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

INDEPENDENT AUDITOR'S REPORT AND CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2018

Building a better working world

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

We have audited the accompanying consolidated statement of financial position of Kuwait Finance House (Bahrain) B.S.C. (c) [the "Bank"] and its subsidiaries [together the "Group"] as of 31 December 2018, 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 2018, the results of its operations, its cash flows, changes in equity and changes in off-balance sheet equity of investment account holders for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

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

Other Matters

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

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

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

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

Ernst + Young

Partner's registration no: 117
6 February 2019
Manama, Kingdom of Bahrain

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2018

	Note	**2018 BD 000**	2017 BD 000
ASSETS			
Cash and balances with banks and Central Bank of Bahrain	7	**49,651**	66,962
Due from banks	8	**74,651**	46,107
Financing contracts	9	**886,779**	737,552
Investments	10	**6,304**	7,747
Investment in sukuk	11	**219,039**	157,065
Investment in associates	12	**12,885**	12,599
Receivables and other assets	13	**250,353**	272,856
Premises and equipments		**5,140**	9,437
TOTAL ASSETS		**1,504,802**	1,310,325
LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNERS' EQUITY			
LIABILITIES			
Customers' current accounts		**127,748**	135,098
Due to banks	16	**224,405**	163,760
Due to non-banks		**367,176**	234,933
Other liabilities	18	**23,946**	23,101
Subordinated wakala payable	19	**94,250**	94,250
		837,525	651,142
EQUITY OF INVESTMENT ACCOUNT HOLDERS	20	**485,014**	477,676
OWNERS' EQUITY			
Equity attributable to shareholders of the Parent			
Share capital	21	**132,519**	132,519
Statutory reserve		**21,613**	19,768
Fair value through equity reserve		**170**	-
Proposed dividend		**16,608**	18,095
Retained earnings		**3,587**	3,321
		174,497	173,703
Non-controlling shareholders		**7,766**	7,804
		182,263	181,507
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNERS' EQUITY		**1,504,802**	1,310,325
OFF-BALANCE SHEET EQUITY OF INVESTMENT ACCOUNT HOLDERS		**135,110**	135,080
CONTINGENT LIABILITIES AND COMMITMENTS	23	**73,191**	135,078

Hamad Abdulmohsen AlMarzouq
Chairman of the Board of Directors

Abdulhakeem Yaqoub Alkhayyat
Managing Director and
Chief Executive Officer

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2018

	Note	2018 BD 000	2017 BD 000
CONTINUING OPERATIONS			
Income from financing contracts	24	**52,321**	42,944
Income from investments	25	**6,653**	10,268
Income from sukuk		**11,245**	6,979
Share of income from associates		**170**	425
Net (loss) revenue from non-banking business entities	27	**(117)**	500
OPERATING INCOME		**70,272**	61,116
Return on equity of investment account holders before Group's share as mudarib		**(14,245)**	(11,554)
Group's share as mudarib		**7,666**	6,311
Return on equity of investment account holders		**(6,579)**	(5,243)
Profit on due to banks, due to non-banks and subordinated wakala payable	30	**(18,551)**	(11,599)
NET OPERATING INCOME		**45,142**	44,274
Staff costs		**14,988**	14,449
Depreciation		**1,180**	1,011
Provisions - net	28	**459**	1,243
Other expenses	29	**9,391**	9,239
Operating expenses of non-banking business entities	27	**707**	920
TOTAL OPERATING EXPENSES		**26,725**	26,862
NET INCOME FOR THE YEAR FROM CONTINUING OPERATIONS		**18,417**	17,412
DISCONTINUED OPERATIONS			
Net results for the year from discontinued operations	15	**-**	2,600
NET INCOME FOR THE YEAR		**18,417**	20,012
Attributable to:			
Shareholders of the Parent		**18,453**	20,106
Non-controlling shareholders		**(36)**	(94)
		18,417	20,012

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 2018

	Note	*2018* *BD 000*	*2017* *BD 000*
OPERATING ACTIVITIES			
Net income for the year from continuing operations		**18,417**	17,412
Net results for the year from discontinued operations		**-**	2,600
Net income for the year		**18,417**	20,012
Adjustments for:			
Share of income from associates		**(170)**	(425)
Net (gain) on sale of investments	25	**(309)**	(8,719)
Net unrealised (gain) on investments	25	**(174)**	(34)
Net unrealised loss on investment in real estate		**-**	309
Dividend income	25	**(39)**	(82)
Foreign exchange gain	25	**(811)**	(380)
Rental income	25	**-**	(7)
Depreciation		**1,184**	1,029
Provisions - net		**626**	(1,259)
Operating income before changes in operating assets and liabilities		**18,724**	10,444
Changes in operating assets and liabilities:			
Mandatory reserve with Central Bank of Bahrain		**(995)**	(1,145)
Due from banks		**19,540**	(12,292)
Financing contracts		**(149,003)**	(86,950)
Receivables and other assets		**4,549**	11,391
Customers' current accounts		**(7,350)**	(12,532)
Due to banks and financial institutions		**60,645**	(9,422)
Customers' murabaha accounts		**132,243**	11,388
Other liabilities		**(48)**	(15,537)
Net cash flows from (used in) operating activities		**78,305**	(104,655)
INVESTING ACTIVITIES			
Sale of investments - net		**1,742**	14,809
(Purchase) sale of investment in sukuk - net		**(60,337)**	6,285
Distributions from investment in associates		**-**	2,962
Purchase of investment in real estate - net		**-**	(87)
Dividend income		**39**	82
Rental income		**-**	7
Disposal (purchase) of premises and equipment - net		**3,114**	(1,022)
Net cash flows (used in) from investing activities		**(55,442)**	23,036
FINANCING ACTIVITY			
Net movement in equity of investment account holders		**7,338**	36,432
Net cash flows from financing activity		**7,338**	36,432
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**30,201**	(45,187)
Cash and cash equivalents at 1 January		**58,500**	103,687
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	31	**88,701**	58,500

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

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

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

For the year ended 31 December 2018

	Equity attributable to shareholders of the Parent												
	Share capital BD 000	*Share premium BD 000*	*Treasury shares BD 000*	*Statutory reserve BD 000*	*General reserve BD 000*	*Fair value through equity reserve BD 000*	*Property fair value reserve BD 000*	*Foreign currency translation reserve BD 000*	*Retained earnings BD 000*	*Proposed dividend BD 000*	*Total BD 000*	*Non - controlling shareholders BD 000*	*Total owners' equity BD 000*
Balance at 1 January 2018	132,519	-	-	19,768	-	-	-	-	3,321	18,095	173,703	7,804	181,507
Net income for the year	-	-	-	-	-	-	-	-	18,453	-	18,453	(36)	18,417
Other comprehensive income for the year (note 22)	-	-	-	-	-	436	-	-	-	-	436	-	436
Total comprehensive income for the year	-	-	-	-	-	436	-	-	18,453	-	18,889	(36)	18,853
Dividend payout	-	-	-	-	-	-	-	-		(18,095)	(18,095)	-	(18,095)
Net transfer from fair value through equity reserve	-	-	-	-	-	(266)		-	266	-	-	-	-
Transfer to statutory reserve	-	-	-	1,845	-	-	-	-	(1,845)	-	-	-	-
Proposed dividend (note 21)	-	-	-	-	-	-	-	-	(16,608)	16,608	-	-	-
Net movement in share of non-controlling shareholders	-	-	-	-	-	-	-	-	-	-	-	(2)	(2)
Balance at 31 December 2018	**132,519**	**-**	**-**	**21,613**	**-**	**170**	**-**	**-**	**3,587**	**16,608**	**174,497**	**7,766**	**182,263**
Balance at 1 January 2017	177,140	71,403	(21,923)	17,757	28,237	(3,574)	30,923	(91)	60,403	-	360,275	8,316	368,591
Net income for the year	-	-	-	-	-	-	-	-	20,106	-	20,106	(94)	20,012
Other comprehensive income for the year (note 22)	-	-	-	-	-	3,231	-	91	-	-	3,322	-	3,322
Total comprehensive income for the year	-	-	-	-	-	3,231	-	91	20,106	-	23,428	(94)	23,334
Cancellation of treasury shares	(12,044)	(9,879)	21,923	-	-	-	-	-	-	-	-	-	-
Distributions	(32,577)	(61,524)	-	-	(28,237)	77	(30,900)	-	(56,839)	-	(210,000)	-	(210,000)
Net transfer from fair value through equity reserve	-	-	-	-	-	266	-	-	(266)	-	-	-	-
Net transfer from property fair value reserve	-	-	-	-	-	-	(23)	-	23	-	-	-	-
Transfer to statutory reserve	-	-	-	2,011	-	-	-	-	(2,011)	-	-	-	-
Proposed dividend (note 21)	-	-	-	-	-	-	-	-	(18,095)	18,095	-	-	-
Net movement in share of non-controlling shareholders	-	-	-	-	-	-	-	-	-	-	-	(418)	(418)
Balance at 31 December 2017	132,519	-	-	19,768	-	-	-	-	3,321	18,095	173,703	7,804	181,507

