

KHALEEJI COMMERCIAL BANK BSC
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2018

Commercial registration	:	55133 (registered with Central Bank of Bahrain as a retail Islamic bank).
Office	:	Bahrain Financial Harbour East Tower PO Box 60002, Manama, Kingdom of Bahrain
Directors	:	Jassim Mohamed Alseddiqi – Chairman Sh. Ahmed Bin Isa Khalifa Al Khalifa – Vice Chairman Hisham Ahmed Al Rayes Reyadh Eid Al Yaqoob Abdulla Abdulkarim Showaiter Dr. Khalid Mohammed Al Khazraji Mustafa Ghazi Kheriba Fawad Tariq Khan Yousef Ibrahim Al Ghanim Mohammad Abdulmohsen Al Rashed
Chief Executive Officer	:	Sattam Sulaiman Algosaibi
Company secretary	:	Mohammed Abdulla Saleh
Auditors	:	KPMG Fakhroo, Bahrain

CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2018

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*In the name of Allah, the beneficent, the merciful,
Prayers and peace upon the last apostle and messenger, our prophet Muhammad.*

Dear Shareholders,

On behalf of the Board of Directors, it is my pleasure to present the annual financial statements of Khaleeji Commercial Bank (the "Bank") for the year ended 31 December 2018.

Throughout this year, the Bank has continued to generate annual profits attributable to the shareholders of the parent company that is despite the challenges the financial sector and market are currently facing due to the continuation of low oil prices. The Bank continued to be profitable during the year, with 2018 positioning the Bank on an upward trend in terms of enhancing its liquidity and asset quality.

Despite the prevailing market situation that continued during the year, the Bank was able to overcome various challenges attributed to the implementation of our approach and strategic direction. Whereby the Bank, as an upcoming Islamic financial institution, was able to provide various innovative financial solutions that added value to all stakeholders. The Bank will continue to pursue its expansion strategy through adopting several initiatives and progressive strategies that are directed towards enhancement of the Bank's positioning, market share/reach and competitive advantage.

Overall Performance

The Bank, during 2018, was able to achieve the strategic goals set by the board. This was achieved by implementation of a work structure that studies the market, invest in available opportunities and offer products and services that are aligned with the clients' expectation. Such enhancement in its products and services was the result of investing in the Bank's positioning locally and regionally.

A positive indicator of the Bank's performance this year is the growth of total assets from BD 785.2 million in 2017 to BD 850.9 million in 2018, a growth of 8.4%. Customer Deposits grew to BD 537.3 million in 2018 compared to BD 496.0 million in 2017, a growth of 8.3%. Corporate financing reached BD 301.2 million in 2018 compared to BD 298.7 million in 2017, a growth of 0.8%.

Furthermore, the Bank was able to achieve growth in liquid assets which currently comprises of 30% of Total Assets while the Capital Adequacy Ratio reached 15.9%. This has in turn allowed the Bank to invest the liquidity in prominent Sukuk Investments that are characterised with high yield and low risk. Such investments resulted in a considerable increase in the Sukuk portfolio reaching BD 161.3 million in 2018 compared to BD 113.3 million in 2017, a growth of 42.3%. As a result, the Bank, thanks to Allah, in 2018 achieved a net profit attributable to the shareholders of the parent BD 0.659 million. As the Bank

continued to execute its strategic plan, the Board and the Management conducted a review to ensure that assets, especially those acquired prior to the new business model reflect realisable and fair value. Based on this review the Board decided to take an amount of BD 6.3 million as provisions for the year ended 31 December 2018, such conservative approach has been taken in order to enhance the Bank's financial positioning and to further support its growth in 2019.

Such results were a factor of the continued expansion of financial activities and efforts of the management that have applied with the organisations' strategic goals. The Bank, throughout this year, worked on improving the Bank's balance sheet by way of booking a strong high quality asset base in addition to improving the services provided to the Bank's clients. In addition, the Bank adopted a strategy of enhancing the revenues targeting both short and long term tenors. This has resulted in the management's focus towards targeting the liquidity and balance sheet towards local and regional projects that are characterised with having strong and adequate collaterals.

Looking Ahead

The Board believes that the Bank is moving steadily towards enhancing its advanced positioning among other Islamic Bank in the Kingdom of Bahrain. The same is evident from the increase in the number of clients of the Bank in 2018. This has in turn driven the Bank toward adopting important and expansionary initiatives that the Bank aims to achieve in 2019 and the years to follow which include the Bank's plans to continue improving the financing portfolio at both the Corporate and Retail level.

Further, the Bank aims to invest the positioning it has achieved both local and regionally to help achieve the strategic goals set. In order to achieve this, the Bank will work on growing and diversifying its products and services that are offered through the branches and electronic channels in order to reach and widen the customers' base along with focus on the service/product quality that will reflect on improving the Bank's competitive advantage. This will further lead to focus on investment in Information Technology and enhancing the risk management.

Appreciation


On behalf of the Board, I would like to express my gratitude to His Majesty King Hamad Bin Isa Al Khalifa; His Royal Highness Prince Khalifa Bin Salman Al Khalifa, the Prime Minister; and His Royal Highness Prince Salman Bin Hamad Al Khalifa, the Crown Prince and Deputy Supreme Commander of Bahrain Defence Force and First Deputy Prime Minister for their encouragement of the growth of the private sector and the development of the banking and finance industry in Bahrain. I also extend my thanks to all government ministries, the Central Bank of Bahrain, and Bahrain Bourse for their continued guidance and support.



**Board of Directors Report
For the Year Ended 31 December 2018
Khaleeji Commercial Bank BSC**

Special appreciation is due to the Bank's shareholders, clients and business partners for their on-going confidence and loyalty; and to the Bank's management and staff for their hard work and dedication.

Allah the almighty is the purveyor of all success.


Mr. Jassim Mohamed Alseddlqi
Chairman

بسم الله الرحمن الرحيم

KHALEEJI
COMMERCIAL
BANK



**SHARI'A SUPERVISORY BOARD REPORT TO THE SHAREHOLDERS
KHALEEJI COMMERCIAL BANK B.S.C.
MANAMA, KINGDOM OF BAHRAIN**

Prayers and Peace upon the Last Apostle and Messenger, Our prophet Mohammed, His Family and companions.

In compliance with our terms of appointment, the Shari'a Supervisory Board "SSB" hereby present the following report to the Shareholder on the activities of Khaleeji Commercial Bank "KHCBS" and its subsidiaries for the financial year ending on 31/12/2018:

The SSB has reviewed the Bank's activities and subsidiaries which includes the Bank investments, financing, contracts, agreements, structures and products. In addition to the consolidated financial statement as of 31/12/2018, in order to ensure that KHCBS adheres to fatwas and decisions issued by SSB and the Shari'a Stenders issued by Accounting and Auditing Organization for Islamic Financial Institutions "AAOIFI".

The SSB appreciates the effort done by the managements in order to comply with the Shari'a Governance issued by the Central Bank of Bahrain.

Respective responsibilities of Board of Directors and "SSB"

The SSB believes that as a general principle and practice, KHCBS's management is responsible for ensuring that it conducts its business in accordance with Islamic Shari'a rules and principles. The SSB's responsibility to form an independent Shari'a opinion based on our review of the Bank's operations and to prepare this report.

Basis of opinion

Based on SSB's Fatwas and decisions, AAOIFI standards and Shari'a Audit Plan, the SSB conducted Shari'a audit and review through its periodic meetings and its executive member, in coordination with the Shari'a Compliance Department through the examination of documents and transactions by conducting samples test method. Moreover, the distribution of profits and loss 'if any' on investment accounts is compatible with established AAOIFI standard. The SSB is further satisfied that any income that is prohibited by the provisions and principles of Islamic Shari'a has been transferred to charity account. In addition, Zakah pool was calculated on the basis of net asset method. The shareholders are responsible of payment of their portion of Zakah on their shares.

Opinion

The SSB is satisfied that the Bank's activities, services, Financing and Investments are in compliance with the Islamic Shari'a rules and principles.

We pray Allah the almighty to grant us all success and prosperity.

وصلى اللهم على سيدنا محمد وعلى آله وصحبه وسلم

Shaikh Dr. Fareed Al-Muftah
Chairman

Shaikh Dr. Fareed Hadi
Executive Member

Shaikh Dr. Nizam Yaqoobi
Board Member



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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS
KHALEEJI COMMERCIAL BANK BSC
Manama, Kingdom of Bahrain

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Khaleeji Commercial Bank B.S.C. ("the Bank") and its subsidiaries (together the "Group"), which comprise the consolidated statement of financial position as at 31 December 2018, and the consolidated statements of income, the changes in equity, cash flows, changes in restricted investment accounts and sources and uses of zakah and charity fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Respective responsibilities of board of directors and auditors

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 board of directors of the Bank. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

Basis of opinion

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by Accounting and Auditing Organisation for Islamic Financial Institutions. 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 financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2018 and of its consolidated results of operations, its consolidated cash flows, its consolidated changes in equity, its consolidated changes in restricted investment accounts and its consolidated sources and uses of zakah and charity fund for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

Report on other regulatory requirements

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

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the chairman's report is consistent with the consolidated financial statements;
- c) we are not aware of any violations during the year of the provisions of the Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2, applicable provisions of Volume 6 and CBB directives), the CBB Capital Markets Regulations and associated resolutions, the Bahrain Bourse rules and procedures or the terms of the Bank's memorandum and articles of association that would have had a material adverse effect on the business of the Bank or on its financial position; and
- d) satisfactory explanations and information have been provided to us by management in response to all our requests.

KPMG Fakhroo
Partner Registration No. 100
6 February 2019


CONSOLIDATED STATEMENT OF FINANCIAL POSITION
as at 31 December 2018

BD 000's

	Note	31 December 2018	31 December 2017
ASSETS			
Cash and bank balances	6	99,401	75,787
Placements with financial institutions	7	43,637	33,989
Financing assets	8	327,640	354,504
Investment in sukuk	9	161,324	113,347
Assets acquired for leasing	10	108,678	97,193
Lease rentals receivables		11,525	8,590
Investment in equity securities	11	50,039	52,203
Investment in real estate	12	18,081	19,621
Development property		6,251	6,251
Other assets		10,498	10,000
Property and equipment	13	7,865	7,755
Total assets		850,939	785,220
LIABILITIES			
Placements from financial institutions		150,349	124,265
Placements from non-financial institutions and individuals	14	120,470	61,359
Medium-term borrowing	15	41,357	41,308
Customers' current accounts		70,416	74,833
Other liabilities	16	10,512	7,953
Total liabilities		401,104	309,718
Equity of investment account holders	17	346,373	359,818
OWNERS' EQUITY			
Share capital	18	105,000	105,000
Statutory reserve		8,225	8,159
Treasury shares		(11,295)	(10,212)
Employee share incentive scheme		(20)	(70)
(Accumulated losses) / retained earnings		(729)	10,162
Total equity attributable to shareholders of the parent (page 7)		101,472	113,039
Non-controlling interest		2,290	2,645
Total liabilities, equity of investment account holders and owners' equity		850,939	785,220

The consolidated financial statements were approved by the Board of directors on 6 February 2019 and signed on its behalf by:


Jassim Mohamed Alseddigi
Chairman


Sh. Ahmed Bin Isa Al Khalifa
Vice Chairman


Sattam Sulaiman Algasalbi
Chief Executive Officer

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT
for the year ended 31 December 2018

BD 000's

	Note	2018	2017
Income from financing assets and assets acquired for leasing		26,565	27,368
Income from placements with financial institutions		955	761
Income from sukuk	19	6,377	4,736
Income from equity securities		1,422	(1,658)
Fees and other income		2,842	2,644
Total income before return to investment account holders		38,161	33,851
Less: Return to investment account holders before Bank's share as Mudarib	17	(14,221)	(14,884)
Bank's share as a Mudarib	17	5,619	7,436
Return to investment account holders		(8,602)	(7,448)
Finance expense on placements from financial institutions, non-financial institutions and individuals		(8,190)	(5,334)
Finance expense on medium-term borrowing		(2,054)	(648)
Total income		19,315	20,421
Staff cost	20	7,175	6,674
Other operating expenses	21	5,252	5,459
Total expenses		12,427	12,133
Profit for the year before impairment allowances		6,888	8,288
Net impairment charge	22	(6,288)	(7,470)
PROFIT FOR THE YEAR		600	818
Attributable to:			
Shareholders of the parent		659	1,969
Non-controlling interest		(59)	(1,151)
		600	818
Earnings per share			
Basic and diluted earnings per share (fils)	27	0.69	2.04

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the year ended 31 December 2018

BD 000's

2018

	Equity attributable to shareholders of the parent						Non-Controlling interest	Total Equity
	Share Capital	Statutory reserve	Treasury shares	Employee share incentive scheme	(Accumulated losses) / retained earnings	Total		
Balance at 1 January 2018 (as previously reported)	105,000	8,159	(10,212)	(70)	10,162	113,039	2,645	115,684
Impact of adopting FAS 30	-	-	-	-	(11,069)	(11,069)	-	(11,069)
Restated balance at 1 January 2018	105,000	8,159	(10,212)	(70)	(907)	101,970	2,645	104,615
Profit for the year	-	-	-	-	659	659	(59)	600
Total recognised income and expense for the year	-	-	-	-	659	659	(59)	600
Transfer to statutory reserve	-	66	-	-	(66)	-	-	-
Net treasury shares purchased	-	-	(1,083)	-	-	(1,083)	-	(1,083)
Issue of shares under incentive scheme	-	-	-	41	42	83	-	83
Loss of Control	-	-	-	-	(16)	(16)	(296)	(312)
Transfer to Zakah fund	-	-	-	-	(441)	(441)	-	(441)
Balance at 31 December 2018	105,000	8,225	(11,295)	(29)	(729)	101,172	2,290	103,462

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the year ended 31 December 2018 *(continued)*

BD 000's

2017

	Equity attributable to shareholders of the parent						Non-Controlling interest	Total Equity
	Share Capital	Statutory reserve	Treasury shares	Employee share incentive scheme	Retained earnings	Total		
Balance at 1 January 2017	105,000	7,962	(8,832)	(182)	8,751	112,699	3,796	116,495
Profit for the year	-	-	-	-	1,969	1,969	(1,151)	818
Total recognised income and expense for the year	-	-	-	-	1,969	1,969	(1,151)	818
Transfer to statutory reserve	-	197	-	-	(197)	-	-	-
Net treasury shares purchased	-	-	(1,380)	-	-	(1,380)	-	(1,380)
Issue of shares under incentive scheme	-	-	-	112	-	112	-	112
Transfer to Zakah fund	-	-	-	-	(361)	(361)	-	(361)
Balance at 31 December 2017	105,000	8,159	(10,212)	(70)	10,162	113,039	2,645	115,684

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
for the year ended 31 December 2018

