair value loss	**(357)**		(1,294)	
Disposals / redemptions during the year	**(138,270)**	-	(15,804)	-
Balance at 31 December	**4,240**	-	142,867	-

Impact on fair value of Level 3 financial instruments measured at fair value of changes to key assumptions

	Carrying amount 2017 BD 000	***Effect of reasonably possible alternative assumption 2017 BD 000***	*Carrying amount 2016 BD 000*	*Effect of reasonably possible alternative assumption 2016 BD 000*
Investments at fair value through statement of income				
Unquoted equity securities	-	-	138,270	13,827
Investments at fair value through equity				
Unquoted equity securities	**4,240**	**424**	4,597	460
	4,240	**424**	142,867	14,287

In order to determine reasonably possible alternative assumptions the Group adjusted key unobservable models inputs as follows:

For equities, the Group adjusted the price earning ratio by increasing and decreasing the price earning ratio by ten percent, which is considered by the Group to be within a range of reasonably possible alternatives based on the price earning ratios of companies with similar industry and risk profiles.

For managed funds, the Group values its investments based on a net asset value, which is determined by the fund manager. The Group adjusted the value of the funds to increase or decrease by ten percent, which is considered by the Group to be within a range of reasonably possible alternatives.

For equity investments in real estate sector, fair value is determined by reference to valuations by independent real estate valuation experts. The determination of the fair value of such assets is based on local market conditions existing at the date of the statement of financial position. The Group adjusted the value of these assets to increase or decrease by ten percent, which is considered by the Group to be within a range of reasonably possible alternatives.

36 MATURITY ANALYSIS OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS

The table below shows an analysis of assets, liabilities and equity of investment account holders analysed according to when they are expected to be recovered or settled. Group's contractual undiscounted repayment obligations are disclosed in note 37.3 'Risk Management - Liquidity Risk and Funding Management'.

	Up to one year			*Over one year*				
	Up to 3 months 2017 BD 000	*3 to 12 months 2017 BD 000*	*Subtotal upto 12 months 2017 BD 000*	*1 to 5 years 2017 BD 000*	*5 to 10 years 2017 BD 000*	*Over 10 years 2017 BD 000*	*Subtotal Over 1 year 2017 BD 000*	*Total 2017 BD 000*
Assets								
Cash and balances with banks and Central Bank of Bahrain	19,447	3,541	**22,988**	10,818	7,453	25,703	**43,974**	**66,962**
Due from banks	46,107	-	**46,107**	-	-	-	**-**	**46,107**
Financing contracts	67,657	115,959	**183,616**	270,464	210,213	73,259	**553,936**	**737,552**
Investments	1,742	1,765	**3,507**	-	4,240	-	**4,240**	**7,747**
Investment in sukuk	8,000	15,627	**23,627**	58,586	74,852	-	**133,438**	**157,065**
Investment in associates	-	-	**-**	12,599	-	-	**12,599**	**12,599**
Development properties	-	-	**-**	-	-	-	**-**	**-**
Receivables and other assets	5,653	15	**5,668**	267,188	-	-	**267,188**	**272,856**
Premises and equipments	-	-	**-**	-	9,437	-	**9,437**	**9,437**
Total	**148,606**	**136,907**	**285,513**	**619,655**	**306,195**	**98,962**	**1,024,812**	**1,310,325**
Liabilities and equity of investment account holders								
Customers' current accounts	8,078	-	**8,078**	42,340	42,340	42,340	**127,020**	**135,098**
Due to banks and financial institutions	63,041	66,537	**129,578**	195,506	-	-	**195,506**	**325,084**
Customers' murabaha accounts	4,402	-	**4,402**	23,069	23,069	23,069	**69,207**	**73,609**
Other liabilities	14,737	4,408	**19,145**	3,956	-	-	**3,956**	**23,101**
Equity of investment account holders	16,181	16,625	**32,806**	148,290	148,290	148,290	**444,870**	**477,676**
Subordinated wakala payable	-	-	**-**	94,250	-	-	**94,250**	**94,250**
Total	**106,439**	**87,570**	**194,009**	**507,411**	**213,699**	**213,699**	**934,809**	**1,128,818**
Net	**42,167**	**49,337**	**91,504**	**112,244**	**92,496**	**(114,737)**	**90,003**	**181,507**
Off-balance sheet equity of investment account holders	**32,460**	**66,885**	**99,345**	**35,735**	**-**	**-**	**35,735**	**135,080**