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 2018

	Balance at 1 January 2018 BD 000	***Additional investments BD 000***	***Gross income BD 000***	***Mudarib share BD 000***	***Withdrawals / distributions BD 000***	***Balance at December 2018 BD 000***
Murabaha contracts	**135,080**	**99,375**	**9,198**	**(2,348)**	**(106,195)**	**135,110**

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

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 compliant money placements / deposits, managing Shari'a compliant profit sharing investment accounts, offering Shari'a compliant 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 wholly owned subsidiary of Kuwait Finance House K.S.C.P. (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 the Group's 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 nine branches (2017: 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 6 February 2019.

2 BASIS OF PREPARATION

2.1 Accounting convention

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

2.2 Statement of compliance

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

2.3 Basis of consolidation

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

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

2 BASIS OF PREPARATION (continued)

2.3 Basis of consolidation (continued)

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

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

3 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

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

3.1 Going concern

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

3.2 Fair value of unquoted equity securities

Fair value is determined for each investment individually in accordance with the valuation policies set out in note 4.24. 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.

3.3 Impairment provisions against financing contracts

In determining impairment on receivables, judgment is required in the estimation of the amount and timing of future cash flows as well as an assessment of whether credit risk on the financial contract has increased significantly since initial recognition and incorporation of forward-looking information in the measurement of expected credit losses ("ECL"). Refer to note 4.1 for further details.

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 36.3. 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 Early adoption of FAS 30 - Impairment, Credit Losses and Onerous Commitments ("FAS 30")

The Group has early adopted FAS 30, effective from 1 January 2018 which has a mandatory date of initial application of 1 January 2020. The requirements of FAS 30 represent a significant change from FAS 11 "Provisions and Reserves".

As permitted by FAS 30, the standard has been applied retrospectively and the comparative amounts have not been restated. The early adoption of FAS 30 has not resulted in any adjustment to the opening retained earnings in the consolidated statment of changes in equity. The standard eliminates the use of the existing FAS 11 incurred loss impairment model approach.

Transition
Changes in accounting policies resulting from the adoption of FAS 30 have been applied retrospectively, except comparative periods which have not been restated. No differences in the carrying amounts of financial assets and financial liabilities have resulted from the adoption of FAS 30 which require adjustment in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of FAS 30 and therefore is not comparable to the information presented for 2018 under FAS 30.

Impact of adopting FAS 30
Following is the impact of early adoption of FAS 30:

	Balance 31 December 2017	*Transition adjustment*	*Restated balance 1 January 2018*
	BD 000	*BD 000*	*BD 000*
Cash and balances with banks and Central Bank of Bahrain	**66,962**	**(249)**	**66,713**
Due from banks	**46,107**	**(27)**	**46,080**
Financing contracts	**737,552**	**840**	**738,392**
Investment in sukuk	**157,065**	**(25)**	**157,040**
Receivables and other assets	**272,856**	**(33)**	**272,823**
Other liabilities	**23,101**	**506**	**23,607**

The key changes to the Group's accounting policies resulting from its adoption of FAS 30 are summarized in note 4.2 (b).

4.2 Summary of significant accounting policies

a) Financial contracts
Financial contracts consist of balances with banks and the Central Bank of Bahrain, Due from banks, Sukuk, Murabaha financing (net of deferred profits), Ijarah Muntahia Bittamleek, Musharaka, other assets, financing commitments and financial guarantee contracts. Balances relating to these contracts are stated net of allowance for credit losses.

b) Impairment assessment (policy applicable from 1st January 2018)

Impairment of financial assets
FAS 30 replaces the 'incurred loss' model in FAS 11 with Expected Credit Loss ("ECL") model. The new impairment model also applies to certain financing commitments and financial guarantee contracts but not to equity investments.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.2 Summary of significant accounting policies (continued)

b) Impairment assessment (policy applicable from 1st January 2018) (continued)

Impairment of financial assets (continued)
The Group applies three-stage approach to measure ECL on financial assets carried at amortised cost. Assets migrate through the following three stages based on the change in credit quality since initial recognition.

Stage 1: Twelve months ECL
For exposures where there has not been a Significant Increase in Credit Risk ("SICR"), since initial recognition, a portion of the lifetime ECL associated with the probability of default events occurring within next twelve months is recognised.

Twelve-month ECL (Stage 1) is the portion of ECL that results from probable default events on a financial contract within twelve months after the reporting date.

Stage 2: Lifetime ECL – not credit impaired
For credit exposures where there has been a SICR since initial recognition but that are not credit impaired, a lifetime ECL is recognised.

Lifetime ECL (Stage 2) is a probability-weighted estimate of credit losses and is determined based on the difference between the present value of all cash shortfalls. The cash shortfall is the difference between all contractual cash flows that are due to the Group and the present value of the recoverable amount, for financial assets that are not credit-impaired at the reporting date.

Stage 3: Lifetime ECL – credit impaired
Financial contracts are assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred.

For Stage 3 financial contracts, the provisions for credit-impairment are determined based on the difference between the net carrying amount and the recoverable amount of the financial contract. As this uses the same criteria as under FAS 11, the Group methodology for specific allowance for credit losses remains largely unchanged.

Credit-impaired financial assets
At each reporting date, the Group assesses whether financial assets carried at amortised cost are credit-impaired. Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event; and
- probability that the borrower will enter bankruptcy or other financial reorganization.

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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.2 Summary of significant accounting policies (continued)

b) Impairment assessment (policy applicable from 1st January 2018) (continued)

Measurement of ECL
The key inputs into the measurement of ECL are the following variables:

- Probability of Default (PD);
- Loss Given Default (LGD); and
- Exposure At Default (EAD).

These parameters are generally derived from internally developed models and other historical data. These are adjusted to reflect forward-looking information as described below.

Probability of default
Credit risk grades are a primary input into the determination of the term structure of PD for exposures. The Group collects performance and default information about its credit risk exposures. The Group employs statistical models for analysing the data collected and generate estimates of PD of exposures and how these are expected to change as a result of the passage of time. This analysis includes the identification and calibration of relationships between changes in default rates and changes in key macro-economic factors, across various geographies in which the Bank has taken exposures. For most exposures, the key macro-economic indicators include gross domestic product (GDP) growth, real interest rates, oil prices and equity prices.

Incorporation of forward - looking information
The Group employs statistical models to incorporate macro-economic factors on historical default rates. In case none of the macro-economic parameters are statistically significant or the results of forecasted PDs are significantly deviated from the present forecast for the economic conditions, quantitative PD overlay shall be used by the management after analyzing the portfolio.

Incorporating forward-looking information increases the level of judgment as to how changes in these macroeconomic factors will affect the ECL applicable to the stage 1 and stage 2 exposures which are considered as performing (Stage 3 are the exposures under default category). The methodologies and assumptions involved, including any forecasts of future economic conditions, are reviewed periodically.

Loss Given Default
LGD is the magnitude of the likely loss if there is a default. The Group estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties and collaterals held, based on historical data using both internal and external factors including hair cuts.

Exposure At Default
EAD represents the expected exposure in the event of a default. The Group derives the EAD from the current exposure to the counterparty and potential changes to the current amounts allowed under the contract including amortisation. The EAD of a financial asset is its gross carrying amount. For financing commitments and financial guarantees, the EAD is converted to consolidated statement of financial position equivalents.

Significant Increase in Credit Risk
When determining whether the risk of default on a financial contracts has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Group's historical experience and expert credit assessment including forward-looking information.

The criteria for determining whether credit risk has increased significantly vary on a portfolio level and include quantitative and qualitative factors, including days past due and risk rating.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.2 Summary of significant accounting policies (continued)

b) Impairment assessment (policy applicable from 1st January 2018) (continued)

Renegotiated financial assets
The contractual terms of a financing may be modified for a number of reasons including changing market conditions, and other factors not related to the current or potential credit deterioration of a customer.

