Annual Report 2016

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Bringing Banking to Life

2016

بيت التمويل الكويتي

Kuwait Finance House

Bahrain B.S.C.(c)

Licensed as an Islamic Retail Bank by the Central Bank of Bahrain

His Royal Highness
Prince Khalifa bin Salman
Al Khalifa
The Prime Minister

His Majesty
King Hamad bin Isa
Al Khalifa
The King of the Kingdom of Bahrain

His Royal Highness
Prince Salman bin Hamad
Al Khalifa
The Crown Prince, First Deputy
Prime Minister and Deputy
Supreme Commander

Best Wealth Management Bank in the Middle East 2016
KFH-Bahrain

Best Corporate Bank in the Middle East 2016
KFH-Bahrain

Pioneer Award in Islamic Banking to KFH-Bahrain from the GIFA 2015
KFH-Bahrain

'Best New Retail Financial Product" 2014
Tamweely Personal Finance

'Best Personal Finance' Award 2014
Tamweely

Best Investment Advisory Service for Three-Way Banker Merger
CPI Financial Banker Middle East Product Awards 2013
KFH-Bahrain

Received Gold Award for KFHB Website for 'Best Navigation' through the Communicator Awards program 2013
KFH-Bahrain

Silver Award for KFHB Website for 'Best in Financial Services' through the Communicator Awards program 2013
KFH-Bahrain

Received Gold Award for KFHB Website for 'Bank Standard of Excellence' through the Web Marketing Award program 2013
KFH-Bahrain

Received Award for KFHB Website for 'Bahrain eContent Award 2013' for its Responsive Website in the eBanking category 2013
KFH-Bahrain

Received Award for the 'Institutional Excellence' Award at the 20th WIBC for being the Lead and Transaction Advisor for the three way bank merger in Bahrain 2013
KFH-Bahrain

The Best Real Estate Investment
Islamic Business and Finance Awards 2012
Diyar Homes

Best Islamic Bank in Bahrain
Islamic Finance News Awards 2011
KFH-Group

Best Mobile Application
Bahrain eContent Award 2011
KFH-Bahrain

Best Investment Product
Banker Middle East 2011
Baytik Industrial Oasis

Best Investment Product
Banker Middle East 2010
Menatelecom

Best Islamic Covered Card
Banker Middle East 2010
Baytik Ijara

Best Islamic Wealth Management
Islamic Business & Finance Awards 2009
Priority Banking

Best Project Finance House
Banker Middle East Industry Awards 2008
Corporate Finance

Best Retail Brand
World Islamic Banking Conference Awards 2008
KFH-Group

Best New Product
Islamic Business & Finance Awards 2008
Priority Banking

Best New Product
Islamic Business & Finance Awards 2007
Durrat Al Bahrain

Kuwait Finance House-Bahrain

Annual Report 2016

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Bringing Banking to Life

Vision

At KFH-Bahrain we believe that banking is not just about money. For us it is something that can improve people's lives. Whether we are providing commercial and investment banking services or financial products for consumers, we start by understanding our customers and their needs. With an emphasis on innovation, we aim to provide cutting edge Islamic banking solutions while staying faithful to Shari'a principles, with a view to enhancing the lives of our customers.

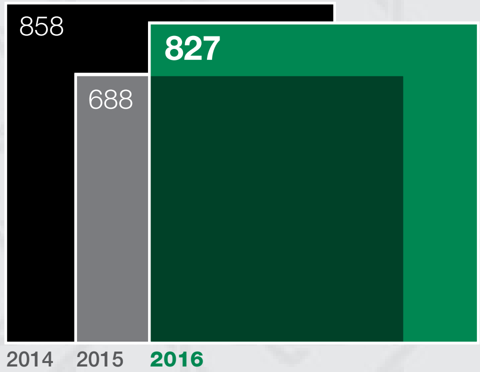
Mission

It is our mission to "Bring Banking to Life" by focusing on innovation, thinking outside the box and insisting on excellence in everything we do. This includes the development and provision of a wide range of integrated products and services in perfect harmony with Shari'a principles. Our mission and our commitment are backed by a robust financial position and a long and proven heritage of ingenuity, innovation and integrity.

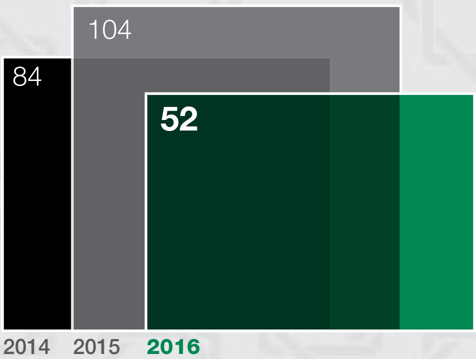
KFH-Bahrain is a wholly-owned subsidiary of KFH-Kuwait who manages its operations in the GCC, Asia, and Europe through over 310 branches. The Group offer services to clients in Kuwait, Bahrain, Turkey, Malaysia and Manheim in Germany.

NET INCOME
BD Million

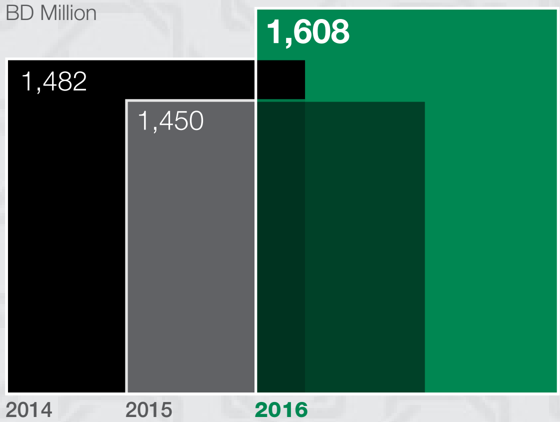
CUSTOMERS DEPOSITS
BD Million



OPERATING INCOME AFTER DIRECT COSTS
BD Million



TOTAL ASSETS
BD Million



Profile

Kuwait Finance House-Bahrain ("KFH-Bahrain" or the "Bank"), is a leading provider of Islamic retail commercial and investment banking services. Established in 2002 as a wholly owned subsidiary of Kuwait Finance House-Kuwait, a global industry leader, KFH-Bahrain specialises in conceptualising the development and introduction of innovative, Shari'a compliant banking and investment products.

KFH-Bahrain enjoys a reputation as a performance-driven, results-oriented institution, combining global investment strategies with the provision of popular retail products and services. KFH-Bahrain has made major advances and experienced considerable growth in the last few years, allowing it to further develop its products and services and provide outstanding investment opportunities for its customers.

At the forefront of the investment and finance sectors, KFH-Bahrain has developed a series of successful projects and made further investments in diverse sectors of the economy.

KFH-Bahrain is continuing its strategy of innovation and change and is committed to setting new standards for Islamic banking and finance. Such a strategy will reaffirm KFH-Bahrain's status as a market leader, enhancing its continued contribution to the economic growth and social development of the Kingdom of Bahrain.

Hamad Abdulmohsen Al-Marzouq
Chairman

Chairman’s Statement

In the name of Allah, the most gracious, the most Merciful.

Peace and Blessings be upon the Last Prophet & Messenger Muhammad, His Household and His Companions.

On behalf of the Board of Directors (the “Board”), it gives me great pleasure to present the 2016 Annual Report of Kuwait Finance House - Bahrain (the “Bank”).

Moving ahead

During 2015, the Board approved a new strategy which paved the way for a better and stronger KFH presence in the Kingdom of Bahrain. In 2016, the Board continued with this strategy primarily focusing on closer group coordination, developing inter-group synergies, transforming the business to achieve efficient usage of capital, further differentiating our banking products & services, achieving enhanced efficiency in operations by optimizing costs and creating a strong balance sheet with sustainable income streams.

Financial Results – Growth with caution

We are pleased to report that in 2016, the balance sheet grew significantly from BD1.45bn to BD1.61bn representing an increase of +11.0% year on year. This was principally achieved through a strong performance of our commercial banking activities which saw ‘Financing with Customers’ increase from BD535m to BD630m representing an increase of +17.8% year on year. Customer deposits also grew strongly from BD688m to BD827m in the year representing an increases of +20.2%.

Corporate and Retail Banking Group – Building sustainable income streams

In 2016, the Corporate Finance team was able to secure in excess of BD163m of new business with an ongoing healthy pipeline of additional deals being processed at various stages. We also focused on increasing our ‘Fee Based Income’ as a key revision of the way in which we structure deals to improve competitiveness and return on equity. We further invested in automation and process standardization to lower the cost of operations and improve the speed at which transactions are processed to enhance the overall customer experience.

In 2016, the Corporate Finance team was able to secure in excess of BD163m of new business with an ongoing healthy pipeline of additional deals being processed at various stages. We also focused on increasing our ‘Fee Based Income’ as a key revision of the way in which we structure deals to improve competitiveness and return on equity.

In response to the needs of our customers we also invested in the introduction of new products such as the 'Corporate Credit Card' and the corporate 'Escrow Account'. Finally, we significantly increased collaboration with our parent company, Kuwait Finance House – Kuwait, to integrate systems, product features and cross-referrals so that our customers can further benefit from our global presence. We are also pleased to announce that the Bank won the "Best Corporate Bank in the Middle East" Awards from CPI Financial at the prestigious 'Islamic Business & Finance' Awards.

With respect to Retail Banking team, we were pleased to introduce the new 'Wakala Profit Sharing Investment Account' where we are appointed by our clients to undertake an investment transaction on their behalf, without any fees, for an agreed term whilst providing monthly distributed profit at an anticipated rate. In addition, our 'Libshara Savings Account', which has seen consistent year on year growth, was further enhanced through the introduction of newly defined segments in support of particular products or service campaigns.

On the financing side, our 'Mazaya Social Housing Finance Scheme' has enjoyed tremendous success with continued significant growth expected in the future. Through this programme, the Bank was the first to sign agreements in conjunction with Eskan Bank to provide financing for the 'Danat Al Seef' and 'Danat Al Riffa' projects as well as the 'Hamad Town Villas' project.

In terms of our Banking operations, we opened a new branch in the highly successful 'Dragon City Mall' as part of the 'Diyar Al Muharraq' project as well as opening new ATM sites in five further locations across Bahrain in response to our customer's needs. Finally, we have been focusing on a competitive fee structure for our clients and have also seen our Credit Card offering and utilization grow significantly.