36 MATURITY ANALYSIS OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS (continued)

	Upto one year			*Over one year*				
	Up to 3 months 2016 BD 000	*3 to 12 months 2016 BD 000*	*Subtotal upto 12 months 2016 BD 000*	*1 to 5 years 2016 BD 000*	*5 to 10 years 2016 BD 000*	*Over 10 years 2016 BD 000*	*Subtotal Over 1 year 2016 BD 000*	*Total 2016 BD 000*
Assets								
Cash and balances with banks and Central Bank of Bahrain	14,702	4,630	19,332	9,541	6,992	20,534	37,067	56,399
Due from banks	77,223	11,197	88,420	-	-	-	-	88,420
Financing contracts	68,652	82,456	151,108	248,041	168,744	62,498	479,283	630,391
Investments	1,085	1,713	2,798	-	142,867	-	142,867	145,665
Investment in sukuk	29,989	36,205	66,194	53,728	43,850	-	97,578	163,772
Investment in associates	5,556	-	5,556	123,746	-	-	123,746	129,302
Investment in real estate	2,690	63,297	65,987	-	223,220	12,356	235,576	301,563
Development properties	-	-	-	-	-	-	-	-
Receivables and other assets	6,661	47	6,708	56,750	-	-	56,750	63,458
Premises and equipments	-	-	-	-	8,682	-	8,682	8,682
Assets classified as held for sale	-	20,272	20,272	-	-	-	-	20,272
Total	206,558	219,817	426,375	491,806	594,355	95,388	1,181,549	1,607,924
Liabilities and equity of investment account holders								
Customers' current accounts	7,545	-	7,545	46,695	46,695	46,695	140,085	147,630
Due to banks and financial institutions	76,514	100,245	176,759	276,201	-	-	276,201	452,960
Customers' murabaha accounts	3,181	-	3,181	19,680	19,680	19,680	59,040	62,221
Other liabilities	32,116	4,094	36,210	5,709	-	-	5,709	41,919
Equity of investment account holders	16,968	18,346	35,314	135,310	135,310	135,310	405,930	441,244
Subordinated wakala payable	-	-	-	91,242	-	-	91,242	91,242
Liabilities classified as held for sale	-	2,117	2,117	-	-	-	-	2,117
Total	136,324	124,802	261,126	574,837	201,685	201,685	978,207	1,239,333
Net	70,234	95,015	165,249	(83,031)	392,670	(106,297)	203,342	368,591
Off-balance sheet equity of investment account holders	42,100	69,595	111,695	23,275	-	-	23,275	134,970

37 RISK MANAGEMENT

37.1 Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring of material risks. The Group manages its exposure to risks within the approved risk limits. The process of risk management is critical to the Group's continuing profitability and each business unit within the Group is accountable for the risk exposures relating to its responsibilities. The Group is mainly exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. The Group is also subject to prepayment risk and operating risk.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. These are monitored through the Group's strategic planning process.

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies, policies and risk appetite of the Bank.

Audit & Compliance Committee (ACC)

The ACC is a Board appointed committee which is comprised of two independent directors and an executive director. The Chairman of the Committee is also an independent director. For audit related matters, the committee assists the Board of Directors in carrying out its responsibilities with respect to assessing the quality and integrity of financial reporting, the audit thereof and the soundness of the internal controls of the Bank. For compliance related matters, the committee assists the Board of Directors in the assessment of compliance with law, regulations and other requirements imposed on the Bank from time to time. The committee also overseas and manages the compliance and anti financial crime requirements of the Bank and legal related matters.

Risk Committee (RC)

The Risk Committee is a Board appointed committee which is comprised of two independent directors and an executive director. The Chairman of the Committee is also an independent director. The committee is a reviewing and recommending body appointed by the Board of Directors to assist the Board in discharging its oversight duties relating to:

- Recommendation of the risk charter of the bank to the Board, highlighting the key risks from identified business strategies, the risk appetite, the risk governance models including strategies, policies, processes, roles and responsibilities relating to various departments and various levels of risk management within the Bank; and

- Establishing appropriate policies and procedures to mitigate the applicable risks on the overall operations of the Bank.