The Group considers renegotiated financing to customers due to financial difficulties as one of the reasons for determining the significant increase in credit risk. This may involve extending the payment arrangements and documenting the agreement of new conditions for providing finance. Management continuously reviews renegotiated facilities to ensure that all criteria are met and that future payments are likely to occur.

The accounts which are performing prior to restructuring but restructured due to financial difficulty are categorised under stage 2. The accounts that are non-performing or meet any criteria for classifying as non-performing (prior to restructuring), then such restructured accounts are categorised under stage 3.

Backward transition
FAS 30 staging model is of symmetrical nature as exposures may migrate from lifetime ECL measurement (Stage 2 and Stage 3) to 12 month ECL measurement (Stage 1). Once such indicators are no longer triggered, movement back to Stage 1 or Stage 2 are subject to certain criteria such as cooling off period, SICR indicators and payment history, where applicable.

Credit Conversion Factor
The estimation of EAD takes into account any unexpected changes in the exposure after the assessment date, including expected drawdowns on committed facilities through the application of a credit conversion factor (CCF). The EAD is estimated using the outstanding exposure adjusted by CCF times undrawn portion of the facilities. In case of financial guarantee, EAD is estimated as CCF times the committed amount.

The outstanding exposure is equivalent to the principal outstanding. The undrawn portion refers to the portion of the unutilized credit limit.

Write-offs
Financing contracts are written-off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. However, financial assets that are written-off could still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due.

Presentation of allowance for credit losses in the consolidated statement of financial position
Allowance for credit losses are presented in the consolidated statement of financial position as follows:

- financial assets measured at amortised cost, as a deduction from the gross carrying amount of the assets; and

- financing commitments and financial guarantee contracts: generally as a provision in other liabilities.

- where a financial contract includes both a drawn and undrawn component, and the Group has identified the ECL on the financing commitments / off-balance sheet component separately from those on the drawn component, the Group presents allowance for credit losses for drawn components. The amount is presented as a deduction from the gross carrying amount of the drawn component. Allowance for credit losses for the undrawn component is presented as a provision in other liabilities.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.2 Summary of significant accounting policies (continued)

c) Impairment assessment (policy applicable up to 31st December 2017)
Prior to adoption of FAS 30, the Group reviewed 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 was required in the estimation of the amount and timing of future cash flows when determining the level of provision required. Such estimates were based on assumptions about factors involving varying degrees of judgment and uncertainty and actual results could differ resulting in future changes to the provisions.

In addition to impairment against individually impaired financing contracts, the Group also made a collective impairment provision against exposures which, although not specifically identified as requiring an individual impairment, had a greater risk of default than when originally granted. That took 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.

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

(i) Transactions and balances
Transactions in foreign currencies are initially recorded in the functional currency using the rate of exchange prevailing at the date of the transaction.

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

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

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

4.4 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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Initial and subsequent measurement of financial instruments

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

(i) Due from banks

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

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

(ii) Financing contracts

(a) Murabaha

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

(b) Ijarah Muntahia Bittamleek

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

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

(c) Musharaka

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

(iii) Investments

Investments are classified as follows:

- Investments at fair value through statement of income
- Investments at fair value through equity
- 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'.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

(iii) Investments (continued)

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

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

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

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

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

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

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

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

4.5 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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.5 Derecognition of financial assets and financial liabilities (continued)

(i) Financial assets (continued)

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.

4.6 Impairment of financial assets

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

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

(i) Financial assets carried at amortised cost

The Group applies three-stage approach to measure ECL on financial assets carried at amortised cost as required by FAS 11 with Expected Credit Loss model explained above.

(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.

4.7 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.

4.8 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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.8 Recognition of income and expense (continued)

(i) Income recognition (continued)

(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.

(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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.8 Recognition of income and expense (continued)

(ii) Expense recognition

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

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

4.9 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.

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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.9 Investment in associates (continued)

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.

4.10 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
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.

4.11 Intangible assets

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

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.12 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.

4.13 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.

4.14 Treasury shares

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

4.15 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.

4.16 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.

4.17 Cash and cash equivalents

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

4.18 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 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.19 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 financing contracts'. 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.

4.20 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.

4.21 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.

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

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

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

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

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

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

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

4.24 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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.24 Fair value of financial instruments (continued)

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. Observable data used along with the Group's approach to determining fair values of financial instruments and quantitative disclosure are disclosed in note 34.

4.25 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".

4.26 Zakah

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

4.27 Provision for onerous contract or commitment to acquire an asset

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

4.28 New standards, amendments and interpretations issued but not yet effective

FAS 28 Murabaha and other deferred payment sales

This standard prescribes the accounting and reporting principles and requirements for Murabaha and deferred payment sales transactions and different elements of such transaction. This standard supersedes the earlier FAS 2 "Murabaha and Murabaha to the Purchase Orderer" and FAS 20 "Deferred Payment Sale". This standard shall be effective beginning on or after 1 January 2019, with early adoption permitted.

FAS 31 Investment Agency (Al-Wakala Bi Al-Istithmar)

This standard intends to define the accounting principles and reporting requirements for investment agency (Al-Wakala Bi Al-Istithmar) transactions and instruments, in the hands of both the principal and the agent. This standard shall be effective beginning on or after 1 January 2020, with early adoption permitted.

The Board of Directors expects that the adoption of the above standards will have no material impact on the financial statements of the Bank in the year of initial application.

5 LIST OF KEY SUBSIDIARIES

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

Subsidiary	*Year of incorporation*	*Country of incorporation*	*Ownership %*	
			2018	*2017*
Kuwait Finance House - Jordan The company and its subsidiaries are engaged in investment advisory and investments in private equities and real estate development.	2007	Hashemite Kingdom of Jordan	**100.00**	100.00
Ishbiliya Village W.L.L. The principal activity of the company is to invest in and develop real estate projects and consequently buying, selling and marketing of such properties.	2005	Kingdom of Bahrain	**100.00**	100.00

6 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

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

At 31 December 2018	***Financial assets at fair value through statement of income***	***Financial assets at fair value through equity***	***Financial assets at cost/ amortised cost***	***Financial liabilities at cost/ amortised cost***	***Total***
	BD 000	***BD 000***	***BD 000***	***BD 000***	***BD 000***
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	-	-	**49,651**	-	**49,651**
Due from banks	-	-	**74,651**	-	**74,651**
Financing contracts	-	-	**886,779**	-	**886,779**
Investments	**1,562**	**4,742**	-	-	**6,304**
Investment in sukuk	-	-	**219,039**	-	**219,039**
Receivables and other assets	-	-	**212,552**	-	**212,552**
	1,562	**4,742**	**1,442,672**	-	**1,448,976**
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS					
Customers' current accounts	-	-	-	**127,748**	**127,748**
Due to banks	-	-	-	**224,405**	**224,405**
Due to non-banks	-	-	-	**367,176**	**367,176**
Other liabilities	-	-	-	**23,737**	**23,737**
Subordinated wakala payable	-	-	-	**94,250**	**94,250**
Equity of investment account holders	-	-	-	**485,014**	**485,014**
	-	-	-	**1,322,330**	**1,322,330**

At 31 December 2017	*Financial assets at fair value through statement of income*	*Financial assets at fair value through equity*	*Financial assets at cost/ amortised cost*	*Financial liabilities at cost/ amortised cost*	*Total*
	BD 000	*BD 000*	*BD 000*	*BD 000*	*BD 000*
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	-	-	66,962	-	66,962
Due from banks	-	-	46,107	-	46,107
Financing contracts	-	-	737,552	-	737,552
Investments	3,125	4,622	-	-	7,747
Investment in sukuk	-	-	157,065	-	157,065
Receivables and other assets	-	-	226,386	-	226,386
	3,125	4,622	1,234,072	-	1,241,819
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS					
Customers' current accounts	-	-	-	135,098	135,098
Due to banks	-	-	-	163,760	163,760
Due to non-banks	-	-	-	234,933	234,933
Other liabilities	-	-	-	21,632	21,632
Subordinated wakala payable	-	-	-	94,250	94,250
Equity of investment account holders	-	-	-	477,676	477,676
	-	-	-	1,127,349	1,127,349

7 CASH AND BALANCES WITH BANKS AND CENTRAL BANK OF BAHRAIN

	Note	*2018* *BD 000*	*2017* *BD 000*
Cash		**9,780**	9,795
Balances with banks		**6,589**	19,573
Balance with CBB		**1,828**	7,134
CBB mandatory reserve	7.1	**31,455**	30,460
Less: allowance for credit losses		**(1)**	-
	7.2	**49,651**	66,962

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

7.2 This balance includes BD 15,650 thousand (2017: BD 27,516 thousand) financed by investment account holders' funds.

8 DUE FROM BANKS

	2018 *BD 000*	*2017* *BD 000*
Murabaha	**24,818**	27,370
Wakala	**50,368**	18,850
	75,186	46,220
Less: allowance for credit losses	**(535)**	(113)
	74,651	46,107

This balance includes BD 12,416 thousand (2017: BD 18,395 thousand) financed by investment account holders' funds. Due from banks carry profit rates ranging from 0.78% to 3.30% per annum (2017: 0.60% to 3.44% per annum).