BD 000's

	Note	2018	2017
OPERATING ACTIVITIES			
Receipts relating to financing assets, net		40,392	23,286
Payment for asset acquired for leasing, net		(15,145)	(10,543)
Receipt of profit on short-term placements		955	760
Returns paid to investment account holders		(7,184)	(7,533)
Withdrawals from investment account holders, net		(13,444)	(44,834)
Payment of profit on placements		(8,190)	(4,612)
Payment for expenses		(10,642)	(13,228)
Other receipts		2,878	2,643
Payment for charity		(422)	(427)
Withdrawals in customers' current accounts, net		(4,341)	(981)
Placements from financial institutions, net		34,084	65,186
Placements from non-financial institutions and individuals, net		59,111	(39,290)
Net (payment to) / withdrawal from CBB reserve account		(3,360)	2,395
Income from sukuk received		5,937	4,015
Placements with financial institutions		-	(1,048)
Net cash generated from / (used in) operating activities		80,629	(24,211)
INVESTING ACTIVITIES			
Purchase of sukuk		(63,205)	(59,054)
Proceed from redemption / sale of sukuk		15,135	19,465
(Purchase) / disposal of equity securities		(97)	92
(Purchase) / disposal of Investment in real estate, net		(105)	452
Receipt of dividends / income from equity securities		1,478	399
(Purchase) / disposal of property and equipment, net		(674)	41
Net cash used in investing activities		(47,468)	(38,605)
FINANCING ACTIVITIES			
Purchase of treasury shares, net		(1,234)	(1,380)
Drawdown of medium-term borrowing, net		50	41,004
Finance expense paid on medium-term borrowing		(2,054)	(425)
Net cash (used in) / generated from financing activities		(3,238)	39,199
Net increase / (decrease) in cash and cash equivalents		29,923	(23,617)
Cash and cash equivalents at 1 January		91,248	114,865
Cash and cash equivalents at 31 December		121,171	91,248
Cash and cash equivalent comprise:			
Cash and bank balances (excluding CBB reserve)	6	78,581	58,327
Placements with financial institutions with original maturities of 90 days or less	7	42,590	32,921
		121,171	91,248

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS
for the year ended 31 December 2018

BD 000's

2018

	Balance at 1 January 2018			Movements during the year						Balance at 31 December 2018		
	No of units (000's)	Average value per share BD	Total BD 000's	Investment (withdrawals) BD 000's	Revalua- tion BD 000's	Gross income/ (loss) BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Administra- tion expenses BD 000's	No of units (000's)	Average value per share BD	Total BD 000's
Safana Investment WLL (RIA 1) and NS12	6,254	1.00	6,254	-	-	-	-	-	-	6,254	1.00	6,254
Shaden Real Estate Investment WLL (RIA 5)	3,529	1.00	3,529	(95)	-	117	(117)	-	-	3,434	1.00	3,434
Locata Corporation Pty Ltd (RIA 6)	2,633	0.38	993	-	-	-	-	-	-	2,633	0.38	993
			10,776	(95)	-	117	(117)	-	-			10,681

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS

for the year ended 31 December 2018 (continued)

BD 000's

2017

	Balance at 1 January 2017			Movements during the year						Balance at 31 December 2017		
	No of units (000's)	Average value per share BD	Total BD 000's	Investment (withdrawals) BD 000's	Revalua- tion BD 000's	Gross income/ (loss) BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Administra- tion expenses BD 000's	No of units (000's)	Average value per share BD	Total BD 000's
Safana Investment WLL (RIA 1) and NS12	6,304	1.00	6,304	(50)	-	-	-	-	-	6,254	1.00	6,254
Shaden Real Estate Investment WLL (RIA 5)	3,652	1.00	3,652	(123)	-	-	-	-	-	3,529	1.00	3,529
Locata Corporation Pty Ltd (RIA 6)	2,633	0.38	993	-	-	-	-	-	-	2,633	0.38	993
			10,949	(173)	-	-	-	-	-			10,776

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF SOURCES AND USES OF ZAKAH AND CHARITY FUND
for the year ended 31 December 2018

BD 000's

	2018	2017
Sources of zakah and charity fund		
At 1 January	674	723
Contributions by the Bank	441	361
Non-Islamic income	15	17
Total sources	1,130	1,101
Uses of zakah and charity fund		
Contributions to charitable organisations	(422)	(427)
Total uses	(422)	(427)
Undistributed zakah and charity fund at 31 December	708	674

The accompanying notes 1 to 37 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2018**

BD 000's

1. REPORTING ENTITY

Khaleeji Commercial Bank BSC ("the Bank"), a public shareholding company, was incorporated on 24 November 2004 in the Kingdom of Bahrain under Commercial Registration No. 55133. The Bank operates under an Islamic retail banking license granted by the Central Bank of Bahrain ("CBB") on 20 October 2003. The Bank's shares are listed on the Bahrain Bourse and Dubai Financial Markets.

The Bank's activities are regulated by the Central Bank of Bahrain (CBB) and supervised by a Religious Supervisory Board to ensure adherence to Shari'a rules and principles in its transactions and activities.

The principal activities of the Bank include providing banking and investment products and services to retail customers, high net worth individuals, corporate entities, and financial institutions. These include retail and corporate banking, consumer finance, wealth management, structured investment products and project financing facilities which comply with Islamic Shari'a rules and principles as determined by the Bank's Shari'a Supervisory Board.

The consolidated financial statements include the financial statements of the Bank and its subsidiaries (together "the Group"). The significant subsidiaries are as follows:

Name	Country of incorporation	% holding 2018	% holding 2017	Nature of business
Hawafiz Khaleeji Management Company BSC (c)	Bahrain	100%	100%	To hold shares for the beneficial interest of the employee incentive scheme. (refer note 20)
Harbour West 2 Real Estate SPC	Bahrain	100%	100%	To hold property for the beneficial interest of the Bank.
Harbour West 4 Real Estate SPC	Bahrain	100%	100%	To hold property for the beneficial interest of the Bank.
Surooh Limited	Cayman Islands	19.08%	19.08%	To construct and sell properties at "Oryx Hills".

2. STATEMENT OF COMPLIANCE

The financial statements have been prepared in accordance with Financial Accounting Standards ('FAS') issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ('AAOIFI'). In line with the requirement of AAOIFI, for matters that are not covered by AAOIFI standards, the Group uses guidance from the relevant International Financial Reporting Standards.

3. BASIS OF PREPARATION

The consolidated financial statements are presented in Bahraini Dinars, which is also the principal currency of the Bank's operations. They have been prepared on the historical cost basis except for the measurement at fair value of certain investments carried at fair value.

The Group classifies its expenses in the income statement by the nature of expense method.

4. USE OF JUDGEMENTS AND ESTIMATES

The preparation of consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and the Group's consolidated financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 24.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

5. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been consistently applied by the Group and are consistent with those used in the previous year, except for the effect of early adoption of FAS 30.

i) Standards issued but not yet effective from 1 January 2018

There were no new standards and / or amendments issued and effective during the year

ii) Standards issued but not yet effective**EARLY ADOPTION OF FAS 30 – IMPAIRMENT, CREDIT LOSSES, AND ONEROUS COMMITMENTS**

AAOIFI issued FAS 30 Impairment, Credit losses and onerous commitments in 2017 with effective date of 1 January 2020 with early adoption permitted. The Group early adopted the standard as of 1 January 2018 as mandated by the CBB. The objective of this standard is to establish the principles of assessing impairment and credit losses on various Islamic financing, investment and certain other assets of Islamic financial institutions and provisions against onerous commitments enabling in particular the users of financial statements to fairly assess the amounts, timing and uncertainties with regard to the future cash flows associated with such assets. FAS 30 will replace FAS 11 Provisions and Reserves and parts of FAS 25 Investment in Sukuk, shares and similar instruments that deals with impairment.

FAS 30 classifies assets and exposures into three categories based on the nature of risks involved (i.e. credit risk and other risks) and prescribes three approaches for assessing losses for each of these categories of assets 1) Credit Losses approach, 2) Net Realizable Value approach ("NRV") and 3) Impairment approach.

For the purpose of this standard, the assets and exposures shall be categorized, as under:

- Assets and exposures subject to credit risk (subject to credit losses approach):
 - Receivables; and
 - Off-balance sheet exposures.
- Inventories (subject to net realizable value approach); and
- Other financing and investment assets subject to risks other than credit risk (subject to impairment approach).

Credit losses approach for receivables and off- balance sheet exposures uses a dual measurement approach, under which the loss allowance is measured as either a 12-month expected credit loss or a lifetime expected credit loss.

Expected credit losses

FAS 30 replaces FAS 11 and introduces the credit losses approach with a forward-looking 'expected credit loss' model. The new impairment model will apply to exposures which are subject to credit risk. A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk (SICR);
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Establishing segments of similar financial assets for the purposes of measuring ECL.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2018**

BD 000's

5 SIGNIFICANT ACCOUNTING POLICIES (continued)**EARLY ADOPTION OF FAS 30 – IMPAIRMENT, CREDIT LOSSES, AND ONEROUS COMMITMENTS
(Continued)**

Impairment loss is the amount by which the carrying amount of asset exceeds its recoverable amount.

The adoption of FAS 30 has resulted in changes in accounting policies for impairment of exposures subject to credit risk and adjustments to the amounts previously recognised in the consolidated financial statements as of the year ended 31 December 2017. As permitted by the transitional provisions of FAS 30, the Group elected not to restate comparative figures. Any adjustments to the carrying amounts of exposures subject to credit risk as at the date of transition were recognised in the opening balance of retained earnings.

Disclosure of FAS 30 transition impacts set out below:

(a) Changes in Accounting Policies

The key changes to the Group's accounting policies resulting from the adoption of FAS 30 are summarised in Note 5 (i) (b). Since the comparative financial information has not been restated, the accounting policies in respect of the exposures subject to credit risk for comparative periods are based on respective standards as disclosed in the audited financial statements as of and for the year ended 31 December 2017.

(b) impact of adopting FAS 30

- (i) The following table reconciles the carrying amounts of exposures subject to credit risk under FAS 11 to the carrying amounts under FAS 30 on 1 January 2018.

	FAS 11 carrying amount at 31 December 2017	Re- Measurement	FAS 30 carrying amount at 1 January 2018
Balances and placements with banks and financial institutions	109,756	2	109,758
Financing assets	354,504	8,833	363,337
Investment in sukuk	113,347	3	113,350
Assets acquired for leasing (including lease rental receivables)	105,783	1,717	107,500
Commitments and financial guarantees	67,137	514	67,651
	750,527	11,069	761,596

- (ii) Impairment of exposures subject to credit risk

Impairment allowance at 31 December 2017 under FAS 11**12,645**

Additional impairment recognised at 1 January 2018 on:

Balances and placements with banks and financial institutions	2
Financing assets	8,833
Assets acquired for leasing (including lease rental receivables)	1,717
Sukuk – Debt-type securities at amortised cost	3
Commitments and financial guarantees	514

Impairment allowance at 1 January 2018 under FAS 30**23,714**

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5 SIGNIFICANT ACCOUNTING POLICIES (continued)

i) EARLY ADOPTION OF FAS 30 – IMPAIRMENT, CREDIT LOSSES, AND ONEROUS COMMITMENTS (Continued)

- iii) The following table shows the carrying amounts of exposures subject to credit risk as of 1 January 2018 by stage:

1 January 2018	Stage 1	Stage 2	Stage 3	Total
Cash and balances with banks	75,787	-	-	75,787
Placements with financial institutions	33,969	-	-	33,969
Financing Assets	232,045	83,337	39,122	354,504
Assets acquired for leasing (including lease rentals receivables)	79,215	16,406	10,162	105,783
Investment in sukuk	113,200	-	147	113,347
Commitments and financial guarantees	46,903	18,950	1,284	67,137
	581,119	118,693	50,715	750,527

- iv) Movement of ECL in various stages during the year is as follows:

31 December 2018	Stage 1	Stage 2	Stage 3	Total
Opening balance at 1 January	2,860	10,537	10,317	23,714
Transfer to Stage 1	3,188	(3,086)	(102)	-
Transfer to Stage 2	(316)	398	(82)	-
Transfer to Stage 3	(229)	(2,463)	2,692	-
Net transfers	2,643	(5,151)	2,508	-
Write-off	-	-	(1,566)	(1,566)
Charge for the period (net)	(404)	(1,468)	5,955	4,083
Closing balance as at 31 December	5,099	3,918	17,214	26,231

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are those enterprises (including special purpose entities) controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases. Control is presumed to exist, when the Group owns more than 50% of voting rights on an entity.

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of a specific borrowing or investment transaction and usually voting rights are relevant for the operating of such entities. An investor that has decision-making power over an investee and exposure to variability of returns determines whether it acts as a principal or as an agent to determine whether there is a linkage between power and returns. When the decision maker is an agent, the link between power and returns is absent and the decision maker's delegated power does not lead to a control conclusion. Where the Group's voluntary actions, such as lending amounts in excess of existing liquidity facilities or extending terms beyond those established originally, change the relationship between the Group and an SPE, the Group performs a reassessment of control over the SPE.

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for the year ended 31 December 2018

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5 SIGNIFICANT ACCOUNTING POLICIES (continued)

(a) Basis of consolidation (continued)

(i) Subsidiaries (continued)

The Group in its fiduciary capacity manages and administers assets held in trust and other investment vehicles on behalf of investors.

The financial statements of SPE are not included in these consolidated financial statements except when the Group controls the entity. Information about the Group's fiduciary assets under management is set out in note 25.

(ii) Associates

Associates are those entities over which the Group holds exercises significant influence, but not control or joint control, over the financial and operating policies.

Investments in associates are initially recognised at cost and the carrying amount is adjusted to recognise the Group's share of the post-acquisition profits or losses of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued, except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

The carrying amount of the equity accounted investment is tested for impairment in accordance with the policy described in note 5 (k) (iii).

(iii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Intra-group gains on transactions between the Group and its equity accounted associates are eliminated to the extent of the Group's interest in the investees. Unrealised losses are also eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment. Accounting policies of the subsidiaries and associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Foreign currency transactions

Items included in the consolidated financial statements of the Group are measured using the currency of the primary economic environment in which the entity operates ('the functional currency').

Foreign currency transactions are translated using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary items carried at their fair value, such as certain equity securities measured at fair value through equity, are included in investments fair value reserve.

The other Group companies functional currencies are either denominated in Bahraini dinars or US dollars which is effectively pegged to the Bahraini dinar. Hence, the translation of financial statements of the group entities that have a functional currency different from the presentation currency do not result in an exchange difference.

(c) Investment securities

Investment securities comprise investments in equity securities and investments in debt-type securities, sukuk. Investment securities exclude investments in subsidiaries and equity accounted investees (refer note 5(a)).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

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5 SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Investment securities (continued)

(i) Classification

The Group segregates its investment securities into debt-type and equity-type instruments. Debt-type instruments are investments that have terms that provide fixed or determinable payments of instruments and include instruments that evidence a residual interest in the assets of an entity after deducting all its liabilities profits and capital. Equity-type instruments are investments that do not exhibit features of debt-type.