Treasury & Capital Markets

The Treasury & Capital Markets department enjoyed a particularly successful year. The sovereign sukuk portfolio increased significantly with a year on year growth of approximately 175% (from $137m in 2015 to $377m in 2016). This not only supported KFH Bahrain's profitability but also its liquidity coverage ratio which stood at 108% as of December 2016 (being well above the regulatory requirement).

Furthermore the Bank was privileged to be engaged in the financing of two key local projects in Bahrain namely Nogaholding's $570m syndicated Murabaha Financing and Alba's $1.5bn Line 6 expansion project where the Bank participated in the capacity of 'Mandated Lead Arranger' and 'Lead Arranger' respectively.

Investment- Participation in shaping Bahrain for a better future

KFH Bahrain continues to be recognized for its ground breaking and iconic real estate developments which support the growth of the country and our customer base. We are committed as part of our new strategy to further focus on our commercial banking activities by bringing to fruition the benefits of these large projects so that our core Banking activities can come to the fore.

Our Investment Banking teams have therefore accelerated their activities in the year to exit or otherwise develop these key projects, through our Real Estate specialized subsidiaries, such as the 'Diyar Al Muharraq Project Habitat' development and divesting key parcels of land within the same development to prominent and well established developers. One case in point saw our participation in the well-received launch of the 'Marasi Al Bahrain Residence' consisting of three towers adjacent to an exceptional beach side development. 'Diyar Homes' also achieved a 70% hand over of their Phase 1 villas to their owners (which are now fully sold). In addition, our support of the 'Durrat Al Bahrain' project saw the successful handover of a number of the new Petal 4 & Petal 5 villas (which are also now fully sold).

Finally, the Investment team has worked hard to restructure some of the key investment assets in our portfolio in close consultation with our parent company which will show overall improvements in 2017.

Shari'a Compliant Wealth Management services and Private Banking

In 2016, our Wealth Management team built on the success of 2015 by further enhancing their product offerings. We received "Best Wealth Management" in the Middle East Awards from CPI Financial as recognition for outstanding performance since the launch of the department. Furthermore, approval was obtained for the discretionary & non-discretionary equities portfolios as well as the sukuk and real estate based products. Work also continued on installing a market leading IT system to support the operations of the portfolio and service offerings.

Risk and Capital Management – Maximizing risk adjusted return in a rapidly changing regulatory landscape

The Bank has embedded a strategy to optimize capital utilization in order to achieve improved returns on equity by reducing exposures to high risk assets. The Bank has also undertaken an International Financial Accounting Standard # 9 (IFRS 9) implementation project along with the group in order to enhance the risk modelling and impairment process. Furthermore, the Bank has implemented a 'Risk Adjusted Return on Capital (RAROC)' framework for sustained achievement of returns.

Group Integration – Building synergies and linkages with KFH entities

In 2016, KFH Group further enhanced their integration programme across all the subsidiary entities in particular conducting the group strategy offsite meetings to establish enhanced visions, values and objectives to prepare the Bank for the challenges and opportunities to come. This helped KFH Bahrain to further deepen its understanding of the key issues faced locally, regionally and internationally and the key steps that would be taken to address them in a profitable, responsible and sustainable manner. The key outcomes are the subject of detailed implementation plans with the teams benefitting from the stronger ties that have been created.

Employees - Nurturing and building human capital

In 2016, KFH Bahrain was pleased to participate in a Group wide 'Employee Engagement and Empowerment Survey' to assess the needs of our staff and assist our managers to develop strategies to improve performance. The outcomes were received very well by all the staff and we are now in a process to seek ways to further improve the scores and benefit from the learning points.

Community Service – Deepening social ties

During 2016, we continued to support the Islamic Banking and Finance sector in Bahrain by participating in various regional and global Banking and Finance conferences and forums. We maintained our annual commitment to a range of initiatives in education, sports, health and community related activities and initiatives. Our aim, as with every year, is to actively contribute to the society with comprehensive Corporate Social Responsibility (CSR) programmes.

Adherence to Islamic Principles – A way of life

On behalf of the Bank's Board of Directors I once again am pleased to recognize the excellent work of our Fatwa and Shari'a Supervisory Board comprising of the well-respected scholars Shaikh Dr. Mohammed Al-Tabatabee (Chairman), Shaikh Dr. Anwar Shuaib Abdulsalam (Member) and Shaikh Dr. Mubarak Jazaa Al-Harbi (Member) who continued to work tirelessly to ensure the Banks products and services adhere to Islamic principles, supported by a hard working professional team within the Bank.

Outlook – Moving forward

2016 saw some momentous and clearly tumultuous developments some of which the world is struggling to fully comprehend. These have led to additional uncertainties being created for the foreseeable future. KFH Group has invested in its people and processes to ensure that we are always able to respond tactically and strategically to the challenges and opportunities that these uncertainties will create from time to time. A key pillar will always be to focus on our local markets and in particular participate to support the various initiatives and needs at the Governmental level whether this means responding positively to regulatory enhancements or seeking to support infrastructure initiatives; KFH Group will always seek to act as a trusted partner for the betterment of society as a whole. As we seek to further optimize our balance sheet and capital structure and improve our key performance ratios we will continue to invest in strengthening our market presence and increase our reach to customers and servicing their needs.

With gratitude

On behalf of the Board and management, with deep gratitude, I thank His Majesty King Hamad bin Isa Al Khalifa, His Royal Highness Prince Khalifa bin Salman Al Khalifa, the Prime Minister, His Royal Highness Prince Salman bin Hamad Al Khalifa, The Crown Prince, Deputy Supreme Commander and First Deputy Prime Minister. I would also like to thank his Excellency the Governor of the Central Bank of Bahrain for their valuable support and direction and the various ministries of the Government of Bahrain.

I once again thank our respected stakeholders for their continued support, our customers and business partners for their trust and loyalty, and the management and staff for their continued dedication and professionalism.

May Allah grant everyone the best in this Life and the Hereafter.
May the peace, mercy and blessings of Allah be upon you.

Hamad Abdulmohsen Al-Marzouq
Chairman

Hamad Abdulmohsen Al-Marzouq
Chairman

Mohammad Naser Al Fouzan
Vice Chairman

Abdulwahab Isa Alrushood
Board Member

Shadi Ahmad Zahran
Board Member

Mahmoud Difrawy
Board Member

Abdullah A. Al-marzouq
Board Member

Noorur Rahman Abid
Board Member

Khalid Mohamed Alsaad
Board Member

Abdulhakeem Y. Alkhayyat
Managing Director & CEO

Board of Directors

Sheikh Dr. Mohammed Abdul Razaq Al-Tabtabaee
Chairman

Sheikh Dr. Mubarak Jazaa Al-Harbi
Member

Sheikh Dr. Anwar Shuaib Al-Abdulsalam
Member

Fatwa and Shari'a Supervisory Board


Abdulhakeem Y. Alkhayyat
Managing Director & CEO


Isa Al Duwaishan
Executive Manager – Shari'a Advisor


Abdul Razak Jawahery
Executive Manager


Ahmad Saeed
Executive Manager


Khalid Al Maarafi
Executive Manager


Lilian Le Falher
Executive Manager


Mohammed F. Hamad
Executive Manager


Paul Mercer
Executive Manager


Sattam Algosaibi
Executive Manager


Yousif Al-Hammadi
Executive Manager


Amit Yashpal
Executive Manager

Executive Management

Raed Ajawi
Senior Manager
Internal Audit

Mazar Jalal
Senior Manager
Compliance

Alya AlShakhoory
Senior Manager
Anti Financial Crimes

Senior Management

Retail Banking Group

The retail banking and finance services provided by KFH-Bahrain combine a broad range of innovative products and services with exceptional customer care.

Bahrain World Trade Center Branch (Main Branch)

Arad Branch

East Riffa Branch

Automall Sitra Branch

Muharraq Branch

Adliya Branch

Exhibition Road Branch

West Riffa Branch

Isa Town Branch

Our Branches

Our growth and success is driven by our determination to always excel in the services that we offer. We continue to provide superior Shari'a compliant products that are innovative and in line with our customer needs. This forms the core of everything we do and everything we stand for.

Innovation and Quality Shaping the Core of Retail Banking & Financial Services

The retail banking and finance services provided by KFH-Bahrain combine a broad range of innovative products and services with exceptional customer care. Our product and financing facilities are developed with the aim of providing for the long term needs of customers in the local market. Our growth is driven by the determination to continuously improve our service quality, while thinking innovatively and striving to deliver superior Islamic Shari'a compliant products remain at the core of all we do.

Innovative products are constantly being introduced for the benefit of our customers. These range from technology and service enhancement that provide greater access to information and funds, both locally and internationally, to the launch of our unique, never-before-seen products.

Our Tamweely product is the first of its kind Shari'a compliant Tawarruq personal finance facility whereby the client experiences every step of the Tawarruq process in real-time. It is based on international commodity murabaha (palm oil) in Bursa, Malaysia. In recognition of its innovative development, Tamweely was awarded with the "Best Personal Finance" and "Best New Retail Financial Product" awards issued by CPI Financials Banker Middle East Product Awards Bahrain 2014.

Well into its fifth successful year, Libshara Savings account continues to offer its depositors valuable prizes. In this year's edition, the account holders have had the chance to win one of 3 luxurious villas at Ishbiliya Village, 3 Luxurious Cars, and 6 Monthly Salaries for one year in addition to instant monthly cash prizes.

The "Wakala Investment Account" is designed according to the Islamic Shari'a principle of Al Wakala. The client appoints the Bank to perform a transaction, without any fees for an agreed upon anticipated profit rate, with a monthly profit distribution mechanism, whereby the Bank invests the deposits in the general portfolio.

The "Mazaya" Programme is the social housing finance scheme between Ministry of Housing and Kuwait Finance House-Bahrain whereby Beneficiaries have the opportunity to own their dream home through a real estate finance facility subsidized by the Government of Bahrain. In line with the Bank's commitment towards social responsibility, this programme provides KFH-Bahrain the opportunity to participate with the Government in catering towards the mass housing demands.

During the year, we expanded our branch network to include our newest additional branch in The Dragon Mall, Diyar Al Muharraq expanding our branches network to 10 branches. In addition, our ATM network coverage has increased with new machines being installed in major residential, financial and shopping districts, including prime locations such as the Dragon Mall in Diyar Al Muharraq, Seef Mall in Muharraq, Arjan Village, Royal University for Woman, and Al Sherooq Petrol Station bringing the current total to 31.

The KFH Automall showroom is considered to be one of the largest in Bahrain to date and is located in Sitra. The showroom provides a unique automotive and marine shopping experience, while also benefitting from a fully-fledged KFH-Bahrain branch within its facility. KFH Automall provides its customers with the convenience of a 'one stop shop' service for financing, insurance, registration, auto services and others, all under one roof.

