

Al Salam Bank-Bahrain B.S.C.

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2017

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AL SALAM BANK-BAHRAIN B.S.C.

Report on the consolidated financial statements

We have audited the accompanying consolidated statement of financial position of Al Salam Bank-Bahrain B.S.C. ["the Bank"] and its subsidiaries [together "the Group"] as of 31 December 2017, and the related consolidated statements of income, cash flows and changes in equity for the year then ended. 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 Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

Opinion

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

Other matters

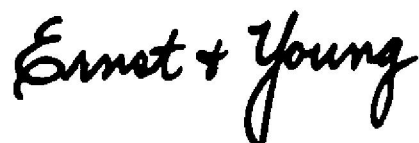
As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 2), we report that:

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; and
- b) the financial information contained in the report of the Board of Directors is consistent with the consolidated financial statements.

**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF
AL SALAM BANK-BAHRAIN B.S.C. (continued)**

Other matters (continued)

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2017 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests. The Bank has also complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.



Partner's Registration No. 115
13 February 2018
Manama, Kingdom of Bahrain

Al Salam Bank-Bahrain B.S.C.

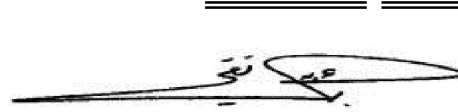
CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 December 2017

	Note	2017 BD '000	2016 BD '000
ASSETS			
Cash and balances with banks and Central Bank	4	66,351	131,990
Sovereign Sukuk		357,778	358,269
Murabaha and Wakala receivables from banks	5	143,803	182,452
Corporate Sukuk	6	10,324	28,934
Murabaha financing	7	197,380	213,687
Mudaraba financing	8	308,093	252,807
Ijarah Muntahia Bittamleek	9	212,148	188,485
Musharaka		19,192	12,304
Assets under conversion	11	2,771	37,016
Non-trading investments	12	111,325	122,073
Investments in real estate	13	52,431	51,863
Development properties	14	6,448	17,781
Investment in associates	15	16,835	10,561
Other assets	16	58,410	27,260
Goodwill	17	25,971	25,971
Assets classified as held-for-sale		-	19,840
TOTAL ASSETS		1,589,260	1,681,293
LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND EQUITY			
LIABILITIES			
Murabaha and Wakala payables to banks		154,641	132,032
Murabaha and Wakala payables to non-banks		597,848	723,439
Current accounts		283,886	279,609
Liabilities under conversion	11	2,729	217
Murabaha term financing	18	79,786	91,837
Other liabilities	19	47,652	49,043
Liabilities relating to assets classified as held-for-sale		-	11,421
TOTAL LIABILITIES		1,166,542	1,287,598
EQUITY OF INVESTMENT ACCOUNTHOLDERS	20	118,881	68,796
EQUITY			
Share capital	21	214,093	214,093
Treasury stock	21	(1,879)	(1,646)
Reserves and retained earnings		76,029	100,213
Proposed appropriations		14,987	10,705
Total equity attributable to shareholders of the Bank		303,230	323,365
Non-controlling interest		607	1,534
TOTAL EQUITY		303,837	324,899
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND EQUITY		1,589,260	1,681,293



Sh. Hessa Bint Khalifa Al Khalifa
Chairperson of the Board



Yousif A. Taqi
Director & Group Chief Executive Officer

The attached notes 1 to 44 form part of these consolidated financial statements.

Al Salam Bank-Bahrain B.S.C.

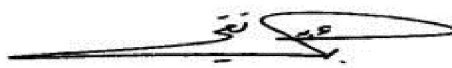
CONSOLIDATED INCOME STATEMENT

Year ended 31 December 2017

	Note	2017 BD '000	2016 BD '000
OPERATING INCOME			
Income from financing contracts	24	43,688	38,850
Income from Sukuk		16,724	15,930
Gain on sale of investments and Sukuk - net	25	6,506	15,153
Income from investments	26	1,745	1,819
Fair value changes on investments		(941)	2,477
Dividend income		669	891
Foreign exchange gain		1,177	2,146
Fees, commission and other income - net	27	12,459	7,929
		82,027	85,195
Profit on Murabaha and Wakala payables to banks		(1,831)	(1,910)
Profit on Wakala payables to non-banks		(15,476)	(18,046)
Profit on Murabaha term financing		(2,411)	(2,120)
Return on equity of investment accountholders before Group's share as a Mudarib	20	(230)	(216)
Group's share as a Mudarib	20	111	97
		(119)	(119)
Total operating income		62,190	63,000
OPERATING EXPENSES			
Staff cost		11,528	11,523
Premises and equipment cost		1,675	2,021
Depreciation		1,509	3,060
Other operating expenses		9,553	9,454
Total operating expenses		24,265	26,058
PROFIT BEFORE PROVISIONS AND RESULTS			
OF ASSOCIATES		37,925	36,942
Net allowance for credit losses / impairment	10	(20,656)	(21,573)
Share of profit from associates	15	786	727
Net profit for the year		18,055	16,096
ATTRIBUTABLE TO:			
- Shareholders of the Bank		18,099	16,219
- Non-controlling interest		(44)	(123)
		18,055	16,096
Weighted average number of shares (in '000)		2,125,147	2,140,820
Basic and diluted earnings per share (fils)	23	8.5	7.6



Sh. Hessa Bint Khalifa Al Khalifa
Chairperson of the Board



Yousif A. Taqi
Director & Group Chief Executive Officer

The attached notes 1 to 44 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2017

	Note	2017 BD '000	2,016 BD '000
OPERATING ACTIVITIES			
Net profit for the year		18,055	16,096
Adjustments:			
Depreciation		1,509	3,060
Amortisation of premium on Sukuk - net		1,179	1,630
Fair value changes on investments		941	(2,441)
Gain on sale of investments and Sukuk -net		(6,506)	-
Net allowance for credit losses / impairment		20,656	21,573
Share of profit from associates		(786)	(727)
Operating income before changes in operating assets and liabilities		35,048	39,191
Changes in operating assets and liabilities:			
Mandatory reserve with Central Bank		(2,710)	2,727
Murabaha financing		1,873	3,756
Mudaraba financing		(76,699)	(4,774)
Ijarah Muntahia Bittamleek		(26,535)	(32,893)
Musharaka		(7,087)	(5,150)
Assets under conversion		10,575	(3,620)
Other assets		(15,121)	16,665
Assets and liabilities classified as held-for-sale		-	(8,419)
Murabaha and Wakala payables to banks		22,609	11,237
Wakala from non-banks		(125,591)	(119,131)
Current accounts		4,277	46,062
Liabilities under conversion		2,512	(2,110)
Other liabilities		(1,769)	248
Net cash used in operating activities		(178,618)	(56,211)
INVESTING ACTIVITIES			
Net cash flow arising on acquisition of a subsidiary		-	8,723
Cash paid on acquisition of a subsidiary		-	(726)
Sovereign Sukuk		(638)	(8,994)
Corporate Sukuk		18,557	21,107
Non-trading investments		14,857	807
Investments in real estate		-	16,904
Development properties		11,333	31,240
Investment in associates		(6,240)	-
Purchase of premises and equipment		(699)	(1,664)
Net movements in non-controlling interest		-	120
Sale of subsidiaries		7,275	-
Net cash from investing activities		44,445	67,517
FINANCING ACTIVITIES			
Murabaha term financing		30,200	56,390
Equity of investment accountholders		50,085	6,445
Dividends paid		(10,626)	(10,705)
Purchase of treasury stock		(233)	(1,646)
Murabaha term financing paid		(42,251)	(539)
Net cash from financing activities		27,175	49,945
NET CHANGE IN CASH AND CASH EQUIVALENTS		(106,998)	61,251
Cash and cash equivalents at 1 January		284,928	223,677
CASH AND CASH EQUIVALENTS AT 31 DECEMBER		177,930	284,928
Cash and cash equivalents comprise of:			
Cash and other balances with Central Bank of Bahrain	4	8,509	72,356
Balances with other banks	4	25,618	30,120
Murabaha and Wakala receivables from banks with original maturities of less than 90 days		143,803	182,452
		177,930	284,928

The attached notes 1 to 44 form part of these consolidated financial statements.

Al Salam Bank-Bahrain B.S.C.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2017

Amounts in BD '000s

	Attributable to shareholders of the Bank												Group Total equity
	Reserves									Proposed appropriations	Total Owners' Equity	Non- controlling interest	
	Share capital	Treasury stock	Statutory reserve	Retained earnings	Changes in fair value	Real estate fair value reserve	Foreign exchange translation reserve	Share premium reserve	Total reserves				
Balance as of 1 January 2017	214,093	(1,646)	15,338	50,695	445	24,234	(2,708)	12,209	100,213	10,705	323,365	1,534	324,899
Transition adjustment on adoption of FAS 30 as of 1 January 2017 (Note. 2.3.1)	-	-	-	(26,759)	-	-	-	-	(26,759)	-	(26,759)	(12)	(26,771)
Restated balance as of 1 January 2017	214,093	(1,646)	15,338	23,936	445	24,234	(2,708)	12,209	73,454	10,705	296,606	1,522	298,128
Net profit for the year	-	-	-	18,099	-	-	-	-	18,099	-	18,099	(44)	18,055
Net changes in fair value	-	-	-	-	(246)	568	-	-	322	-	322	-	322
Foreign currency re-translation	-	-	-	-	-	-	(211)	-	(211)	-	(211)	-	(211)
Dividend paid	-	-	-	79	-	-	-	-	79	(10,705)	(10,626)	(12)	(10,638)
Disposal of subsidiaries	-	-	-	-	-	(727)	-	-	(727)	-	(727)	(871)	(1,598)
Proposed dividend for the year 2017	-	-	-	(14,987)	-	-	-	-	(14,987)	14,987	-	-	-
Purchase of treasury stock	-	(233)	-	-	-	-	-	-	-	-	(233)	-	(233)
Movements in non-controlling interest	-	-	-	-	-	-	-	-	-	-	-	12	12
Transfer to statutory reserve	-	-	1,810	(1,810)	-	-	-	-	-	-	-	-	-
Balance at 31 December 2017	214,093	(1,879)	17,148	25,317	199	24,075	(2,919)	12,209	76,029	14,987	303,230	607	303,837
Balance as of 1 January 2016	214,093	-	13,716	46,803	(148)	24,253	(2,693)	12,209	94,140	10,705	318,938	1,064	320,002
Net profit for the year	-	-	-	16,219	-	-	-	-	16,219	-	16,219	(123)	16,096
Net changes in fair value	-	-	-	-	593	(19)	-	-	574	-	574	-	574
Foreign currency re-translation	-	-	-	-	-	-	(15)	-	(15)	-	(15)	11	(4)
Dividend paid	-	-	-	-	-	-	-	-	-	(10,705)	(10,705)	-	(10,705)
Proposed dividend for the year 2016	-	-	-	(10,705)	-	-	-	-	(10,705)	10,705	-	-	-
Purchase of treasury stock	-	(1,646)	-	-	-	-	-	-	-	-	(1,646)	-	(1,646)
Movements in non-controlling interest due to ASBS acquisition	-	-	-	-	-	-	-	-	-	-	-	582	582
Transfer to statutory reserve	-	-	1,622	(1,622)	-	-	-	-	-	-	-	-	-
Balance at 31 December 2016	214,093	(1,646)	15,338	50,695	445	24,234	(2,708)	12,209	100,213	10,705	323,365	1,534	324,899

The attached notes 1 to 44 form part of these consolidated financial statements.