Debt-type Instruments

A debt-type investment is classified and measured at amortised cost only if the instrument is managed on a contractual yield basis or the instrument is not held for trading and has not been designated at FVTIS. Debt-type investments at amortised cost include investment in sukuk.

Equity-type investments:

Investments in equity type instruments are classified in the following categories: 1) at fair value through income statement ('FVTIS') or 2) at fair value through equity ('FVTE'), consistent with its investment strategy.

The Group has one investment in equity securities that is designated at FVTIS. The rest are classified as investments at fair value through equity.

(ii) Recognition and de-recognition

Investment securities are recognised at the trade date i.e. the date that the Group contracts to purchase or sell the asset, at which date the Group becomes party to the contractual provisions of the instrument.

Investment securities are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risk and rewards of ownership.

(iii) Measurement

Investment securities are measured initially at fair value, which is the value of the consideration given. For FVTIS investments, transaction costs are expensed in the income statement. For other investment securities, transaction costs are included as a part of the initial recognition.

Subsequent to initial recognition, investments carried at FVTIS and FVTE are re-measured to fair value. Gains and losses arising from a change in the fair value of investments carried at FVTIS are recognised in the income statement in the period in which they arise. Gains and losses arising from a change in the fair value of investments carried at FVTE are recognised in the consolidated statement of changes in equity and presented in a separate fair value reserve within equity. The fair value gains/losses are recognised taking into consideration the split between portions related to owners' equity and equity of investment account holders. When the investments carried at FVTE are sold, impaired, collected or otherwise disposed of, the cumulative gain or loss previously recognised in the statement of changes in equity is transferred to the income statement.

Subsequent to initial recognition, debt-type securities, other than those carried at FVTIS, are measured at amortised cost using the effective profit method less any impairment allowances.

(iv) Measurement principles*Amortised cost measurement*

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus capital repayments, plus or minus the cumulative amortisation using the effective profit method of any difference between the initial amount recognised and the maturity amount, minus any reduction (directly or through use of an allowance account) for impairment or uncollectability. The calculation of the effective profit rate includes all fees and points paid or received that are an integral part of the effective profit rate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

5 SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Investment securities (continued)

(iv) Measurement principles (continued)

Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date. When available, the Group measure the fair value of an instruments using the quoted price in an active market for that instrument.

For unquoted investments at fair value, the Group uses recognised valuation techniques for fair valuation. Some or all of the inputs into these models may not be market observable, but are estimated based on assumptions. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

Valuation adjustments are recorded to allow for bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state the values of these investments.

When there is no quoted price or other appropriate methods from which to derive a reliable fair value, equity investments are carried at cost less impairment.

(d) Financing assets

Financing assets comprise Shari'a compliant financing contracts with fixed or determinable payments. These include financing provided through Murabaha, Musharaka, Mudharaba, Istisna and Wakala contracts. Financing assets are recognised on the date they are originated and are carried at their amortised cost less impairment allowances, if any.

(e) Placements with and from financial institutions, non-financial institutions and individuals

These comprise inter-bank and over the counter customer placements made/received using Shari'a compliant contracts. Placements are usually for short-term and are stated at their amortised cost.

(f) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash and bank balances (excluding CBB reserve account), and placement with financial institutions with original maturities of three months or less when acquired which are subject to insignificant risk of changes in fair value and are used by the Group in the management of its short-term commitments.

(g) Assets acquired for leasing

Assets acquired for leasing (Ijarah Muntahia Bittamleek) are stated at cost less accumulated depreciation and any impairment. Under the terms of lease, the legal title of the asset passes to the lessee at the end of the lease term, provided that all lease instalments are settled. Depreciation is calculated on a straight line basis at rates that systematically reduce the cost of the leased assets over the period of the lease. The Group assesses at each reporting date whether there is objective evidence that the assets acquired for leasing are impaired. Impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount. Impairment losses, if any, are recognised in the income statement. The estimates of future cash flows, when dependent on a single customers, takes into consideration the credit evaluation of the respective customer in addition to other factors.

(h) Investment in real estate

Real estate properties held for rental, or for capital appreciation purposes, or both, are classified as investment in real estate. Investments in real estate are carried at cost less depreciation and impairment allowances, if any. Cost includes expenditure that is directly attributable to the acquisition of the investment property. Investment in real estate includes plots of land held for capital appreciation purposes, villas and buildings held for earning rentals. Land is not depreciated. Buildings are depreciated over 25 years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

5 SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) **Development properties**

Development property consists of villas being developed for sale in the ordinary course of business and costs incurred in bringing such property to its saleable condition.

Development property is stated at lower of cost or net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less costs to complete development and selling expenses.

(j) **Property and equipment**

Property and equipment is stated at cost, net of accumulated depreciation and impairment allowances, if any. Property includes land which is not depreciated. Other equipment is depreciated using the straight-line method to write-off the cost of the assets over their estimated useful lives ranging from 3 to 5 years. The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

(k) **Impairment of financial instruments*****Policy applicable from 1 January 2018*****i) Exposures subject to credit risk**

The Group recognises loss allowances for ECLs on:

- Cash and bank balances;
- Placements with financial institutions;
- Financing assets;
- Assets acquired for leasing (including lease rental receivable);
- Investments in Sukuk - debt-type securities at amortised cost; and
- Undrawn financing commitments and financial guarantee contracts issued.

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

- Debt-type securities that are determined to have low credit risk at the reporting date; and
- other debt-type securities and bank balances for which credit risk (i.e. the risk of default occurring over the expected life of the financial instrument) has not increased significantly since initial recognition.

When determining whether the credit risk of an exposure subject to credit risk has increased significantly since initial recognition when estimating ECLs, 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 informed credit assessment including forward-looking information.

The Group assumes that the credit risk on a financial asset has increased significantly if it is more than 30 days past due.

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

- the borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as realising security, if any is held; or
- the financial asset is more than 90 days past due

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

5 SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Impairment of financial instruments (continued)

The Group considers a debt security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Group considers this to be BBB- or higher per S&P.

The Group applies a three-stage approach to measuring ECL on exposures subject to credit risk. Assets migrate through the following three stages based on the change in credit quality since initial recognition.

Stage 1: 12-months ECL

Stage 1 includes exposures subject to credit risk on initial recognition and that do not have a significant increase in risk since initial recognition or that have low credit risk. 12-month ECL is the expected credit losses that from default events that are possible within 12 months after the reporting date. It is not the expected cash shortfalls over the 12-month period but the entire credit loss on an asset weighted by the probability that the loss will occur in the next 12-months.

Stage 2: Lifetime ECL - not credit impaired

Stage 2 includes exposures subject to credit risk that have had a significant increase in credit risk since initial recognition but that do not have objective evidence of impairment. For these assets, lifetime ECL are recognised. Lifetime ECL are the expected credit losses that result from all possible default events over the expected life of the financial instrument. Expected credit losses are the weighted average credit losses with the life-time probability of default ('PD').

Stage 3: Lifetime ECL - credit impaired

Stage 3 includes exposures subject to credit risk that have objective evidence of impairment at the reporting date in accordance with the indicators specified in the CBB's rule book. For these assets, lifetime ECL is recognised.

The maximum period considered when estimating ECLs is the maximum contractual period over which the Group is exposed to credit risk.

Measurement of ECLs

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

- Financing assets and assets acquired for leasing that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Group expects to receive).
- Financing assets and assets acquired for leasing that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- Undrawn financing commitment: as the present value of the difference between the contractual cash flows that are due to the Group if the commitment is drawn and the cash flows that the Group expects to receive; and
- Financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Group expects to recover.

ECLs are discounted at the effective profit rate of the financial instrument.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

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5 SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Impairment of financial instruments (continued)

Credit-impaired exposures

At each reporting date, the Group assesses whether exposures subject to credit risk are credit-impaired. An exposure is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the exposure have occurred. Evidence that an exposure 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 being more than 90 days past due;
- the restructuring of a financing facility or advance by the Group on terms that the Group would not consider otherwise;
- it is probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for financial assets measured at amortised cost and assets acquired for leasing are deducted from the gross carrying amount of the assets.

ii) Equity investments classified at fair value through equity (FVTE)

In the case of investments in equity securities classified as FVTE and measured at fair value, a significant or prolonged decline in the fair value of the security below its cost is an objective evidence of impairment. The group considers a decline of 30% to be significant and a period of nine months to be prolonged. If any such evidence exists, 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 income statement – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are subsequently reversed through equity.

For FVTE investments carried at cost less impairment due to the absence of reliable measure of fair value, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is below the carrying value of the investment.

Policy applicable before 1 January 2018

The Group assesses at each reporting date whether there is objective evidence a financial asset is impaired. Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of financing facility or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

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5 SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Impairment of financial instruments (continued)

(i) Financial assets carried at amortised cost

These include financing assets, Sukuk (debt-type instruments), and other receivables. For financial assets carried at amortised cost, impairment is measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses are recognised in income statement and reflected in an allowance account. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the income statement. Recovery of written off financial assets is credited to impairment charge for the year. The Group considers evidence of impairment for financial assets carried at amortised cost at both a specific asset and collective level.

All individually significant financial assets are assessed for specific impairment. All individually significant financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Financial assets that are not individually significant are collectively assessed for impairment by grouping together assets with similar risk characteristics.

(ii) Equity investments classified at fair value through equity (FVTE)

In the case of investments in equity securities classified as FVTE and measured at fair value, a significant or prolonged decline in the fair value of the security below its cost is an objective evidence of impairment. The group considers a decline of 30% to be significant and a period of nine months to be prolonged. If any such evidence exists, 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 income statement – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are subsequently reversed through equity.

For FVTE investments carried at cost less impairment due to the absence of reliable measure of fair value, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is below the carrying value of the investment.

(l) Impairment of non-financial assets

The carrying amount of the Group's non-financial assets (other than for financial assets covered above), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. The recoverable amount of an asset is the greater of its value in use or fair value less costs to sell. An impairment loss is recognised whenever the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash generating unit. An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount. Separately recognised goodwill is not amortised and is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on separately recognised goodwill are not reversed. As at December 2018, the Group did not have any goodwill recognised.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

5 SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Customers' current accounts

Balances in current (non-investment) accounts are recognised when received by the Group. The transaction are measured at the cash equivalent amount received by the Group at the time of contracting. At the end of the accounting period, the accounts are measured at their book value.

(n) Equity of investment account holders

Equity of investment account holders are funds held by the Group in unrestricted investment accounts, which it can invest at its own discretion. The investment account holder authorises the Group to invest the account holders' funds in a manner which the Group deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested.

The Group charges management fee (Mudarib fees) to investment account holders. Of the total income from investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions, reserves (Profit equalisation reserve and Investment risk reserve) and deducting the Group's share of income as a Mudarib. The allocation of income is determined by the management of the Group within the allowed profit sharing limits as per the terms and conditions of the investment accounts. Only the income earned on pool of assets funded from IAH are allocated between the owners' equity and investment account holders. Administrative expenses incurred in connection with the management of the funds are borne directly by the Group and are not charged separately to investment accounts.

The Group charges specific provision and collective provision to owners' equity. Amounts recovered from these impaired assets is not subject to allocation between the IAH and owners' equity.

Investment accounts are carried at their book values and include amounts retained towards profit equalisation, investment risk reserves, if any. Profit equalisation reserve is the amount appropriated by the Group out of the Mudaraba income, before allocating the Mudarib share, in order to maintain a certain level of return to the deposit holders on the investments. Investment risk reserve is the amount appropriated by the Group out of the income of investment account holders, after allocating the Mudarib share, in order to cater against future losses for investment account holders. Creation of any of these reserves results in an increase in the liability towards the pool of unrestricted investment accounts.

(o) Restricted investment accounts

Restricted investment accounts represents assets acquired by funds provided by holders of restricted investment accounts and their equivalent and managed by the Group as an investment manager based on either a Mudharaba contract or agency contract. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders. Assets that are held in such capacity are not included as assets of the Group in the consolidated financial statements.

(p) Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee contract is recognised from the date of its issue. The liability arising from a financial guarantee contract is recognised at the present value of any expected payment, when a payment under the guarantee has become probable.

(q) Treasury shares

The amount of consideration paid including all directly attributable costs incurred in connection with the acquisition of the treasury shares are recognised in equity. Consideration received on sale of treasury shares is presented in the financial statements as a change in equity. No gain or loss is recognised in the income statement on sale of treasury shares.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

5 SIGNIFICANT ACCOUNTING POLICIES (continued)

(r) **Statutory reserve**

The Bahrain Commercial Companies Law 2001 requires that 10 per cent of the annual net profit be appropriated to a statutory reserve which is normally distributable only on dissolution. Appropriations may cease when the reserve reaches 50 per cent of the paid up share capital.

(s) **Revenue recognition**

Income from Murabaha and Wakala contracts are recognised on a time-apportioned basis over the period of the contract using the effective profit method.

Profit or losses in respect of the Group's share in **Musharaka and Mudharaba financing** transaction that commence and end during a single financial period are recognised in the income statement at the time of liquidation (closure of the contract). Where the Musharaka and Mudharaba financing continues for more than one financial period, profit is recognised to the extent that such profits are being distributed during that period in accordance with profit sharing ratio as stipulated in the agreements.

Istisna'a revenue and the associated profit margin is recognised using the percentage of completion method.

Income from assets acquired for leasing (Ijarah Muntahia Bittamleek) are recognised proportionately over the lease term.

Income from sukuk and income/expenses on placements is recognised at its effective profit rate over the term of the instrument.

Dividend income is recognised when the right to receive is established.

Rental income is recognised on a straight line basis over the term of the contract.

Fees and commission income that are integral to the effective profit rate on a financial asset carried at amortised cost are included in the measurement of the effective profit rate of the financial asset. Other fees and commission income, including account servicing fees, sales commission, management fees, placement and arrangement fees and syndication fees, are recognised as the related services are performed.

(t) **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 credited to a charity account where the Group uses these funds for charitable purposes.

(u) **Zakah**

Zakah is calculated on the Zakah base of the Group in accordance with FAS 9 Zakah using the net assets method. Zakah is paid by the Group based on the eligible reserve and retained earnings balances at the end of the year and the remaining Zakah is payable by individual shareholders. The Group calculates and notifies the shareholders of their pro-rata share of the Zakah payable annually. The Group also pays Zakah on the balance of treasury shares held at the year-end based on the pro-rata share of Zakah. The calculations of Zakah is approved by the Shari'a Supervisory Board. Payment of Zakah on the unrestricted investment and other accounts is the responsibility of the investment account holders.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

5 SIGNIFICANT ACCOUNTING POLICIES (continued)

(v) **Employee benefits****(i) Short-term benefits**

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(ii) Post-employment benefits

Pensions and other social benefits for Bahraini employees are covered by the Social Insurance Organisation scheme, which is a “defined contribution scheme” in nature, and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis. Contributions by the Group are recognised as an expense in income statement when they are due.

Expatriate employees on fixed contracts are entitled to leaving indemnities payable under the Bahraini Labour Law, based on length of service and final remuneration. Provision for this unfunded commitment has been made by calculating the notional liability had all employees left at the reporting date.