Corporate Governance Committee

The Corporate Governance Committee is a Board appointed committee which is comprised of three independent directors including the Chairman. The committee is a reviewing and recommending body appointed by the Board of Directors to assist the Board in discharging its oversight duties relating to:

- Establishing appropriate Corporate Governance structures, delegation of authority and reporting protocols;

- Ensure potential measure and improvements in corporate governance are implemented.

37 RISK MANAGEMENT (continued)

37.1 Introduction (continued)

Internal Control Systems
The Board is responsible for approving and reviewing the effectiveness of the Bank's system of internal control, for the purpose of ensuring effective and efficient operations, quality of internal and external reporting, internal control, and compliance with laws and regulations. Senior Management is responsible for establishing and maintaining the system of internal control designed to manage the risk of failure to achieve the Bank's objectives. The system of internal control can only provide reasonable but not absolute assurance against the risk of material loss.

The effectiveness of the internal control system is reviewed by the Board and the Audit & Compliance Committee, which also receives review reports undertaken by the Bank's Internal Audit, Compliance and Anti Financial Crime departments. The Audit & Compliance Committee reviews the management letters issued by the external auditors and holds periodic meetings with them to discuss various matters including existing and potential internal control issues.

The regulatory non-compliances, if any, resulting in financial penalties are disclosed in the Annual Public Disclosures of the Bank. The Bank always enhances its internal control environment to avoid recurrence of similar penalties.

Asset and Liability Committee (ALCO) / Risk Management Committee (RMC)
ALCO / RMC is a senior management committee responsible for maintaining oversight of the Bank's risk profile and governance aspects. It helps the Risk Committee in establishing the risk policies and strategies and monitors the risk appetite in terms of risk limits and reports. It also controls the risks by appropriate actions. ALCO / RMC establishes policy and objectives for the asset and liability management of the Bank in terms of structure, distribution, risk and return and its impact on profitability. It also monitors the cash flow, cost and yield profiles and tenor of assets and liabilities and evaluates both from profit rate sensitivity and liquidity points of view, makes corrective adjustments based upon perceived trends and market conditions and monitors liquidity, foreign exchange exposures and positions.

Shari'a Supervisory Board
The Bank's Shari'a Supervisory Board is entrusted with the responsibility of ensuring the Bank's adherence to Shari'a rules and principles in its transactions and activities.

Provisioning Committee (PC)
The PC is a senior management committee responsible for ensuring adequate provisions and profit suspensions against all the past due and impaired exposures of the Bank. It reviews past due details and approve the resulting provisioning and profit suspension amounts submitted by the respective departments in line with the approved Provisioning Policy of the Bank. The PC also reviews credit classification and reclassification requests submitted by Business Units and recommends the provisions and profit suspensions to the Audit & Compliance Committee and Board of Directors for final approval.

Risk management department
The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure an independent control process. It also helps the ALCO / RMC in establishing risk strategies, policies and limits, across the Bank. The department is also responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This department also ensures the complete capture of the risks in risk measurement and reporting systems and performs stress tests on the various portfolios of the Bank.

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

37 RISK MANAGEMENT (continued)

37.1 Introduction (continued)

Internal audit
Independent, objective activity that reviews the effectiveness of risk management, internal control environment and governance processes. Internal Audit discusses the results of all assessments with the management, and reports its findings and recommendations to the Audit & Compliance Committe.

Compliance department
The compliance department is responsible for managing all the compliance related issues with the external parties and regulators.

Risk measurement and reporting systems
The Group identifies, measures, controls and monitors its material risks on a periodic basis. The Bank has established relevant risk limit structures to quantify its risk appetite. The Bank conducts stress testing under various scenarios for its material portfolios using statistical methods to assess the impact of such scenarios on its portfolio and regulatory capital.

Established risk limits reflect the business strategy and market environment in which the Bank operates as well as the level of risk that the Bank is willing to accept. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposures across its material risk types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify risks at an early stage. This information is presented and explained to the Board of Directors, the Risk Committee and senior management. The report includes aggregate credit exposures, concentration limits, investment limits, foreign exchange exposures, profit rate limits, liquidity gaps and ratios and changes in Group's risk profile. On a periodic basis, detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the general allowance for credit losses on a quarterly basis. The Board of Directors receives the risk management report once in a quarter or when needed which is designed to provide all the necessary information to assess and conclude on the risks of the Group.