1 INCORPORATION AND PRINCIPAL ACTIVITIES

Al Salam Bank-Bahrain B.S.C. ("the Bank") was incorporated in the Kingdom of Bahrain under the Bahrain Commercial Companies Law No. 21/2001 and is registered with Ministry of Industry, Commerce and Tourism ("MOICT") under Commercial Registration Number 59308 on 19 January 2006. The Bank is regulated and supervised by the Central Bank of Bahrain ("the CBB") and has an Islamic retail banking license and operates under Islamic principles in accordance with all the relevant regulatory guidelines for Islamic banks issued by the CBB. The Bank's registered office is P.O. Box 18282, Bahrain World Trade Center, East Tower, King Faisal Highway, Manama 316, Kingdom of Bahrain.

On 30 March 2014, the Bank acquired 100% stake in BMI Bank B.S.C.(c) ("BMI"), a closed shareholding company in the Kingdom of Bahrain, through exchange of shares. During January 2015, the Shari'a Supervisory Board approved BMI Bank to be an Islamic bank effective 1 January 2015.

On 29 November 2016, the shareholders of BMI resolved to approve the transfer of the operations of BMI to the Bank. The transfer of business was approved by the CBB on 17 April 2017 which was subsequently published in the official gazette dated 20 April 2017. The Bank has transferred majority of the BMI's rights and assumed all of its obligations at their respective carrying values.

During 2016, the Bank acquired 70% stake in Al Salam Bank Seychelles Limited ("ASBS").

The Bank and its principal subsidiary operates through 10 branches in the Kingdom of Bahrain and Seychelles and offer a full range of Shari'a-compliant banking services and products. The activities of the Bank includes managing profit sharing investment accounts, offering Islamic financing contracts, dealing in Shari'a-compliant financial contracts as principal / agent, managing Shari'a-compliant financial contracts and other activities permitted for under the CBB's Regulated Islamic Banking Services as defined in the licensing framework. The Bank's ordinary shares are listed in Bahrain Bourse and Dubai Financial Market.

In addition to ASBS, the other subsidiaries of the Bank are as follows:

Name of entity	Nature of entity	% holding	
		2017	2016
Al Salam Leasing Two Ltd ("ASL II")	Aircraft under lease	-	76%
Auslog Holding Trust	Investment in real estate	-	90%

The Bank together with its subsidiaries is referred to as "the Group".

These consolidated financial statements have been authorised for issue in accordance with a resolution of the Board of Directors dated 13 February 2018.

2 ACCOUNTING POLICIES**2.1 BASIS OF PREPARATION**

The consolidated financial statements are prepared on a historical cost basis, except for investments held at fair value through profit or loss, fair value through equity and investments in real estates which are held at fair value. These consolidated financial statements incorporate all assets, liabilities and off-balance sheet financial contracts held by the Group.

These consolidated financial statements are presented in Bahraini Dinars, being the functional and presentation currency of the Group, rounded to the nearest thousand [BD '000], except where otherwise indicated.

2 ACCOUNTING POLICIES (continued)

2.1 BASIS OF PREPARATION (continued)

2.1.a Statement of compliance

The consolidated financial statements of the Group are prepared in accordance with the Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"), the Islamic Sharia' rules and Principles as determined by the Sharia' Supervisory Board of the Group and in conformity with the Bahrain Commercial Companies Law, the guidelines of CBB and Financial Institutions Law. The matters for which no AAOIFI standards exist, the Group uses the relevant applicable International Financial Reporting Standards ("IFRS") as issued by International Accounting Standard Board ("IASB").

The Group presents its consolidated statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within twelve months after the consolidated statement of financial position date (current) and more than twelve months after the consolidated statement of financial position date (non-current) is presented in Note 34.

2.1.b Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries as at 31 December 2017. The financial statements of the subsidiaries are prepared for the same reporting year using consistent accounting policies of the Bank. All intra-group balances, transactions, income and expenses and unrealised gains and losses resulting from intra-group transactions are eliminated in full.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and continue to be consolidated until the date when such control ceases. Control is achieved where the Group has the power to govern the financial and operating policies of an entity with the objective of obtaining benefits from its operations. The results of subsidiaries acquired or disposed off during the year, if any, are included in the consolidated income statement from the date of acquisition or up to the date of disposal, as appropriate.

Share of minority stakeholders' interest (non-controlling interest) represents the portion of profit or loss and net assets not held by the Group and are presented separately in the consolidated income statement and within equity in the consolidated statement of financial position, separately from the equity attributable to shareholders of the Bank.

2.2 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of the consolidated financial statements requires management to make judgments and estimates that affect the reported amount of financial assets and liabilities and disclosure of contingent liabilities. These judgments and estimates also affect the revenues and expenses and the resultant allowance for losses as well as fair value changes reported in equity.

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimating uncertainty at the date of the consolidated statement of financial position, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment of goodwill

Impairment exists when carrying value of an asset or cash generating unit (CGU) exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use.

The recoverable amount of each cash-generating unit's goodwill is based on value-in-use calculations using cash flow projections from financial budgets approved by the Board of Directors, extrapolated for five years projection using nominal projected growth rate. The determination of projected growth rate and discount rate involves judgment whereas, preparation of cash flow projections requires various management assumptions.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates based on the actual loss experience.

2 ACCOUNTING POLICIES (continued)

2.2 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES (continued)

Estimation uncertainty (continued)

Impairment of fair value through equity investments

The Group treats fair value through equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of significant or prolonged decline and other objective evidence involves judgment. In addition, the Group evaluates other factors, including normal volatility in share price for quoted equities, the future cash flows and the present value calculation factors for unquoted equities.

Valuation of unquoted private equity and real estate investments

Valuation of above investments involve judgment and is normally based on one of the following:

- valuation by independent external valuers;
- recent arm's length market transactions;
- current fair value of another contract that is substantially similar;
- present value of expected cash flows at current rates applicable for items with similar terms and risk characteristics; or
- application of other valuation models.

The Group calibrates the valuation techniques periodically and tests these for validity using either prices from observable current market transactions in the same contract or other available observable market data.

Judgments

Going concern

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

Control over special purpose entities

The Group sponsors the formation of special purpose entities (SPEs) primarily for the purpose of allowing clients to hold investments. The Group does not consolidate SPEs that it does not have the power to control. In determining whether the Group has the power to control an SPE, judgments are made about the objectives of the SPEs activities, and Group's exposures to the risk and rewards, as well as its ability to make operational decisions of the SPEs.

Classification of investments

Management decides upon acquisition of an investment whether it should be classified as fair value through profit or loss or fair value through equity.

Impairment assessment of financial contracts - policy applicable from 1 January 2017

In determining impairment on receivables, judgment is required in the estimation of the amount and timing of future cash flows as well as an assessment of whether credit risk on the financial contract has increased significantly since initial recognition and incorporation of forward-looking information in the measurement of expected credit losses ("ECL"). Refer to note 2.3.2 (b) for further details.

2 ACCOUNTING POLICIES (continued)**2.3 SIGNIFICANT ACCOUNTING POLICIES****2.3.1 Early adoption of FAS 30 - Impairment, Credit Losses and Onerous Commitments ("FAS 30")**

The Group has early adopted FAS 30, effective from 1 January 2017 which has a mandatory date of initial application of 1 January 2020. The requirements of FAS 30 represent a significant change from FAS 11 "Provisions and Reserves".

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

Transition

Changes in accounting policies resulting from the adoption of FAS 30 have been applied retrospectively, except comparative periods which have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of FAS 30 are recognised in retained earnings and reserves as at 1 January 2017. Accordingly, the information presented for 2016 does not reflect the requirements of FAS 30 and therefore is not comparable to the information presented for 2017 under FAS 30.

Impact of adopting FAS 30

Following is the impact of early adoption of FAS 30:

	Balance 31 December 2016 BD '000	Transition adjustment BD '000	Restated balance 1 January 2017 BD '000
Retained earnings	50,695	(26,759)	23,936
Non-controlling interest	1,534	(12)	1,522
Murabaha and Wakala receivables from banks	182,452	(4)	182,448
Murabaha financing	213,687	(14,636)	199,051
Mudaraba financing	252,807	(4,742)	248,065
Ijarah Muntahia Bittamleek	188,485	(4,151)	184,334
Musharaka	12,304	(91)	12,213
Assets under conversion	37,016	(44)	36,972
Investment in associates	10,561	(541)	10,020
Other assets	27,260	(891)	26,369
Other liabilities	49,043	(1,647)	50,690

The key changes to the Group's accounting policies resulting from its adoption of FAS 30 are summarized in note 2.3.2 (b).