9 FINANCING CONTRACTS

The table below shows the financing contracts by stage and type of facility:

	31 December 2018			
Self financed	*Murabaha*	*Musharaka*	*Ijarah Muntahia Bittamleek*	*Total*
	BD 000	*BD 000*	*BD 000*	*BD 000*
Stage 1: 12-month ECL	**176,498**	**121**	**225,439**	**402,058**
Stage 2: Lifetime ECL not credit-impaired	**19,060**	**-**	**37,874**	**56,934**
Stage 3: Lifetime ECL credit-impaired	**16,438**	**40**	**26,712**	**43,190**
Total allowance for credit losses	**(6,380)**	**(31)**	**(5,562)**	**(11,973)**
	205,616	**130**	**284,463**	**490,209**
31 December 2017 (Audited)	159,920	291	207,448	367,659

9 FINANCING CONTRACTS (continued)

Financed through investment account holders' funds	31 December 2018			
	Murabaha	*Musharaka*	*Ijarah Muntahia Bittamleek*	*Total*
	BD 000	*BD 000*	*BD 000*	*BD 000*
Stage 1: 12-month ECL	**142,821**	**-**	**182,424**	**325,245**
Stage 2: Lifetime ECL not credit-impaired	**15,423**	**-**	**30,647**	**46,070**
Stage 3: Lifetime ECL credit-impaired	**13,302**	**-**	**21,616**	**34,918**
Total allowance for credit losses	**(5,162)**	**-**	**(4,501)**	**(9,663)**
	166,384	**-**	**230,186**	**396,570**
31 December 2017 (Audited)	158,707	-	218,620	377,327
31 December 2017 (Audited) - Collective impairment provision - total				(7,434)

The table below shows the credit quality and the maximum exposure to credit risk based on the customer's past due status and year end stage classification. The amounts presented are gross of impairment allowances.

	31 December 2018				31 December 2017
	Stage 1: 12-month ECL	*Stage 2: Lifetime ECL not credit-impaired*	*Stage 3: Lifetime ECL credit-impaired*	*Total*	*Total*
	BD 000	*BD 000*	*BD 000*	*BD 000*	*BD 000*
Not past due	**727,303**	**100,314**	**4,251**	**831,868**	619,413
1 to 89 days past due	**-**	**2,690**	**1,052**	**3,742**	80,345
90 days or more past due	**-**	**-**	**72,805**	**72,805**	69,217
Total allowance for credit losses	**(2,638)**	**(13,337)**	**(5,661)**	**(21,636)**	(31,423)
	724,665	**89,667**	**72,447**	**886,779**	737,552

Movements in allowance for credit losses on financing contracts

	Stage 1: 12-month ECL	*Stage 2: Lifetime ECL not credit-impaired*	*Stage 3: Lifetime ECL credit-impaired*	*Total*
	BD 000	*BD 000*	*BD 000*	*BD 000*
Balance at 31 December 2017				**31,423**
Transition adjustment on adoption of FAS 30				**(840)**
Balance at 1 January 2018 (after transition adjustment)	**5,201**	**12,452**	**12,930**	**30,583**
- transferred to Stage 1: 12-month ECL	347	(75)	(272)	-
- transferred to Stage 2: Lifetime ECL not credit-impaired	(14)	1,350	(1,336)	-
- transferred to Stage 3: Lifetime ECL credit-impaired	(37)	(876)	913	-
Net remeasurement of loss allowance	(2,752)	559	4,157	1,964
Recoveries / write-backs	(107)	(73)	(1,179)	(1,359)
Allowance for credit losses	(2,563)	885	2,283	**605**
Amounts written off during the period	-	-	(9,552)	(9,552)
Balance at 31 December 2018	**2,638**	**13,337**	**5,661**	**21,636**

9 FINANCING CONTRACTS (continued)

	Year ended 31 December 2017		
	Individual impairment BD 000	*Collective impairment BD 000*	*Total BD 000*
As at 1 January	12,254	25,845	38,099
Charge / transfers	16,074	1,264	17,338
Reversals / transfers	(1,749)	(19,675)	(21,424)
Provisions - net	14,325	(18,411)	(4,086)
Write-offs	(2,590)	-	(2,590)
As at 31 December 2017	23,989	7,434	31,423

9.1 Ijarah Muntahia Bittamleek mainly comprise of land and building and are presented net of accumulated depreciation amounting to BD 107,833 thousand (2017: BD 93,600 thousand).

9.2 During the year, the Bank took possession of properties with a carrying value of BD 250 thousand (2017 : 2,876 thousand) as part of financing settlement and were classified as repossessed assets in the receivables and other assets.

10 INVESTMENTS

The Group's investments are classified as follows:

	Note	***2018 BD 000***	*2017 BD 000*
Investments at fair value through statement of income	10.1	**1,562**	3,125
Investments at fair value through equity	10.2	**4,742**	4,622
		6,304	7,747

10.1 Carried at fair value through statement of income

	2018 BD 000	*2017 BD 000*
Held for trading	**-**	1,742
Designated at fair value upon initial recognition - Managed Fund	**1,562**	1,383
	1,562	3,125

10.2 Carried at fair value through equity

	2018 BD 000	*2017 BD 000*
Quoted equity securities - cost	**1,572**	1,572
Unquoted equity securities - cost	**8,065**	8,065
	9,637	9,637
Impairment provisions	**(5,065)**	(5,015)
Fair value changes	**170**	-
	4,742	4,622

10.2.1 Movement in impairment provisions relating to investments:

	2018 BD 000	*2017 BD 000*
At 1 January	**5,015**	1,504
Charge / reclassification to income statement	**50**	3,511
At 31 December	**5,065**	5,015

10 INVESTMENTS (continued)

10.2 Carried at fair value through equity (continued)

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

	2018 BD 000	2017 BD 000
At 1 January	**4,622**	5,099
Impairment provisions	**(50)**	(3,511)
Fair value changes	**170**	-
Reclassification to income statement on impairment	**-**	3,034
At 31 December	**4,742**	4,622

10.3 Composition of investment portfolio:

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

	Middle East BD 000	Total 2018 BD 000	Total 2017 BD 000
Banking and financial services	**6,304**	**6,304**	6,442
Others	**-**	**-**	1,305
	6,304	**6,304**	7,747

11 INVESTMENT IN SUKUK

	Note	2018 BD 000	2017 BD 000
Quoted sukuk			
Government		**111,951**	65,479
Unquoted sukuk			
Government		**86,211**	70,700
Others		**20,886**	20,886
Less: allowance for credit losses		**(9)**	-
	11.1	**219,039**	157,065

11.1 Investment in sukuk includes an amount of BD 52,750 thousand (2017: BD 54,438 thousand) financed by investment account holders' funds. Fair value of investment in sukuk as at 31 December 2018 amounted to BD 219,656 thousand (2017: BD 158,346 thousand).