Given its nature and involvement, the Treasury & Capital Markets Department is exposed to external parties including financial institutions and sovereign/quasi-sovereign entities, while having internally a strong connection with the parent company in Kuwait.

The team enjoyed a successful year. In charge of monitoring in terms of liquidity, funding and foreign exchange across the Bank, the department manages treasury lines and relationships with financial institutions regionally within the GCC and internationally that includes Europe and South East Asia.

As part of the key milestones reached, the department substantially grew KFH-Bahrain's sovereign exposure. Mandated with managing the Bank's sukuk portfolio, the department had the sovereign sukuk holding increased significantly with a year-on-year size growth of close to 175% (from $137m in 2015 to $377m in 2016). This not only supported KFH-Bahrain's profitability but also its liquidity coverage ratio which stood at 108% as of December 2016 (being well above the regulatory requirement).

Furthermore KFH-Bahrain engaged in leading roles in relation to key projects in Bahrain through its participation in local financing transactions.

Treasury & Capital Markets

The Corporate Banking Group (CBG), strives to provide excellent customer services through Shari'a compliant solutions. It is with a thorough understanding of customer requirements aligned with a comprehensive understanding of the customers' businesses and their needs, that our team of professionals is able to tailor financing facilities to aid business sustainability and growth. With expertise in various market sectors, the CBG team is able to understand business trends, specific business characteristics of each sector and its requirements.

Through its innovative range of Shari'a compliant financing instruments which include Murabaha, Ijara, Istisna'a, as well as Commodity and Convertible Murabaha facilities, the CBG has continued to strongly service the requirements of large corporations as well as small and medium enterprises in the Kingdom of Bahrain across all industry sectors using various facility structures which include the following:

- Real Estate Financing
- Project Financing
- Working Capital Financing
- Trade Financing

With its current platform and infrastructure, Kuwait Finance House–Bahrain, will continue to support the corporate sector of the country aligning the Bank's growth targets with the continuous development and progress of the Kingdom of Bahrain.

Corporate Banking Group

Investment Portfolio

The Bank continued to focus on value-creation through its main projects and on profitable realization of its investment portfolio with the aim to re-deploy the realization in a yielding asset base.

The Bank continued to work on various projects within the major developments to pursue realization. The portfolio comprises mainly of large iconic real estate assets within the Kingdom of Bahrain.

The Bank also explored and identified strategies to improve the capital utlisation. These strategies will be implemented in the ensuing year.

Key developments

Durrat Al Bahrain

After the successful distribution of assets in Durrat Al Bahrain project to the shareholders, the Bank has commenced studies for new developments within Durrat Khaleej Al Bahrain. Petal 4 and 5 villas continued towards completion in 2016 and handover process commenced during the year. The Bank has initiated the process of preparing the Crescent beachfront area to be open for the public to generate awareness for the Crescent area in Durrat Al Bahrain.

Diyar Al Muharraq

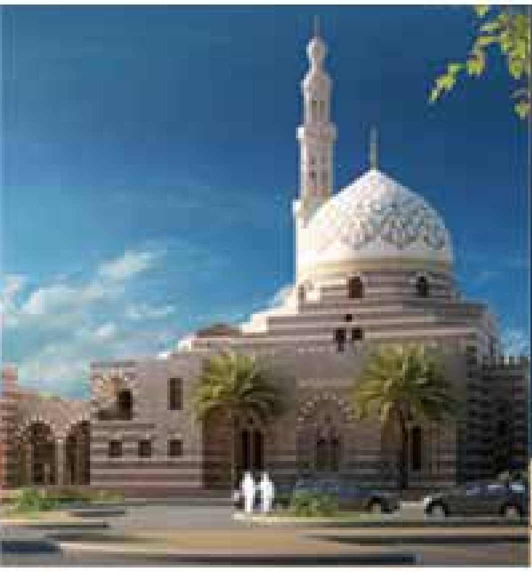
Diyar Al Muharraq has continued to progress on various existing and new initiatives. Diyar entered into a deal with the Ministry of Housing for the construction of approximately 3,100 housing units to address the growing housing needs in the Kingdom and contractors have commenced work on the project. The joint venture with Eagle Hills, which intends to develop a sustainable urban community comprising of beachfront shopping, luxury hotels and apartment buildings, achieved positive sales activity for the three residential buildings which were launched in 2016. Dragon Mall, a unique mall focused on retailing and wholesaling Chinese manufactured products, was successfully opened to the public and is achieving an average monthly footfall in excess of 400,000. New projects planned and launched in Diyar include:

- Diyar Al Bareh “Residential plots”
- Diyar Al Gamrah “Residential plots”
- Diyar Floating City (to be launched)

We also pursued the asset realization strategy of the non-core investment assets that fall outside the mega developments. The yielding real estate assets were also managed effectively to enhance the returns.

menatelecom
BAHRAIN'S MOST POWERFUL BROADBAND

TURKCAPITAL
HOLDING



KFH-Bahrain's Approach to Risk Management

At KFH-Bahrain, we believe that a robust and well implemented risk management framework is essential in protecting the interests of our stakeholders and translating our banking processes into tangible results. We aim at pursuing strategies that build long-term shareholder value, whilst meeting regulatory requirements as well as economic capital standards. Our Risk Management Framework aims at proactive management of risks in the full life cycle of a financial transaction, including its operating circumstances from origination to final disposal from the books of the Bank.

The Board is the highest authority responsible for managing risk in the Bank. The board manages risk through setting of the risk appetite in the form of a comprehensive limit structure and aligning business and risk strategies to achieve the targeted risk adjusted returns. The Board level Risk Committee (BRC) meets regularly to oversee the Bank-wide implementation of the Board-approved strategies, policies and the risk appetite. The senior management through the Risk Management Committee develops and implements appropriate risk and business processes to monitor and manage risk within the parameters set by the Board.

The Bank enforces the culture of risk management across its business, control and support units. The different business units are the front line operators of risk management practices in the Bank and are the first line of control. The support and control units are the second line of control on the risks taken by the business units. The Risk Management Group provides the risk management tools and framework for business and support units.

Risk Management

The Audit function is responsible to independently evaluate the adequacy of controls and the adherence to the Bank's risk policies and procedures.

The Risk Management group helps the Asset and Liability Committee (ALCO), the BRC and the Board in taking sound business and operating decisions. In the last few years, the Bank has put tremendous effort into improving, monitoring and gathering quality data into systems and formats which give a timely and accurate picture of the risk profile of the Bank. Sophisticated and prudent models are developed and refined periodically to allow measurement of risk taken and project the likely impact of various risk factors in the Bank's business and operating goals. The models such as internal scoring systems, stress test programmes and the Internal Capital Adequacy and Assessment Programme (ICAAP) have become valuable decision tools in the Bank. The Bank also uses models for Funds Transfer Pricing (FTP) and risk adjusted performance measurements tools including Risk-Adjusted Return on Capital (RAROC) as essential elements for maximizing the risk-adjusted returns of the Bank.

In 2016, the Bank has enhanced the risk management framework and processes in place to adequately and proactively identify, monitor and manage risks effectively across the Bank. The Bank is also implementing IFRS 9 impairment models to estimate forward-looking Expected Credit Losses (ECL) which is an important input to the risk adjusted performance and pricing frameworks. In order to improve the asset quality and credit processes in the Bank, the Bank has set up a Financing Restructuring Department (FRD) and integrated and synchronized the various credit risk related departments for better risk assessment and decision making processes.

At KFH-Bahrain, we provide support to the socio-economic development of the country to be in-line with our ethical practices and principles. Through our Corporate Social Responsibility (CSR) programme, we are committed to giving back to the local community by lending a helping hand to enhance the quality of life for the nation and its people.

In 2016, the Bank conducted its sustainable CSR programme, extending and reaffirming its support, both financial and practical, to deserving causes and projects. These include charities, educational initiatives, cultural as well as sporting and social events. The Bank also sponsored and participated in a number of significant banking-related events, to support the development of banking business and economic progress.

Some of our CSR activities during the year are as follows:

Supporting Islamic Banking and Finance

- Platinum Sponsor of the Annual Conference of the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) in Bahrain
- Platinum Sponsor of the World Islamic Banking Conference (WIBC) in Bahrain
- Sponsored the Women in the Financial and Banking Sector Conference
- Sponsored the 2nd Arab Gulf Forum of Accountants and Auditors.

Developing Tomorrow's Sporting Champions

- Sponsored the BFA Futsal League & Super Cup 2016
- Sponsored the KFH-Bahrain Golf team at Island Classic Tournament
- Sponsored the H.H. King Hamad Trophy – Golf Championship
- Sponsored the H.H. Khalid bin Hamad Al Khalifa 4th edition Indoor Football League for Youth Centers and the 1st edition for Disabilities
- Sponsored the Bahrain–Merida Pro Cycling Team
- Sponsored the Durrat Marina Triathlon

Promoting Health, Education and Leadership

- Sponsored the Sh. Hessa Girls School

Corporate Social Responsibility

Fatwa & Shari’a Supervisory Board Report

In the Name of Allah Most Gracious Most Merciful
Praise be to Allah, Almighty, and Prayers and Peace be upon Prophet Mohammed, his family and Companions

To: The Shareholders of Kuwait Finance House-Bahrain

Al Salam Alaikum Wa Rahmatu Allah Wa Barakatuh

In compliance with the letter of appointment, we are required to submit the following report:

We have supervised the products and contracts relating the transactions and applications introduced by Kuwait Finance House – Bahrain (the Bank) during the period ended 31st Dec 2016. We have performed our supervision to form an opinion as to whether the Bank has complied with the Rules and Principles of Islamic Shari’a, as well as Fatwas, rules and guidelines issued by us.

Responsibility of Management

The Bank management is responsible for ensuring that the Bank conducts its business in accordance with the Rules and Principles of Islamic Shari’a. It is our responsibility to form an independent opinion based on our review of the operations of the Bank and preparing a report for you.

Scope of work of the Fatwa and Shari’a Supervisory Board

Through the periodic reports provided by the head of Shari’a Department, The Fatwa and Shari’a Supervisory Board (The Board) confirmed that the Bank did not violate the Provisions, Rules and Principles of Islamic Shari’a. The reports contained the results of reviewed, approved contracts and agreements and the results of the Bank operations reviewed on a random sample selection in accordance to the annual audit plan for the Shari’a Department which was approved by The Board including the field visits, supervision of the workflow from Shari’a viewpoint and implementation of Fatwa and decisions issued by us.