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3.2 Summary of significant accounting policies

a) Financial contracts

Financial contracts consist of balances with banks and the Central Bank, Sovereign Sukuk, Corporate Sukuk, Murabaha financing (net of deferred profits), Mudaraba financing, Musharaka, Ijarah Muntahia Bittamleek, asset under conversion and other assets. Balances relating to these contracts are stated net of allowance for credit losses.

b) Impairment assessment (policy applicable from 1st January 2017)

Impairment of financial assets

FAS 30 replaces the 'incurred loss' model in FAS 11 with ECL model. The new impairment model also applies to certain financing commitments and financial guarantee contracts but not to equity investments.

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

Stage 1: twelve months ECL

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

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

Stage 2: Lifetime ECL – not credit impaired

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

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

Stage 3: Lifetime ECL – credit impaired

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

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

Credit-impaired financial assets

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

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- probability that the borrower will enter bankruptcy or other financial reorganization; or
- the restructuring of a facility by the Group on terms that the Group would not consider otherwise.

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3.2 Summary of significant accounting policies (continued)

b) Impairment assessment (policy applicable from 1st January 2017) (continued)

Measurement of ECL

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

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

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

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 liquidating collateral; or the borrower is past due more than 90 days or any credit obligation to the Group. In assessing whether a borrower is in default, the Group considers both qualitative factors such as breaches of covenants and quantitative factors such as overdue status and non-payment on another obligation of the same issuer to the Group.

Probability of default

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

Incorporation of forward - looking information

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

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

Loss Given Default

LGD is the magnitude of the likely loss if there is a default. The Group estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties, based on historical data using both internal and external factors. The LGD is estimated using below factors:

Cure Rate: Defined as the ratio of accounts which have fallen to default and have managed to move backward to the performing accounts.

Recovery Rate: Defined as the ratio of liquidation value to market value of the underlying collateral at the time of default would also account for expected recovery rate from a general claim on the individual's assets for the unsecured portion of the exposure.

Discounting Rate: Defined as the opportunity cost of the recovery value not being realized on the day of default adjusted for time value.

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3.2 Summary of significant accounting policies (continued)

b) Impairment Assessment (policy applicable from 1st January 2017) (continued)

Exposure At Default

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

Significant Increase in Credit Risk

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

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

Renegotiated financial assets

The contractual terms of a financing may be modified for a number of reasons including changing market conditions, and other factors not related to the current or potential credit deterioration of a customer. When the terms of a financial asset are modified and the modification does not result in a derecognition, the determination of whether the asset's credit risk has increased significantly reflects a comparison of its remaining lifetime PD at the reporting date based on 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 to maximize collection opportunities and minimize the risk of default. This may involve extending the payment arrangements and documenting the agreement of new conditions for providing finance. Management continuously reviews renegotiated facilities to ensure that all criteria are met and that future payments are likely to occur.

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

Backward transition

FAS 30 staging model is of symmetrical nature as exposures may migrate from lifetime ECL measurement (Stage 2 and Stage 3) to 12 month ECL measurement (Stage 1). However, movement across stages are not immediate once SICR indicators are no longer triggered. Once such indicators are no longer triggered, movement back to Stage 1 or Stage 2 has to be calibrated and cannot be automatic or immediate. Certain criteria like cooling off period, SICR indicators and payment history are considered for migrating customers to Stage 2 or Stage 1.

Credit Conversion Factor

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

The outstanding exposure is calculated as principal plus profit less expected prepayments. The undrawn portion refers to the portion of the unutilized credit limit. CCF applied to the facilities would be the higher of average behavioral utilization over the last five years or capital charge.

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3.2 Summary of significant accounting policies (continued)

b) Impairment Assessment (policy applicable from 1st January 2017) (continued)

Write-offs

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

Presentation of allowance for credit losses in the consolidated statement of financial position

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

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

c) Impairment and uncollectability of financial assets (applicable up to 31st December 2016)

An assessment is made at each reporting date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, impairment loss, if any, is recognised in the consolidated income statement.

Impairment is determined as follows:

- (i) for assets carried at amortised cost, impairment is based on estimated cash flows based on the original effective profit rate;
- (ii) for assets carried at fair value, impairment is the difference between cost and fair value; and
- (iii) for assets carried at cost, impairment is based on present value of anticipated cash flows based on the current market rate of return for a similar financial asset.

For fair value through equity investments, reversal of impairment losses are recorded as increases in cumulative changes in fair value through equity.

d) Sovereign Sukuk and Corporate Sukuk

These are quoted / unquoted securities and are classified as investments carried at amortised cost.

e) Murabaha financing

Murabaha is a contract whereby one party ("Seller") sells an asset to the other party ("Purchaser") at cost plus profit and on a deferred payment basis, after the Seller has purchased the asset based on the Purchaser's promise to purchase the same on such Murabaha basis. The sale price comprises the cost of the asset and an agreed profit margin. The sale price (cost plus the profit amount) is paid by the Purchaser to the Seller on installment basis over the agreed finance tenure. Under the Murabaha contract, the Group may act either as a Seller or a Purchaser, as the case may be.

The Group considers the promise to purchase made by the Purchaser in a Murabaha transaction in favor of the Seller to be binding.

Murabaha receivables are stated at cost, net of deferred profits and / or allowance for credit losses, if any, and amounts settled.

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3.2 Summary of significant accounting policies (continued)

f) Mudaraba financing

Mudaraba is a contract between two parties whereby one party is a fund provider (Rab Al Mal) who would provide certain amount of funds (Mudaraba Capital), to the other party (Mudarib). Mudarib would then invest the Mudaraba Capital in a specific enterprise or activity deploying its experience and expertise for a specific pre-agreed share in the resultant profit. The Rab Al Mal is not involved in the management of the Mudaraba activity. The Mudarib would bear the loss in case of its default, negligence or violation of any of the terms and conditions of the Mudaraba contract; otherwise the loss would be borne by the Rab Al Mal. Under the Mudaraba contract, the Group may act either as Mudarib or as Rab Al Mal, as the case may be.

Mudaraba financing are recognised at fair value of the Mudaraba assets net of allowance for credit losses, if any, and Mudaraba Capital amounts settled. If the valuation of the Mudaraba assets results in difference between fair value and book value, such difference is recognised as profit or loss to the Group.

g) Ijarah Muntahia Bittamleek

Ijara Muntahia Bittamleek is an agreement whereby the Group ("Lessor") leases an asset to the customer ("Lessee") after purchasing / acquiring a specified asset, either from a third party seller or from the customer, according to the customer's request and promise to lease against certain rental payments for a specific lease term / periods, payable on fixed or variable rental basis.

The Ijara agreement specifies the leased asset, duration of the lease term, as well as, the basis for rental calculation, the timing of rental payment and responsibilities of both parties during the lease term. The Lessee provides the Lessor with an undertaking to renew the lease periods and pay the relevant rental payment amounts as per the agreed schedule throughout the lease term.

The Lessor retains the ownership of the assets throughout the lease term. At the end of the lease term, upon fulfillment of all the obligations by the Lessee under the Ijara agreement, the Lessor will sell the leased asset to the Lessee for a nominal value based on sale undertaking given by the Lessor. Leased assets are usually in the type of residential properties, commercial real estate or aircrafts.

Depreciation is provided on a systematic basis on all Ijarah Muntahia Bittamleek assets other than land (which is deemed to have an indefinite useful life), at rates calculated to write off the cost of each asset over the shorter of either the lease term or economic life of the asset.

h) Musharaka

Musharaka is used to provide venture capital or project finance. The Group and customer contribute towards the capital of the Musharaka. Usually a special purpose company or a partnership is established to undertake the Musharaka. Profits are shared according to a pre-agreed profit distribution ratio but losses are borne by the partners according to the capital contributions of each partner. Capital contributions may be in cash or in kind, as valued at the time of entering into the Musharaka.

Musharaka is stated at cost, less any allowance for credit losses.

i) Assets and liabilities under conversion

Assets under conversion:

Loans and advances

At amortised cost less any amounts written off and allowance for credit losses, if any.

Non-trading investments

These are classified as fair value through equity investments and are fair valued based on criteria set out in note 2.3.2 (b). Any changes in fair values subsequent to acquisition date are recognised in total comprehensive income (note 28).

Liabilities under conversion:

These are remeasured at amortised cost.

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3.2 Summary of significant accounting policies (continued)

j) Non-trading investments

These are classified as fair value through equity or fair value through profit or loss investments.

All investments are initially recognised at cost, being the fair value of the consideration given including acquisition costs associated with the investment. Acquisition cost relating to investments designated as fair value through profit or loss is charged to consolidated income statement.

Following the initial recognition of investments, the subsequent reporting values are determined as follows:

Fair value through equity investments

After initial recognition, equity investments which are classified as investments at fair value through equity are normally remeasured at fair value, unless the fair value cannot be reliably determined, in which case they are measured at cost less impairment, if any. Fair value changes are reported in equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment, the cumulative gain or loss previously reported as "changes in fair value" within equity, is included in the consolidated income statement.

Impairment losses on fair value through equity investments are not reversed through the consolidated income statement and increases in their fair value after impairment are recognised directly in owners' equity.

Fair value through profit or loss investments

Investments in this category are designated as such on initial recognition if these investments are evaluated on a fair value basis in accordance with the Group's risk management policy and its investment strategy. These include all private equity investments including those in joint ventures and associates which are not strategic in nature.

Investments at fair value through profit or loss are recorded in the consolidated statement of financial position at fair value. Changes in fair value are recorded as "fair value changes on investments" in the consolidated income statement. Gain on sale of these investments is included in "gain on sale of investments and Sukuk" in the consolidated income statement. Income earned on these investments is included in "income from investments" in the consolidated income statement.

k) Investments in associates

The Group's investments in associates, that are acquired for strategic purposes, are accounted for under the equity method of accounting. Other equity investments in associates are accounted for as fair value through profit or loss by availing the scope exemption under FAS 24, Investments in Associates. An associate is an entity over which the Group has significant influence and which is neither a subsidiary nor a joint venture. An entity is considered as an associate if the Group has more than 20% ownership of the entity or the Group has significant influence through any other manner.