These benefits are in the nature of “defined benefit scheme” and any increase or decrease in the benefit obligation is recognised in the income statement.

The Group also operates a voluntary employees saving scheme under which the Group and the employee contribute monthly on a fixed percentage of salaries basis. The scheme is managed and administered by a board of trustees who are employees of the Group. The scheme is in the nature of a defined contribution scheme and contributions by the Group are recognised as an expense in the income statement when they are due.

(iii) Share-based employee incentive scheme

The grant-date fair value of equity-settled share-based payment arrangements granted to employees is generally recognised as an expense, with a corresponding increase in equity, over the vesting period of the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market performance conditions are expected to be met, such that the amount ultimately recognised is based on the number of awards that meet the related service and non-market performance conditions at the vesting date.

For share-based payment awards with non-vesting conditions, the grant-date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

(w) Dividends and board remuneration

Dividends to shareholders and board remuneration are recognised as liabilities in the period in which they are declared.

(x) Trade date accounting

All “regular way” purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset.

(y) Offsetting

Financial assets and liabilities are offset only when there is a legal or Shari’a based enforceable 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.

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5 SIGNIFICANT ACCOUNTING POLICIES (continued)

(z) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

(aa) URIA Protection Scheme

Funds held with the Group in investment accounts and current accounts are covered by the Deposit and URIA Protection Scheme ('the Scheme') established by the Central Bank of Bahrain regulation in accordance with Resolution No (34) of 2010.

The Scheme applies to all eligible accounts held with the Group subject to certain specific exclusions, maximum total amount entitled and other regulations governing the establishment of a Deposit and URIA Protection Scheme and a Deposit Protection Board.

(bb) Repossessed assets

In certain circumstance, properties are repossessed following the foreclosure on financing facilities that are in default. Repossessed properties are measured at the lower of carrying value and fair value less cost to sell.

(cc) Medium term Borrowing

Medium-term borrowing represents borrowing obtained through murabaha contract recognized on the origination date and carried at amortized cost.

6. CASH AND BANK BALANCES

	31 December 2018	31 December 2017
Cash	8,130	8,134
Balances with banks	55,551	24,461
Balances with the Central Bank:		
- Current account	14,950	25,732
- Reserve account	20,820	17,460
Less: Impairment allowance	(50)	-
	99,401	75,787

The reserve account with the Central Bank of Bahrain is not available for day-to-day operational purposes.

7. PLACEMENTS WITH FINANCIAL INSTITUTIONS

	31 December 2018	31 December 2017
Gross Murabaha and Wakala receivable	43,689	33,998
Less: Deferred profits	(50)	(27)
Less: Impairment allowance	(2)	(2)
	43,637	33,969

The average profit rate on placement with financial institutions for 2018 was 2.92% per annum (31 December 2017: 1.59% per annum). Placements with financial institutions with original maturities of 90 days or less is BD 42,590 (31 December 2017: BD 32,921)

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8. FINANCING ASSETS

	31 December 2018	31 December 2017
Murabaha	338,012	335,064
Musharaka	3,541	6,918
Wakala	5,007	21,482
Mudharaba	1,049	1,137
Istisna	2,054	-
	349,663	364,601
Less: Impairment allowances	(22,023)	(10,097)
	327,640	354,504

Murabaha financing receivables are net of deferred profits of BD 25,088 thousand (2017: BD 23,039 thousand).

The movement on impairment allowances is as follows:

2018	Stage 1	Stage 2	Stage 3	Total
At 1 January 2018	2,647	9,621	7,778	20,046
Net movement between stages	2,545	(4,792)	2,247	-
Write-off	-	-	(1,566)	(1,566)
Net charge for the year	(430)	(1,134)	5,107	3,543
At 31 December 2018	4,762	3,695	13,566	22,023

2017	Specific	Collective	Total
At 1 January 2017	15,164	3,404	18,568
Net charge for the year	4,794	(37)	4,757
Write-off	(13,228)	-	(13,228)
At 31 December 2017	6,730	3,367	10,097

9. INVESTMENT IN SUKUK

	31 December 2018	31 December 2017
Debt type instruments – at amortized cost		
- Quoted sukuk *	161,327	112,971
- Unquoted sukuk	1,317	1,565
Less: Impairment allowances	(1,320)	(1,189)
	161,324	113,347

* Includes Sukuk of BD 48,888 thousand (2017: BD 48,888 thousand) pledged against medium-term borrowing of BD 41,357 thousand (2017: BD 41,308 thousand) (refer note 15).

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10. ASSETS ACQUIRED FOR LEASING

	2018	2017
Cost		
At 1 January	119,995	104,816
Additions during the year	31,446	21,873
Settlements/adjustments during the year	(12,489)	(6,694)
At 31 December	138,952	119,995
Accumulated depreciation		
At 1 January	22,802	11,977
Charge for year	11,400	13,415
Settlements during the year	(3,928)	(2,590)
At 31 December	30,274	22,802
Net book value at 31 December	108,678	97,193

At 31 December 2018, accrued lease rental receivable amounted to BD 11,525 thousand (2017: BD 8,590 thousand). Lease rental receivable is net of stage 1 and 2 ECL of BD 245 thousand (2017: BD 1,052 thousand) and Stage 3 ECL of BD 2,211 thousand (2017: 79 thousand). During the year, an impairment allowance of BD 725 thousand (2017: BD 173 thousand) was provided on the lease rental receivables.

Of the total net book value of assets acquired for leasing, consumer financing amounted to BD 85,644 thousand (2017: BD 88,984 thousand).

11. INVESTMENT IN EQUITY SECURITIES

	31 December 2018	31 December 2017
<i>At fair value through income statement</i>		
- Unquoted equity securities (at fair value)	13,148	13,148
<i>At fair value through equity</i>		
- Gross Unquoted equity securities carrying amount (carried at cost less impairment)*	51,972	51,931
Less: Impairment allowances	(15,081)	(12,876)
	50,039	52,203

* Unquoted equity securities at fair value through equity comprise investments in closed companies managed by external investment managers or represent investments in projects promoted by the Group. These investments are carried at cost less impairment in the absence of a market price or a reliable measure of fair value. The Group intends to exit these investments principally by means of private placements, strategic buy outs or sale of underlying assets.

During the year, impairment charge of BD 2,205 thousand (31 December 2017: BD 1,311 thousand) was recognised on equity securities carried at cost.

During the year, the Group has written off fully provided investments of NIL (2017: BD 2,988 thousand).

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12. INVESTMENT IN REAL ESTATE

	Land	Building	2018 Total	2017 Total
Cost				
At 1 January	19,167	1,825	20,992	22,866
Additions	105	-	105	-
Disposals	(1,191)	(1,825)	(3,016)	(1,084)
Impairment (note 22)	-	-	-	(790)
At 31 December	18,081	-	18,081	20,992
Accumulated Depreciation				
At 1 January	-	1,371	1,371	1,358
Charge for year	-	-	-	73
Disposals	-	(1,371)	(1,371)	(60)
At 31 December	-	-	-	1,371
Net book value at 31 December	18,081	-	18,081	19,621

13. PROPERTY AND EQUIPMENT

	Land	Furniture and fixtures	Computers	Motor vehicle and Other equipment	2018 Total	2017 Total
Cost						
At 1 January	6,714	4,423	4,490	542	16,169	16,216
Additions	-	49	595	30	674	391
Disposals	-	-	-	-	-	(438)
At 31 December	6,714	4,472	5,085	572	16,843	16,169
Accumulated Depreciation						
At 1 January	-	4,208	3,800	406	8,414	8,008
Charge for year	-	77	434	53	564	411
Disposals	-	-	-	-	-	(5)
At 31 December	-	4,285	4,234	459	8,978	8,414
Net book value at 31 December 2018	6,714	187	851	113	7,865	7,755
Net book value at 31 December 2017	6,714	215	690	136	7,755	

14. PLACEMENTS FROM NON-FINANCIAL INSTITUTIONS AND INDIVIDUALS

	31 December 2018	31 December 2017
Non-financial institutions	48,325	14,853
Individuals	72,145	46,506
	120,470	61,359

These represent placements in the form of Murabaha and Wakala contracts. These are net of deferred profit of BD 4,188 thousand (2017: BD 1,856 thousand).

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15. MEDIUM-TERM BORROWING

Comprise two medium-term Murabaha facilities of BD 41,357 thousand (2017: BD 41,308 thousand) secured by pledge over sukuk of BD 48,888 thousand (2017: BD 48,888 thousand).

16. OTHER LIABILITIES

	31 December 2018	31 December 2017
Mudaraba profit accrual	4,278	2,860
Employee related accruals	245	189
Zakah and charity payable	708	674
Payable for Istisna'a contracts	27	27
Other payables and accrued expenses	5,254	4,203
	10,512	7,953

17. EQUITY OF INVESTMENT ACCOUNT HOLDERS

The funds received from investment account holders have been commingled and jointly invested with the Group in the following asset classes:

	31 December 2018	31 December 2017
Balances with banks	55,550	24,461
CBB reserve account	20,820	17,460
Placements with financial institutions	43,637	33,969
Debt type instruments – sukuk	161,327	113,199
Financing assets	65,039	170,729
	346,373	359,818

As at 31 December 2018, the balance of profit equalisation reserve and investment risk reserve was Nil (2017: Nil).

Only the profits earned on pool of assets funded from IAH are allocated between the owners' equity and IAH. The Group did not charge any administration expenses to investment accounts.

Following is the average percentage for profit allocation between owner's equity and investment accountholders.

	2018		2017	
	Mudarib share	IAH shares	Mudarib share	IAH shares
1 month Mudharaba *	78.66%	21.34%	73.34%	26.66%
3 months Mudharaba	54.41%	45.59%	58.58%	41.42%
6 months Mudharaba	49.31%	50.69%	55.30%	44.70%
12 months Mudharaba	29.50%	70.50%	37.99%	62.01%
18 months Mudharaba	23.28%	76.72%	80.55%	19.45%
24 months Mudharaba	21.15%	78.85%	25.63%	74.37%
36 months Mudharaba	14.70%	85.30%	12.22%	87.78%

* Includes savings, Al Waffer and Call Mudaraba accounts.

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17 EQUITY OF INVESTMENT ACCOUNT HOLDERS (continued)

During the year, average mudarib share as a percentage of total income allocated to IAH was 41.82% (2017: 41.86%) as against the average mudarib share contractually agreed with IAH. Hence the Group sacrificed average mudarib fees of 20.38% (2017: 16.94%).

The Group does not share profits resulting from the assets funded through current accounts and other funds received on the basis other than mudarba contract.

The funds raised from IAH are deployed in the assets on a priority basis after setting aside certain amount in cash and placement with Banks for liquidity management purposes.

18. SHARE CAPITAL

Authorised:

3,000,000,000 ordinary shares of BD 0.100 each

Issued and fully paid up:

1,050,000,000 ordinary shares (2016: 1,050,000,000) of BD 0.100 each

31 December 2018	31 December 2017
300,000	300,000
105,000	105,000

The Group has only one class of equity shares and the holders of these shares have equal voting rights. At 31 December 2018, the Group holds 101,081,714 as treasury shares (2017: 90,644,113 shares).

Names and nationalities of the major shareholders and the number of equity shares held in which they have an interest of 5% or more of outstanding shares:

	Nationality	Number of shares	% of total outstanding shares
GFH Financial Group *	Bahrain	493,490,918	47.00
Goldilocks Investment Company Limited	UAE	104,779,110	9.98
Khaleeji Commercial Bank B.S.C	Bahrain	96,125,759	9.37
Emirates Islamic Bank PJSC	UAE	88,322,425	8.41

*As at 31 December 2018, these shares representing 47% (2017: 47%) were held by KHCB Asset Company on behalf of GFH Financial Group, which is considered as the parent of the Bank for financial reporting purposes.

19. INCOME FROM SUKUK

Profit earned on debt-type Sukuk
(Loss) / Gain on sale of Sukuk

2018	2017
6,489	4,628
(112)	108
6,377	4,736

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20. STAFF COST

	2018	2017
Salaries and short-term benefits	6,075	5,679
Social insurance expenses	929	852
Other staff expenses	171	143
	7,175	6,674

21. OTHER OPERATING EXPENSES

	2018	2017
Premises cost	1,037	1,114
Advertisement and marketing expenses	437	534
Professional fees	825	757
Information technology expenses	483	446
Board expenses	441	356
Communication expenses	300	313
Distribution channel expenses	495	537
Other administrative expenses	670	991
Depreciation expenses	564	411
	5,252	5,459

22. NET IMPAIRMENT CHARGE

	2018	2017
Balances and placements with banks and financial institutions	50	-
Financing assets (note 8)	3,543	4,757
Investments in Sukuk	(100)	396
Assets acquired for leasing (including lease rentals receivables)	725	173
Investments at fair value through equity (note 11)	2,205	1,311
Investment in real estate (note 12)	-	790
Other assets	-	43
Commitments and financial guarantees	(135)	-
	6,288	7,470

23. SHARE-BASED EMPLOYEE INCENTIVE SCHEME

The Group has incorporated a Trust, Khaleeji Commercial Bank Employee Benefit Trust ("Trust"), to hold the beneficial interest of the shares under the scheme. Prior to this the shares were held in Hawafiz Khaleeji Management Company BSC (c).

The shareholders, in their annual general meeting held on 30 March 2015, approved the employee share based incentive scheme (the "scheme") which is in line with the CBB's Sound Remuneration Practices. Under the share incentive scheme, certain covered employees are granted the Group's shares as compensation for their performance.

As per the scheme, the share awards from each performance year will vest immediately but will be released over three years period from the date of grant. The share awards are subject to an additional retention period of six months from the date of completion of deferred period, after which the employee is unconditionally allowed to sell the shares in the market. The scheme allows the Bank Nomination, Remuneration and

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23. SHARE-BASED EMPLOYEE INCENTIVE SCHEME (continued)

Governance Committee ("BNRGC") to determine that, if appropriate, un-awarded shares can be forfeited or clawed back in certain situations.

As at 31 December 2018, 2,746,957 shares were held by the Trust (2017: 4,643,765 shares were held by Hawafiz). During the year 917,628 shares (2017: 1,091,962 shares) shares were awarded to the employees as awards under the terms of the scheme subject to a three year deferment period. During the year the Group transferred 1,896,808 shares (2017: 1,633,866 shares) to the employees.

24. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances.

Judgements***Applicable to 2018 only***

- Establishing the criteria for determining whether credit risk on an exposure subject to credit risk has increased significantly since initial recognition, determining methodology for incorporating forward looking information into measurement of ECL and selection and approval of models used to measure ECL is set out in Note 5(k) and Note 34.

Applicable to 2018 and 2017***Classification of investments***

In the process of applying the Group's accounting policies, management decides on acquisition of an investment whether it should be classified as 1) debt type instruments carried at fair value through equity or at amortised cost, or 2) equity-type instruments carried at fair value through equity or at fair value through income statement. The classification of each investment reflects the management's intention in relation to each investment and is subject to different accounting treatments based on such classification (refer note 5 (c) (i)).