We planned and performed our supervision to obtain all the information and explanations, which we considered necessary to provide us with sufficient evidence to give reasonable assurance that the Bank did not violate the Rules and Principles of Islamic Shari’a.

In our opinion

1. The contracts, transactions, and dealings entered into by the Bank during the year ended 31st December 2016 that we have reviewed are in compliance with the provisions and principles of Islamic Shari’a.
2. The allocation of profits and charging of losses relating to investment accounts conform to the basis that had been approved by us in accordance with the provisions and principles of Islamic Shari’a.
3. All earnings that have been realized from sources or by means of prohibited by the Rules and Principles of Islamic Shari’a have been set aside in an independent account and disposed of to charitable causes; and
4. The calculation of Zakat is in compliance with the Rules and Principles of Islamic Shari’a.
5. The Bank has committed to the Shari’a Principles, Fatawa and Directions given by us.

The Fatwa and Shari’a Supervisory Board approved the report based on the periodic reports provided by the Shari’a Department.

The Board thanks the senior management, the departments and the staff of Kuwait Finance House - Bahrain for their cooperation and commitment to our decisions and guidelines and asks Allah Almighty to bring them success and rashad.

We pray to Allah Almighty to guide us to the righteous path.

Sh. Dr. Mohammed Al-Tabatabaee
Chairman
Fatwa and Shari’a Supervisory Board

Sh. Dr. Mubarak Jazaa Al-Harbi
Member
Fatwa and Shari’a Supervisory Board

Sh. Dr. Anwar Shuaib Al-Abdulsalam
Member
Fatwa and Shari’a Supervisory Board

Independent Auditors' 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 2016, 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 2016, 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.

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
8 February 2017
Manama, Kingdom of Bahrain

Consolidated Financial Statements

Consolidated Statement of Financial Position

At 31 December 2016

	Note	2016 BD 000	2015 BD 000
ASSETS			
Cash and balances with banks and Central Bank of Bahrain	7	**56,399**	54,142
Due from banks	8	**88,420**	77,966
Financing contracts with customers	9	**630,391**	535,395
Investments	10	**145,665**	166,412
Investment in sukuk	11	**163,772**	73,816
Investment in joint ventures and associates	12	**129,302**	130,340
Investment in real estate	13	**301,563**	301,758
Receivables, prepayments and other assets	14	**63,458**	81,075
Premises and equipments		**8,682**	29,400
		1,587,652	1,450,304
Assets classified as held for sale	15	**20,272**	-
TOTAL ASSETS		**1,607,924**	1,450,304
LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS, AND OWNERS' EQUITY			
LIABILITIES			
Customers' current accounts		**147,630**	116,534
Due to banks	16	**277,317**	252,932
Due to non-banks		**237,864**	114,521
Other liabilities	18	**41,919**	48,453
Subordinated murabaha payable	19	**91,242**	91,753
		795,972	624,193
Liabilities classified as held for sale	15	**2,117**	-
		798,089	624,193
EQUITY OF INVESTMENT ACCOUNT HOLDERS	20	**441,244**	456,700
OWNERS' EQUITY			
Equity attributable to shareholders of the Parent			
Share capital	21	**177,140**	177,140
Share premium		**71,403**	71,403
Treasury shares		**(21,923)**	(21,923)
Statutory reserve		**17,757**	17,642
General reserve		**28,237**	28,237
Fair value through equity reserve		**(3,574)**	(1,876)
Property fair value reserve		**30,923**	31,501
Foreign currency translation reserve		**(91)**	232
Retained earnings		**60,403**	58,791
		360,275	361,147
Non-controlling shareholders		**8,316**	8,264
		368,591	369,411
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNERS' EQUITY		**1,607,924**	1,450,304
OFF-BALANCE SHEET EQUITY OF INVESTMENT ACCOUNT HOLDERS		**134,970**	135,210
CONTINGENT LIABILITIES AND COMMITMENTS	23	**154,797**	45,905

Hamad Abdulmohsen AlMarzouq
Chairman of the
Board of Directors

Abdulhakeem Yaqoub Alkhayyat
Managing Director and
Chief Executive Officer

The attached notes 1 to 40 form part of these consolidated financial statements.

Consolidated Statement of Income

For the year ended 31 December 2016

	Note	2016 BD 000	2015 BD 000
Income from retail and corporate banking activities	24	**38,187**	36,657
Net income (loss) from investment activities	25	**4,004**	(7,386)
Income from sukuk		**4,957**	3,344
Share of income from joint ventures and associates		**4,281**	74,669
Revenue from non-banking business entities	27	**5,622**	4,084
OPERATING INCOME		**57,051**	111,368
Direct cost of non-banking business entities	27	**(4,577)**	(6,923)
OPERATING INCOME AFTER DIRECT COSTS		**52,474**	104,445
Return on equity of investment account holders before Group's share as mudarib		**(5,107)**	(3,994)
Group's share as mudarib		**1,004**	237
Return on equity of investment account holders	20	**(4,103)**	(3,757)
Profit on due to banks, due to non-banks and subordinated murabaha payable	30	**(11,391)**	(9,741)
Profit paid by non-banking business entities	27	**-**	(345)
NET OPERATING INCOME		**36,980**	90,602
Staff costs		**13,882**	13,913
Depreciation		**1,075**	1,471
Provisions - net	28	**7,127**	33,928
Other expenses	29	**9,085**	9,558
Operating expenses of non-banking business entities	27	**1,420**	6,579
TOTAL OPERATING EXPENSES		**32,589**	65,449
NET INCOME FOR THE YEAR FROM OPERATIONS		**4,391**	25,153
ASSETS CLASSIFIED AS HELD FOR SALE			
Net loss for the year from assets classified as held for sale	15	**(3,199)**	(14,415)
NET INCOME FOR THE YEAR		**1,192**	10,738
Attributable to:			
Shareholders of the Parent		**1,149**	10,742
Non-controlling shareholders		**43**	(4)
		1,192	10,738

Hamad Abdulmohsen AlMarzouq
Chairman of the
Board of Directors

Abdulhakeem Yaqoub Alkhayyat
Managing Director and
Chief Executive Officer

The attached notes 1 to 40 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

For the year ended 31 December 2016

	Note	2016 BD 000	2015 BD 000
OPERATING ACTIVITIES			
Net income for the year from continuing operations		4,391	25,153
Net loss from assets classified as held for sale		(3,199)	(14,415)
Net income for the year		1,192	10,738
Adjustments for:			
Share of income of joint ventures and associates		(4,281)	(74,669)
Net gain on sale of investments	25	(173)	-
Net gain on sale of investment in real estate	25	(609)	(588)
Net unrealised loss on investments	25	171	4,575
Net unrealised loss on investment in real estate		1,302	4,550
Dividend income	25	(71)	(1,050)
Foreign exchange gain	25	(772)	(407)
Rental income	25	(107)	(83)
Depreciation		4,451	7,142
Provisions - net		9,632	50,128
Operating income before changes in operating assets and liabilities		10,735	336
Changes in operating assets and liabilities:			
Mandatory reserve with Central Bank of Bahrain		95	4,540
Due from banks		(11,817)	-
Financing contracts with customers		(95,169)	(1,387)
Receivables, prepayments and other assets		13,579	14,545
Customers' current accounts		31,096	11,292
Due to banks		24,385	109,268
Due to non-banks		123,343	(129,715)
Other liabilities		(11,735)	21,646
Net cash flows from operating activities		84,512	30,525
INVESTING ACTIVITIES			
Sale (purchase) of investments - net		25,618	(19,244)
(Purchase) sale of investment in sukuk - net		(90,358)	11,683
Distributions from investment in joint ventures and associates		-	3,541
Purchase of investment in real estate - net		(498)	(17,025)
Dividend income		71	1,050
Rental income		107	83
Purchase of premises and equipments - net		(3,007)	(2,158)
Net cash flows used in investing activities		(68,067)	(22,070)
FINANCING ACTIVITY			
Net movement in equity of investment account holders		(15,456)	(52,344)
Net cash flows used in financing activity		(15,456)	(52,344)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		989	(43,889)
Cash and cash equivalents at 1 January		102,698	146,587
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	31	103,687	102,698

The attached notes 1 to 40 form part of these consolidated financial statements.

Consolidated Statement of Changes in Owners' Equity

For the year ended 31 December 2016

	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	Total BD 000	Non-controlling stakeholders BD 000	Total owners' equity BD 000
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 income for the year (note 22)	-	-	-	-	-	(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**
Balance at 1 January 2015	177,140	71,403	(21,923)	16,568	28,237	(1,978)	32,759	29	47,865	350,100	10,791	360,891
Net income (loss) for the year	-	-	-	-	-	-	-	-	10,742	10,742	(4)	10,738
Other comprehensive income for the year (note 22)	-	-	-	-	-	102	-	203	-	305	-	305
Total comprehensive income (loss) for the year	-	-	-	-	-	102	-	203	10,742	11,047	(4)	11,043
Net transfer from property fair value reserve	-	-	-	-	-	-	(1,258)	-	1,258	-	-	-
Transfer to statutory reserve	-	-	-	1,074	-	-	-	-	(1,074)	-	-	-
Net movement in share of non-controlling shareholders	-	-	-	-	-	-	-	-	-	-	(2,523)	(2,523)
Balance at 31 December 2015	177,140	71,403	(21,923)	17,642	28,237	(1,876)	31,501	232	58,791	361,147	8,264	369,411

The attached notes 1 to 40 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 2016

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

	Balance at 1 January 2015 BD 000	Additional Investments BD 000	Gross Income BD 000	Mudarib Share BD 000	Withdrawals / distributions BD 000	Balance at 31 December 2015 BD 000
Murabaha contracts	107,546	103,600	9,447	(2,367)	(83,016)	135,210
	107,546	103,600	9,447	(2,367)	(83,016)	135,210

The attached notes 1 to 40 form part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

At 31 December 2016

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 (2015: 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 8 February 2017.

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.

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. Transaction 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 with customers

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.

3.4 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 35. 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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(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 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 in 'other operating expenses' or 'other income'.

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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(ii) Financing contracts with customers

(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.

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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(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 with customers. 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.

4.3 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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(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.

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 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.6 Land and development costs

Land and development costs 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.

4.7 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)

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 murabaha payables (banks and non banks)
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.

4.9 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 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

4.11 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 their 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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

4.14 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. Any share options exercised during the reporting period are satisfied with treasury shares.