12 INVESTMENT IN ASSOCIATES

The Group has the following associates as at 31 December 2018:

Name of the associates	*Nature of business*	*Country of incorporation*	*Holding*
Deera Investment and Real Estate Development Company	Real estate project development and property management.	Hashemite Kingdom of Jordan	28.00%
Energy Central B.S.C. (c)	Providing district cooling, sea water desalination, waste water treatment and related services.	Kingdom of Bahrain	48.25%

12 INVESTMENT IN ASSOCIATES (continued)

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

	Note	2018 BD 000	2017 BD 000
At 1 January		**12,599**	129,302
Investments during the year		**-**	1,323
Disposals during the year		**-**	(115,156)
Distributions from the associates		**-**	(2,962)
Share of income from associates		**170**	425
Share of other comprehensive income	22	**266**	197
Provision for impairment		**(150)**	(757)
Other movements		**-**	227
At 31 December		**12,885**	12,599

The quoted value of the investment in associates for which quoted prices are available is BD 4,527 thousand (2017: BD 5,182 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 RECEIVABLES AND OTHER ASSETS

	Note	2018 BD 000	2017 BD 000
Land and development cost	13.1	**33,929**	37,717
Fees receivable		**2,489**	2,416
Project expenses receivable		**1,233**	1,150
Inventories		**1,071**	796
Profit receivable		**3,798**	2,375
Repossessed assets		**7,273**	7,023
Trade receivables of subsidiaries		**2,363**	4,387
Prepaid expenses		**1,752**	1,870
Receivables relating to disposal of investments	14	**205,400**	223,663
Receivables from corporate customers		**1,113**	1,442
Other assets		**1,322**	1,589
Gross receivables and other assets		**261,743**	284,428
Impairment provisions	13.2	**(11,390)**	(11,572)
		250,353	272,856

13.1 Land and development cost

	2018 BD 000	2017 BD 000
Land	**27,226**	28,700
Development cost	**6,703**	9,017
	33,929	37,717

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

13 RECEIVABLES AND OTHER ASSETS (continued)

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

	2018 ***BD 000***	*2017* *BD 000*
At 1 January	**11,572**	10,961
Transitional adjustment	**33**	-
Charge for the year	**(28)**	1,061
Settlements / write-offs	**(187)**	(450)
At 31 December	**11,390**	11,572

14 TRANSFER OF ASSETS TO THE ULTIMATE PARENT

During 2017, the Ultimate Parent approved a capital optimization plan for the Bank pursuant to which certain assets were transferred to a nominated entity of the Ultimate Parent. The transferred assets included investments of BD 134,855 thousand, investment in real estate of BD 302,528 thousand and investment in associates of BD 109,300 thousand.

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

During the year, the receivable from the nominated entity has reduced by BD 18,095 thousand on account of dividend payout.

15 DISCONTINUED OPERATIONS

On 14 December 2017, the Group signed the share sale agreement for the transfer of ownership and control of a wholly owned subsidiary, Mena Telecom W.L.L. ("Mena"). Mena was engaged in providing telecommunication services under licenses issued by the Telecommunications Regulatory Authority of the Kingdom of Bahrain.

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

	2018 ***BD 000***	*2017* *BD 000*
Revenue	-	10,433
Cost of sales	-	(2,516)
Operating income	-	7,917
Operating expenses	-	(7,819)
Reversals (povisions) - net	-	2,502
	-	2,600

The net cash flows received by Mena are as follows:

	2018 ***BD 000***	*2017* *BD 000*
Net cash flows from operating activities	-	3,124
Net cash flows from investing activities	-	(1,519)
	-	1,605

16 DUE TO BANKS

	2018	2017
	BD 000	BD 000
Murabaha payables	**112,540**	90,849
Wakala payables	**111,350**	72,321
Current accounts	**515**	590
	224,405	163,760

17 ASSETS UNDER MANAGEMENT

At 31 December 2018, assets managed in a fiduciary capacity amounted to BD 649,294 thousand (2017: BD 609,857 thousand).

18 OTHER LIABILITIES

	2018	2017
	BD 000	BD 000
Pay orders issued but not presented	**2,623**	2,320
Payable on account of financing contracts	**1,243**	851
Staff related accruals	**4,070**	4,393
Profit payable on due to banks, non-banks and subordinated wakala payable	**7,968**	4,616
Profit payable on equity of investment account holders	**1,694**	1,160
Trade payables of subsidiaries	**195**	2,042
Advance from customers	**209**	1,469
Contingencies and others	**5,944**	6,250
	23,946	23,101

19 SUBORDINATED WAKALA PAYABLE

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

During the year, an amount of BD 3,074 thousand (2017: BD 2,962 thousand) has been charged to the consolidated statement of income in respect of subordinated wakala payable.

20 EQUITY OF INVESTMENT ACCOUNT HOLDERS

The mudarib share on investment accounts ranges from 30% to 85% (2017: 30% to 85%) depending on the investment period and in the case of saving accounts, where there is no restriction on cash withdrawal, the mudarib share ranges from 85% to 95% (2017: 85% to 95%). The rate of return to investment account holders, as at 31 December 2018 and 2017, for various types of investment accounts, denominated in BD and USD, is as follows:

	2018 Rate of return %	2017 Rate of return %
Investment accounts - denominated in BD		
Saving accounts	**0.15**	0.14
VIP saving accounts	**0.46**	0.41
One month investment accounts	**1.30 - 1.50**	1.20
Three months investment accounts	**1.60 - 1.70**	1.40
Six months investment accounts	**1.90 - 2.00**	1.65
Nine months investment accounts	**2.10 - 2.20**	1.80
One year investment accounts	**2.30 - 2.60**	1.90 - 2.00

20 EQUITY OF INVESTMENT ACCOUNT HOLDERS (continued)

	2018 Rate of return %	*2017 Rate of return %*
Investment accounts - denominated in USD		
Saving accounts	**0.15**	0.14
VIP saving accounts	**0.31**	0.30
One month investment accounts	**0.95 - 1.00**	0.85 - 0.95
Three months investment accounts	**1.25 - 1.35**	1.20
Six months investment accounts	**1.55 - 1.65**	1.40
Nine months investment accounts	**1.70**	1.50
One year investment accounts	**1.85 - 2.00**	1.65

20.1 Investment accounts by type

	2018 BD 000	*2017 BD 000*
Saving accounts	**189,228**	184,071
VIP saving accounts	**13,380**	22,285
One month investment accounts	**33,231**	67,108
Three months investment accounts	**52,609**	67,828
Six months investment accounts	**45,591**	47,175
Nine months investment accounts	**3,081**	2,767
One year and above investment accounts	**147,894**	86,442
	485,014	477,676

21 SHARE CAPITAL AND RESERVES

Share capital

	2018 BD 000	*2017 BD 000*
Authorised:		
3,500,000 thousand (2017 : 3,500,000 thousand) ordinary shares of BD 0.1 each	**350,000**	350,000
Issued and fully paid up:		
As at the beginning and end of the year		
1,325,187 thousand (2017 : 1,325,187 thousand) shares	**132,519**	132,519

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").

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.

21 SHARE CAPITAL AND RESERVES (continued)

Fair value through equity reserve

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

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 1,459 thousand (2017: BD 1,502 thousand) relating to subsidiaries of the Bank.

Proposed dividend

Proposed dividend is shown seperately within equity till it is approved by the Annual General Meeting. The Board of Directors of the Bank have proposed a dividend of BD 16,608 thousand for the year ended 31 December 2018 (2017 : BD 18,095 thousand). This proposal is subject to the approval of the Annual General Meeting of the Bank and completion of legal formalities.

22 TOTAL COMPREHENSIVE INCOME

	2018	*2017*
	BD 000	*BD 000*
Net income for the year	**18,417**	20,012
Other comprehensive income		
Fair value adjustments against fair value through equity investments	**170**	-
Reclassification to income statement on impairment of equity investment	**-**	3,034
Net movement in foreign currency translation reserve	**-**	91
Share of other comprehensive income of associates	**266**	197
Total other comprehensive income for the year	**436**	3,322
Total comprehensive income for the year	**18,853**	23,334
Adjustment attributable to non-controlling shareholders	**36**	94
	18,889	23,428

23 CONTINGENT LIABILITIES AND COMMITMENTS

	Note	***2018***	*2017*
		BD 000	*BD 000*
Contingent liabilities			
Letters of credit		**9,660**	25,536
Guarantees		**9,788**	11,076
		19,448	36,612
Irrevocable commitments to extend credit (original term to maturity of one year or less)		**53,355**	97,949
Development cost commitment	23.1	**388**	517
		73,191	135,078

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

Operating lease commitments

At 31 December 2018, the Group had commitments in respect of non-cancellable operating leases amounting to BD 3,877 thousand (2017: BD 1,424 thousand) relating to leasehold premises. Of the commitments in respect of operating leases, BD 1,184 thousand (2017: BD 1,130 thousand) are due within one year, BD 2,667 thousand (2017: BD 250 thousand) are due in one to five years and the remaining over five years.