As part of the Risk Management's reporting framework, tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information. Periodic briefing is given to the Managing Director and Chief Executive Officer and all other relevant members of the Bank on the utilisation of market limits, proprietary investments and liquidity and any other risk developments.

37.2 Credit risk
Credit risk is the risk that the Group will incur a loss because its customers, clients or counterparties fail to discharge their contractual obligations. The Bank manages and controls its credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions for corporate portfolio. Counterparty limits are established with the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings for corporate customers are subject to revision at the time of renewal of the corporate facility. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

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

37 RISK MANAGEMENT (continued)

37.2 Credit risk (continued)

Risk concentrations of the maximum exposure to credit risk without taking collateral

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

The maximum credit exposure to any client or counterparty as of 31 December 2017 was BD 62,684 thousand (2016: BD 62,723 thousand).

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

The table below shows the maximum exposure to credit risk for the components of the consolidated statement of financial position. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Gross maximum exposure 2017 BD 000	*Gross maximum exposure 2016 BD 000*
Balances with banks	**57,167**	48,257
Due from banks	**46,107**	88,420
Financing contracts	**737,552**	630,391
Investment in sukuk	**157,065**	163,772
Receivables and other assets	**231,277**	10,818
Total	**1,229,168**	941,658
Contingent liabilities and commitments	**135,078**	154,797
Total credit risk exposure	**1,364,246**	1,096,455

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

37 RISK MANAGEMENT (continued)

37.2 Credit risk (continued)

Risk concentrations of the maximum exposure to credit risk

The Group financial assets having credit risk, before taking into account any collateral held can be analysed by the following geographical regions:

	Middle East 2017 BD 000	*North America 2017 BD 000*	*Europe 2017 BD 000*	*Other 2017 BD 000*	*Total 2017 BD 000*
Balances with banks and Central Bank of Bahrain	41,719	15,343	85	20	57,167
Due from banks	46,107	-	-	-	46,107
Financing contracts	737,552	-	-	-	737,552
Investment in sukuk	157,065	-	-	-	157,065
Receivables and other assets	231,277	-	-	-	231,277
Contingent liabilities and commitments	135,078	-	-	-	135,078
Total	1,348,798	15,343	85	20	1,364,246

	Middle East 2016 BD 000	*North America 2016 BD 000*	*Europe 2016 BD 000*	*Other 2016 BD 000*	*Total 2016 BD 000*
Balances with banks and Central Bank of Bahrain	42,675	5,427	137	18	48,257
Due from banks	88,420	-	-	-	88,420
Financing contracts	630,391	-	-	-	630,391
Investment in sukuk	163,772	-	-	-	163,772
Receivables and other assets	10,818	-	-	-	10,818
Contingent liabilities and commitments	154,797	-	-	-	154,797
Total	1,090,873	5,427	137	18	1,096,455

An industry sector analysis of the Group's financial assets having credit risk, before taking into account collateral held or other credit enhancements, is as follows:

	Trading and manufacturing 2017 BD 000	*Banking and financial institutions 2017 BD 000*	*Construction and real estate 2017 BD 000*	*Other 2017 BD 000*	*Total 2017 BD 000*
Balances with banks and Central Bank of Bahrain	-	57,167	-	-	57,167
Due from banks	-	46,107	-	-	46,107
Financing contracts	74,239	12,262	427,140	223,911	737,552
Investment in sukuk	-	136,179	20,886	-	157,065
Receivables and other assets	-	2,655	5,574	223,048	231,277
Contingent liabilities and commitments	66,350	-	8,983	59,745	135,078
Total	140,589	254,370	462,583	506,704	1,364,246

37 RISK MANAGEMENT (continued)

37.2 Credit risk (continued)

Risk concentrations of the maximum exposure to credit risk (continued)