Under the equity method, investment in associate is carried in the consolidated statement of financial position at cost plus post-acquisition changes in the Group's share of net assets of the associates. Losses in excess of the cost of the investment in associates are recognised when the Group has incurred obligations on its behalf. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised. The consolidated income statement reflects the Group's share of results of operations of the associates. Where there has been a change recognised directly in the equity of the associate, the Group recognises its share of any changes and discloses this, when applicable, in the consolidated statement of changes in equity.

The reporting dates of the Group's associates are identical with the Group and the associates accounting policy conform to those used by the Group for like transactions and events in similar transactions.

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

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3.2 Summary of significant accounting policies (continued)

k) Investments in associates (continued)

Profit and losses resulting from transactions between the Group and the associates are eliminated to the extent of the interest in associates.

Foreign exchange translation gains / losses arising out of the above investment in the associates are included in the consolidated statement of changes in equity.

l) Investments in real estate

Properties held for rental, or for capital appreciation purposes, or both, are classified as investments in real estate. The investment in real estate is initially recognised at cost and subsequently measured based on intention whether the investments in real estate is held-for-use or held-for-sale. The Group has adopted the fair value model for its investments in real estate. Under the fair value model, any unrealized gains are recognised directly in owners' equity. Any unrealized losses are adjusted in equity to the extent of the available credit balance. Where unrealized losses exceed the available balance in owners' equity, these are recognised in the consolidated income statement. In case there are unrealized losses relating to investments in real estate that have been recognised in the consolidated income statement in a previous financial period, the unrealized gains relating to the current financial period is recognised to the extent of crediting back such previous losses in the consolidated income statement. Investments in real estate held-for-sale is carried at lower of its carrying value and expected fair value less costs to sell. Investments in real estate carried at fair value shall continue to be measured at fair value.

m) Development properties

Properties acquired exclusively for development are classified as development properties and are measured at the lower of cost or net realisable value.

n) Premises and equipment

Premises and equipment are stated at cost less accumulated depreciation and any impairment in value. Depreciation is changed on a straight-line basis over the estimated useful lives of all premises and equipment, other than freehold land and capital work-in-progress.

- Computer hardware	3 to 5 years
- Computer software	3 to 5 years
- Furniture and office equipment	3 to 5 years
- Motor vehicle	4 to 5 years
- Leasehold improvements	Over the lease period

o) Subsidiaries acquired with a view to sell

A subsidiary acquired with a view to subsequent disposal within twelve months is classified as "held-for-sale" when the sale is highly probable. Related assets and liabilities of the subsidiary are shown separately on the consolidated statement of financial position as "assets held-for-sale" and "liabilities relating to assets classified as held-for-sale" respectively. Assets that are classified as held-for-sale are measured at the lower of carrying amount and fair value less costs to sell. Any resulting impairment loss reduces the carrying amount of the assets. Assets that are classified as held-for-sale are not depreciated.

p) Business combinations and goodwill

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred measured at acquisition date fair value and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets.

In a business combination achieved in stages, the group remeasures its previously held equity interest in the acquiree at its acquisition date fair value and recognises the resulting gain or loss, if any, in the consolidated income statement or total comprehensive income as appropriate.

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3.2 Summary of significant accounting policies (continued)

p) Business combinations and goodwill (continued)

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date.

In a business combination in which the Bank and the acquiree exchange only equity interests, the acquisition-date fair value of the acquiree's equity interests is used to determine the amount of goodwill.

Investments acquired but do not meet the definition of business combination are recorded as financing assets or investment in properties as appropriate. When such investments are acquired, the Group allocates the cost of acquisition between the individual identifiable assets and liabilities based on their relative fair values at the date of acquisition. Cost of such assets is the sum of all consideration given and any non-controlling interest recognised. If the non-controlling interest has a present ownership interest and is entitled to a proportionate share of net assets upon liquidation, the Group recognises the non-controlling interest at its proportionate share of net assets.

Goodwill is initially measured at cost, being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interests, and any previous interest held, over the net identifiable assets acquired and liabilities assumed. If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the re-assessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognised in consolidated income statement.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is tested for impairment at least annually. Any impairment is recognised immediately in the consolidated income statement. Goodwill is allocated to each of the Group's cash-generating units (CGU) that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Impairment exists when carrying value of an asset or CGU exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use.

Impairment of goodwill is determined by assessing the recoverable amount of the CGU (or group of CGUs), to which the goodwill relates. Where the recoverable amount of the CGU (or group of CGUs) is less than the carrying amount, an impairment loss is recognised immediately in the consolidated income statement.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's CGU, or groups of CGUs, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- is / are not larger than a segment based on either the Group's primary or the Group's geographic segment reporting format.

q) Offsetting

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

r) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and able to be reliably measured.

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3.2 Summary of significant accounting policies (continued)

s) Employees' end-of-service benefits

The Group provides end of service benefits to its expatriate employees. Entitlement to these benefits is based upon the employees' final salary and length of service, subject to completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

For Bahraini employees, the Group makes contributions to Social Insurance Organisation calculated as a certain percentage of the employees' salaries. The Group's obligations are limited to these contributions, which are expensed when due.

t) Revenue recognition

Murabaha and Wakala receivables

As the income is quantifiable and contractually determined at the commencement of the contract, income is recognised on a straight-line basis over the deferred period. Recognition of income is suspended when the Group believes that the recovery of these amounts may be doubtful or when the payments of Murabaha installments are overdue by 90 days, whichever is earlier.

Sukuk

Income on Sukuk is recognised on a time-proportionate basis based on underlying rate of return of the respective type of Sukuk. Recognition of income is suspended when the Group believes that the recovery of these amounts may be doubtful or when the payments are overdue by 90 days, whichever is earlier.

Mudaraba

Income on Mudaraba transactions are recognised when the right to receive payment is established or these are declared by the Mudarib, whichever is earlier. In case of losses in Mudaraba, the Group's share of loss is recognised to the extent that such losses are being deducted from its share of the Mudaraba Capital.

Dividend

Dividend income is recognised when the Group's right to receive the dividend is established.

Ijarah Muntahia Bittamleek

Ijarah Muntahia Bittamleek income is recognised on a time-proportionate basis over the lease term. Income related to non-performing Ijarah Muntahia Bittamleek is suspended. Accrual of income is suspended when the Group believes that the recovery of these amounts may be doubtful or normally when the rental payments are overdue by 90 days, whichever is earlier.

Musharaka

Income on Musharaka is recognised when the right to receive payment is established or on distributions. In case of losses in Musharaka, the Group's share of loss is recognised to the extent that such losses are being deducted from its share of the Musharaka capital.

Fees and commission income

The Group earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following main categories:

- Fee income on financing transactions: Fee earned on financing transactions including up-front fees and early settlement fees are recognised when earned. To the extent the fees are deemed yield enhancement they are recognised over the period of the financing contracts.
- Fee income from transaction services: Fee arising from corporate finance, corporate advisory, arranging the sale of assets and wealth management are recognised when earned or on a time proportionate basis when the fee is linked to time.
- Other fee income: This is recognised when services are rendered.

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3.2 Summary of significant accounting policies (continued)

u) Fair value of financial assets

For investments that are traded in organised financial markets, fair value is determined by reference to the prevailing market bid price on the reporting date.

For investments where there is no quoted market price, a reasonable estimate of fair value is determined by reference to valuation by independent external valuers or based on recent arm's length market transactions. Alternatively, the estimate would also be based on current market value of another contract, which is substantially the same, or is based on the assessment of future cash flows. The cash equivalent values are determined by the Group by calculating the present value of future cash flows at current profit rates for contracts with similar terms and risk characteristics.

For assets having fixed or determinable payments, fair value is based on the net present value of estimated future cash flows determined by the Group using current profit rates for contracts with similar terms and risk characteristics.

v) Foreign currencies

Foreign currency transactions are recorded at rates of exchange prevailing at the dates of the transactions. Monetary assets and liabilities in foreign currencies at the consolidated statement of financial position date are retranslated at market rates of exchange prevailing at that date. Gains and losses arising on translation are recognised in the consolidated income statement. Non-monetary assets that are measured in terms of historical cost in foreign currencies are recorded at rates of exchange prevailing at the value dates of the transactions. Translation gains or losses on non-monetary items classified as "fair value through equity" and investment in associates are included in consolidated statement of changes in equity until the related assets are sold or derecognised at which time they are recognised in the consolidated income statement. Translation gains on non-monetary assets classified as "fair value through profit or loss" are directly recognised in the consolidated income statement.

w) Translation of foreign operations

Assets and liabilities of foreign subsidiaries whose functional currency is not Bahraini Dinars are translated into Bahraini Dinars at the rates of exchange prevailing at the reporting date. Income and expense items are translated at average exchange rates prevailing for the reporting period. Any exchange differences arising on translation are included in foreign exchange translation reserve forming part of other comprehensive income except to the extent that the translation difference is allocated to the non-controlling interest. On disposal of foreign operations, exchange differences relating thereto and previously recognised in other comprehensive income are recognised in the consolidated income statement.

x) Repossessed assets

Reposessed assets are assets acquired in settlement of dues. These assets are carried at the lower of carrying amount and fair value less costs to sell and reported within 'other assets'. The Group's policy is to determine whether a reposessed asset can be best used for its internal operations or should be sold. Assets determined to be useful for the internal operations are transferred to their relevant asset category at the lower of their reposessed value or the carrying value of the original secured asset. Assets for which selling is determined to be a better option are transferred to assets held for sale at their fair value or fair value less cost to sell for non-financial assets at the repossession date in line with the Group's policy.

y) Trade and settlement date accounting

Purchases and sales of financial assets and liabilities are recognised on the trade date, i.e. the date that the Group contracts to purchase or sell the asset or liability.

z) Derecognition of financial assets

Financial assets 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.

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3.2 Summary of significant accounting policies (continued)

z) Derecognition of financial assets (continued)

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to pay.

aa) Fiduciary assets

Assets held in a fiduciary capacity are not treated as assets of the Group and are accordingly not included in the consolidated statement of financial position.

ab) Dividend on ordinary shares

Dividend payable on ordinary issued and fully paid shares of the Bank is recognised as a liability and deducted from equity when it is approved by the Group's shareholders. Dividend for the year that is approved after the reporting date is included in the equity and is disclosed as an event after the consolidated statement of financial position date.

ac) Equity of investment account holders

All equity of investment accountholders are carried at cost plus profit and related reserves less amounts settled.