24 INCOME FROM FINANCING CONTRACTS

	Note	2018 BD 000	2017 BD 000
Murabaha		**20,730**	16,922
Ijarah Muntahia Bittamleek	24.1	**26,495**	21,384
Musharaka		**19**	26
Due from banks		**1,764**	972
	24.2	**49,008**	39,304
Mudarib share from off balance sheet equity of investment account holders		**2,348**	2,692
Fees and commission income		**965**	948
Income from financing contracts		**52,321**	42,944

24.1 This is presented net of depreciation on Ijarah Muntahia Bittamleek assets amounting to BD 42,881 thousand (2017: BD 40,589 thousand).

24.2 This is excluding income of BD 3,239 thousand (2017: BD 954 thousand) suspended during the year on account of regulatory requirements.

25 INCOME FROM INVESTMENTS

		2018 BD 000	2017 BD 000
Net unrealised gain on investments	25.1	**174**	34
Net gain on sale of investments		**1,309**	8,719
Dividend income		**39**	82
Fee income		**1,745**	1,029
Foreign exchange		**811**	380
Rental income		**-**	24
Other income	25.2	**2,575**	-
		6,653	10,268

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

25.2 Other income include gain from the sale of an asset of BD 2,548 thousand recorded during the year.

26 INCOME AND EXPENSE RELATING TO FINANCING CONTRACTS AND SUKUK

	Note	2018 BD 000	2017 BD 000
Income from on-balance sheet financing contracts	24	**49,008**	39,304
Income from sukuk		**11,245**	6,979
		60,253	46,283
Less: Profit on due to banks, due to non-banks and subordinated wakala payable	30	**18,551**	11,599
Less: Return on equity of investment account holders		**6,579**	5,243
		25,130	16,842
		35,123	29,441

27 NON-BANKING BUSINESS ENTITIES

	Note	2018 BD 000	2017 BD 000
Revenue		**3,362**	5,576
Direct cost		**3,479**	5,076
Net (loss) revenue from non-banking business entities		**(117)**	500
Operating expenses of non-banking business entities	27.1	**(707)**	(920)
		(824)	(420)

27.1 Operating expenses

	2018 BD 000	2017 BD 000
Staff costs	**349**	251
Depreciation	**4**	18
Other expenses	**354**	651
	707	920

28 PROVISIONS - NET

	Note	2018 BD 000	2017 BD 000
Balances with Banks and Central Bank of Bahrain		**(249)**	-
Due from banks		**395**	-
Financing contracts	9	**605**	(4,086)
Investments	10.2.1	**50**	3,511
Investment in sukuk		**(17)**	-
Investment in associates		**150**	757
Receivables and other assets		**(28)**	1,061
Financing commitments and financial guarantees		**(447)**	-
		459	1,243

29 OTHER EXPENSES

	2018 BD 000	2017 BD 000
Business development	**1,813**	1,428
Technology and communication	**3,129**	2,937
Legal, consulting and outsourcing	**539**	860
Premises - rentals and maintenance	**2,393**	2,330
Administration, selling and others	**1,517**	1,684
	9,391	9,239

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

	2018 BD 000	2017 BD 000
Due to banks	**6,368**	4,356
Due to non-banks	**9,109**	4,281
Subordinated wakala payable (note 19)	**3,074**	2,962
	18,551	11,599

31 CASH AND CASH EQUIVALENTS

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

	2018	*2017*
	BD 000	*BD 000*
Cash	**9,780**	9,795
Balances with banks	**6,589**	19,573
Balances with CBB excluding mandatory reserve	**1,828**	7,134
Due from banks with original maturity of less than ninety days	**70,504**	21,998
	88,701	58,500

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, are unsecured.

The balances with related parties included in the consolidated financial statements are as follows:

	Parent BD 000	*Directors and key management personnel BD 000*	*Other related parties BD 000*	*Total 2018 BD 000*	*Total 2017 BD 000*
Balances with Banks	**1,400**	**-**	**20**	**1,420**	1,549
Financing contracts *	**-**	**4,914**	**58,811**	**63,725**	69,033
Investment in sukuk	**-**	**-**	**20,886**	**20,886**	20,886
Fees receivable	**-**	**-**	**835**	**835**	762
Receivables and other assets	**-**	**-**	**203,904**	**203,904**	222,000
Due to banks	**32,873**	**-**	**-**	**32,873**	50,266
Due to non-banks	**-**	**-**	**25,550**	**25,550**	27,825
Customers' current accounts	**292**	**444**	**5,612**	**6,348**	3,456
Subordinated wakala payable	**94,250**	**-**	**-**	**94,250**	94,250
Equity of investment account holders	**-**	**1,444**	**12,921**	**14,365**	11,834
Letters of credit	**-**	**-**	**1,528**	**1,528**	4,378
Commitments to extend credit	**-**	**-**	**4,501**	**4,501**	1,163
Off balance sheet equity of investment account holders					
- Funds extended to related parties	**-**	**-**	**135,110**	**135,110**	135,080
- Funds received from related parties	**-**	**-**	**4,550**	**4,550**	4,550
Assets under management	**-**	**-**	**597,872**	**597,872**	596,149

* includes stage 3 exposures of BD 16,961 thousand (2017: BD 17,046 thousand).

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:

	Parent BD 000	*Directors and key management personnel BD 000*	*Other related parties BD 000*	*Total 2018 BD 000*	*Total 2017 BD 000*
Income from financing contracts	-	**189**	**2,078**	**2,267**	3,592
Income from investment in sukuk	-	-	**1,271**	**1,271**	1,271
Fee income	-	-	**1,347**	**1,347**	798
Allowance for credit losses	-	**17**	**1,603**	**1,620**	-
Profit on due to banks	**672**	-	-	**672**	2,876
Profit on due to non-banks	-	-	**998**	**998**	554
Profit on subordinated wakala payable	**3,074**	-	-	**3,074**	2,962
Profit on equity investment account holders	-	**30**	**828**	**858**	783
Staff costs	-	**6,495**	**152**	**6,647**	5,626
Other expenses	-	-	**1,161**	**1,161**	1,120
Mudarib share of off-balance sheet equity of investment account holders	-	-	**2,348**	**2,348**	2,692

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

	2018 BD 000	*2017 BD 000*
Short term employee benefits	**6,133**	5,202
Long term employee benefits	**362**	296

Directors' remuneration and attendance fee for the year ended 31 December 2018 amounted to BD 195 thousand and BD 116 thousand respectively (2017: BD 198 thousand and BD 120 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 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 2018:

	Retail & Corporate Group BD 000	*Investment Banking Group BD 000*	*Total BD 000*
Operating income after direct costs	**60,509**	**9,763**	**70,272**
Net income for the year from continuing operations	**14,036**	**4,381**	**18,417**
Net income for the year			**18,417**
Segment assets	**1,208,023**	**296,779**	**1,504,802**
Segment liabilities and equity of investment account holders	**1,321,707**	**832**	**1,322,539**

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 2018.

	Bahrain BD 000	*Other countries BD 000*	*Total BD 000*
Operating income after direct costs	**68,489**	**1,783**	**70,272**
Segment assets	**1,452,224**	**52,578**	**1,504,802**

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 2017:

	Retail & Corporate Group BD 000	*Investment Banking Group BD 000*	*Total BD 000*
Operating income after direct costs	49,923	11,193	61,116
Net income for the year from continuing operations	11,580	5,832	17,412
Net results for the year from discontinued operations	-	2,600	2,600
Net income for the year			20,012
Segment assets	979,451	330,874	1,310,325
Segment liabilities and equity of investment account holders	722,664	406,154	1,128,818

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

	Bahrain BD 000	*Other countries BD 000*	*Total BD 000*
Operating income after direct costs	60,082	1,034	61,116
Segment assets	1,250,508	59,817	1,310,325

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

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 2018 and 2017, 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 2018 BD 000	***Level 2 2018 BD 000***	***Level 3 2018 BD 000***	***Total 2018 BD 000***
Investments at fair value through statement of income				
Managed funds	**-**	**1,562**	**-**	**1,562**
Investments at fair value through equity				
Quoted equity securities	**552**	**-**	**-**	**552**
Unquoted equity securities	**-**	**-**	**4,190**	**4,190**
	552	**1,562**	**4,190**	**6,304**

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

During the year ended 31 December 2018, 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.