Estimations***Applicable to 2018 only******Impairment of financing assets at amortised cost***

Determining inputs into ECL measurement model including incorporation of forward looking information is set out in Note 5(k) and Note 34.

Applicable to 2018 and 2017***Impairment of equity investments at fair value through equity***

The Group determines that equity securities carried at fair value are impaired when there is an objective evidence of impairment and there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment.

In case of quoted equity securities, the Group considers a decline of more than 30% in the fair value below cost to be significant and considers a decline below cost which persists for more than 9 months as prolonged.

For unquoted equity investments carried at cost less impairment, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

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24 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES
(continued)*Estimations (continued)**Determining fair value of unquoted equity securities*

The Group determines the fair value of unquoted investments by using valuation techniques. This includes using recent arm's length transactions between knowledgeable, willing parties (if available), discounted cash flow analysis or market multiples for similar instruments. Fair value estimates are made at a specific point in time, based on market conditions and information about the investee companies. These estimates involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. There is no certainty about future events (such as continued operating profits and financial strengths). It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the investments.

Significant judgment is required to be made by the Group and the Board of Directors in the selection of an approach that would reflect the best measure of fair value of the investments. The choice of the models used for valuation on each reporting period may have a significant impact on the fair value of investments and the amounts reported in the consolidated financial statements. The Group has adopted price earning multiple approach for valuation of its unquoted equity security.

The potential effect of using reasonable possible alternative assumptions for valuing the investments resulting in 5% decrease/increase in the market multiple would increase/decrease the reported fair value by BD 657 thousand (31 December 2017: BD 657 thousand). The corresponding impact would be on the profit or loss reported by the Group.

25. ASSETS UNDER MANAGEMENT

The Group provides corporate administration, investment management and advisory services to its investment entities, which involves making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the reporting date, the Group had assets under management of BD 230.72 million (31 December 2017: BD 240.97 million). During the year, the Group has not charged any management fees (2017: BD Nil) for the management of these assets.

26. RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include the parent company, other significant shareholders and entities over which the Group and the shareholders exercises significant influence, directors, sharia board members and executive management of the Group.

Details of Directors' interests in the Bank's ordinary shares as at the end of the year were:

Categories*	Number of Shares	Number of Directors
Less than 1%	1,050,763	1

* Expressed as a percentage of total outstanding shares of the Bank.

Compensation of key management personnel

Key management personnel of the Group comprise of the Board of Directors and key members of management having authority and responsibility for planning, directing and controlling the activities of the Group.

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26. RELATED PARTY TRANSACTIONS (continued)

The key management personnel compensation during the year is as follows:

	2018	2017
Board member fees and allowances	391	314
Salaries and other short-term benefits	1,402	1,328

The related party balances and transactions (except for compensation of key managerial personnel) included in these consolidated financial statements are as follows:

31 December 2018

	Associates	Directors / Key management personnel and shari'a board members	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
Financing assets	-	2,268	5,710	-	7,978
Investment in equity securities	-	-	2,284	20,719	23,003
Other assets	117	-	-	853	970
Liabilities					
Placement from financial institutions and others	-	-	93,917	-	93,917
Customers' current accounts	67	798	695	1,205	2,765
Equity of investment account holders	480	1,370	10,779	468	13,097

31 December 2017

	Associates	Directors / Key management personnel and shari'a board members	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
Financing assets	-	967	5,710	1,388	8,065
Investment in equity securities	-	-	2,284	23,794	26,078
Other assets	4,727	-	-	1,029	5,756
Liabilities					
Placement from financial institutions and others	-	-	15,091	-	15,091
Customers' current accounts	55	-	595	1,359	2,009
Equity of investment account holders	592	241	21,034	875	22,742

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26. RELATED PARTY TRANSACTIONS (continued)

2018

	Associates	Directors / Key management personnel	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
Income from financing assets and assets acquired for leasing	-	133	373	-	506
Income from equity securities	-	-	-	143	143
Fees and other income	-	-	-	-	-
Expenses					
Finance expense on placements from financial institutions, non-financial institutions and individuals	-	-	2,278	-	2,278
Return to investment account holders	12	31	350	11	404
Staff cost	-	1,402	-	-	1,402
Other expenses	-	-	-	59	59
(Recoveries)/Impairment	-	-	-	-	-

2017

	Associates	Directors / Key management personnel	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
Income from financing assets and assets acquired for leasing	-	48	334	87	469
Income from equity securities	-	-	-	-	-
Fees and other income	7	-	-	-	7
Expenses					
Finance expense on placements from financial institutions, non-financial institutions and individuals	-	-	369	-	369
Return to investment account holders	30	7	302	25	364
Staff cost	-	1,328	-	-	1,328
Other expenses	-	-	-	-	-
(Recoveries)/Impairment	-	-	-	842	842

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27. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit for the year by the weighted average number of equity shares outstanding during the year adjusted for impact arising from shares issued under the employee share incentive scheme.

Basic EPS

	2018	2017
Profit attributable to parent for the year (BD 000's)	659	1,969
Weighted average number of equity shares (Nos. in 000's)	956,400	963,071
Basic earnings per share (in fils)	0.69	2.04

The Group did not have any dilutive instruments as of 31 December 2018 and December 2017.

28. SHARI'A SUPERVISORY BOARD

The Group's Shari'a Supervisory Board consists of three Islamic scholars who review the Group's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Group to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

29. ZAKAH

Zakah is directly borne by the shareholders on distributed profits and investment account holders. The Group currently does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Group on the basis of the method prescribed by the Group's Shari'a Supervisory Board and notified to shareholders annually. During the year, the Shari'a Supervisory Board has computed Zakah payable of BD 191 thousand (2017: BD 556 thousand) of which BD 187 thousand (2017: 431 thousand) represents the Zakah computed on the statutory reserve and cumulative retained earnings as at 31 December 2018, payable by the Group. The remaining Zakah balance amounting to BD 4 thousand or 0.4 fils per share (2017: BD 125 thousand or 12 fils per share) is due and payable by the shareholders. The Group will pay Zakah of BD 0.4 thousand (2017: BD 11 thousand) on the treasury shares held as of 31 December 2018 based on 0.4 fils per share.

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30. SEGMENT REPORTING

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, whose operating results are regularly reviewed by the Group's chief operating decision maker (Board of Directors) to make decisions about resource allocation to each segment and assess its performance and for which discrete financial information is available. An operating segment is divided into business segment and geographic segments. For management purposes, the Group is organised into two major business segments:

Corporate and retail banking

Providing customer services such as accepting Mudaraba deposits, savings account and current account facilities, fund transfer facilities, bill payment facilities. It also provides financing facilities (in the form of Commodity Murabaha, Musharaka, Istisna'a and Ijarah facilities) to corporate clients and High-Networth-Individuals and consumer finance products. This segment includes money market and treasury services in the form of short term Commodity Murabaha and Wakala to banks, financial institutions and investments in sukuk to manage funding of the Group

Investment banking

Primarily relates to conceptualising of investment deals and performing roles of an arranger, lead manager, and administrator of the funds (involves structuring of deals, raising of funds through private placement and fund administration). Also offers products like Restricted Investment Accounts (RIA) and management of funds raised through the RIA structures. Also involves carrying out strategic investments in the form of equity contribution (either in the funds created and managed by the Group or other institutions).

Segment performance is measured based on results for each department as mentioned in the internal management reports that are reviewed by the Board of directors on a quarterly basis. Segment results is used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate in these industries.

The Group reports directly attributable revenue and cost relating to transactions originating from respective segments as segment revenue and segment cost respectively. Indirect costs and corporate overheads are treated as unallocated. The internal management reports are designed to reflect revenue and cost for respective segments which are measured against the budgeted figures.

The Group primarily operates from Bahrain and does not have any overseas branches/divisions. The geographic concentration of assets and liabilities is disclosed in note 32 (b) to the consolidated financial statements.

The Group is winding down in investment banking business.

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30. SEGMENT REPORTING (continued)

These segments are the basis on which the Group reports its primary segment information. Transactions between segments (if any) are conducted on an arm's length basis

31 December 2018	Investment Banking	Corporate and Retail Banking	Unallocated	Total
Cash and bank balances	1	99,400	-	99,401
Placements with financial institutions	1,175	42,462	-	43,637
Financing assets	-	327,640	-	327,640
Investment in sukuk	-	161,324	-	161,324
Assets acquired for leasing (including lease rentals receivables)	-	120,203	-	120,203
Investment in equity securities	50,039	-	-	50,039
Investment in real estate	18,081	-	-	18,081
Development property	6,251	-	-	6,251
Other assets	11,320	3,958	1,220	16,498
Property and equipment	-	-	7,865	7,865
Total segment assets	86,867	754,987	9,085	850,939
Placements from financial institutions	-	158,349	-	158,349
Placements from non- financial institutions and individuals	-	120,470	-	120,470
Medium-term borrowing	-	41,357	-	41,357
Customers' current accounts	1,175	69,241	-	70,416
Other liabilities	2,171	6,220	2,121	10,512
Total segment liabilities	3,346	395,637	2,121	401,104
Equity of investment account holders	-	346,373	-	346,373
Restricted investment accounts	10,681	-	-	10,681

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30. *SEGMENT REPORTING (continued)*

2018	Investment Banking	Corporate and Retail Banking	Unallocated	Total
Income from financing assets and assets acquired for leasing	-	26,565	-	26,565
Income from placements with financial institutions	25	930	-	955
Income from sukuk	-	6,377	-	6,377
Income from equity securities	1,422	-	-	1,422
Fees and other income	(35)	2,877	-	2,842
Total income before return to investment account holders	1,412	36,749	-	38,161
Less: Return to investment account holders before Bank's share as Mudarib	-	(14,221)	-	(14,221)
Bank's share as a Mudarib	-	5,619	-	5,619
Return to investment account holders	-	(8,602)	-	(8,602)
Less:				
Expense on placements from financial institutions, non- financial institutions and individuals	-	(8,190)	-	(8,190)
Finance expense on medium- term borrowing	-	(2,054)	-	(2,054)
Total segment income	1,412	17,903	-	19,315
Staff cost	718	2,870	3,587	7,175
Other expenses	92	951	4,209	5,252
Total segment expenses	810	3,821	7,796	12,427
Segment results before impairment allowances	602	14,082	(7,796)	6,888
Net impairment allowances	(2,205)	(4,083)	-	(6,288)
Segment results	(1,603)	9,999	(7,796)	600

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30. *SEGMENT REPORTING (continued)*

31 December 2017

	Investment Banking	Corporate and Retail Banking	Unallocated	Total
Cash and bank balances	7	75,780	-	75,787
Placements with financial institutions	1,094	32,875	-	33,969
Financing assets	-	354,504	-	354,504
Investment in sukuk	-	113,347	-	113,347
Assets acquired for leasing (including lease rentals receivables)	-	105,783	-	105,783
Investment in equity securities	52,203	-	-	52,203
Investment in real estate	19,621	-	-	19,621
Development property	6,251	-	-	6,251
Other assets	10,635	3,541	1,824	16,000
Property and equipment	-	-	7,755	7,755
Total segment assets	89,811	685,830	9,579	785,220
Placements from financial institutions	-	124,265	-	124,265
Placements from non- financial institutions and individuals	-	61,359	-	61,359
Medium-term borrowing	-	41,308	-	41,308
Customers' current accounts	1,094	73,739	-	74,833
Other liabilities	2,002	4,435	1,516	7,953
Total segment liabilities	3,096	305,106	1,516	309,718
Equity of investment account holders	-	359,818	-	359,818
Restricted investment accounts	10,776	-	-	10,776

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30. SEGMENT REPORTING (continued)

2017	Investment Banking	Corporate and Retail Banking	Unallocated	Total
Income from financing assets and assets acquired for leasing	-	27,368	-	27,368
Income from placements with financial institutions	25	736	-	761
Income from sukuk	-	4,736	-	4,736
Income from equity securities	(1,658)	-	-	(1,658)
Fees and other income	(92)	2,736	-	2,644
Total income before return to investment account holders	(1,725)	35,576	-	33,851
Less: Return to investment account holders before Bank's share as Mudarib	-	(14,884)	-	(14,884)
Bank's share as a Mudarib	-	7,436	-	7,436
Return to investment account holders	-	(7,448)	-	(7,448)
Less:				
Expense on placements from financial institutions, non- financial institutions and individuals	-	(5,334)	-	(5,334)
Finance expense on medium- term borrowing	-	(648)	-	(648)
Total segment income	(1,725)	22,146	-	20,421
Staff cost	667	2,670	3,337	6,674
Other expenses	349	1,103	4,007	5,459
Total segment expenses	1,016	3,773	7,344	12,133
Segment results before impairment allowances	(2,741)	18,373	(7,344)	8,288
Net impairment allowances	(2,101)	(5,369)	-	(7,470)
Segment results	(4,842)	13,004	(7,344)	818

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31. MATURITY PROFILE

The maturity profile of placements with and from financial institutions, financing assets, assets acquired for leasing, (including lease rental receivable), and equity of investment account holders has been presented using their contractual maturity period. For other balances, maturity profile is based on expected cash flows/ settlement profile of the respective assets and liabilities.