Share of income for equity of investment accountholder is calculated based on the income generated by the assets funded by such investment accounts after deducting Mudarib share (as Mudarib and Rabalmaal). Operating expenses are additionally charged to shareholders' funds and are not included in the calculation.

The basis applied by the Group in arriving at the equity of investment accountholders' share of income is total investment income less shareholders' income.

Under FAS 30, ECL is allocated to the assets invested using funds from unrestricted investment accounts.

ad) Treasury stock

Own equity contracts that are re-acquired, are recognised at cost and deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Bank's own equity contracts. Any difference between the carrying amount and the consideration, if re-issued, is recognised in share premium in consolidated statement of changes in equity.

ae) Zakah

In accordance with the articles of association of the Group, the responsibility to pay Zakah is on the shareholders of the Bank.

af) Cash and cash equivalents

Cash and cash equivalents comprise of cash and balances with the CBB and Murabaha receivables from banks with original maturities of less than 90 days.

ag) Wakala payables

The Group accepts funds from banks and customers under Wakala arrangements in which a return is payable to customers as agreed in the agreement. There is no restriction on the Group for the use of funds received under Wakala agreement.

Profit on these is accrued on a time-apportioned basis over the period of the contract based on the principal amounts outstanding.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2017

2 ACCOUNTING POLICIES (continued)**2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)****2.3.2 Summary of significant accounting policies (continued)****ah) Jointly-financed and self-financed**

Investments, financing and receivables that are jointly-funded by the Group and the equity of investment accountholders are classified under the caption "jointly-financed" in the consolidated financial statements. Investments, financing and receivables that are funded solely by the Group are classified under "self-financed".

ai) Earnings prohibited by Shari'a

The Group is committed to contributing to charity any income generated from non-Islamic sources. Accordingly, any earning prohibited by Shari'a is credited to charity funds to be used for social welfare purposes.

3 CLASSIFICATION OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS

	31 December 2017			
	At fair value through profit or loss BD '000	At fair value through equity BD '000	At amortised cost / others BD '000	Total BD '000
ASSETS				
Cash and balances with banks and				
Central Bank	-	-	66,351	66,351
Sovereign Sukuk	-	-	357,778	357,778
Murabaha and Wakala receivables				
from banks	-	-	143,803	143,803
Corporate Sukuk	-	-	10,324	10,324
Murabaha financing	-	-	197,380	197,380
Mudaraba financing	-	-	308,093	308,093
Ijarah Muntahia Bittamleek	-	-	212,148	212,148
Musharaka	-	-	19,192	19,192
Assets under conversion	-	-	2,771	2,771
Non-trading investments	109,393	1,932	-	111,325
Investments in real estate	-	52,431	-	52,431
Development properties	-	-	6,448	6,448
Investment in associates	-	-	16,835	16,835
Other assets	-	1,359	57,051	58,410
Goodwill	-	-	25,971	25,971
	109,393	55,722	1,424,145	1,589,260
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS				
Murabaha and Wakala payables				
to banks	-	-	154,641	154,641
Murabaha and Wakala payables				
to non-banks	-	-	597,848	597,848
Current accounts	-	-	283,886	283,886
Liabilities under conversion	-	-	2,729	2,729
Term financing	-	-	79,786	79,786
Other liabilities	-	-	47,652	47,652
Equity of investment accountholders	-	-	118,881	118,881
	-	-	1,285,423	1,285,423

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**3 CLASSIFICATION OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT
ACCOUNTHOLDERS (continued)**

	31 December 2016			
	At fair value through profit or loss BD '000	At fair value through equity BD '000	At amortised cost / others BD '000	Total BD '000
ASSETS				
Cash and balances with banks and				
Central Bank	-	-	131,990	131,990
Sovereign Sukuk	-	-	358,269	358,269
Murabaha and Wakala receivables				
from banks	-	-	182,452	182,452
Corporate Sukuk	-	-	28,934	28,934
Murabaha financing	-	-	213,687	213,687
Mudaraba financing	-	-	252,807	252,807
Ijarah Muntahia Bittamleek	-	-	188,485	188,485
Musharaka	-	-	12,304	12,304
Assets under conversion	-	41	36,975	37,016
Non-trading investments	115,403	6,670	-	122,073
Investments in real estate	-	51,863	-	51,863
Development properties	-	-	17,781	17,781
Investment in associates	-	-	10,561	10,561
Other assets	-	1,449	25,811	27,260
Goodwill	-	-	25,971	25,971
Assets classified as held-for-sale	-	19,636	204	19,840
	<u>115,403</u>	<u>79,659</u>	<u>1,486,231</u>	<u>1,681,293</u>
	At fair value through profit or loss BD '000	At fair value through equity BD '000	At amortised cost / others BD '000	Total BD '000
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS				
Murabaha and Wakala payables				
to banks	-	-	132,032	132,032
Murabaha and Wakala payables				
to non-banks	-	-	723,439	723,439
Current accounts	-	-	279,609	279,609
Liabilities under conversion	-	-	217	217
Term financing	-	-	91,837	91,837
Other liabilities	-	-	49,043	49,043
Equity of investment accountholders	-	-	68,796	68,796
Liabilities relating to assets classified as held-for-sale	-	-	11,421	11,421
	<u>-</u>	<u>-</u>	<u>1,356,394</u>	<u>1,356,394</u>

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4 CASH AND BALANCES WITH BANKS AND CENTRAL BANK

	2017	2016
	BD '000	BD '000
Mandatory reserve with Central Bank*	32,224	29,514
Cash and other balances with Central Bank	8,509	72,356
Balances with other banks**	25,618	30,120
	66,351	131,990

* This balance is not available for use in the day-to-day operations of the Group.

** This balance is net of an insignificant amount of allowance for credit losses.

5 MURABAHA AND WAKALA RECEIVABLES FROM BANKS

	2017	2016
	BD '000	BD '000
Jointly-financed assets	118,879	68,796
Self-financed assets	24,924	113,656
	143,803	182,452

The above receivables are net of allowance for credit losses of BD 2 thousands (2016: BD nil) which is wholly allocated to jointly-financed assets.

At 31 December 2017, deferred profits on Murabaha and Wakala receivables from banks amounted to BD 35 thousands (2016: BD 60 thousands).

The entire exposure of Murabaha and Wakala receivables from Banks at 31 December 2017 and 31 December 2016 are with financial entities mainly based in GCC countries.

6 CORPORATE SUKUK

	2017	2016
	BD '000	BD '000
Investment grade	5,689	17,865
Non-investment grade	4,635	3,843
Un-rated Sukuk	-	7,226
	10,324	28,934

The above balance is net of allowance for credit losses of BD 3 thousands (2016: BD nil).

7 MURABAHA FINANCING

	2017	2016
	BD '000	BD '000
Murabaha financing	223,749	231,363
Less: allowance for credit losses	(26,369)	(17,676)
	197,380	213,687

Murabaha financing is reported net of deferred profits of BD 29,694 thousands (2016: BD 39,249 thousands).

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7 MURABAHA FINANCING (continued)**7.1 Movements in allowance for credit losses on Murabaha financing**

	2017				2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit- impaired BD '000	Stage 3: Lifetime ECL credit- impaired BD '000	Total ECL BD '000	Total BD '000
Balance at 1 January on adoption of FAS 30	2,680	12,766	16,866	32,312	8,288
Changes due to receivables recognised in opening balance that have:					
- transferred to Stage 1: 12 month ECL	454	(304)	(150)	-	-
- transferred to Stage 2: Lifetime ECL not credit-impaired	(24)	24	-	-	-
- transferred to Stage 3: Lifetime ECL credit-impaired	(16)	(187)	203	-	-
Net remeasurement of loss allowance	1,096	(1,282)	12,536	12,350	14,645
Recoveries / write-backs	(455)	(206)	(115)	(776)	(1,767)
Allowance for credit losses	1,055	(1,955)	12,474	11,574	12,878
Reclass to other financing contracts	-	-	-	-	(2,643)
Amounts written off during the year	-	-	(17,517)	(17,517)	(847)
Balance at the end of the year	3,735	10,811	11,823	26,369	17,676

8 MUDARABA FINANCING

	2017 BD '000	2016 BD '000
Mudaraba financing	325,748	267,559
Less: allowance for credit losses	(17,655)	(14,752)
	308,093	252,807

8.1 Movements in allowance for credit losses on Mudaraba financing

	2017				2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total ECL BD '000	Total BD '000
Balance at 1 January on adoption of FAS 30	4,711	3,281	11,502	19,494	10,633
Changes due to receivables recognised in opening balance that have:					
- transferred to Stage 1: 12 month ECL	735	(732)	(3)	-	-
- transferred to Stage 2: Lifetime ECL not credit-impaired	(100)	416	(316)	-	-
- transferred to Stage 3: Lifetime ECL credit-impaired	(22)	(2,142)	2,164	-	-
Net remeasurement of loss allowance	907	3,952	(135)	4,724	290
Recoveries / write-backs	(134)	(100)	(193)	(427)	(52)
Allowance for credit losses	1,386	1,394	1,517	4,297	238
Reclass from other financing contracts	-	-	-	-	4,289
Amounts written off during the year	-	-	(6,136)	(6,136)	(408)
Balance at the end of the year	6,097	4,675	6,883	17,655	14,752

9 IJARAH MUNTAHIA BITTAMLEEK

This represents net investment in assets leased for periods which either approximate or cover major parts of the estimated useful lives of such assets. The majority of the lease documentations provide that the Lessor undertakes to transfer the leased assets to the Lessee at the end of the lease term upon the lessee fulfilling all its obligations under the lease agreement.