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 2018 BD 000	***Managed funds 2018 BD 000***	*Unquoted equity securities 2017 BD 000*	*Managed funds 2017 BD 000*
Balance at 1 January	**4,240**	-	142,867	-
Provisions / unrealised fair value loss	**(50)**		(357)	
Disposals / redemptions during the year	-	-	(138,270)	-
Balance at 31 December	**4,190**	-	4,240	-

34 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

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

	Carrying amount 2018 BD 000	***Effect of reasonably possible alternative assumption 2018 BD 000***	*Carrying amount 2017 BD 000*	*Effect of reasonably possible alternative assumption 2017 BD 000*
Investments at fair value through equity				
Unquoted equity securities	**4,190**	**419**	4,240	424
	4,190	**419**	4,240	424

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

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

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

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 2018 BD 000	*3 to 12 months 2018 BD 000*	*Subtotal upto 12 2018 BD 000*	*1 to 5 years 2018 BD 000*	*5 to 10 years 2018 BD 000*	*Over 10 years 2018 BD 000*	*Subtotal Over 1 year 2018 BD 000*	*Total 2018 BD 000*
Assets								
Cash and balances with banks and Central Bank of Bahrain	10,090	1,720	**11,810**	14,818	6,963	16,060	**37,841**	**49,651**
Due from banks	74,651	-	**74,651**	-	-	-	**-**	**74,651**
Financing contracts	185,381	91,452	**276,833**	292,043	230,843	87,060	**609,946**	**886,779**
Investments	-	-	**-**	6,304	-	-	**6,304**	**6,304**
Investment in sukuk	-	37,699	**37,699**	44,393	136,947	-	**181,340**	**219,039**
Investment in associates	-	-	**-**	12,885	-	-	**12,885**	**12,885**
Receivables and other assets	22,384	37,063	**59,447**	190,906	-	-	**190,906**	**250,353**
Premises and equipments	-	-	**-**	-	5,140	-	**5,140**	**5,140**
Total	**292,506**	**167,934**	**460,440**	**561,349**	**379,893**	**103,120**	**1,044,362**	**1,504,802**
Liabilities and equity of investment account holders								
Customers' current accounts	6,872	-	**6,872**	40,292	40,292	40,292	**120,876**	**127,748**
Due to banks	82,985	9,000	**91,985**	132,420	-	-	**132,420**	**224,405**
Due to non-banks	5,027	25,550	**30,577**	277,658	29,471	29,470	**336,599**	**367,176**
Other liabilities	17,541	3,965	**21,506**	2,440	-	-	**2,440**	**23,946**
Equity of investment account holders	12,008	11,863	**23,871**	153,715	153,714	153,714	**461,143**	**485,014**
Subordinated wakala payable	-	-	**-**	94,250	-	-	**94,250**	**94,250**
Total	**124,433**	**50,378**	**174,811**	**700,775**	**223,477**	**223,476**	**1,147,728**	**1,322,539**
Net	**168,073**	**117,556**	**285,629**	**(139,426)**	**156,416**	**(120,356)**	**(103,366)**	**182,263**

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

	Upto one year			*Over one year*				
	Up to 3 months 2017 BD 000	*3 to 12 months 2017 BD 000*	*Subtotal upto 12 months 2017 BD 000*	*1 to 5 years 2017 BD 000*	*5 to 10 years 2017 BD 000*	*Over 10 years 2017 BD 000*	*Subtotal Over 1 year 2017 BD 000*	*Total 2017 BD 000*
Assets								
Cash and balances with banks and Central Bank of Bahrain	19,447	3,541	22,988	10,818	7,453	25,703	43,974	66,962
Due from banks	46,107	-	46,107	-	-	-	-	46,107
Financing contracts	67,657	115,959	183,616	270,464	210,213	73,259	553,936	737,552
Investments	1,742	1,765	3,507	-	4,240	-	4,240	7,747
Investment in sukuk	8,000	15,627	23,627	58,586	74,852	-	133,438	157,065
Investment in associates	-	-	-	12,599	-	-	12,599	12,599
Receivables and other assets	5,653	15	5,668	267,188	-	-	267,188	272,856
Premises and equipments	-	-	-	-	9,437	-	9,437	9,437
Total	148,606	136,907	285,513	619,655	306,195	98,962	1,024,812	1,310,325
Liabilities and equity of investment account holders								
Customers' current accounts	8,078	-	8,078	42,340	42,340	42,340	127,020	135,098
Due to banks	63,040	-	63,040	100,720	-	-	100,720	163,760
Due to non-banks	4,402	66,537	70,939	117,856	23,069	23,069	163,994	234,933
Other liabilities	14,737	4,408	19,145	3,956	-	-	3,956	23,101
Equity of investment account holders	16,181	16,625	32,806	148,290	148,290	148,290	444,870	477,676
Subordinated wakala payable	-	-	-	94,250	-	-	94,250	94,250
Total	106,438	87,570	194,008	507,412	213,699	213,699	934,810	1,128,818
Net	42,168	49,337	91,505	112,243	92,496	(114,737)	90,002	181,507

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.

Board Risk Committee (BRC)

The Board Risk Committee is a Board appointed committee which is comprised of three independent directors and one 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.

36 RISK MANAGEMENT (continued)

36.1 Introduction (continued)

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

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

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

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

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

Provisioning Committee (PC)
The PC is a senior management committee responsible for ensuring adequate provisions and profit suspensions against all the past due and impaired exposures of the Bank. It reviews past due details and approve the resulting provisioning and profit suspension amounts submitted by the respective departments in line with the approved Provisions & Impairment 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.

36 RISK MANAGEMENT (continued)

36.1 Introduction (continued)

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

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

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

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

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

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

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. 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.

The Bank has adopted FAS 30 starting January 2018 where impairment is based on a forward-looking Expected Credit Loss (ECL) model. ECL would be measured taking into account the projected cash flows, Probability of Default (PD), Loss Given Default (LGD) and Exposure At Default (EAD). The amount of ECLs recognised as a loss allowance or provision depends on the extent of credit deterioration since initial recognition.

36 RISK MANAGEMENT (continued)

36.2 Credit risk (continued)

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 2018 was BD 64,686 thousand (2017: BD 62,684 thousand).

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

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

	Gross maximum exposure 2018 BD 000	*Gross maximum exposure 2017 BD 000*
Balances with banks	**39,871**	57,167
Due from banks	**74,651**	46,107
Financing contracts	**886,779**	737,552
Investment in sukuk	**219,039**	157,065
Receivables and other assets	**212,552**	226,386
Total	**1,432,892**	1,224,277
Contingent liabilities and commitments	**73,191**	135,078
Total credit risk exposure	**1,506,083**	1,359,355

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.

36 RISK MANAGEMENT (continued)

36.2 Credit risk (continued)

Risk concentrations of the maximum exposure to credit risk

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

	Bahrain 2018 BD 000	*Other GCC 2018 BD 000*	*North America 2018 BD 000*	*Other 2018 BD 000*	*Total 2018 BD 000*
Balances with banks and Central Bank of Bahrain	**33,295**	**2,854**	**3,565**	**157**	**39,871**
Due from banks	**36,148**	**34,356**	**4,147**	-	**74,651**
Financing contracts	**876,118**	**10,661**	-	-	**886,779**
Investment in sukuk	**219,039**	-	-	-	**219,039**
Receivables and other assets	**6,711**	**205,841**	-	-	**212,552**
Contingent liabilities and commitments	**73,191**	-	-	-	**73,191**
Total	**1,244,502**	**253,712**	**7,712**	**157**	**1,506,083**

	Bahrain 2017 BD 000	*Other GCC 2017 BD 000*	*North America 2017 BD 000*	*Other 2017 BD 000*	*Total 2017 BD 000*
Balances with banks and Central Bank of Bahrain	38,085	3,634	15,343	105	57,167
Due from banks	11,197	22,934	11,976	-	46,107
Financing contracts	707,478	30,074	-	-	737,552
Investment in sukuk	157,065	-	-	-	157,065
Receivables and other assets	2,384	224,002	-	-	226,386
Contingent liabilities and commitments	135,078	-	-	-	135,078
Total	1,051,287	280,644	27,319	105	1,359,355

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 2018 BD 000	*Banking and financial institutions 2018 BD 000*	*Construction and real estate 2018 BD 000*	*Other 2018 BD 000*	*Total 2018 BD 000*
Balances with banks and Central Bank of Bahrain	-	**39,871**	-	-	**39,871**
Due from banks	-	**74,651**	-	-	**74,651**
Financing contracts	**83,340**	**1,988**	**480,147**	**321,304**	**886,779**
Investment in sukuk	-	**198,156**	**20,883**	-	**219,039**
Receivables and other assets	-	**3,932**	**207,654**	**966**	**212,552**
Contingent liabilities and commitments	**21,455**	-	**7,162**	**44,574**	**73,191**
Total	**104,795**	**318,598**	**715,846**	**366,844**	**1,506,083**

36 RISK MANAGEMENT (continued)

36.2 Credit risk (continued)

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

	Trading and manufacturing 2017 BD 000	*Banking and financial institutions 2017 BD 000*	*Construction and real estate 2017 BD 000*	*Other 2017 BD 000*	*Total 2017 BD 000*
Balances with banks and Central Bank of Bahrain	-	57,167	-	-	57,167
Due from banks	-	46,107	-	-	46,107
Financing contracts	74,239	12,262	427,140	223,911	737,552
Investment in sukuk	-	136,179	20,886	-	157,065
Receivables and other assets	-	2,655	222,683	1,048	226,386
Contingent liabilities and commitments	66,350	-	8,983	59,745	135,078
Total	140,589	254,370	679,692	284,704	1,359,355

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 Expected credit losses.