	Trading and manufacturing 2016 BD 000	*Banking and financial institutions 2016 BD 000*	*Construction and real estate 2016 BD 000*	*Other 2016 BD 000*	*Total 2016 BD 000*
Balances with banks and Central Bank of Bahrain	-	48,257	-	-	48,257
Due from banks	-	88,420	-	-	88,420
Financing contracts	31,662	16,214	436,425	146,090	630,391
Investment in sukuk	-	142,963	20,809	-	163,772
Receivables and other assets	828	2,575	6,298	1,117	10,818
Contingent liabilities and commitments	27,322	-	30,673	96,802	154,797
Total	59,812	298,429	494,205	244,009	1,096,455

Collateral and other credit enhancements

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

The main types of collateral obtained by the Bank are as follows:

- For commercial financing, lien over investment accounts, charges over real estate properties, inventory, trade receivables and unlisted equities; and
- For retail and consumer financing, lien over investment accounts, and mortgages over the related assets.

The Bank also obtains personal guarantees from companies owners for commercial financing obtained. Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained periodically during its review of the adequacy of the allowance for impairment losses.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank using internal credit gradings. These internal credit gradings are assigned to each individual borrower. They are defined as follows:

Good

Good credits are those, which are performing, as the contract requires. There is no reason to suspect that the creditor's financial condition or collateral adequacy has depreciated in any way.

Watchlist

Watchlist facilities include:-

- all past due deals which fall within the bracket of (1-90) days, excluding restructured deals;
- facilities which are more than ninety days past due, however, management, for reasons such as the availability of sufficient collateral after haircut, and other reasons, is confident that no losses will be incurred and as a result is not carrying any provisions on these facilities;

37 RISK MANAGEMENT (continued)

37.2 Credit risk (continued)

Rescheduled
This includes all restructured facilities / deals due to financial distress at the time of restructuring (now performing), regardless of any specific provisions.

Substandard
Substandard credits are inadequately protected by the repayment capacity of the obligor or by the collateral pledged. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets does not have to exist in individual assets classified as substandard. They may include facilities in past due for more than 90 days which are not classified as doubtful or loss (based on management's assessment).

Doubtful
Doubtful credits have all the weaknesses inherent in a credit classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable or improbable. They may include facilities in past due for more than 180 days but less than 365 days (based on management's assessment).

Loss
Loss facilities are considered uncollectible and of such little value that their continuance as assets is not warranted. Total loss is expected for loss credits however if management has reasons to believe that it could recover the exposure in full and no shortfalls are anticipated based on financial strength of the customers and/or collaterals provided, write off may be deferred. They may include facilities in past due for more than 365 days (based on management's assessment).

Credit quality per class of financial assets

	Good 2017 BD 000	Watchlist 2017 BD 000	Rescheduled 2017 BD 000	Sub-standard 2017 BD 000	Doubtful 2017 BD 000	Loss 2017 BD 000	Total 2017 BD 000
Balances with banks	57,167	-	-	-	-	-	57,167
Due from banks	46,107	-	-	-	-	-	46,107
Financing contracts (gross)	560,104	80,345	59,309	41,891	1,537	25,789	768,975
Investment in sukuk	157,065	-	-	-	-	-	157,065
Receivables and other assets (gross)	268,994	-	-	-	-	5,745	274,739
Total	1,089,437	80,345	59,309	41,891	1,537	31,534	1,304,053

	Good 2016 BD 000	Watchlist 2016 BD 000	Rescheduled 2016 BD 000	Sub-standard 2016 BD 000	Doubtful 2016 BD 000	Loss 2016 BD 000	Total 2016 BD 000
Balances with banks	48,257	-	-	-	-	-	48,257
Due from banks	88,420	-	-	-	-	-	88,420
Financing contracts (gross)	495,731	41,825	68,150	28,442	2,715	31,627	668,490
Investment in sukuk	163,772	-	-	-	-	-	163,772
Receivables and other assets (gross)	10,210	-	-	-	-	5,345	15,555
Total	806,390	41,825	68,150	28,442	2,715	36,972	984,494

37 RISK MANAGEMENT (continued)

37.2 Credit risk (continued)

Credit quality per class of financial assets (continued)

Rescheduled, substandard, doubtful and loss categories are secured with collateral amounting to BD 245,640 thousand (2016: BD 250,050 thousand), BD 179,170 thousand (2016: BD 77,865 thousand), BD 3,420 thousand (2016: nil) and BD 89,378 thousand (2016: BD 95,170 thousand) respectively. The utilisation of the above collaterals will be on a customer by customer basis and will be limited to the customer's total exposure.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographical regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's rating policy. The attributable risk ratings are assessed and updated regularly for corporate customers.