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 murabaha and due from banks with original maturity of 90 days or less from the date of financial position.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

4.22 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 of assets classified as held for sale are presented as a single amount as income or loss from assets classified as held for sale 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, prepayments and other assets" in the consolidated statement of financial position.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 intruments are disclosed in note 34.

Fair value is the price that would be received to sell an asset or paid to transfer a liabilty 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.

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 34.

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.

5 LIST OF KEY SUBSIDIARIES

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

Subsidiary	Activities	Year of incorporation	Country of incorporation	Ownership %	
				2016	2015
Al-Enma House for Real Estate B.S.C. (c)	The company is engaged in property management of commercial, industrial and residential buildings and the provision of security services to buildings and facilities.	2003	Kingdom of Bahrain	100.00	100.00
Bayan Group for Property Investments W.L.L.	The principal activity of the company is to buy, sell and lease properties and to undertake joint ventures with other companies engaged in similar activities.	2004	Kingdom of Bahrain	100.00	100.00
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
Mena Telecom W.L.L.	The company is a licensed telecommunications company.	2003	Kingdom of Bahrain	100.00	100.00
Baytik Bahrain Real Estate Holding Co. W.L.L.	The company is incorporated to hold certain real estate assets.	2015	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:

	Financial assets at fair value through statement of income BD 000	Financial assets at fair value through equity BD 000	Financial assets at cost/ amortised cost BD 000	Financial liabilities at cost/ amortised cost BD 000	Total 2016 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	-	-	10,818	-	10,818
	140,566	5,099	949,800	-	1,095,465
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS					
Customers' current accounts	-	-	-	147,630	147,630
Due to banks	-	-	-	277,317	277,317
Murabaha due to non-banks	-	-	-	237,864	237,864
Other liabilities	-	-	-	31,633	31,633
Subordinated murabaha payable	-	-	-	91,242	91,242
Equity of investment account holders	-	-	-	441,244	441,244
	-	-	-	1,226,930	1,226,930

	Financial assets at fair value through statement of income BD 000	Financial assets at fair value through equity BD 000	Financial assets at cost/ amortised cost BD 000	Financial liabilities at cost/ amortised cost BD 000	Total 2015 BD 000
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	-	-	54,142	-	54,142
Due from banks	-	-	77,966	-	77,966
Financing contracts with customers	-	-	535,395	-	535,395
Investments	159,798	6,614	-	-	166,412
Investment in sukuk	-	-	73,816	-	73,816
Receivables	-	-	24,019	-	24,019
	159,798	6,614	765,338	-	931,750
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS					
Customers' current accounts	-	-	-	116,534	116,534
Due to banks	-	-	-	252,932	252,932
Murabaha due to non-banks	-	-	-	114,521	114,521
Other liabilities	-	-	-	37,451	37,451
Subordinated murabaha payable	-	-	-	91,753	91,753
Equity of investment account holders	-	-	-	456,700	456,700
	-	-	-	1,069,891	1,069,891

7 CASH AND BALANCES WITH BANKS AND CENTRAL BANK OF BAHRAIN

	Note	2016 BD 000	2015 BD 000
Cash		**8,142**	8,490
Balances with banks		**9,449**	10,779
Balance with CBB		**9,493**	5,463
CBB mandatory reserve	7.1	**29,315**	29,410
	7.2	**56,399**	54,142

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

7.2 This balance includes BD 26,388 thousand (2015: BD 30,302 thousand) financed by investment account holders' funds.

8 DUE FROM BANKS

	2016 BD 000	2015 BD 000
Murabaha	**53,552**	29,514
Wakala	**34,981**	48,452
	88,533	77,966
Impairment provision	**(113)**	-
	88,420	77,966

This balance includes BD 44,652 thousand (2015: BD 54,311 thousand) financed by investment account holders' funds. These carry profit rates ranging from 0.15% to 2.95% per annum (2015: 0.01% to 1.50% per annum).

9 FINANCING CONTRACTS WITH CUSTOMERS

	Self financed		Financed through investment account holders' funds		Total	
	2016 BD 000	2015 BD 000	2016 BD 000	2015 BD 000	2016 BD 000	2015 BD 000
Murabaha	**185,888**	131,767	**122,951**	138,522	**308,839**	270,289
Deferred profits	**(13,408)**	(13,002)	**(10,074)**	(16,418)	**(23,482)**	(29,420)
Individual impairment provision	**(4,230)**	(3,154)	**(3,178)**	(3,982)	**(7,408)**	(7,136)
	168,250	115,611	**109,699**	118,122	**277,949**	233,733
Ijarah Muntahia Bittamleek (note 9.1)	**192,038**	110,531	**190,753**	220,875	**382,791**	331,406
Individual impairment provision	**(2,408)**	(1,840)	**(2,438)**	(3,780)	**(4,846)**	(5,620)
	189,630	108,691	**188,315**	217,095	**377,945**	325,786
Musharaka	**342**	974	**-**	-	**342**	974
	342	974	**-**	-	**342**	974
	358,222	225,276	**298,014**	335,217	**656,236**	560,493
Collective impairment provision					**(25,845)**	(25,098)
					630,391	535,395

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 80,787 thousand (2015: BD 64,643 thousand).

9.2 During the year, the Bank took possession of properties with a carrying value of BD 1,030 thousand (2015 : Nil) as part of financing settlement and were classified as repossessed assets in the receivables, prepayments 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 2016 BD 000	Collective impairment 2016 BD 000	Total 2016 BD 000	Individual impairment 2015 BD 000	Collective impairment 2015 BD 000	Total 2015 BD 000
At 1 January	12,756	25,098	37,854	6,201	5,782	11,983
Charge for the year	1,386	1,151	2,537	11,820	19,316	31,136
Reversals / transfers for the year	(1,650)	(404)	(2,054)	(2,737)	-	(2,737)
Net provision for the year	(264)	747	483	9,083	19,316	28,399
Write-offs	(238)	-	(238)	(2,528)	-	(2,528)
At 31 December	12,254	25,845	38,099	12,756	25,098	37,854

10 INVESTMENTS

The Group's investments are classified as follows:

	Note	2016 BD 000	2015 BD 000
Investments at fair value through statement of income	10.1	140,566	159,798
Investments at fair value through equity	10.2	5,099	6,614
		145,665	166,412

10.1 Carried at fair value through statement of income

	Note	2016 BD 000	2015 BD 000
Held for trading		1,086	462
Designated at fair value upon initial recognition	10.1.1	139,480	159,336
		140,566	159,798

10.1.1 Designated at fair value upon initial recognition

	2016 BD 000	2015 BD 000
Unquoted equity securities	138,270	154,074
Managed funds - at Net Asset Value	1,210	5,262
	139,480	159,336

10 INVESTMENTS (continued)

10.2 Carried at fair value through equity

	2016 BD 000	2015 BD 000
Quoted equity securities	502	723
Unquoted equity securities	5,254	6,480
	5,756	7,203
Impairment provisions	(657)	(589)
	5,099	6,614

10.2.1 Movement in impairment provisions relating to investments.

	2016 BD 000	2015 BD 000
At 1 January	589	265
Impairment provisions	68	324
At 31 December	657	589

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

	2016 BD 000	2015 BD 000
At 1 January	6,614	7,188
Impairment provisions	(68)	(324)
Fair value changes	(1,447)	(250)
At 31 December	5,099	6,614

10.2.3 Composition of investment portfolio:

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

	Middle East	Total	
	BD 000	2016 BD 000	2015 BD 000
Real estate development	138,309	138,309	159,195
Banking and financial services	7,013	7,013	6,623
Others	343	343	594
	145,665	145,665	166,412

11 INVESTMENT IN SUKUKS

	Note	2016 BD 000	2015 BD 000
Quoted sukuk			
Government		**34,878**	16,430
Unquoted sukuk			
Government		**108,085**	36,500
Others		**20,809**	20,886
	11.1	**163,772**	73,816

11.1 Investment in sukuk includes an amount of BD 72,190 thousand (2015: BD 36,870 thousand) financed by investment account holders' funds. Fair value of investment in sukuk as at 31 December 2016 amounted to BD 166,569 thousand (2015: BD 73,843 thousand).

12 INVESTMENT IN JOINT VENTURES AND ASSOCIATES

The Group has the following joint ventures and associates as at 31 December 2016:

Name of the joint venture / associate	Nature of business	Country of incorporation	Holding
Joint Ventures			
Diyar Homes Company W.L.L.	Real estate development, project management and the buying and selling of properties.	Kingdom of Bahrain	50.0%
Durrat Khaleej Al Bahrain B.S.C. (c)	Development of Durrat Al Bahrain project with a view of sale of land, residential and commercial properties.	Kingdom of Bahrain	50.0%
Durrat 4 W.L.L.	Real estate development, project management and the buying and selling of properties.	Kingdom of Bahrain	50.0%
Associates			
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%
Seef Properties B.S.C.	Engaged in the real estate development and operation sector.	Kingdom of Bahrain	15.6%
Marina Durrat Al Bahrain for Development Real Estate W.L.L.	Engaged in the real estate development.	Kingdom of Bahrain	20.0%
Dragon City Bahrain B.S.C.(c)	Engaged in the real estate development and operation sector.	Kingdom of Bahrain	22.1%

Durrat Khaleej Al Bahrain B.S.C. (c), Durrat 4 W.L.L. and Diyar Homes Company W.L.L. are jointly controlled entities whereby the venturers have an arrangement that establishes joint control over the economic activities of these entities. The Group recognises its stake in the joint ventures using the equity method of accounting.

Although the Group holds less than 20% of the equity shares of Seef Properties B.S.C., the Group exercises significant influence by virtue of its contractual right to appoint three directors to the board of directors of the company and has the power to participate in the financial and operating policy decisions.

12 INVESTMENT IN JOINT VENTURES AND ASSOCIATES (continued)

The following table illustrates the summarised financial information of joint ventures and associates:

	2016 BD 000	2015 BD 000
Current assets	**226,040**	123,352
Non-current assets	**412,058**	512,791
Current liabilities	**(119,905)**	(106,060)
Non-current liabilities	**(41,293)**	(60,634)
Total net assets	**476,900**	469,449
Commitments	**4,646**	18,070

Total income and net profit of joint ventures and associates for the year:

	2016 BD 000	2015 BD 000
Total income	**136,281**	361,321
Net profit	**14,888**	309,693

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

	Note	2016 BD 000	2015 BD 000
At 1 January		**130,340**	160,826
Investments made during the year		**1,755**	17,187
Distributions from the joint ventures and associates		**(6,496)**	(119,752)
Share of income from joint ventures and associates		**4,281**	74,669
Share of other comprehensive loss	22	**(251)**	(555)
Provision for impairment		**-**	(1,700)
Other movements		**(327)**	(335)
At 31 December		**129,302**	130,340

The quoted value of the investment in associates for which quoted prices are available is BD 21,133 thousand (2015: BD 20,059 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.