31 December 2018	Up to 3 months	3 to 6 months	6 months- 1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	87,253	3,591	6,065	2,492	-	99,401
Placements with financial institutions	42,590	-	1,047	-	-	43,637
Financing assets	73,057	26,731	69,848	119,405	38,599	327,640
Investment in sukuk	112,436	-	48,888	-	-	161,324
Assets acquired for leasing (including lease rentals receivables)	4,805	3,549	7,069	34,572	70,208	120,203
Investment in equity securities	-	-	-	25,273	24,766	50,039
Investment in real estate	-	-	-	-	18,081	18,081
Development property	-	-	-	-	6,251	6,251
Other assets	1,939	-	9	12,028	2,522	16,498
Property and equipment	-	-	-	-	7,865	7,865
Total assets	322,080	33,871	132,926	193,770	168,292	850,939
Liabilities						
Placements from financial institutions	31,312	17,664	109,373	-	-	158,349
Placements from non-financial institutions and individuals	35,172	38,057	34,314	10,108	2,819	120,470
Medium-term borrowing	-	-	41,357	-	-	41,357
Customers' current account	21,649	6,853	7,442	8,505	25,967	70,416
Other liabilities	3,233	1,304	1,131	4,844	-	10,512
Total liabilities	91,366	63,878	193,617	23,457	28,786	401,104
Equity of investment account holders	69,089	43,815	98,703	55,512	79,254	346,373
Restricted investment accounts	-	-	-	10,681	-	10,681
Commitments and financial guarantees	20,284	3,986	16,204	5,577	6	46,057

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31. *MATURITY PROFILE (continued)*

31 December 2017

	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	66,167	3,212	4,821	1,587	-	75,787
Placements with financial institutions	32,921	-	1,048	-	-	33,969
Financing assets	71,931	31,456	54,039	115,068	82,010	354,504
Investment in sukuk	64,459	-	-	48,888	-	113,347
Assets acquired for leasing (including lease rentals receivable)	1,898	1,710	3,313	20,089	78,773	105,783
Investment in equity securities	-	-	-	52,203	-	52,203
Investment in real estate	-	-	-	-	19,621	19,621
Development property	-	-	-	-	6,251	6,251
Other assets	10,605	931	93	397	3,974	16,000
Property and equipment	-	-	-	-	7,755	7,755
Total assets	247,981	37,309	63,314	238,232	198,384	785,220
Liabilities						
Placements from financial institutions	91,652	14,319	11,505	6,789	-	124,265
Placements from non-financial institutions and individuals	21,341	11,090	27,641	-	1,287	61,359
Medium-term borrowing	-	-	-	41,308	-	41,308
Customers' current account	46,997	10,566	6,418	3,760	7,092	74,833
Other liabilities	2,393	638	739	4,183	-	7,953
Total liabilities	162,383	36,613	46,303	56,040	8,379	309,718
Equity of investment account holders	175,109	32,670	47,852	15,192	88,995	359,818
Restricted investment accounts	-	4,522	-	6,254	-	10,776
Commitments and financial guarantees	3,863	19,336	17,242	26,695	1	67,137

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32. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS

(a) Industry sector

31 December 2018

	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	99,401	-	-	99,401
Placements with financial institutions	43,637	-	-	43,637
Financing assets	10,358	51,630	265,652	327,640
Investment in sukuk	11,795	7,540	141,989	161,324
Assets acquired for leasing (including lease rentals receivables)	-	118,615	1,588	120,203
Investment in equity securities	13,148	33,223	3,668	50,039
Investment in real estate	-	18,081	-	18,081
Development property	-	6,251	-	6,251
Other assets	1,040	6,822	8,636	16,498
Property and equipment	-	6,739	1,126	7,865
Total assets	179,379	248,901	422,659	850,939
Liabilities				
Placements from financial institutions	158,349	-	-	158,349
Placements from non-financial institutions and individuals	101	-	120,369	120,470
Medium-term borrowing	41,357	-	-	41,357
Customers' current accounts	4,920	7,832	57,664	70,416
Other liabilities	-	27	10,485	10,512
Total liabilities	204,727	7,859	188,518	401,104
Equity of investment account holders	14,543	12,894	318,936	346,373
Restricted investment accounts	-	9,668	993	10,681
Commitments and financial guarantees	513	12,913	32,631	46,057

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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32. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (continued)

(a) Industry sector (continued)

31 December 2017

	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	75,787	-	-	75,787
Placements with financial institutions	33,969	-	-	33,969
Financing assets	11,011	75,688	267,805	354,504
Investment in sukuk	11,857	146	101,344	113,347
Assets acquired for leasing (including lease rentals receivables)	-	105,715	68	105,783
Investment in equity securities	13,147	35,387	3,669	52,203
Investment in real estate	-	19,621	-	19,621
Development property	-	6,251	-	6,251
Other assets	1,050	5,535	8,875	16,000
Property and equipment	-	6,715	1,040	7,755
Total assets	146,821	255,598	382,801	785,220
Liabilities				
Placements from financial institutions	124,265	-	-	124,265
Placements from non-financial institutions and individuals	-	-	61,359	61,359
Medium-term borrowing	41,308	-	-	41,308
Customers' current accounts	2,688	11,448	60,697	74,833
Other liabilities	-	2,003	5,950	7,953
Total liabilities	168,261	13,451	128,006	309,718
Equity of investment account holders	29,990	16,552	313,276	359,818
Restricted investment accounts	-	9,783	993	10,776
Commitments and financial guarantees	619	24,645	41,873	67,137

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for the year ended 31 December 2018

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32. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (continued)

(b) Geographic sector

31 December 2018

Assets

	GCC countries	Europe	America	Asia	Australia	Total
Cash and bank balances	73,827	7,230	18,306	38	-	99,401
Placements with financial institutions	43,637	-	-	-	-	43,637
Financing assets	313,642	13,960	-	38	-	327,640
Investment in sukuk	161,324					161,324
Assets acquired for leasing (including lease rentals receivables)	120,162	-	-	41	-	120,203
Investment in equity securities	29,320	-	-	17,051	3,668	50,039
Investment in real estate	18,081	-	-	-	-	18,081
Development property	6,251	-	-	-	-	6,251
Other assets	15,794	15	-	689	-	16,498
Property and equipment	7,865	-	-	-	-	7,865

Total assets

789,903	21,205	18,306	17,857	3,668	850,939
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Liabilities

Placements from financial institutions	158,349	-	-	-	-	158,349
Placements from non-financial institutions and individuals	120,470	-	-	-	-	120,470
Medium-term borrowing	41,357	-	-	-	-	41,357
Customers' current accounts	69,916	274	-	226	-	70,416
Other liabilities	10,512	-	-	-	-	10,512

Total liabilities

400,604	274	-	226	-	401,104
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Equity of investment account holders

343,589	545	-	2,231	8	346,373
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Restricted investment accounts

9,688	-	-	993	-	10,681
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Commitments and financial guarantee

45,801	256	-	-	-	46,057
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Concentration by location for financing assets is measured based on the location of the counterparty, which has a high correlation with the location of the collateral for the exposure.

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32. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (continued)

(b) Geographic sector (continued)

31 December 2017

	GCC countries	Europe	America	Asia	Australia	Total
Assets						
Cash and bank balances	61,083	2,933	11,761	10	-	75,787
Placements with financial institutions	33,969	-	-	-	-	33,969
Financing assets	337,937	16,531	-	36	-	354,504
Investment in sukuk	113,347	-	-	-	-	113,347
Assets acquired for leasing (including lease rentals receivables)	105,783	-	-	-	-	105,783
Investment in equity securities	29,279	-	-	19,256	3,668	52,203
Investment in real estate	19,621	-	-	-	-	19,621
Development property	6,251	-	-	-	-	6,251
Other assets	15,175	15	-	810	-	16,000
Property and equipment	7,755	-	-	-	-	7,755
Total assets	730,200	19,479	11,761	20,112	3,668	785,220
Liabilities						
Placements from financial institutions	124,265	-	-	-	-	124,265
Placements from non-financial institutions and individuals	61,359	-	-	-	-	61,359
Medium-term borrowing	41,308	-	-	-	-	41,308
Customers' current accounts	67,332	6,921	-	580	-	74,833
Other liabilities	7,953	-	-	-	-	7,953
Total liabilities	302,217	6,921	-	580	-	309,718
Equity of investment account holders	354,290	3,043	-	2,485	-	359,818
Restricted investment accounts	9,783	-	-	-	993	10,776
Commitments and financial guarantee	65,893	1,244	-	-	-	67,137

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33. FAIR VALUE*a) Fair value of financial instruments*

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

The fair value of quoted Sukuk carried at amortised cost of BD 161,327 thousand (31 December 2017: BD 113,199 thousand) is BD 161,644 thousand as at 31 December 2018 (31 December 2017: BD 112,077 thousand).

In case of financing assets and lease receivables, the average profit rate of the portfolio is in line with current market rates for similar facilities and hence after consideration of adjustment for prepayment risk and impairment charges it is expected that the current value would not be materially different to fair value of these assets. Other than equity investments carried at cost of BD 36,891 thousand (2017: BD 39,056 thousand), the estimated fair values of the Group's other financial instruments are not significantly different from their carrying values due to their short-term nature.

b) Fair value hierarchy

The table below analyses the financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets and liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

31 December 2018

Unquoted equity type securities
carried at fair value through income
statement

Level 1	Level 2	Level 3	Total
-	-	13,148	13,148
-	-	13,148	13,148

31 December 2017

Unquoted equity type securities
carried at fair value through income
statement

Level 1	Level 2	Level 3	Total
-	-	13,148	13,148
-	-	13,148	13,148

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33. FAIR VALUE (continued)**b) Fair value hierarchy (continued)**

The table below shows the reconciliation of movements in value of investments measured using Level 3 inputs:

	2018	2017
At 1 January	13,148	15,148
Fair value loss in income statement	-	(2,000)
At 31 December	13,148	13,148

34. RISK MANAGEMENT**Introduction and overview**

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

- credit risk
- liquidity risk
- market risk
- operational risk

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

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board has established various committees with responsibilities for managing the overall risks associated with the Group. The committees also continuously monitors consistent implementation of the Board approved policies in the Group and reports deviations, if any, to the Board. The committees consists of heads of business and other functional units in the Group. The committees comprise the following: Management Committee (operational risks), Executive Credit and Investment Committee (credit and investment risks), and Assets and Liabilities Committee (market and capital risks). In addition to the Committees, the Board has established an independent Risk Management Department with an overall responsibility to identify, measure, control risks and recommend policies and corrective actions. Risk Management Department reports directly to the Board Audit and Risk Management Committee.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Group's Audit and Risk Management Committee is responsible for monitoring compliance with the risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Group. The Audit and Risk Management Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit and Risk Management Committee.

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34. RISK MANAGEMENT (continued)

CREDIT RISK

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's exposures to placements with financial institutions, financing assets, assets acquired for leasing (including lease rental receivable), investment in sukuk and other receivables. For risk management reporting purposes, the Group considers and consolidates all elements of credit risk exposure (such as individual and group exposure risk, country and sector concentration risk, related party exposure, etc.).

The Group manages its credit risks through its various business units, an independent Risk Management Department, Board Audit & Risk Management Committee ("BARMC"), and the Executive Credit & Investment Committee ("ECICOM"). The Credit risk management framework comprises the following:

- Formulating credit risk strategies policies and risk appetite which are developed after careful assessment of the market, capital requirement, regulatory rules, and the Board's risk appetite. The risk strategies and risk appetites are coded into policies approved by the Board. The Group's credit policy framework includes, inter alia, the following: in consultation with business units, credit risk management framework, credit risk mitigations, credit risk rating, credit risk pricing, expected credit loss, cross boarder business policy, personal finance product programs, approval authorities' matrix, and many others.
- Credit granting process. All credit exposures are assumed after careful assessment of the risks. Business proposals are initiated by the business units through formal credit applications. Such credit application provide adequate information about the proposed exposure including description of possible risks and mitigating factors. All credit applications are independently reviewed by Credit Review Unit to assess the adequacy of the due diligence conducted, independent assessment of the risks and mitigants, ensure compliance with limits and policies. Credit Review Unit issue formal opinion in respect of the proposals which may include recommendations for enhancing the Group's position. Proposals are then presented to approving authorities for their considerations (see proceeding point below). Where applicable and necessary, credit applications are also independently reviewed by the Sharia Compliance Officer to ensure adherence to Islamic principles.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Approval authorities are documented in the Credit Authorities Policy of the Group which describes the various approval authorities, conditions, and limits for approving business transactions arising from investment and credit activities within the Group. There are 5 main levels of credit and investment authorities within the Group: Board of Directors, Board Investment & Credit Committee, Executive Credit & Investment Committee, Chief Executive Officer, and Heads of Business Units. Approval authorities are decided based on the magnitude of the risk and transactions size while at the same time allowing for smooth business operations.
- Managing concentrations. The Group places significant emphasis on diversifying its portfolio through applying a portfolio strategy in which the Group spreads its assets and liabilities' businesses so that results from volatility or fluctuations in such businesses become subdued, controlled, and assist in the consistent long-term growth of the shareholders' interests. An important element of such portfolio strategy is to establish limits within which the Management may conduct business. In principle, the Group shall adhere to all maximum limits established by regulatory authorities. At the same time, the Group has defined its own internal limits to control the following: Credit risk concentration, Counterparty limits, Industry limits, Country limits, Collateral concentration limits, Product mix, Maturity limits, amongst others. These internal limits are reviewed on periodic basis taking into considerations the following factors: The Group's risk appetite, Business and budget plans, Counterparty's risk rating, Risk rating of the Counterparty's country, The Group's financial positions including liquidity and Capital adequacy, General market condition; and other factors as determined by the Board of Directors or the Board Audit & Risk Management Committee. In general, the Group adopts a negative correlation between risks and limits in that lower limits are defined for higher risks.

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34. RISK MANAGEMENT (continued)

- Credit Measurement Methodologies. The Group quantifies its credit risk using two main metrics: expected loss (EL) and economic capital (EC). The expected loss reflects the average value of the estimated losses (i.e. the cost of the business) and is associated with the Group's policy on provisions, while economic capital is the amount of capital necessary to cover unexpected losses (i.e. if actual losses are higher than expected losses). As part of its measurement techniques, the Group conducts adequate stress testing on its portfolio.
- Credit risk rating. An important tool in monitoring the quality of individual credits, as well as the total portfolio, is the use of Credit Risk Rating systems. The Group adopts a well-structured internal CRR system as a mean of differentiating the degree of credit risk in the different credit exposures of the Group to allow more accurate determination of the overall characteristics of the asset portfolio, concentrations, limits management, problem assets, pricing, and the adequacy of loss reserves (provisions). As well as identifying the risks associated with a counterparty and a credit facility, CRRs provide a key input for the capital charges and risk weights. The Group's approach to credit risk rating is documented in the Credit Risk Rating Policy which aims at achieving the following: (a) create a benchmark for assessing relative creditworthiness of the graded entity and measure credit risk in relation to the market, (b) arrive at a system of risk-based pricing for credit facilities granted by the Group, (c) monitor the overall credit risk inherent in the Group's Credit portfolio, (d) create a benchmark for recognition of accrued income on credit assets, (e) link asset review frequency and approval authority levels to Credit risk and emphasize focus on effective management of weak assets, and (f) provide a means to link Internal Capital Adequacy to the portfolio credit risk.
- Classifications and identification of non-performing exposures. The Group has adopted FAS 30 / IFRS 9 standards for classifying exposures into three stages. Accounts are moved into higher staging depending on occurrence of Significant Increase in Credit Risks. Exposures with past due exceeding 90 days are classified as non-performing.
- Remedial management. All credit exposures assumed by the Group are considered after thorough risk and reward analysis adequate for the size and nature of business being considered. However, despite all due diligence exercised to minimize the risks involved, it is inevitable that certain exposures may experience setbacks due to various reasons such as: fundamental changes in the market conditions, changes in regulations and laws, changes in the status of counterparties (such as death, loss of job, sanctions, seizure of business, or bankruptcy), delays in deliverables (such as delays in completion of projects), or Unintentional errors in the initial assumptions. From business impact point of view, such exposures would have high costs due to suspension of profits, provisioning, liquidity, reputational, or opportunity costs. To prevent such adverse business impact, the Group has developed a prudent remedial strategy appropriate for the size, nature, and delinquency period. Such strategy is documented in the Remedial Management Policy. The Group, through its Remedial and Collection department pursue various recovery techniques including: dunning, rescheduling, restructuring, collateral foreclosure, legal actions, and cash settlement amongst others.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