	2017	2016
	BD '000	BD '000
Movements in Ijarah Muntahia Bittamleek assets are as follows:		
At 1 January	188,485	155,217
Additions during the year - net	54,782	29,006
Ijarah assets depreciation	(17,996)	(10,568)
(Disposal) / transfer	(14,400)	14,400
Reversal of allowance for credit losses during the year	1,277	430
At 31 December	212,148	188,485

	2017	2016
	BD '000	BD '000

The future minimum lease receivable in aggregate are as follows:

Due within one year	6,314	4,304
Due in one to five years	98,459	79,273
Due after five years	107,375	104,908
	212,148	188,485

Ijarah Muntahia Bittamleek is divided into the following asset classes:

Land and buildings	212,148	181,685
Aircraft	-	6,800
	212,148	188,485

The accumulated depreciation on Ijarah Muntahia Bittamleek assets amounted to BD 43,832 thousands (2016: BD 40,403 thousands).

9.1 Movements in allowance for credit losses on Ijarah Muntahia Bittamleek

	2017			2016	
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total ECL BD '000	Total BD '000
Balance at 1 January on adoption of FAS 30	1,009	1,106	12,212	14,327	9,304
Changes due to receivables recognised in opening balance that have:					
- transferred to Stage 1: 12 month ECL	234	(229)	(5)	-	-
- transferred to Stage 2: Lifetime ECL not credit-impaired	(5)	16	(11)	-	-
- transferred to Stage 3: Lifetime ECL credit-impaired	(2)	(117)	119	-	-
Net remeasurement of loss allowance	(174)	(286)	(445)	(905)	2
Recoveries / write-backs	-	-	(372)	(372)	(432)
Allowance for credit losses	53	(616)	(714)	(1,277)	(430)
Reclass from other financing contracts	-	-	-	-	1,302
Amounts written off during the year	-	-	(7,769)	(7,769)	-
Balance at the end of the year	1,062	490	3,729	5,281	10,176

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10 NET ALLOWANCE FOR CREDIT LOSSES / IMPAIRMENT

	2017	2016
	BD '000	BD '000
Murabaha and Wakala receivables from banks	(3)	-
Corporate Sukuk	3	-
Murabaha financing	11,574	12,878
Mudaraba financing	4,297	238
Ijarah Muntahia Bittamleek	(1,277)	(430)
Musharaka	108	(6)
Assets under conversion	(1,677)	501
Other assets	5,833	5,239
Financing commitments and financial guarantee contracts	(802)	-
	18,056	18,420
Impairment for fair value through equity investments (note 10.1)	886	3,153
	18,942	21,573

10.1 Movements in impairment for fair value through equity investments

	2017	2016
	BD '000	BD '000
Balance at the beginning of the year	8,624	5,471
Provision during the year	1,048	3,153
Recoveries / reversals	(162)	-
Allowance for impairment	886	3,153
Write-offs	(6,259)	-
Balance at the end of the year	3,251	8,624

11 ASSETS AND LIABILITIES UNDER CONVERSION

These represent interest bearing non-Shari'a compliant assets and liabilities of ASBS. These assets and liabilities have been reported as separate line items on the face of the consolidated statement of financial position. The details of the assets and liabilities under conversion are as follows:

	2017	2016
	BD '000	BD '000
Assets		
Loans and advances*	1,688	35,408
Non-trading investments - debt	926	1,592
Non-trading investment - fair value through equity	-	16
Other assets	157	-
	2,771	37,016
Liabilities		
Customers' deposits	2,729	-
Other liabilities	-	217
	2,729	217

During the year, assets under conversion related to BMI have been transferred to other assets upon completion of the conversion period (note 16).

* This balance is net of allowance for credit losses of BD 93 thousands (2016: BD 1,714 thousands).

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11 ASSETS AND LIABILITIES UNDER CONVERSION (continued)**11.1 Movements in allowance for credit losses on assets under conversion**

	2017				2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit- impaired BD '000	Stage 3: Lifetime ECL credit- impaired BD '000	Total ECL BD '000	Total BD '000
Balance at 1 January on adoption of FAS 30	56	671	1,043	1,770	1,213
Transfer to other assets	-	(671)	(1,043)	(1,714)	-
Net remeasurement of loss allowance	37	-	-	37	584
Recoveries / write-backs	-	-	-	-	(83)
Allowance for credit losses	37	(671)	(1,043)	(1,677)	501
Amounts written off during the year	-	-	-	-	-
Balance at the end of the year	93	-	-	93	1,714

12 NON-TRADING INVESTMENTS

Non-trading investments are classified as fair value through equity or fair value through profit or loss.

Fair value hierarchy

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

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs that have a significant effect on the recorded fair value are observable, either directly or indirectly; or

Level 3: techniques that use inputs that have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of the non-trading investments carried at fair value in the consolidated statement of financial position:

31 December 2017	Level 1 BD '000	Level 2 BD '000	Level 3 BD '000	Total BD '000
Financial assets at fair value through profit or loss	5,903	5,561	97,929	109,393
Financial assets at fair value through equity	-	-	1,932	1,932
	5,903	5,561	99,861	111,325
31 December 2016	Level 1 BD '000	Level 2 BD '000	Level 3 BD '000	Total BD '000
Financial assets at fair value through profit or loss	7,755	5,011	102,637	115,403
Financial assets at fair value through equity	3,968	-	2,702	6,670
	11,723	5,011	105,339	122,073

As of 31 December 2017, no transfers from have been made from Level 1 to Level 3 fair value measurements (2016: BD 1,793 thousands).

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12 NON-TRADING INVESTMENTS (continued)

The movements in fair value of non-trading investments classified in Level 3 of the fair value hierarchy are as follows:

	Fair value measurement using significant unobservable inputs Level 3	
	2017	2016
	BD '000	BD '000
At 1 January	105,339	106,392
Fair value changes	1,228	228
Provision for impairment	(726)	(1,030)
Disposals during the year	(2,346)	(2,151)
Repayments during the year	(3,634)	(307)
Additions during the year	-	414
Transfer from Level 1 to Level 3	-	1,793
At 31 December	99,861	105,339

13 INVESTMENTS IN REAL ESTATE

	2017	2016
	BD '000	BD '000
Land	49,498	48,930
Buildings	2,933	2,933
	52,431	51,863

The movements in fair value of investments in real estate classified in Level 3 of the fair value hierarchy are as follows:

	Fair value measurement using significant unobservable inputs Level 3	
	2017	2016
	BD '000	BD '000
At 1 January	51,863	68,786
Fair value changes	568	(19)
Additions during the year	-	2,732
Transfer to assets classified as held-for-sale	-	(19,636)
At 31 December	52,431	51,863

14 DEVELOPMENT PROPERTIES

These represent properties acquired and held through investment vehicles exclusively for development in the Kingdom of Bahrain and the United Kingdom. The carrying amounts include land price and related construction costs.

15 INVESTMENT IN ASSOCIATES

The Group has a 14.4% (2016: 14.4%) stake in Al Salam Bank Algeria (ASBA), an unlisted bank incorporated in Algeria. The Bank has representation on the board of ASBA through which the Bank exercises a significant influence on ASBA.

The Group has a 20.94% (2016: 20.94%) stake in Gulf African Bank ("GAB"), a private Islamic bank incorporated in Kenya.

15 INVESTMENT IN ASSOCIATES (continued)

During the year, the Group has made an investment in CSQ1 Property Unit Trust, a private company incorporated in Jersey. The Group has 23.2% stake in CSQ1 Property Unit Trust (2016: nil).

The Group's interest in ASBA, GAB and CSQ1 Property Unit Trust is accounted for using the equity method in the consolidated financial statements.

The following table illustrates summarised financial information of Group's investments in ASBA:

	2017 BD '000	2016 BD '000
Associates' statement of financial position:		
Total assets	282,037	180,792
Total liabilities	227,465	128,426
Net assets	54,572	52,366
Total revenue	13,093	9,428
Total expenses	9,144	5,751
Net profit for the year	3,949	3,677
Group's share of associates' net profit	451	164

The following table illustrates summarised financial information of Group's investments in GAB:

	2017 BD '000	2016 BD '000
Associates' statement of financial position:		
Total assets	115,427	99,856
Total liabilities	96,734	83,889
Net assets	18,693	15,967
Total revenue	11,661	10,729
Total expenses	10,074	9,021
Net profit for the year	1,587	1,708
Group's share of associates' net profit	335	563

16 OTHER ASSETS

	2017 BD '000	2016 BD '000
Assets under conversion (a)		
Loans and advances to customers	20,149	-
Non-trading investments - debt	29	344
Non-trading investments - fair value through equity (b)	1,359	1,341
	21,537	1,685
Reposessed assets (c)	14,351	4,863
Profit receivable	11,410	9,922
Premises and equipment	1,704	2,514
Prepayments	1,136	1,874
Rental receivable on Ijarah Muntahia Bittamleek	1,090	449
Credit card receivables - net	2,437	2,926
Other receivables and advances	4,745	3,027
	58,410	27,260

(a) These represent non-Shari'a compliant assets resulted from the acquisition of BMI and Bahraini Saudi Bank B.S.C. ("ex-BSB"). This balance is net of allowance for credit losses of BD 4,970 thousands (2016: BD nil).

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16 OTHER ASSETS (continued)

(b) The above fair value through equity investments are classified as Level 3 in the fair value hierarchy (note 12). Movements in fair value through equity investments are as follows:

	Fair value measurement using significant unobservable inputs Level 3	
	2017 BD '000	2016 BD '000
At 1 January	1,341	1,928
Transfer during the year	18	(82)
Disposals during the year	-	(505)
At 31 December	1,359	1,341

(c) This balance is net of provision of BD 611 thousands (2016: BD nil).

16.1 Movements in allowance for credit losses on other assets

	2017				2016
	Stage 1: 12-month ECL BD '000	Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total ECL BD '000	Total BD '000
Balance at 1 January on adoption of FAS 30	52	(419)	3,674	3,307	125
Transfer from assets under conversion	-	671	1,043	1,714	-
Net remeasurement of loss allowance	95	(213)	6,676	6,558	5,532
Recoveries / write-backs	-	-	(1,336)	(1,336)	(293)
Allowance for credit losses	95	(213)	5,340	5,222	5,239
Reclass to other financing contracts	-	-	-	-	(2,948)
Amounts written off during the year	-	-	(2,184)	(2,184)	-
Balance at the end of the year	147	39	7,873	8,059	2,416

17 GOODWILL

In 30 March 2014, the Bank acquired 100% of the paid-up capital of BMI. Goodwill of BD 25,971 thousands (2016: BD 25,971 thousands) arose from the business combination and is associated with the banking segment of the Group.