13 INVESTMENT IN REAL ESTATE

	Note	2016 BD 000	2015 BD 000
Cost			
At 1 January		298,027	176,548
Additions / transfers		1,865	130,270
Disposals / transfers		(514)	(8,791)
At 31 December		299,378	298,027
Fair value adjustment			
At 1 January		3,731	9,631
Fair value adjustments		(1,302)	(4,550)
Relating to disposals		(244)	(1,350)
At 31 December		2,185	3,731
Total	13.1	301,563	301,758

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

	2016 BD 000	2015 BD 000
Buildings	37,075	38,656
Lands	264,488	263,102
	301,563	301,758

Rental income included in the consolidated statement of income from investment in real estate amounted to BD 3,369 thousand (2015: BD 1,184 thousand).

Direct operating expenses (including repairs and maintenance) amounting to BD 1,570 thousand (2015: BD 1,409 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 64 thousand (2015: BD 49 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.

Investments in real estate are stated at fair value which has been determined based on valuations performed by independent valuers possessing relevant professional qualification, with recent experience in the location and category of the properties being fair valued, at dates close to 31 December 2016 and 31 December 2015. The fair values have been determined based on recent transactions in the market, the independent valuers' knowledge and professional judgement.

Investment in real estate includes the Bank's share of BD 13,744 thousand (2015: BD 14,094 thousand) which are jointly owned with third parties and are subject to normal conditions applicable to joint ownership.

The Group's investment in real estate is not subject to any other charge, pledge or restriction on transfer of title.

14 RECEIVABLES, PREPAYMENTS AND OTHER ASSETS

	Note	2016 BD 000	2015 BD 000
Land and development cost	14.1	**43,183**	45,966
Fees receivable		**1,654**	864
Project expenses receivable		**1,007**	2,740
Inventories		**9,799**	12,385
Profit receivable		**1,909**	1,203
Repossessed assets		**4,147**	3,117
Trade receivables of subsidiaries		**5,058**	8,798
Prepaid expenses		**1,735**	1,812
Receivables relating to sale of investments		**2,099**	7,280
Receivables from corporate customers		**1,471**	6,575
Other assets		**2,357**	8,848
Gross receivables, prepayments and other assets		**74,419**	99,588
Impairment provisions	14.2	**(10,961)**	(18,513)
		63,458	81,075

14.1 Land and development cost

	2016 BD 000	2015 BD 000
Land	**31,922**	33,328
Development cost	**11,261**	12,638
	43,183	45,966

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, prepayments and other assets.

	Note	2016 BD 000	2015 BD 000
At 1 January		**18,513**	11,295
Charge for the year	14.2.1	**(1,689)**	7,218
Disposals / settlements		**(5,863)**	-
At 31 December		**10,961**	18,513

14.2.1 Charge for the year

	Note	2016 BD 000	2015 BD 000
Provisions against receivables, prepayments and other assets	28	**(1,536)**	4,358
Non-banking business entities		**(153)**	2,860
		(1,689)	7,218

15 ASSETS CLASSIFIED AS HELD FOR SALE

Wholly owned subsidiay ("Company")

The Group classified a wholly owned subsidiary as held for sale in December 2016 due to discussions with potential buyers and based on Board of Directors approval. Accordingly the assets and liabilities of the Company have not been consolidated on a line by line basis.

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

	2016 BD 000	2015 BD 000
Revenue	10,901	11,568
Cost of sales	(2,641)	(3,160)
Operating income	8,260	8,408
Other operating expenses and finance cost	(8,801)	(11,181)
Provision	(2,658)	(11,642)
Net loss	(3,199)	(14,415)

The major classes of assets and liabilities of the Company, classified as held for sale as at 31 December 2016, are as follows:

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

The net cash flows received by the Company are as follows:

	2016 BD 000	2015 BD 000
Net cash flows from operating activities	2,785	2,251
Net cash flows from investing activities	(1,857)	(1,529)
	928	722

16 DUE TO BANKS

	2016 BD 000	2015 BD 000
Murabaha payables	**74,505**	85,814
Wakala payables	**202,072**	164,490
Other balances	**740**	2,628
	277,317	252,932

17 FUNDS UNDER MANAGEMENT

At 31 December 2016, clients' funds managed in a fiduciary capacity amounted to BD 41,904 thousand (2015: BD 41,904 thousand).

18 OTHER LIABILITIES

	2016 BD 000	2015 BD 000
Pay orders issued but not presented	**4,130**	17,025
Payable on account of financing contracts	**1,227**	715
Staff related accruals	**3,678**	3,408
Profit payable on account of murabaha and due to banks and non-banks	**4,870**	1,942
Profit payable on equity of investment account holders	**1,318**	1,427
Trade payables of subsidiaries	**2,960**	5,138
Due to investors	**136**	4,206
Advance from customers	**10,286**	11,002
Others and contingencies	**13,314**	3,590
	41,919	48,453

19 SUBORDINATED MURABAHA PAYABLE

The subordinated murabaha payable carries a profit equivalent to a rate of 2% over the six month Kuwait Inter Bank Offer Rate (KIBOR). 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 2019. Starting from 2015, 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 3,519 thousand (2015: BD 3,227 thousand) has been charged to the consolidated statement of income in respect of subordinated murabaha payable.

20 EQUITY OF INVESTMENT ACCOUNT HOLDERS

The mudarib share on investment accounts ranges from 30% to 85% (2015: 20% 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% (2015: 85% to 95%). The rate of return to investment account holders, as at 31 December 2016 and 2015, for various types of investment accounts, denominated in BD and USD, is as follows:

	2016 Rate of return %	2015 Rate of return %
Investment Accounts - Denominated in BHD		
Saving accounts	**0.25**	0.20
VIP saving accounts	**0.30**	0.25
One month investment accounts	**1.20**	0.95
Three months investment accounts	**1.40**	1.15
Six months investment accounts	**1.65**	1.40
Nine months investment accounts	**1.80**	-
One year investment accounts	**1.90 / 2.00**	1.65
Investment accounts - denominated in USD		
Saving accounts	**0.20**	0.20
VIP saving accounts	**0.30**	0.25
One month investment accounts	**0.95**	0.70
Three months investment accounts	**1.20**	0.95
Six months investment accounts	**1.40**	1.15
Nine months investment accounts	**1.50**	-
One year investment accounts	**1.65**	1.40

20.1 Investment Accounts by type

	2016 BD 000	2015 BD 000
Saving accounts	**169,875**	155,062
VIP saving accounts	**20,938**	25,940
One month investment accounts	**66,190**	81,861
Three months investment accounts	**76,546**	103,145
Six months investment accounts	**46,684**	46,115
Nine months investment accounts	**110**	-
One year investment accounts	**60,901**	44,577
	441,244	456,700

21 SHARE CAPITAL AND RESERVES

Share capital

	2016 BD 000	2015 BD 000
Authorised:		
3,500,000 thousand (2015 : 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 1,771,405 thousand (2015 : 1,771,405 thousand) shares	**177,140**	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.

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.

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.

Included in the property fair value reserve is an unrealised gain of BD 24,403 thousand, on an investment carried at fair value through statement of income pertaining to prior years. No gain is recognised in the current year (2015 : BD 24,403 thousand).

21 SHARE CAPITAL AND RESERVES (continued)

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 1,575 thousand (2015: BD 1,575 thousand) relating to subsidiaries of the Bank.

22 TOTAL COMPREHENSIVE INCOME

	2016 BD 000	2015 BD 000
Net income for the year	**1,192**	10,738
Other comprehensive (loss) income		
Fair value adjustments against fair value through equity investments	**(1,447)**	657
Net movement in foreign currency translation reserve	**(323)**	203
Share of other comprehensive loss of joint ventures and associates	**(251)**	(555)
Total other comprehensive (loss) income for the year	**(2,021)**	305
Total comprehensive income for the year	**(829)**	11,043
Adjustment attributable to non-controlling shareholders	**(43)**	4
	(872)	11,047

23 CONTINGENT LIABILITIES AND COMMITMENTS

	Note	2016 BD 000	2015 BD 000
Contingent liabilities:			
Letters of credit		**9,096**	8,740
Guarantees		**14,524**	5,981
		23,620	14,721
Irrevocable commitments to extend credit			
Original term to maturity of one year or less		**131,077**	21,360
Development cost commitment	23.1	**100**	9,824
		154,797	45,905

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

Operating lease commitments
At 31 December 2016, the Group had commitments in respect of non-cancellable operating leases amounting to BD 1,801 thousand (2015: BD 3,759 thousand) relating to leasehold premises. Of the commitments in respect of operating leases, BD 1,140 thousand (2015: BD 2,399 thousand) are due within one year, BD 446 thousand (2015: BD 1,162 thousand) are due in one to five years and the remaining over five years.

Construction commitments
At 31 December 2016, the Group had commitments in respect of construction contracts amounting to NIL (2015: BD 4 thousand).

24 INCOME FROM RETAIL AND CORPORATE BANKING ACTIVITIES

	Note	2016 BD 000	2015 BD 000
Murabaha		**14,236**	17,067
Ijarah Muntahia Bittamleek	24.1	**18,612**	15,428
Musharaka		**18**	184
Murabaha and due from banks		**1,082**	625
Financing income from retail and corporate banking activities		**33,948**	33,304
Mudarib share from off balance sheet equity of investment account holders		**2,760**	2,367
Fees and commission income		**1,479**	986
		38,187	36,657

24.1 This is presented net of depreciation on Ijarah Muntahia Bittamleek assets amounting to BD 37,238 thousand (2015: BD 48,850 thousand).

25 NET INCOME (LOSS) FROM INVESTMENT ACTIVITIES

	Note	2016 BD 000	2015 BD 000
Net unrealised loss on investments	25.1	**(171)**	(4,575)
Net unrealised loss on investment in real estate		**-**	(1,050)
Net gain on sale of investments		**173**	-
Net gain on sale of investment in real estate		**609**	588
Dividend income		**71**	1,050
Fee income		**1,198**	(889)
Foreign exchange		**772**	407
Rental income		**107**	83
Investors payment		**-**	(4,200)
Other income		**1,245**	1,200
		4,004	(7,386)

25.1 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.