34. RISK MANAGEMENT (continued)
CREDIT RISK (continued)

Exposures subject to credit risk

31 December 2018	Stage 1	Stage 2	Stage 3	Total
Financing facilities				
Grade 8 -10 Impaired	1,071	70	71,628*	72,769
Past due but not impaired				
Grade 1-6 Low-Fair Risk	28,158	10,732	3,349*	42,239
Grade 7 Watch list	14	15,403	-	15,417
<u>Past due comprises:</u>				
Up to 30 days	27,287	15,866	-	43,153
30-60 days	885	1,743	-	2,628
60-90 days	-	8,526	3,349*	11,875
Neither past due nor impaired				
Grade 1-6 Low-Fair Risk	196,925	18,829	-	215,754
Grade 7 Watch list	139	3,345	-	3,484
Gross carrying amount	226,307	48,379	74,977	349,663
Less expected credit losses	(4,762)	(3,695)	(13,566)	(22,023)
Net carrying amount	221,545	44,684	61,411	327,640
Assets acquired for leasing (including lease rentals receivables)				
Grade 8 -10 Impaired	-	316	18,613	18,929
Past due but not impaired				
Grade 1-6 Low-Fair Risk	12,990	2,388	-	15,378
Grade 7 Watch list	-	3,846	-	3,846
<u>Past due comprises:</u>				
Up to 30 days	12,212	1,926	-	14,138
30-60 days	778	3,227	-	4,005
60-90 days	-	1,080	-	1,080
Neither past due nor impaired				
Grade 1-6 Low-Fair Risk	82,417	2,041	-	84,458
Grade 7 Watch list	-	48	-	48
Gross carrying amount	95,407	8,639	18,613	122,659
Less expected credit losses	(106)	(139)	(2,211)	(2,456)
Net carrying amount	95,301	8,500	16,402	120,203

* Includes facilities of BD 31,133 thousand which is under cooling off period.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

34. *RISK MANAGEMENT (continued)**CREDIT RISK (continued)**Exposures subject to credit risk (continued)***31 December 2018**

	Stage 1	Stage 2	Stage 3	Total
Investment in Sukuk				
Grade 8 -10 Impaired	-	-	1,317	1,317
Grade 1-6 Low-Fair Risk	161,327	-	-	161,327
Gross carrying amount	161,327	-	1,317	162,644
Less: expected credit losses	(3)	-	(1,317)	(1,320)
Net carrying amount	161,324	-	-	161,324
Balances with banks and placements				
Grade 1-6 Low-Fair Risk	134,960	-	-	134,960
Gross carrying amount	134,960	-	-	134,960
Less: expected credit losses	(52)	-	-	(52)
Net carrying amount	134,908	-	-	134,908
Commitments and financial guarantees				
Grade 8 -10 Impaired	-	-	1,670	1,670
Grade 1-6 Low-Fair Risk	41,733	2,639	-	44,372
Grade 7 Watch list	-	15	-	15
Gross carrying amount	41,733	2,654	1,670	46,057
Less: expected credit losses	(176)	(84)	(120)	(380)
Net carrying amount	41,557	2,570	1,550	45,677
Total net carrying amount	654,635	55,754	79,363	789,752

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

34. RISK MANAGEMENT (continued)

CREDIT RISK (continued)

Exposure to credit risk (continued)

31 December 2017	Placements with financial institutions	Financing assets	Assets acquired for leasing (including lease rentals receivables)	Investment in sukuk	Other financial assets	Total
<u>Impaired</u> Grade 8-10						
<u>Impaired</u>	-	55,045	5,926	1,564	-	62,535
<u>Unrated</u>	-	-	-	-	5,869	5,869
<u>Allowance for impairment</u>	-	(6,730)	(79)	(1,417)	(997)	(9,223)
<u>Carrying amount</u>	-	48,315	5,847	147	4,872	59,181
<u>Past due but not impaired</u> Grade 1-6						
<u>Low-Fair Risk</u>	-	19,965	8,432	-	-	28,397
<u>Grade 7 Watch list</u>	-	8,690	10,599	-	-	19,289
<u>Past due comprises:</u>						
<u>Up to 30 days</u>	-	18,235	10,512	-	-	28,747
<u>30-60 days</u>	-	7,332	2,793	-	-	10,125
<u>60-90 days</u>	-	3,088	5,726	-	-	8,814
<u>Carrying amount</u>	-	28,655	19,031	-	-	47,686
<u>Neither past due nor impaired</u> Grade 1-6						
<u>Low-Fair Risk</u>	33,969	272,260	79,612	113,200	-	499,041
<u>Grade 7 Watch list</u>	-	8,641	2,345	-	-	10,986
<u>Unrated</u>	-	-	-	-	11,128	11,128
<u>Carrying amount</u>	33,969	280,901	81,957	113,200	11,128	521,155
<u>Less:</u>						
<u>Collective impairment provisions</u>	-	(3,367)	(1,052)	-	-	(4,419)
Total	33,969	354,504	105,783	113,347	16,000	623,603

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2018**

BD 000's

34. RISK MANAGEMENT (continued)**CREDIT RISK (continued)****Significant increase in credit risk**

When determining whether the risk of default on a financial instrument and assets acquired for leasing 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 and including forward-looking information.

In determining whether credit risk has increased significantly since initial recognition, the following criteria are considered:

- 1 Downgrade in risk rating according to the approved ECL policy;
- 2 Facilities restructured during previous twelve months;
- 3 Qualitative indicators; and
- 4 Facilities overdue by 30 days as at the reporting date subject to rebuttal in deserving circumstances

Credit risk grades

The Group allocates each exposure to credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower.

Credit risk grades are defined and calibrated such that the risk of default occurring increases exponentially as the credit risk deteriorates so, for example, the difference in risk of default between credit risk grades 1 and 2 is smaller than the difference between credit risk grades 2 and 3.

Each exposure is allocated to a credit risk grade at initial recognition based on available information about the borrower. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade. Exposers are rated 1 to 10 with 1 to being good and 7 being watch list and 8, 9 and 10 default grades. The monitoring typically involves use of the following data.

Corporate exposures

- Information obtained during periodic review of customer files- e.g. audited financial statements, management accounts, budgets and projections. Examples of areas of particular focus are: gross profit margins, financial leverage ratios, debt service coverage, compliance with covenants, quality of management, senior management changes
- Data from credit reference agencies. press articles, changes in external credit ratings
- Quoted bond and credit default swap (CDS) prices for the borrower where available
- Actual and expected significant changes in the political, regulatory and technological environment of the borrower or in its business activities

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2018**

BD 000's

34. RISK MANAGEMENT (continued)**CREDIT RISK (continued)****Credit risk grades (continued)****Retail exposures**

- Internally collected data on customer behaviour -e.g. utilisation of credit card facilities
- Affordability metrics
- External data from credit reference agencies including industry-standard credit scores

All exposures

- Payment record this includes overdue status as well as a range of variables about payment ratios
- Utilisation of the granted limit
- Requests for and granting of forbearance
- Existing and forecast changes in business, financial and economic conditions

Generating the term structure of PD

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 analyzed by jurisdiction or region and by type of product and borrower as well as by credit risk grading.

The Group employs statistical models to analyze the data collected and generate estimates of the remaining lifetime 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 as well as in-depth analysis of the impact of certain other factors (e.g. forbearance experience) on the risk of default. For most exposures, key macro-economic indicators include: GDP growth, benchmark profit rates and oil price. For exposures to specific industries and/or regions, the analysis may extend to relevant commodity and/or real estate prices.

Based on advice from the Risk Management Department and economic experts and consideration of a variety of external actual and forecast information, the Group formulates a 'base case' view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios (see discussion below on incorporation of forward-looking information). The Group then uses these forecasts to adjust its estimates of PDs.

Determining whether credit risk has increased significantly

The criteria for determining whether credit risk has increased significantly vary by portfolio and include quantitative changes in PDs and qualitative factors, including a backstop based on delinquency.

Using its expert credit judgement and, where possible, relevant historical experience, the Group may determine that an exposure has undergone a significant increase in credit risk based on particular qualitative indicators that it considers are indicative of such and whose effect may not otherwise be fully reflected in its quantitative analysis on a timely basis.

Qualitative indicators, including different criteria used for different portfolios credit cards and commercial real estate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2018**

BD 000's

34. RISK MANAGEMENT (continued)**CREDIT RISK (continued)***Determining whether credit risk has increased significantly (continued)*

As a backstop, the Group considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower.

The Group monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- the criteria do not align with the point in time when an asset becomes 30 days past due; and
- there is no unwarranted volatility in loss allowance from transfers between 12-month PD (stage 1) and lifetime PD (stage 2).

Definition of default

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

- the borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as realising security (if any is held); or
- the borrower is more than 90 days past due on any material obligation to the Group.
- It is becoming probable that the borrower will restructure the asset as a result of bankruptcy due to the borrower's inability to pay its credit obligation.

In assessing whether the borrower is in default, the Group considers qualitative and quantitative indicators. The definition of default aligns with that applied by the Group for regulatory capital purposes.

Incorporation of forward looking information

The Group incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. Based on advice from the Assets and Liabilities Committee ("ALCO") and economic experts and consideration of a variety of external actual and forecast information, the Group formulates a 'base case' view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios. This process involves developing two or more additional economic scenarios and considering the relative probabilities of each outcome.

External information includes economic data and forecasts published by governmental bodies and monetary authorities in the countries where the Group operates, supranational organisations such as the OECD and the International Monetary Fund, and selected private-sector and academic forecasters.

The base case represents a most-likely outcome and is aligned with information used by the Group for other purposes such as strategic planning and budgeting. The other scenarios represent more optimistic and more pessimistic outcomes. Periodically, the Group carries out stress testing of more extreme shocks to calibrate its determination of these other representative scenarios.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2018**

BD 000's

34. RISK MANAGEMENT (continued)**CREDIT RISK (continued)***Incorporation of forward looking information (continued)*

The Group has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses. The economic scenarios used as at 31 December 2018 included the key indicators for the selected countries such as the unemployment rates, interest rates and the GDP growth.

Modified financial assets and assets acquired for leasing

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

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- Its remaining lifetime PD at the reporting date based on the modified terms; with
- The remaining lifetime PD estimated based on data at initial recognition and the original contractual terms.

The Group renegotiates financing to customers in financial difficulties (referred to as 'forbearance activities') to maximise collection opportunities and minimise the risk of default. Under the Group's forbearance policy, forbearance of financing assets is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of profit payments and amending the terms of loan covenants. Both retail and corporate financings are subject to the forbearance policy.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired / in default (refer Note 5). A customer needs to demonstrate consistently good payment behaviour over a period of time (12 months) before the exposure is no longer considered to be credit-impaired/ in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to 12-month ECL.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2018**

BD 000's

34. *RISK MANAGEMENT (continued)**CREDIT RISK (continued)***Measurement of ECLs**

ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Group expects to receive). ECLs are discounted at the effective profit rate of the financial asset.

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

- probability of default (PD);
- loss given default (LGD);
- exposure at default (EAD).

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

PD estimates are estimates at a certain date, which are calculated based on statistical rating models, and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models are based on internally compiled data comprising both quantitative and qualitative factors. Where it is available, market data may also be used to derive the PD for large corporate counterparties. If a counterparty or exposure migrates between rating classes, then this will lead to a change in the estimate of the associated PD.

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. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For financing assets secured by retail property, LTV ratios are a key parameter in determining LGD. They are calculated on a discounted cash flow basis using the effective interest rate as the discounting factor.

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 amount allowed under the contract including amortisation. The EAD of a financial asset is its gross carrying amount. For lending commitments and financial guarantees, the EAD includes the amount drawn, as well as potential future amounts that may be drawn under the contract, which are estimated based on historical observations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2018**

BD 000's

34. *RISK MANAGEMENT (continued)*
CREDIT RISK (continued)
Incorporation of forward looking information (continued)

The following tables show reconciliations from the opening to the closing balance of the loss allowance: 12-month ECL, lifetime ECL and credit-impaired.

	12 month ECL (Stage 1)	Lifetime ECL not credit impaired (Stage 2)	Lifetime ECL credit impaired (Stage 3)	Total 2018
Balance at 1 January	2,860	10,537	10,317	23,714
Transfer to 12-month ECL	3,188	(3,086)	(102)	-
Transfer to lifetime ECL non-credit-impaired	(316)	398	(82)	-
Transfer to lifetime ECL credit-impaired	(229)	(2,463)	2,692	-
Net transfers	2,643	(5,151)	2,508	-
Net re-measurement of loss allowance	(404)	(1,468)	7,668	5,796
Recoveries / write backs	-	-	(1,713)	(1,713)
Write-offs	-	-	(1,566)	(1,566)
Balance at 31 December	5,099	3,918	17,214	26,231

Break down of ECL by category of assets in the statement of financial position and off-balance sheet commitments:

	12 month ECL (Stage 1)	Lifetime ECL not credit impaired (Stage 2)	Lifetime ECL credit impaired (Stage 3)	Total 2018
Cash and balances with banks	50	-	-	50
Placements with financial institutions	2	-	-	2
Financing assets	4,762	3,695	13,566	22,023
Assets acquired for leasing (including lease rental receivables)	106	139	2,211	2,456
Investment in sukuk	3	-	1,317	1,320
Commitments and financial guarantees	176	84	120	380
	5,099	3,918	17,214	26,231

Impaired financial assets

Impaired financial assets are those for which the Group determines that it is probable that it will be unable to collect all or part of the principal and profit due according to the contractual terms of the exposure and these fall under risk grades 8, 9 and 10. For other financial assets impairment is assessed on an individual basis for each exposure by considering various factors.

Past due but not impaired exposures

The exposure pertains to financing assets where contractual profit or principal payments are past due but the Group believes that impairment is not appropriate on the basis of subsequent collections, the level of security / collateral available and / or the stage of collection of amounts owed to the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2018**

BD 000's

34. RISK MANAGEMENT (continued)**CREDIT RISK (continued)****Renegotiated facilities**

During the year, facilities of BD 16,896 thousands (2017: BD 25,160 thousand) were renegotiated, out of which BD 8,806 thousand (2017: BD 2,000 thousand) are classified as neither past due nor impaired as of 31 December 2018. The renegotiated terms usually require settlement of profits accrued till date on the facility and/or part payment of the principal and/or obtaining of additional collateral coverage. The renegotiated facilities are subject to revised credit assessments and independent review by the RMD. Of the total past due facilities of BD 142,895 thousand (2017: BD 117,168 thousand) only instalments of BD 39,269 thousand (2017: BD 13,352 thousand) are past due as at 31 December 2018.

Allowances for impairment

The Group makes provisions for impairment on individual assets classified under grades 8,9 and 10. This is done on the basis of the present value of projected future cash flows from the assets themselves and consideration of the value of the collateral securities available. On a collective basis, the Group has provided for impairment losses based on management's judgment of the extent of losses incurred but not identified based on the current economic and credit conditions.

Non-accrual basis

Group classifies financing facility/Sukuk as non-accrual status, if the facility/Sukuk is past due greater than 90 days or there is reasonable doubt about the collectability of the receivable amount. The profits on such facilities are not recognized in the income statement until there are repayments from the borrower or the exposure is upgraded to regular status.