The recoverable amount of goodwill is based on value-in-use calculations using cash flow projections from financial forecasts approved by Board of Directors, extrapolated for five years projection using terminal growth rate of 1.5% (2016: 3%) and discount rate of 21.5% (2016: 11%).

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates based on the actual loss experience.

Management performed a sensitivity analysis by changing the key assumptions to assess the impact of recoverable amount of the CGU. The discount rate and earnings are considered as key assumptions, a 0.5% change in the discount rate and a 0.25% change in earnings would have no impact on the carrying value of goodwill.

18 MURABAHA TERM FINANCING

These represents short-term to long-term financings with various financials institutions that are collateralised against corporate and sovereign Sukuk carrying value of BD 116,006 thousands (2016: BD 171,779 thousands).

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19 OTHER LIABILITIES

	2017	2016
	BD '000	BD '000
Accounts payable and accruals	21,555	25,524
Investment related payables	7,208	7,808
Profit payable	5,293	5,917
Dividend payable	4,704	3,988
Project payables	4,645	886
End of service benefits and other employee related accruals	3,402	4,144
Allowance for credit losses relating to financing commitments and financial guarantee contracts	845	-
Advances received from customers for sale of properties	-	776
	47,652	49,043

20 EQUITY OF INVESTMENT ACCOUNTHOLDERS

Equity of investment accountholders funds are commingled with the Group's funds and used to fund / invest in asset contracts and no priority is granted to any party for the purpose of investments and distribution of profits. According to the terms of acceptance of the unrestricted investment accounts, 100% of the funds are invested taking into consideration the relevant weightage, if any. The Mudarib's share of profit ranges between 40% and 50%. Operating expenses are charged to shareholders' funds and not included in the calculation. The Mudarib reserves its right to deduct, if required, a percentage of net profits before distribution out the investment funds to improve profits and may deduct another percentage out of the accountholders' share of the profits after distribution as a reserve against risks. This percentage shall be specified from time to time in the profit distribution at the Mudarib's discretion.

The balances consists of savings accounts of BD 58,014 thousands (2016: BD 50,944 thousands), call accounts of BD 37,932 thousands (2016: BD 12,207 thousands) and margin accounts of BD 22,935 thousands (2016: BD 5,645 thousands).

Allowance for credit losses allocated to the assets invested using funds from unrestricted investment accounts is immaterial.

The average profit rate attributed to the equity of investment accountholders for the year 2017 was 0.20% (2016: 0.27%).

21 SHARE CAPITAL

	2017	2016
	BD '000	BD '000
Authorised:		
2,500,000,000 ordinary shares (2016: 2,500,000,000 shares) of BD 0.100 each	250,000	250,000
Issued and fully paid: (BD 0.100 per share)		
Number of shares 2,140,930,752 (2016: 2,140,930,752)	214,093	214,093

Total number of treasury stock outstanding as of 31 December 2017 was 19,218,000 shares (2016: 15,032,732 shares).

21.1 Proposed appropriation

The Board of Directors in its meeting on 13 February 2018 has resolved to recommend a cash dividend of 7 fils per share or 7% (2016: 5 fils or 5%) of the paid-up capital subject to approval at the forthcoming Annual General Meeting.

22 STATUTORY RESERVE

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

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23 EARNINGS PER SHARE

Basic earnings per share (EPS) is calculated by dividing the net profit for the year attributable to shareholders of the Bank by the weighted average number of ordinary shares outstanding during the year.

24 INCOME FROM FINANCING CONTRACTS

	2017 BD '000	2016 BD '000
Murabaha financing	10,826	12,870
Mudaraba financing	17,289	13,069
Ijarah Muntahia Bittamleek*	10,499	10,030
Musharaka	961	591
Murabaha and Wakala receivables from banks	1,656	1,415
Income from assets under conversion **	2,457	875
	43,688	38,850

* Depreciation on Ijarah Muntahia Bitamleek amounted to BD 17,996 thousands (2016: BD 10,568 thousands).

** The Bank's shareholders are advised, but not obliged, to contribute this income to charity at their discretion.

25 GAIN ON SALE OF INVESTMENTS AND SUKUK - NET

	2017 BD '000	2016 BD '000
Net gain on sale of:		
Development properties*	4,771	12,130
Fair value through equity investments	1,294	-
Other investments	229	398
Fair value through profit or loss investments	202	2,611
Sukuk	10	14
	6,506	15,153

* Sales: BD 23,152 thousands (2016: BD 49,131 thousands) and cost: BD 18,381 thousands (2016: BD 37,001 thousands).

26 INCOME FROM INVESTMENTS

	2017 BD '000	2016 BD '000
Gain / (loss) from fair value through profit or loss investments	1,532	(128)
Rental income from investments in real estate	213	1,947
	1,745	1,819

27 FEES, COMMISSION AND OTHER INCOME - NET

	2017 BD '000	2016 BD '000
Financing and transaction related fees and commission	4,613	5,953
Other income*	7,691	1,751
Fiduciary and other fees	155	225
	12,459	7,929

* This includes a sale of a facility to a third party resulting in an income of BD 1,594 thousands (2016: BD nil). In addition, the Group recovered excess amount of BD 3,933 thousands (2016: BD nil) over acquired values from settlement of non-performing financing facilities.

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28 TOTAL COMPREHENSIVE INCOME

	2017 BD '000	2016 BD '000
Net profit for the year	18,055	16,096
Unrealized gain reclassified to consolidated income statement on disposal of fair value through equity investments	(246)	(82)
Unrealised gain on fair value through equity investments	-	675
Changes in fair value of investments in real estate	(159)	(19)
Foreign currency re-translation	(211)	(4)
Other comprehensive income for the year	(616)	570
Total comprehensive income for the year	17,439	16,666
Attributable to:		
Equity holders of the Bank	17,483	16,778
Non-controlling interest	(44)	(112)
	17,439	16,666

29 RELATED PARTY TRANSACTIONS

Related parties comprise major shareholders, Directors of the Bank, senior management, close members of their families, entities owned or controlled by them and companies affiliated by virtue of common ownership or directors with that of the Bank. The transactions with these parties were approved by the Board of Directors.

The balances with related parties at 31 December 2017 and 31 December 2016 were as follows:

	2017				
	Associates and joint ventures BD '000	Major shareholders BD '000	Directors and related entities BD '000	Senior management BD '000	Total BD '000
Assets:					
Cash and balances with banks and					
Central Bank	-	92	-	-	92
Murabaha financing	9,084	-	-	235	9,319
Mudaraba financing	3,104	-	4,163	-	7,267
Ijarah Muntahia Bittamleek	-	-	1,674	647	2,321
Musharaka financing	-	-	35	-	35
Other assets	94	-	201	36	331
Liabilities and equity of investment accountholders:					
Wakala payables to non-banks	1,860	17,295	426	2,314	21,895
Current accounts	306	438	775	158	1,677
Equity of investment accountholders	-	-	555	200	755
Other liabilities	55	98	6	19	178
Contingent liabilities and commitments	1,261	22	-	-	1,283
Equity					
Transition adjustment	12,317	-	-	-	12,317

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29 RELATED PARTY TRANSACTIONS (continued)

	2016				
	Associates, and joint ventures BD '000	Major shareholders BD '000	Directors and related entities BD '000	Senior management BD '000	Total BD '000
Assets:					
Cash and balances with banks and Central Bank	-	181	-	-	181
Murabaha and Wakala receivables from banks	-	6,786	-	-	6,786
Murabaha financing	25,172	-	-	115	25,287
Mudaraba financing	1,885	-	2,137	-	4,022
Ijarah Muntahia Bittamleek	-	-	143	226	369
Musharaka financing	-	-	45	-	45
Other assets	947	2	108	24	1,081
Liabilities and equity of investment accountholders:					
Wakala payables to non-banks	4,235	10,505	48	1,134	15,922
Current accounts	343	9	1,331	132	1,815
Equity of investment accountholders	-	-	825	135	960
Other liabilities	60	-	-	5	65
Contingent liabilities and commitments	743	-	-	-	743

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

	2017				
	Associates and joint ventures BD '000	Major shareholders BD '000	Directors and related entities BD '000	Senior management BD '000	Total BD '000
Income:					
Income from financing contracts	-	8	227	23	258
Share of profit from associates	786	-	-	-	786
Expenses:					
Profit on Murabaha and Wakala payables to banks	-	16	-	-	16
Profit paid on Wakala from non-banks	69	421	7	22	519
Share of profits on equity of investment account holders	-	-	2	2	4
Other operating expenses	-	-	740	-	740
Allowance for credit losses	6,516	-	-	-	6,516

	2016				
	Associates and joint ventures BD '000	Major shareholders BD '000	Directors and related entities BD '000	Senior management BD '000	Total BD '000
Income:					
Income from financing contracts	-	19	81	6	106
Share of profit from associates	727	-	-	-	727
Expenses:					
Profit paid on Wakala from non-banks	27	380	1	22	430
Share of profits on equity of investment account holders	-	-	3	-	3
Other operating expenses	-	-	593	-	593
Provision for impairment	8,947	-	-	-	8,947

29 RELATED PARTY TRANSACTIONS (continued)

Board of Directors' remuneration for 2017 amounted to BD 415 thousands (2016: BD 389 thousands).

Sharia Supervisory Boards' remuneration for 2017 amounted to BD 66 thousands (2016: BD 49 thousands).

Compensation of key management personnel, consisting of short-term benefits and non-cash remuneration, for the year was BD 2,981 thousands (2016: BD 2,902 thousands).

30 CONTINGENT LIABILITIES AND COMMITMENTS

	2017 BD '000	2016 BD '000
Contingent liabilities on behalf of customers		
Guarantees	19,419	24,993
Letters of credit	10,767	20,788
Acceptances	954	3,607
	<u>31,140</u>	<u>49,388</u>
Irrevocable unutilised commitments		
Unutilised financing commitments	81,941	114,491
Unutilised non-funded commitments	9,594	23,308
Commitments towards development cost	-	2,951
	<u>91,535</u>	<u>140,750</u>
Forward foreign exchange contracts - notional amount	<u>37,814</u>	<u>20,280</u>

Letters of credit, guarantees (including standby letters of credit) commit the Group to make payments on behalf of customers contingent upon their failure to perform under the terms of the contract.