26 INCOME AND EXPENSE RELATING TO FINANCING CONTRACTS AND SUKUKS

	2016 BD 000	2015 BD 000
Financing income from retail and corporate banking activities	**33,948**	33,304
Income from sukuk	**4,957**	3,344
	38,905	36,648
Less: Profit on due to banks, due to non-banks and subordinated murabaha payable	**11,391**	9,741
Less: Return on equity of investment account holders	**4,103**	3,757
	15,494	13,498
	23,411	23,150

27 NON-BANKING BUSINESS ENTITIES

	Note	2016 BD 000	2015 BD 000
Revenue	27.1	**5,622**	4,084
Less:			
Direct cost		**4,577**	6,923
Profit paid		**-**	345
Operating expenses	27.2	**1,420**	6,579
		(375)	(9,763)

27.1 This includes unreaslied fair value losses amounting to BD 1,302 thousand (2015 : BD 3,500 thousand) on account of investment in real estate.

27.2 Operating expenses

	Note	2016 BD 000	2015 BD 000
Staff costs		**673**	681
Depreciation		**23**	45
Provisions - net	14.2.1 & 27.2.1	**(153)**	4,558
Other expenses		**877**	1,295
		1,420	6,579

27.2.1 This pertains to impairment recorded against the non-financial assets of individual subsidiaries on account of difference between carrying values and estimated realizable values.

28 PROVISIONS - NET

	Note	2016 BD 000	2015 BD 000
Due from banks	8	**113**	-
Financing contracts with customers	9.3	**483**	28,399
Investments	28.1	**68**	1,171
Receivables, prepayments and other assets	14.2.1	**(1,536)**	4,358
Others	28.2	**7,999**	-
		7,127	33,928

28 PROVISIONS - NET (continued)

28.1 This includes impairment provision of BD 68 thousand (2015: BD 324 thousand) (note 10.2.1) recognised against investments carried at fair value through equity and Nil (2015: BD 847 thousand) on account of reclassification of available for sale reserve to consolidated statement of income.

28.2 This includes provision against certain investments where the Bank expects future volatility in valuation due to high level of uncertainty involved.

29 OTHER EXPENSES

	2016 BD 000	2015 BD 000
Business development	1,675	1,779
Technology and communication	2,407	2,277
Legal, consulting and outsourcing	632	872
Premises - rentals and maintenance	2,269	2,359
Administration, selling and others	2,102	2,271
	9,085	9,558

30 PROFIT ON DUE TO BANKS, DUE TO NON-BANKS AND SUBORDINATED MURABAHA PAYABLE

	2016 BD 000	2015 BD 000
Due to banks	4,176	2,781
Murabaha due to non-banks	3,696	3,733
Subordinated murabaha payable (note 19)	3,519	3,227
	11,391	9,741

31 CASH AND CASH EQUIVALENTS

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

	2016 BD 000	2015 BD 000
Cash	8,142	8,490
Balances with banks	9,449	10,779
Balances with CBB excluding mandatory reserve deposit	9,493	5,463
Due from banks with original maturity of less than ninety days	76,603	77,966
	103,687	102,698

32 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 with customers, 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 2016 BD 000	Total 2015 BD 000
Cash & Balances with Banks	-	233	-	62	295	393
Financing contracts with customers *	20,378	-	4,567	48,945	73,890	78,622
Investments at amortised cost	-	-	-	20,809	20,809	20,886
Fees receivable	-	-	-	790	790	264
Project expenses receivable	-	-	-	-	-	1,829
Other assets	436	-	-	-	436	5,591
Due to banks	-	150,800	-	-	150,800	125,600
Due to non-banks	-	-	-	61,508	61,508	66,889
Customers' current accounts	10,337	840	350	1,007	12,534	12,785
Subordinated murabaha payable	-	91,242	-	-	91,242	91,753
Equity of investment account holders	8,448	-	918	4,166	13,532	40,212
Letters of credit	20	-	-	-	20	4,104
Commitments to extend credit	-	-	-	85	85	1,280
Off balance sheet equity of investment account holders						
- Funds extended to related parties	-	-	-	134,970	134,970	135,210
- Funds received from related parties	2,000	-	-	4,100	6,100	2,800

* includes balances amounting to BD 1,345 thousand (2015: Nil) which are past due and impaired.

32 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 2016 BD 000	Total 2015 BD 000
Income from due from banks	-	-	-	-	-	3
Income from financing contracts with customers	585	-	192	2,854	3,631	4,570
Income from investments at amortised cost	-	-	-	1,274	1,274	2,188
Fee income	96	-	-	790	886	396
Profit on due to banks	-	2,255	-	-	2,255	871
Profit on due to non-banks	-	-	-	960	960	1,953
Profit on subordinated murabaha payable	-	3,519	-	-	3,519	3,227
Profit on equity investment account holders	267	-	4	254	525	570
Staff costs	-	-	-	128	128	128
Other expenses	-	-	-	1,377	1,377	1,359
Mudarib share of off-balance sheet equity of investment account holders	-	-	-	2,760	2,760	2,367

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

	2016 BD 000	2015 BD 000
Short term employee benefits	5,191	4,143
Long term employee benefits	250	241

Directors' remuneration and attendance fee for the year ended 31 December 2016 amounted to BD 103 thousand and BD 191 thousand respectively (2015: BD 187 thousand and BD 63 thousand respectively).

33 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 2016:

	Retail & Corporate Group BD 000	Investment Banking Group BD 000	Total BD 000
Operating income	38,187	18,864	57,051
Net income for the year from continuing operations	3,613	778	4,391
Net loss for the year from disposal group classified as held for sale	-	(3,199)	(3,199)
			1,192
Segment assets	897,431	690,221	1,587,652
Assets of disposal group 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 of disposal group 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	55,057	1,994	57,051
Segment assets	1,517,142	70,510	1,587,652
Assets of disposal group classified as held for sale	20,272	-	20,272
			1,607,924

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

33 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 2015:

	Retail & Corporate Group BD 000	Investment Banking Group BD 000	Total BD 000
Operating income	36,657	74,711	111,368
Net income for the year from continuing operations	(19,816)	44,969	25,153
Net loss for the year from disposal group classified as held for sale	-	(14,415)	(14,415)
			10,738
Total assets	693,437	756,867	1,450,304
Total liabilities and equity of investment account holders	621,687	459,206	1,080,893

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 2015.

	Bahrain BD 000	Other countries BD 000	Total BD 000
Operating income	109,655	1,713	111,368
Total assets	1,419,757	30,547	1,450,304

Other countries mainly represent State of Kuwait, Republic of Turkey, Hashemite Kingdom of Jordan and United Kingdom.

34 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 2016 and 2015, 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.

34 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

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

	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**

	Level 1 2015 BD 000	Level 2 2015 BD 000	Level 3 2015 BD 000	Total 2015 BD 000
Investments at fair value through statement of income				
Investments held for trading	462	-	-	462
Unquoted equity securities	-	-	154,074	154,074
Managed funds	-	5,262	-	5,262
Investments at fair value through equity				
Quoted equity securities	723	-	-	723
Unquoted equity securities	-	-	5,891	5,891
	1,185	5,262	159,965	166,412

During the year ended 31 December 2016, 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.

34 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 2016 BD 000	Managed funds 2016 BD 000	Unquoted equity securities 2015 BD 000	Managed funds 2015 BD 000
Balance at 1 January	159,965	-	160,178	1,074
Investments made during the year		-	2,810	-
Provisions / unrealised fair value loss	(1,294)		(2,946)	(1,074)
Disposals / redemptions during the year	(15,804)	-	(77)	-
Balance at 31 December	142,867	-	159,965	-

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

	Carrying amount 2016 BD 000	Effect of reasonably possible alternative assumption 2016 BD 000	Carrying amount 2015 BD 000	Effect of reasonably possible alternative assumption 2015 BD 000
Investments at fair value through statement of income				
Unquoted equity securities	138,270	13,827	154,074	15,407
Investments at fair value through equity				
Unquoted equity securities	4,597	460	5,891	589
	142,867	14,287	159,965	15,996

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 10 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.

35 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 36.3 'Risk Management - Liquidity Risk and Funding Management'.

	Up to one year			Over one year				
	Up to 3 months 2016 BD 000	3 months up to 12 months 2016 BD 000	Subtotal up to 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 with customers	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 joint ventures and 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**
Receivables, prepayments 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	76,516	-	**76,516**	200,801	-	-	**200,801**	**277,317**
Due to non-banks	3,179	100,245	**103,424**	95,080	19,680	19,680	**134,440**	**237,864**
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 murabaha payable	-	-	-	91,242	-	-	**91,242**	**91,242**
Liabilities associated with disposal group 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**

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

	Up to one year			Over one year				
	Up to 3 months 2015 BD 000	3 months up to 12 months 2015 BD 000	Subtotal up to 12 months 2015 BD 000	1 to 5 years 2015 BD 000	5 to 10 years 2015 BD 000	Over 10 years 2015 BD 000	Subtotal Over 1 year 2015 BD 000	Total 2015 BD 000
Assets								
Cash and balances with banks and Central Bank of Bahrain	13,772	1,117	14,889	10,753	8,067	20,433	39,253	54,142
Due from banks	77,966	-	77,966	-	-	-	-	77,966
Financing contracts with customers	35,157	43,844	79,001	250,812	140,908	64,674	456,394	535,395
Investments	463	723	1,186	21,066	144,160	-	165,226	166,412
Investment in sukuk	-	-	-	73,816	-	-	73,816	73,816
Investment in joint ventures and associates	-	-	-	130,340	-	-	130,340	130,340
Investment in real estate	-	-	-	-	289,155	12,603	301,758	301,758
Receivables, prepayments and other assets	7,407	71	7,478	73,597	-	-	73,597	81,075
Premises and equipments	-	-	-	-	29,400	-	29,400	29,400
Total	134,765	45,755	180,520	560,384	611,690	97,710	1,269,784	1,450,304
Liabilities and equity of investment account holders								
Customers' current accounts	6,446	-	6,446	36,696	36,696	36,696	110,088	116,534
Due to banks	67,907	101,177	169,084	83,848	-	-	83,848	252,932
Due to non-banks	2,633	-	2,633	81,898	14,995	14,995	111,888	114,521
Other liabilities	33,865	3,063	36,928	11,525	-	-	11,525	48,453
Equity of investment account holders	19,634	15,815	35,449	140,417	140,417	140,417	421,251	456,700
Subordinated murabaha payable	-	-	-	91,753	-	-	91,753	91,753
Total	130,485	120,055	250,540	446,137	192,108	192,108	830,353	1,080,893
Net	4,280	(74,300)	(70,020)	114,247	419,582	(94,398)	439,431	369,411
Off-balance sheet equity of investment account holders	-	92,295	92,295	42,915	-	-	42,915	135,210

36 RISK MANAGEMENT

36.1 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.