Write-off policy

The gross carrying amount of a financial asset is written off when the Group has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. The Group expects no significant recovery from the amount written 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. During the year, the Group has written off financing facilities amounting to BD 1,566 thousand (2017: BD 13,228 thousand) which were fully impaired. The Group has recovered BD 99 thousand from a financing facility written off in previous years (2017: 38 thousand).

Collaterals

The Group holds collateral against financing assets and receivables from assets acquired for leasing in the form of mortgage/ pledge over property, listed securities, other assets and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing. Valuation of collateral is updated when the loan is put on a watch list and the loan is monitored more closely. Collateral generally is not held against exposure to other banks and financial institutions. An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below. This includes the value of financial guarantees from banks, but not corporate and personal guarantees as the values thereof are not readily quantifiable. The collateral values considered for disclosure are restricted to the extent of the outstanding exposures.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

34. RISK MANAGEMENT (continued)

CREDIT RISK (continued)

Collaterals (continued)

	As at 31 December 2018			As at 31 December 2017		
	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total
<u>Against impaired</u>						
Property	40,471	16,587	57,058	28,545	5,844	34,389
Other	2,193	-	2,193	2,175	-	2,175
<u>Against past due but not impaired</u>						
Property	21,397	19,232	40,629	23,193	21,428	44,621
Other	2,929	-	2,929	5,182	-	5,182
<u>Against neither past due nor impaired</u>						
Property	87,637	82,680	170,317	94,368	78,575	172,943
Other	12,416	-	12,416	25,566	20	25,586
Total	167,043	118,499	285,542	179,029	105,867	284,896

The average collateral coverage ratio on secured facilities is 136.05% at 31 December 2018 (31 December 2017: 126.86%).

For analysis of concentration of total assets and liabilities refer note 32.

Further, for financing assets and Sukuk, the Group monitors concentrations of credit risk by sector and by geographic location.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

34. RISK MANAGEMENT (continued)

CREDIT RISK (continued)

An analysis of concentrations of credit risk at the reporting date is shown below:

Concentration by Sector	As at 31 December 2018			As at 31 December 2017		
	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total
Banking and finance	10,358	-	10,358	11,011	-	11,011
Real estate	51,630	118,615	170,245	39,771	105,715	145,486
Construction	54,803	-	54,803	35,917	-	35,917
Trading	78,009	-	78,009	90,691	-	90,691
Manufacturing	13,880	-	13,880	45,090	-	45,090
Others	118,960	1,588	120,548	132,024	68	132,092
Total carrying amount	327,640	120,203	447,843	354,504	105,783	460,287

Settlement risk

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

Settlement limits form part of the credit approval / limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from RMD.

LIQUIDITY RISK

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial assets.

Management of liquidity risk

The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

Financial Control Department (FCD) collates data from treasury and other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. FCD communicates the information to the treasury who manages the Group's portfolio of short-term liquid assets, largely made up of short-term placements with other banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole.

The daily liquidity position is monitored by FCD. The Group has in place a Liquidity Contingency Plan, the elements of which are periodically tested. Tools for implementation of regular stress testing under various scenarios are in place. All liquidity policies and procedures are subject to review by ALCO and approval by appropriate authorities. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO members.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

34. RISK MANAGEMENT (continued)

LIQUIDITY RISK (continued)

Exposure to liquidity risk

The key measure used by the Group for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For computation of this, net liquid assets are considered as including cash and bank balances and placements with financial Institutions and investments in sukuk net of sukuk pledged against medium-term borrowing less placements from financial institution, and deposits comprise current accounts, placements from non-financial institutions and individuals, and equity of investment account holders.

Details of the reported Group ratio of net liquid assets to deposits and customers current accounts at the reporting date and during the reporting period were as follows:

	2018 %	2017 %
At 31 December	16.79	9.3
Average for the period	13.09	18.26
Maximum for the period	19.55	29.97
Minimum for the period	6.60	5.15

For maturity profile of assets and liabilities refer note 31.

MARKET RISK

Market risk is the risk that changes in market prices, such as profit rate, equity prices, foreign exchange rates and credit spreads will affect the Group's income, future cash flows or the value of its holdings of financial instruments. Market risk comprises three types of risk: currency risk, profit rate risk and other price risk. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks

The Group separates its exposure to market risk between trading and non-trading portfolios. The Group has no trading positions in equity or commodities and the main source of market risk for the Group is its foreign exchange exposure and profit rate gap.

The Group does not do any trading in foreign exchange. The Group does not engage in proprietary trading of foreign exchange derivatives. All foreign exchange income/ losses arising out of customer transactions and revaluation of statement of financial position assets and liabilities are booked by the treasury operations. The responsibility for monitoring and managing the related risks also rests with the Treasury department.

Overall authority for market risk management is vested with ALCO. The RMD is responsible for the development of detailed risk management policies (subject to review and approval by appropriate approval authorities) and the Financial Control Department is responsible for the day-to-day review of their implementation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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34. RISK MANAGEMENT (continued)

MARKET RISK (continued)

Exposure to profit rate risk–non–trading portfolios

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for re-pricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by the Group's Risk Management Department in its day-to-day monitoring activities.

A summary of the Group's profit rate gap position at 31 December 2018 is as follows:

31 December 2018	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	42,590	-	1,047	-	-	43,637
Financing assets	40,881	9,345	36,588	66,003	174,823	327,640
Assets acquired for leasing (including lease rentals receivables)	15	7	230	7,528	112,423	120,203
Investments securities (sukuk)	-	-	-	16,227	145,097	161,324
Total profit rate sensitive assets	83,486	9,352	37,865	89,758	432,343	652,804
Liabilities and investment accounts						
Placements from financial institutions	31,312	17,664	109,373	-	-	158,349
Medium-term borrowing	-	-	41,357	-	-	41,357
Placements from non-financial institutions and individuals	37,180	21,163	27,722	34,405	-	120,470
Customers' current accounts	1,199	-	-	-	-	1,199
Equity of investments account holders	154,133	73,102	98,830	20,308	-	346,373
Total profit rate sensitive liabilities and investment accounts	223,824	111,929	277,282	54,713	-	667,748
Profit rate gap	(140,338)	(102,577)	(239,417)	35,045	432,343	(14,944)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

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34. RISK MANAGEMENT (continued)

MARKET RISK (continued)

31 December 2017	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	32,921	-	1,048	-	-	33,969
Financing assets	51,219	12,275	53,402	62,832	174,776	354,504
Assets acquired for leasing (including lease rentals receivables)	-	7	-	7,777	97,999	105,783
Investments securities (sukuk)	-	-	284	147	112,916	113,347
Total profit rate sensitive assets	84,140	12,282	54,734	70,756	385,691	607,603
Liabilities and investment accounts						
Placements from financial institutions	91,652	14,319	11,505	6,789	-	124,265
Medium-term borrowing	-	-	-	41,308	-	41,308
Placements from non-financial institutions and individuals	7,630	9,660	24,606	19,463	-	61,359
Customers' current accounts	1,286	-	-	-	-	1,286
Equity of investments account holders	190,691	66,559	88,789	13,778	1	359,818
Total profit rate sensitive liabilities and investment accounts	291,259	90,538	124,900	81,338	1	588,036
Profit rate gap	(207,119)	(78,256)	(70,166)	(10,582)	385,690	19,567

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis point (bp) parallel fall or rise across all yield curves and a 50 bp rise or fall of all yield curves.

An analysis of the Group's sensitivity to an increase or decrease in market profit rates (assuming no asymmetrical movement in yield curves and a constant statement of financial position) is as follows:

At 31 December 2018
At 31 December 2017

100bp parallel increase/decrease	50bp increase/decrease
± 149	± 67
±196	±98

Overall non-trading profit rate risk positions are managed by Treasury department, which uses short term investment securities, placement with banks and placement from banks to manage the overall position arising from the Group's non-trading activities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

34. RISK MANAGEMENT (continued)

MARKET RISK (continued)

Exposure to foreign exchange risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group had the following significant net exposures denominated in foreign currency as of 31 December.

	2018 BHD Equivalent	2017 BHD Equivalent
US Dollars*	28,905	12,236
Other GCC Currencies *	20,226	(7,707)
Euros	(402)	(297)
Australian Dollars	4,627	4,607
Kuwaiti Dinars	3,379	3,544
Sterling Pounds	(579)	480
Indian Rupee	38	9

(*) The exposure in US dollars and other GCC currencies does not create any foreign exchange risk for the Group since Bahrain Dinars and other GCC currencies except for Kuwaiti Dinars are effectively pegged to the US Dollars.

The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various foreign exchange scenarios. Standard scenarios that are considered on a monthly basis include a 5% plus/minus increase in exchange rates, for currencies other than US Dollars, other GCC currencies.

An analysis of the Group's sensitivity to an increase or decrease in foreign exchange rates (assuming all other variables, primarily profit rates, remain constant) is as follows:

	2018 BHD Equivalent	2017 BHD Equivalent
Euros	±20	±15
Australian Dollars	±231	±230
Kuwaiti Dinars	±169	±177
Sterling Pounds	±29	±24
Indian Rupees	±2	-

Exposure to other price risks—non-trading portfolios

Credit spread risk on debt securities is subject to regular monitoring by RMD, but is not currently significant in relation to the overall financial position of the Group.

The Group's unquoted equity securities carried at cost are exposed to risk of changes in equity values. Refer to note 24 for significant estimates and judgments in relation to impairment assessment of unquoted equity investments carried at cost. The Group manages exposure to other price risks by actively monitoring the performance of the equity securities. The performance assessment is performed on a quarterly basis and is reported to the Board Investment and Credit Committee.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

34. RISK MANAGEMENT (continued)

MARKET RISK (continued)

OPERATIONAL RISK

Operational risk is the risk of loss arising from systems and control failures, fraud and human errors, which can result in financial and reputation loss, and legal and regulatory consequences. The Group manages operational risk through appropriate controls, instituting segregation of duties and internal checks and balances, including internal audit and compliance. The Risk Management Department is in charge of identifying, monitoring and managing operational risk in the Group. The Group already has an approved policy for doing this and all required organisational and physical infrastructure are in place.

The Group has completed conducting one cycle of Risk Control Self-Assessment (RCSA) of Operational risk for majority of the departments of the Group to identify the important Key Risk Areas, Key Risk Indicators and Key Risk Triggers. Furthermore for the remaining departments Key Risk Areas have been identified and the next process will be the identification of Key Risk Indicators and Key Risk Triggers. The RCSA process is a continuous process and will be conducted at regular frequencies across the Group. It will be an annual process to review all the KRI's. A software for monitoring these triggers and recording actual and near miss losses is already in place. The medium term objective of the Group is to generate statistically reliable data to upgrade to more sophisticated modes of Operational Risk Control both to manage the risk better and to reduce capital commitment.

CAPITAL MANAGEMENT

The Central Bank of Bahrain (CBB) sets and monitors capital requirements for the Group as a whole. In implementing current capital requirements CBB requires the Group to maintain a prescribed ratio of total capital to total risk-weighted assets. The capital adequacy regulations of CBB is based on the principles of Basel III of the IFSB guidelines.

The Group's regulatory capital is analysed into two tiers:

- *Tier 1 capital: includes CET1 and AT1.*

CET1 comprise of ordinary share capital that meet the classification as common shares for regulatory purposes, disclosed reserves including share premium, general reserves, legal / statutory reserve, common shares issued by consolidated banking subsidiaries of the Bank and held by third parties, retained earnings after regulatory adjustments relating to goodwill and items that are included in equity which are treated differently for capital adequacy purposes.

AT1 comprise instruments issued by consolidated banking subsidiaries of the Bank held by third parties which meet the criteria of AT1, and regulatory adjustments applied in calculation of AT1.

- *Tier 2 capital, includes instruments issued by the Bank that meet the criteria for inclusion in Tier 2 capital, stock surplus resulting from issue of Tier 2 capital, instruments issued by consolidated banking subsidiaries of the Bank held by third parties that meet the criteria for inclusion in Tier 2, general provisions held against unidentified losses on financing and qualify for inclusion within Tier 2, asset revaluation reserve from revaluation of fixed assets and instruments purposes and regulatory adjustments applied in the calculation of Tier 2 capital.*

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2018

BD 000's

34. RISK MANAGEMENT (continued)

CAPITAL MANAGEMENT (continued)

The regulatory adjustments are subject to limits prescribed by the CBB requirements, these deductions would be effective in a phased manner through transitional arrangements from 2016 to 2018. The regulations prescribe higher risk weights for certain exposures that exceeds materiality thresholds. These regulatory adjustments required for certain items such as goodwill on mortgage service right, deferred tax assets, cash flow hedge reserve, gain on sale of related securitization transactions, defined benefit pension fund assets and liabilities, investment in own shares and reciprocal cross holdings in the capital of Banking and financial entities, investment in the capital of Banking and financial entities that are outside the scope of regulatory consolidation and where the Group does not own more than 10% of issued common shares capital of the entity and significant investments in the capital of banking and financial entities that are outside the scope of regulatory consolidation.

As at 31 December 2018, the Group has made regulatory adjustments of BD 13,720 thousand (2017: 11,325 thousand) in line with the CBB requirements.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

The Group's regulatory capital position at 31 December was as follows:

	31 December 2018	31 December 2017
Total risk weighted exposure	667,077	683,784
Tier 1 capital:		
- CET 1 capital prior to regulatory adjustments	112,467	123,141
- Less: regulatory adjustments	(13,720)	(11,325)
CET 1 after regulatory adjustments	98,747	111,816
AT 1	-	-
Tier 2 capital:	7,382	4,419
Total regulatory capital	106,129	116,235
Total regulatory capital expressed as a percentage of total risk weighted assets	15.91%	17.00%
Liquidity coverage ratio	395.03%	111.99%
Net stable funding ratio	88.31%	196.01%
Leverage ratio	4.75	19.02

The Group has complied with all externally imposed capital requirements throughout the year.

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BD 000's

34. RISK MANAGEMENT (continued)

CAPITAL MANGEMENT (continued)

Capital allocation

The allocation of capital between specific operations and activities is primarily driven by regulatory requirements. The Group's capital management policy seeks to maximise return on risk adjusted while satisfying all the regulatory requirements. The Group's policy on capital allocation is subject to regular review by the Board.

35. COMMITMENTS

The commitments contracted in the normal course of business of the Group:

	2018	2017
Undrawn commitments to extend finance *	33,193	48,747
Financial guarantees	12,864	18,390
	46,057	67,137

* The Group has a right to revoke the undrawn commitment to extend finance prior to expiry of its tenor.

Performance obligations

During the ordinary course of business, the Group may enter into performance obligations in respect of certain of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2018 due to the performance of any of its projects.

36. SOCIAL RESPONSIBILITY

The Group discharges its social responsibilities through donations to charitable causes and organisations.

37. COMPARITIVES

Certain prior year amounts have been regrouped to conform the current year's presentation. Such regrouping did not affect previously reported profit for the year or owner's equity.