Aging analysis of watchlist facilities

	Less than 30 days 2017 BD 000	***31 to 60 days 2017 BD 000***	***61 to 90 days 2017 BD 000***	***More than 90 days 2017 BD 000***	***Total 2017 BD 000***
Financing contracts	**37,345**	**20,936**	**22,064**	**-**	**80,345**

	Less than 30 days 2016 BD 000	*31 to 60 days 2016 BD 000*	*61 to 90 days 2016 BD 000*	*More than 90 days 2016 BD 000*	*Total 2016 BD 000*
Financing contracts	18,277	20,999	2,549	-	41,825

The estimated value of collateral held by the Bank against watchlist facilities amounts to BD 139,645 thousand (2016: BD 164,335 thousand). The utilisation of the above collaterals will be on a customer by customer basis and will be limited to the customer's total exposure.

Impairment assessment

The main considerations for the impairment assessment include whether any payments of principal or profit are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract.

37 RISK MANAGEMENT (continued)

37.2 Credit risk (continued)

Individually assessed provisions
The Group determines the provisions appropriate for each individually significant financing contract on an individual basis. Items considered when determining provision amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support, the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed provisions
Provisions are assessed collectively for losses on financing contracts that are not individually significant and for individually significant financing contract where there is not yet objective evidence of individual impairment. Provisions are evaluated on each reporting date with each portfolio subjected to a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment provision, and expected receipts and recoveries once impaired. Management is responsible for deciding the length of this period which can extend for as long as one year. The impairment provision is then reviewed as a part of the credit management framework to ensure alignment with the Group's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for financing contracts.

37.3 Liquidity risk and funding management
Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management arranges diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Group maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Group also has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains a mandatory reserve with the Central Bank of Bahrain equal to 5% of customer deposits denominated in Bahrain Dinars, excluding deposits from resident subsidiaries. The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank. The most important of these is to maintain limits on the ratio of liquid assets to customer liabilities. Liquid assets comprise of cash and balances with banks and Central Bank of Bahrain, due from banks, investment in quoted securities and liquid sukuk. Customer liabilities comprise of customers' current accounts, investment accounts and murabaha due to non-banks. The ratios during the year were as follows:

	2017	*2016*
	%	*%*
31 December	**29.60**	34.86
During the year:		
Average	**30.78**	30.96
Highest	**36.32**	35.45
Lowest	**25.83**	25.05

37 RISK MANAGEMENT (continued)

37.3 Liquidity risk and funding management (continued)

Analysis of financial liabilities and equity of investment account holders by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities and equity of investment account holders at 31 December 2017 and 2016 based on contractual undiscounted repayment obligations. Maturity analysis of assets, liabilities and equity of investment account holders by expected maturities is disclosed in Note 36. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

	On demand BD 000	*Less than 3 months BD 000*	*3 to 12 months BD 000*	*1 to 5 years BD 000*	*Over 5 years BD 000*	*Total BD 000*
At 31 December 2017						
Due to banks and financial institutions	137	276,387	31,002	20,963	-	328,489
Cutomers' murabaha accounts	-	44,237	29,188	1,100	-	74,525
Customers' current accounts	135,098	-	-	-	-	135,098
Other liabilities	-	14,737	4,408	3,956	-	23,101
Equity of investment account holders	206,356	173,388	99,050	390	-	479,184
Subordinated wakala payable	-	-	-	103,524	-	103,524
Total undiscounted financial liabilities 2017	**341,591**	**508,749**	**163,648**	**129,933**	**-**	**1,143,921**
At 31 December 2016						
Due to banks and financial institutions	740	213,464	115,287	132,337	-	461,828
Cutomers' murabaha accounts	-	1,256	61,645	-	-	62,901
Customers' current accounts	147,630	-	-	-	-	147,630
Other liabilities	-	32,116	4,094	5,709	-	41,919
Equity of investment account holders	190,813	177,926	73,096	43	-	441,878
Subordinated wakala payable	-	-	-	97,326	-	97,326
Total undiscounted financial liabilities 2016	339,183	424,762	254,122	235,415	-	1,253,482

Contingent liabilities and commitments

These include commitments to enter into contracts which are designed to meet the requirements of the Group's customers. Commitments represent contractual commitments under murabaha, musharaka and ijarah muntahia bittamleek contracts. Commitments generally have fixed expiration dates, or other termination clauses. Since commitments may expire without being exercised, the total contract amounts do not necessarily represent future cash flow requirements.

Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract

37 RISK MANAGEMENT (continued)

37.3 Liquidity risk and funding management (continued)

Contingent liabilities and commitments (continued)

The table below shows the contractual expiry by maturity of the Group's credit commitments and contingent items.

	On demand BD 000	*Less than 3 months BD 000*	*3 to 12 months BD 000*	*1 to 5 years BD 000*	*Total BD 000*
At 31 December 2017					
Letters of credit	**5,201**	**-**	**20,335**	**-**	**25,536**
Guarantees	**11,076**	**-**	**-**	**-**	**11,076**
Irrevocable commitments to extend credit	**-**	**5,170**	**67,627**	**25,152**	**97,949**
Development commitment	**-**	**-**	**517**	**-**	**517**
Total	**16,277**	**5,170**	**88,479**	**25,152**	**135,078**
At 31 December 2016					
Letters of credit	764	-	8,332	-	9,096
Guarantees	14,524	-	-	-	14,524
Irrevocable commitments to extend credit	-	97,907	7,402	25,768	131,077
Investment commitment	-	-	100	-	100
Total	15,288	97,907	15,834	25,768	154,797

The Group does not expect any material loss in respect of the above.

37.4 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as profit rates, foreign exchange rates, and equity prices. The Group manages and monitors the positions using sensitivity analysis.

Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Bank measures the profit rate risk by measuring and managing the repricing gaps. It also performs sensitivity analysis.

The following table demonstrates the sensitivity to reasonably possible change in profit rates, with all other variables held constant of the Group's consolidated statement of income. The sensitivity of the consolidated statement of income is the effect of the assumed changes in profit rates on the consolidated net income for the year, based on the non-trading financial assets and financial liabilities held as at the date of statement of financial position.

37 RISK MANAGEMENT (continued)

37.4 Market risk (continued)

Profit rate risk (continued)

The effect of decrease in basis points is expected to be equal and opposite to the effect of the increase shown.

	2017 ***BD 000***	***Change in basis points***	***Effect on net income for the year*** ***BD 000***
ASSETS			
Due from banks	**46,107**	**+25**	**115**
Financing contracts	**581,382**	**+25**	**1,453**
Investment in sukuk	**157,065**	**+25**	**393**
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS			
Due to banks and financial institutions	**325,084**	**+25**	**(813)**
Customers' murabaha accounts	**73,609**	**+25**	**(184)**
Subordinated wakala payable	**94,250**	**+25**	**(236)**
Equity of investment account holders	**477,676**	**+25**	**(1,194)**
Total			**(466)**

	2016 *BD 000*	*Change in basis points*	*Effect on net income for the year* *BD 000*
ASSETS			
Due from banks	88,420	+25	221
Financing contracts	500,041	+25	1,250
Investment in sukuk	163,772	+25	409
LIABILITIES AND EQUITY INVESTMENT ACCOUNT HOLDERS			
Due to banks and financial institutions	452,960	+25	(1,132)
Customers' murabaha accounts	62,221	+25	(156)
Subordinated wakala payable	91,242	+25	(228)
Equity of investment account holders	441,244	+25	(1,103)
Total			(739)

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank has established Value at Risk limit for foreign currency exposures. This limit is monitored on a regular basis by the risk management department and reported to the ALCO / RMC.

37 RISK MANAGEMENT (continued)

37.4 Market risk (continued)

Currency risk (continued)

The Group had the following significant net exposures denominated in foreign currencies as of 31 December:

	Equivalent long (short) 2017 BD 000	*Equivalent long (short) 2016 BD 000*
Currency		
KWD	**(351)**	36
GBP	**(5)**	(95)
EUR	**(108)**	(160)

The table below indicates the currencies to which the Group had significant exposure at 31 December on all its monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Bahraini Dinar, with all other variables held constant, on the consolidated statement of income.