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.

36 RISK MANAGEMENT (continued)

36.1 Introduction (continued)

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.

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.

36 RISK MANAGEMENT (continued)

36.1 Introduction (continued)

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.

36.2 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.

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 2016 was BD 43,090 thousand (2015: BD 45,668 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.

36 RISK MANAGEMENT (continued)

36.2 Credit Risk (continued)

	Gross maximum exposure 2016 BD 000	Gross maximum exposure 2015 BD 000
Balances with banks	**48,257**	45,652
Due from banks	**88,420**	77,966
Financing contracts with customers	**630,391**	535,395
Investments at amortised cost	**163,772**	73,816
Receivables	**10,818**	24,019
Total	**941,658**	756,848
Contingent liabilities and commitments	**154,797**	45,905
Total credit risk exposure	**1,096,455**	802,753

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.

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 2016 BD 000	**North America 2016 BD 000**	**Europe 2016 BD 000**	**Other 2016 BD 000**	**Total 2016 BD 000**
Balances with banks	**42,675**	**5,427**	**137**	**18**	**48,257**
Due from banks	**88,420**	**-**	**-**	**-**	**88,420**
Financing contracts with customers	**630,391**	**-**	**-**	**-**	**630,391**
Investments at amortised cost	**163,772**	**-**	**-**	**-**	**163,772**
Receivables	**10,818**	**-**	**-**	**-**	**10,818**
Contingent liabilities and commitments	**154,797**	**-**	**-**	**-**	**154,797**
Total	**1,090,873**	**5,427**	**137**	**18**	**1,096,455**

	Middle East 2015 BD 000	North America 2015 BD 000	Europe 2015 BD 000	Other 2015 BD 000	Total 2015 BD 000
Balances with banks	36,214	9,343	90	5	45,652
Due from banks	77,966	-	-	-	77,966
Financing contracts with customers	535,395	-	-	-	535,395
Investments at amortised cost	73,816	-	-	-	73,816
Receivables	24,019	-	-	-	24,019
Contingent liabilities and commitments	45,905	-	-	-	45,905
Total	793,315	9,343	90	5	802,753

36 RISK MANAGEMENT (continued)

36.2 Credit Risk (continued)

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 2016 BD 000	Banking and financial 2016 BD 000	Construction and real estate 2016 BD 000	Other 2016 BD 000	Total 2016 BD 000
Balances with banks	-	48,257	-	-	48,257
Due from banks	-	88,420	-	-	88,420
Financing contracts with customers	31,662	16,214	436,425	146,090	630,391
Investments at amortised cost	-	142,963	20,809	-	163,772
Receivables	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**

	Trading and manufacturing 2015 BD 000	Banking and financial 2015 BD 000	Construction and real estate 2015 BD 000	Other 2015 BD 000	Total 2015 BD 000
Balances with banks	-	45,652	-	-	45,652
Due from banks	-	77,966	-	-	77,966
Financing contracts with customers	31,660	6,587	406,897	90,251	535,395
Investments at amortised cost	-	52,930	20,886	-	73,816
Receivables	3,674	5,921	9,012	5,412	24,019
Contingent liabilities and commitments	18,221	-	16,234	11,450	45,905
Total	53,555	189,056	453,029	107,113	802,753

36 RISK MANAGEMENT (continued)

36.2 Credit Risk (continued)

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;

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).

36 RISK MANAGEMENT (continued)

36.2 Credit Risk (continued)

Credit quality per class of financial assets

	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 with customers (gross)	495,731	41,825	68,150	28,442	2,715	31,627	668,490
Investments at amortised cost	163,772	-	-	-	-	-	163,772
Receivables (gross)	10,210	-	-	-	-	5,345	15,555
Total	806,390	41,825	68,150	28,442	2,715	36,972	984,494

	Good 2015 BD 000	Watchlist 2015 BD 000	Rescheduled 2015 BD 000	Sub-standard 2015 BD 000	Doubtful 2015 BD 000	Loss 2015 BD 000	Total 2015 BD 000
Balances with banks	45,652	-	-	-	-	-	45,652
Due from banks	77,966	-	-	-	-	-	77,966
Financing contracts with customers (gross)	407,968	29,594	71,831	28,313	13,635	21,908	573,249
Investments at amortised cost	73,816	-	-	-	-	-	73,816
Receivables (gross)	23,054	-	-	-	-	13,254	36,308
Total	628,456	29,594	71,831	28,313	13,635	35,162	806,991

Rescheduled, substandard, doubtful and loss categories are secured with collateral amounting to BD 250,050 thousand (2015: BD 267,854 thousand), BD 77,865 thousand (2015: BD 77,042 thousand), NIL (2015: BD 30,000) and BD 95,170 thousand (2015: BD 61,576 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.

36 RISK MANAGEMENT (continued)

36.2 Credit Risk (continued)

Aging analysis of watchlist facilities

	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 with customers	**18,277**	**20,999**	**2,549**	**-**	**41,825**

	Less than 30 days 2015 BD 000	31 to 60 days 2015 BD 000	61 to 90 days 2015 BD 000	More than 90 days 2015 BD 000	Total 2015 BD 000
Financing contracts with customers	21,016	7,956	622	-	29,594

The estimated value of collateral held by the Bank against watchlist facilities amounts to BD 164,335 thousand (2015: BD 308,754 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.

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.

36 RISK MANAGEMENT (continued)

36.3 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:

	2016 **%**	2015 %
31 December	**34.86**	26.99
During the year:		
Average	**30.96**	25.91
Highest	**35.45**	29.98
Lowest	**25.05**	22.32

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 2016 and 2015 based on contractual undiscounted repayment obligations. Maturity analysis of assets, liabilities and equity of investment account holders by expected maturities is disclosed in Note 35. 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.

36 RISK MANAGEMENT (continued)

36.3 Liquidity risk and funding management (continued)

	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 2016						
Due to banks	**740**	**151,760**	**76,272**	**53,083**	**-**	**281,855**
Murabaha due to non-banks	**-**	**62,960**	**100,660**	**79,254**	**-**	**242,874**
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 murabaha payable	**-**	**-**	**-**	**97,326**	**-**	**97,326**
Total undiscounted financial liabilities 2016	**339,183**	**424,762**	**254,122**	**235,415**	**-**	**1,253,482**
At 31 December 2015						
Due to banks	6,398	187,678	9,511	52,430	-	256,017
Murabaha due to non-banks	-	84,115	9,004	22,684	-	115,803
Customers' current accounts	116,534	-	-	-	-	116,534
Other liabilities	-	33,865	3,063	11,525	-	48,453
Equity of investment account holders	181,002	220,255	55,983	-	-	457,240
Subordinated murabaha payable	-	-	-	100,584	-	100,584
Total undiscounted financial liabilities 2015	303,934	525,913	77,561	187,223	-	1,094,631

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.

36 RISK MANAGEMENT (continued)

36.3 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 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**
Development commitment	**-**	**-**	**100**	**-**	**100**
Total	**15,288**	**97,907**	**15,834**	**25,768**	**154,797**
At 31 December 2015					
Letters of credit	890	-	7,850	-	8,740
Guarantees	5,981	-	-	-	5,981
Irrevocable commitments to extend credit	-	4,114	12,301	4,945	21,360
Investment commitment	-	-	-	9,824	9,824
Total	6,871	4,114	20,151	14,769	45,905

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

36.4 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.

36 RISK MANAGEMENT (continued)

36.4 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.

	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 with customers	500,041	+25	1,250
Investments at amortised cost	163,772	+25	409
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS			
Due to banks	277,317	+25	(693)
Murabaha due to non-banks	237,864	+25	(595)
Subordinated murabaha payable	91,242	+25	(228)
Equity of investment account holders	441,244	+25	(1,103)
Total			(739)

	2015 BD 000	Change in basis points	Effect on net income for the year BD 000
ASSETS			
Due from banks	77,966	+25	195
Financing contracts with customers	394,492	+25	986
Investments at amortised cost	73,816	+25	185
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS			
Due to banks	252,932	+25	(632)
Murabaha due to non-banks	114,521	+25	(286)
Subordinated murabaha payable	91,753	+25	(229)
Equity of investment account holders	456,700	+25	(1,142)
Total			(923)

36 RISK MANAGEMENT (continued)

36.4 Market risk (continued)

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The 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.

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

	Equivalent long (short) 2016 BD 000	Equivalent long (short) 2015 BD 000
Currency		
KWD	36	2,664
JOD	20,681	21,505
GBP	(95)	190
EUR	(160)	327

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 2016 BD 000	Effect on equity 2016 BD 000	Change in currency rate %	Effect on profit 2015 BD 000	Effect on equity 2015 BD 000
KWD	+20	7	-	+20	533	-
JOD	+20	-	4,136	+20	-	4,641
GBP	+20	(19)	-	+20	38	-
EUR	+20	(32)	-	+20	65	-
Total		(44)	4,136		636	4,641

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 2016) due to a reasonably possible change (i.e. +10%) in the value of individual investments, with all other variables held constant, is BD 13,936 thousand and BD 698 thousand (2015: BD 15,454 thousand and BD 720 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.

36 RISK MANAGEMENT (continued)

36.5 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.

36.6 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 BD 45,234 thousand (2015: BD 45,264 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.

36.7 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.

37 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 five 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.

37 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	2016 BD 000	2015 BD 000
Common equity Tier 1 capital	37.1	**354,118**	354,334
Tier 2 capital	37.2	**77,041**	93,636
Total capital		**431,159**	447,970
Credit risk-weighted assets		**2,240,238**	2,846,797
Market risk-weighted assets		**35,320**	39,980
Operational risk-weighted assets		**188,659**	180,611
Total risk weighted assets		**2,464,217**	3,067,388
Capital adequacy ratio		**17.5%**	14.6%
Minimum requirement		**12.5%**	12.5%

37.1 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.

37.2 Tier 2 capital comprises of subordinated murabaha 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.

38 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.

39 SOCIAL RESPONSIBILITY

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

40 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.

Kuwait Finance House - Bahrain
PO Box 2066, Manama
Kingdom of Bahrain

Tel: (+973) 7777 7777
Fax: (+973) 7700 0600

Call Centre
Tel: (+973) 7777 7777

www.kfh.bh

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