The Bank closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Bank will take possession of the collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to miitgate potential losses are shown below:

	Gross Exposures 2018 BD 000	***Expected Credit Loss 2018 BD 000***	***Carrying Amount 2018 BD 000***	***Fair Value Collateral Held 2018 BD 000***
Murabaha	**29,740**	**2,109**	**27,631**	**165,935**
Ijarah Muntahia Bittamleek	**48,328**	**3,522**	**44,806**	**158,497**
Musharaka	**40**	**31**	**9**	**148**
Total	**78,108**	**5,662**	**72,446**	**324,580**

	Gross Exposures 2017 BD 000	*Impairment Allowance 2017 BD 000*	*Carrying Amount 2017 BD 000*	*Fair Value of Collateral Held 2017 BD 000*
Murabaha	33,930	6,716	27,214	132,539
Ijarah Muntahia Bittamleek*	31,291	6,204	25,087	138,115
Musharaka	66	10	56	131
Total	65,287	12,930	52,357	270,785

36 RISK MANAGEMENT (continued)

36.2 Credit risk (continued)

Individually assessed provisions
The Group performs assessment of Expected Credit Loss (ECL) and Significant Increase in Credit Risk (SICR) using qualitative and quantitative information appropriate for each individually significant financing contract on an individual basis. Individual assessment is important for large material exposures, as these are managed individually and incorporate obligor and facility specific information. 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 ECL is evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed provisions
ECLs are assessed collectively for financing contracts in case of small, very immaterial portfolios. Provisions are evaluated on each reporting date with each portfolio subjected to a separate review. Collective assessment would enable application of standardized rules to specific portfolios for assessing SICR.

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.

36.3 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:

	2018	*2017*
	%	%
31 December	**32.95**	29.60
During the year:		
Average	**33.24**	30.78
Highest	**35.69**	36.32
Lowest	**28.58**	25.83

36 RISK MANAGEMENT (continued)

36.3 Liquidity risk and funding management (continued)

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

The table below summarises the maturity profile of the Group's financial liabilities and equity of investment account holders at 31 December 2018 and 2017 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.

	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 2018						
Due to banks	**515**	**92,130**	**-**	**147,710**	**-**	**240,355**
Due to non-banks	**-**	**135,434**	**226,921**	**12,371**	**-**	**374,726**
Customers' current accounts	**127,748**	**-**	**-**	**-**	**-**	**127,748**
Other liabilities	**-**	**17,541**	**3,965**	**2,440**	**-**	**23,946**
Equity of investment account holders	**202,608**	**133,612**	**139,425**	**11,639**	**-**	**487,284**
Subordinated wakala payable	**-**	**-**	**-**	**107,963**	**-**	**107,963**
Total undiscounted financial liabilities 2018	**330,871**	**378,717**	**370,311**	**282,123**	**-**	**1,362,022**
At 31 December 2017						
Due to banks	137	276,387	31,002	20,963	-	328,489
Due to non-banks	-	44,237	29,188	1,100	-	74,525
Customers' current accounts	135,098	-	-	-	-	135,098
Other liabilities	-	14,737	4,408	3,956	-	23,101
Equity of investment account holders	206,356	173,388	99,050	390	-	479,184
Subordinated wakala payable	-	-	-	103,524	-	103,524
Total undiscounted financial liabilities 2017	341,591	508,749	163,648	129,933	-	1,143,921

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 3 months BD 000*	*3 to 12 months BD 000*	*1 to 5 years BD 000*	*Total BD 000*
At 31 December 2018					
Letters of credit	**2,435**	**-**	**7,225**	**-**	**9,660**
Guarantees	**9,788**	**-**	**-**	**-**	**9,788**
Irrevocable commitments to extend credit	**-**	**3,587**	**40,856**	**8,912**	**53,355**
Development commitment	**-**	**-**	**388**	**-**	**388**
Total	**12,223**	**3,587**	**48,469**	**8,912**	**73,191**
At 31 December 2017					
Letters of credit	5,201	-	20,335	-	25,536
Guarantees	11,076	-	-	-	11,076
Irrevocable commitments to extend credit	-	5,170	67,627	25,152	97,949
Investment commitment	-	-	517	-	517
Total	16,277	5,170	88,479	25,152	135,078

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.

	2018 BD 000	**Change in basis points**	**Effect on net income for the year BD 000**
ASSETS			
Due from banks	**74,651**	**+25**	**187**
Financing contracts	**729,828**	**+25**	**1,825**
Investment in sukuk	**219,039**	**+25**	**548**
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS			
Due to banks	**224,405**	**+25**	**(561)**
Due to non-banks	**367,176**	**+25**	**(918)**
Subordinated wakala payable	**94,250**	**+25**	**(236)**
Equity of investment account holders	**485,014**	**+25**	**(1,213)**
Total			**(368)**

	2017 BD 000	*Change in basis points*	*Effect on net income for the year BD 000*
ASSETS			
Due from banks	46,107	+25	115
Financing contracts	581,382	+25	1,453
Investment in sukuk	157,065	+25	393
LIABILITIES AND EQUITY INVESTMENT ACCOUNT HOLDERS			
Due to banks	163,760	+25	(409)
Due to non-banks	234,933	+25	(588)
Subordinated wakala payable	94,250	+25	(236)
Equity of investment account holders	477,676	+25	(1,194)
Total			(466)

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.

36 RISK MANAGEMENT (continued)

36.4 Market risk (continued)

Currency risk (continued)

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

	Equivalent long (short) 2018 BD 000	*Equivalent long (short) 2017 BD 000*
Currency		
NZD	**67**	3
KWD	**723**	(351)
GBP	**(66)**	(5)
EUR	**(92)**	(108)

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 2018 BD 000***	***Effect on equity 2018 BD 000***	*Change in currency rate %*	*Effect on profit 2017 BD 000*	*Effect on equity 2017 BD 000*
NZD	+20	**13**	-	+20	1	-
KWD	+20	**145**	-	+20	(70)	-
GBP	+20	**(13)**	-	+20	(1)	-
EUR	+20	**(18)**	-	+20	(22)	-
Total		**127**	-		(92)	-

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 2018) due to a reasonably possible change (i.e. +10%) in the value of individual investments, with all other variables held constant, is nil and BD 660 thousand (2017: BD 174 thousand and BD 964 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.

36.5 *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 RISK MANAGEMENT (continued)

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 three years based on the Bank's projected financials and the risk charges required for its significant risks including credit risk, market risk, profit rate risk, liquidity risk, investments risks and operational risks. The Board of Directors, on an annual basis, review and approve the ICAAP plan for both normal and stress conditions.

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

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

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	***2018*** ***BD 000***	*2017* *BD 000*
Common equity Tier 1 capital	37.1	**173,645**	173,703
Tier 2 capital	37.2	**78,696**	92,259
Total capital		**252,341**	265,962
Credit risk-weighted assets		**1,017,716**	888,069
Market risk-weighted assets		**27,959**	31,715
Operational risk-weighted assets		**149,859**	176,254
Total risk weighted assets		**1,195,534**	1,096,038
Capital adequacy ratio		**21.1%**	24.3%
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 CAPITAL MANAGEMENT (continued)

37.2 Tier 2 capital comprises of subordinated wakala payable, provisions against stage 1 and stage 2 exposures 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.