The effect of decreases in currency rate is expected to be equal and opposite to the effect of the increases shown.

	Change in currency rate %	***Effect on profit 2017 BD 000***	***Effect on equity 2017 BD 000***	*Change in currency rate %*	*Effect on profit 2016 BD 000*	*Effect on equity 2016 BD 000*
KWD	+20	**(70)**	-	+20	7	-
GBP	+20	**(1)**	-	+20	(19)	-
EUR	+20	**(22)**	-	+20	(32)	-
Total		**(93)**	-		(44)	-

Equity price risk

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

The effect on income and equity (as a result of a change in the fair value of equity instruments at 31 December 2017) due to a reasonably possible change (i.e. +10%) in the value of individual investments, with all other variables held constant, is BD 174 thousand and BD 964 thousand (2016: BD 13,936 thousand and BD 698 thousand) respectively, except in cases where impairment loss occured which will result in decrease being taken to the consolidated statement of income. The effect of decrease in the value of individual investments is expected to be equal and opposite to the effect of the increase shown.

37.5 *Prepayment risk*

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier than expected. The Group is not exposed to any significant prepayment risk.

37 RISK MANAGEMENT (continued)

37.6 *Real estate investment price risk*

Real estate investment price risk is the risk that the fair values of real estate investments decrease as a result of downfall in the real estate market. The real estate investment price risk exposure arises from Group's holding of real estate investments (land and buildings).

The effect on income due to a reasonably possible change (i.e. +15%) in the value of individual investments in real estate, with all other variables held constant, is nil (2016: BD 45,234 thousand). The effect of decrease in the value of individual investment is expected to be equal and opposite to the effect of the increase shown.

37.7 *Operational risk*

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks. The Bank has implemented Risks Controls and Self Assessment process (RCSA) whereby each of the units identifies risks in processes, key risk indicators and implemented controls. The key risk indicators values and actual incidents to the operational risk unit are reported to senior management for action. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

38 CAPITAL MANAGEMENT

The Group maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") and adopted by the Central Bank of Bahrain in supervising the Group. The Bank has also implemented the Internal Capital Adequacy and Assessment Plan (ICAAP) as per the CBB guidelines based on Pillar II recommendations of the Basel Committee. The Bank had identified the capital requirement for future three years based on the Bank's projected financials and the risk charges required for its significant risks including credit risk, market risk, profit rate risk, liquidity risk, investments risks and operational risks. The Board of Directors, on an annual basis, review and approve the ICAAP plan for both normal and stress conditions.

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains healthy capital ratios in order to support its business and to maximise shareholders' value.

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

38 CAPITAL MANAGEMENT (continued)

Regulatory capital and risk-weighted assets

The regulatory capital and risk-weighted assets have been calculated in accordance with Basel III as adopted by the CBB.

	Note	*2017* *BD 000*	*2016* *BD 000*
Common equity Tier 1 capital	38.1	**173,703**	354,118
Tier 2 capital	38.2	**92,259**	77,041
Total capital		**265,962**	431,159
Credit risk-weighted assets		**888,069**	2,240,238
Market risk-weighted assets		**31,715**	35,320
Operational risk-weighted assets		**176,254**	188,659
Total risk weighted assets		**1,096,038**	2,464,217
Capital adequacy ratio		**24.3%**	17.5%
Minimum requirement		**12.5%**	12.5%

38.1 Common equity Tier 1 capital comprises of share capital, share premium, general reserve, statutory reserve and retained earnings, less unrealised loss arising from fair valuing equities.

38.2 Tier 2 capital comprises of subordinated wakala payable, collective impairment provision and asset revaluation reserves. Certain adjustments are made to AAOIFI-based results and reserves, as prescribed by the Central Bank of Bahrain.

39 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

The Group did not receive any significant income or incur significant expenses which were prohibited by the Shari'a.

40 SOCIAL RESPONSIBILITY

The Bank discharges its social responsibilities through donations to charitable causes and organisations approved by Shari'a Supervisory Board.

41 COMPARATIVE FIGURES

Certain of the prior year figures have been reclassified to conform to the presentation adopted in the current year. Such reclassification does not affect previously reported net income or owners' equity.