Commitments generally have fixed expiration dates, or other termination clauses. Since commitments may expire without being utilized, the total contract amounts do not necessarily represent future cash requirements.

Operating lease commitment - Group as lessee

The Group has entered into various operating lease agreements for its premises. Future minimal rentals payable under the non-cancellable leases are as follows:

	2017 BD '000	2016 BD '000
Within 1 year	1,204	1,168
After one year but not more than five years	1,971	2,360
	<u>3,175</u>	<u>3,528</u>

31 RISK MANAGEMENT**31.1 Introduction**

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to credit risk, liquidity risk, operational risk, and market risk. It is also subject to early settlement risk and operational risks.

The Group's risk function is independent of lines of business and the acting Group Chief Risk Officer reports to the Group Chief Executive Officer with access to the Audit and Risk Committee.

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

31 RISK MANAGEMENT (continued)

31.1 Introduction (continued)

Board of Directors

The Board of Directors is responsible for setting the overall risk management framework and appetite encompassing the risk strategies and policies.

Executive Committee

The Executive Committee has the responsibility to review and recommend to the Board for approval the overall risk process and policies within the Bank.

Shari'a Supervisory Board

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

Risk Committee

Risk Committee exercises its authority to review and approve proposals within its delegated limits. The Committee recommends the risk policies and framework to the Board. The Committee has a primary role in selection and implementation of risk management systems, portfolio monitoring, stress testing, risk reporting to the Board, Board Committees, Regulators and Executive Management. The Committee discharges its authority after adequate due diligence.

Asset and Liability Committee

The Asset and Liability Committee (ALCO) establishes policy and objectives for the asset and liability management of the Group's financial position in terms of structure, distribution, risk and return and its impact on profitability. It also monitors the cash flow, tenor and cost / yield profiles of assets and liabilities and evaluates the Group's financial position both from profit rate sensitivity and liquidity points of view, making corrective adjustments based upon perceived trends and market conditions, monitoring liquidity, monitoring foreign exchange exposures and positions.

Audit and Risk Committee

The Audit and Risk Committee is appointed by the Board of Directors who are non-executive directors of the Group. The Audit and Risk Committee assists the Board in carrying out its responsibilities with respect to assessing the quality and integrity of financial reporting, the audit thereof, the soundness of the internal controls of the Group, reviewing and monitoring the overall risk framework and profile of the Group as well as its adherence to stipulated policies and limits, and the methods for monitoring compliance with laws, regulations and supervisory and internal policies.

The Audit and Risk Committee reviews Group's accounting and financial practices, risk management reports, integrity of the Group's financial and internal controls and consolidated financial statements. It also reviews the Group's compliance with legal requirements, recommends the appointment, compensation and oversight of the Group's external and internal auditors.

Internal Audit

Risk management processes throughout the Group are audited by the internal audit function that examines both the adequacy of the procedures and the Group's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit and Risk Committee.

Risk measurement and reporting systems

The Group's risk management policies aim to identify, analyse and manage the risks faced by the Group, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. The Group's risk management department is also responsible for identifying risk characteristics inherent in new and existing products, activities and setting exposure limits to mitigate these risks.

Monitoring and controlling risks is primarily performed based on limits established by the Group. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept, with additional emphasis on selected industries. In addition, the Group monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across respective risk types and activities.

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31 RISK MANAGEMENT (continued)

31.1 Introduction (continued)

Risk measurement and reporting systems (continued)

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Board of Directors, the Audit and Risk Committee and ALCO, whenever required. The reports include aggregate credit quality and exposures, market risk exposures, operational risk metrics, limit exceptions, liquidity ratios, stress testing, and risk profile changes. A detailed report is produced on a quarterly basis with simplified reports produced on a monthly basis. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Board of Directors receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess the risks of the Group.

For all levels throughout the Group, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information. A daily briefing is given to all relevant members of the Group on the utilization of market limits, proprietary investments and liquidity, plus any other risk developments.

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

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

31.2 Credit risk

Credit risk is the risk that one party to a financial contract will fail to discharge an obligation and cause the other party to incur a financial loss. The Group attempts to control credit risk by monitoring credit exposures, setting limits for transactions with counterparties, and continually assessing the creditworthiness of counterparties.

In addition to monitoring credit limits, the Group manages the credit exposures by entering into collateral arrangements with counterparties in appropriate circumstances and by limiting the duration of the exposure.

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

Credit risk grades

The Group allocates each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgment. 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. 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.

31 RISK MANAGEMENT (continued)**31.2 Credit risk (continued)****Maximum exposure to credit risk without taking account of any collateral and other credit enhancements (continued)**

Credit risk grades (continued)

The table below shows the maximum exposure (excluding sovereign exposures) to credit risk for the components of the consolidated statement of financial position. The maximum exposure is shown net of provision, before the effect of mitigation through the use of master netting and collateral agreements.

	Gross maximum exposure 2017 BD '000	Gross maximum exposure 2016 BD '000
ASSETS		
Balances with other banks	25,618	30,120
Murabaha receivables from banks	143,803	182,452
Corporate Sukuk	10,324	28,934
Murabaha financing	194,265	209,800
Mudaraba financing	269,750	201,409
Ijarah Muntahia Bittamleek	211,420	187,356
Musharaka financing	19,577	12,305
Assets under conversion	2,771	34,465
Financing contracts under other assets	21,402	9,918
Total	898,930	896,759
Contingent liabilities and commitments	93,420	132,216
Total credit risk exposure	992,350	1,028,975

In addition to the above, the financing facilities provided to the Government of Bahrain, its related entities and GCC sovereign entities amounts to BD 61,132 thousands (2016: BD 70,718 thousands).

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

Type of credit risk

Various contracts entered into by the Group comprise Murabaha financing, Mudaraba financing, Musharaka, Corporate Sukuk and Ijarah Muntahia Bittamleek contracts. Murabaha financing contracts cover land, buildings, commodities, motor vehicles and others. Mudaraba financing consist of financing transactions entered through other Islamic banks and financial institutions. Mudaraba is a partnership agreement in which the Islamic bank acts as the provider of funds (the Rabamal) while the recipient of the funds (the Mudarib or the manager) provides the professional, managerial and technical know-how towards carrying out the venture, trade or service with an aim of earning profit.

The Group follows an internal rating mechanism for grading relationships for financial assets. All financial assets are assigned a rating in accordance with the defined criteria. The Group utilises a scale ranging from 1 to 10 for credit relationships, with 1 to 7 denoting performing grades and 8 to 10 denoting non-performing grades. Ratings 1 to 4 represent good grade, 5 to 7 represents satisfactory grade and 8 to 10 represents default grade.

For externally rated exposures, credit risk ratings of an authorised Credit Rating Agency (S&P, Moody's, Fitch & Capital Intelligence) are converted into internal ratings which are calibrated with the risk appetite of the Bank. Conversion of an external credit risk rating to an internal risk rating is done to ensure consistency across publicly rated and unrated entities.

The Group endeavours continuously to improve upon the internal credit risk rating methodologies and credit risk management policies and practices to reflect the true underlying credit risk of the portfolio and the credit culture in the Group.

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31 RISK MANAGEMENT (continued)**31.2 Credit risk (continued)**

a) The credit quality of balances with banks and Murabaha and Wakala receivables from banks subject to credit risk is as follows:

	2017			2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
Good (R1-R4)	100,220	-	-	100,220
Satisfactory (R5-R7)	69,203	-	-	69,203
Total allowance for credit losses	(2)	-	-	(2)
	169,421	-	-	169,421
				212,572

b) The following tables sets out information about the credit quality of financial assets. For financing commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed.

i) Corporate Sukuk

	2017			2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
Good (R1-R4)	10,327	-	-	10,327
Default (D8-D10)	-	-	-	-
Total allowance for credit losses	(3)	-	-	(3)
	10,324	-	-	10,324
				30,003

ii) Murabaha financing

	2017			2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
Good (R1-R4)	102,231	391	-	102,622
Satisfactory (R5-R7)	68,843	32,666	-	101,509
Default (D8-D10)	-	-	16,516	16,516
Total allowance for credit losses	(3,738)	(10,814)	(11,830)	(26,382)
	167,336	22,243	4,686	194,265
				209,800

The above table includes profit receivables of BD 2,701 thousands (2016: BD 1,687 thousands) and related allowance for credit losses of BD 13 thousands (2016: BD nil).

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31 RISK MANAGEMENT (continued)**31.2 Credit risk (continued)****iii) Mudaraba financing**

	2017			2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
Good (R1-R4)	186,681	5,055	-	191,736
Satisfactory (R5-R7)	56,906	13,724	-	70,630
Default (D8-D10)	-	-	25,063	25,063
Total allowance for credit losses	(6,099)	(4,690)	(6,890)	(17,679)
	237,488	14,089	18,173	269,750
				201,409

The above table includes profit receivables of BD 2,416 thousands (2016: BD 1,391 thousands) and related allowance for credit losses of BD 24 thousands (2016: BD nil).

iv) Ijarah Muntahia Bittamleek

	2017			2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
Good (R1-R4)	143,211	620	-	143,831
Satisfactory (R5-R7)	21,783	8,823	-	30,606
Default (D8-D10)	-	-	42,298	42,298
Total allowance for credit losses	(1,079)	(492)	(3,744)	(5,315)
	163,915	8,951	38,554	211,420
				188,217

The above table includes profit receivables of BD 1,090 thousands (2016: BD 449 thousands) and related allowance for credit losses of BD 34 thousands (2016: BD nil).

v) Musharaka

	2017			2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
Good (R1-R4)	14,190	-	-	14,190
Satisfactory (R5-R7)	4,015	1,337	-	5,352
Default (D8-D10)	-	-	235	235
Total allowance for credit losses	(133)	(43)	(24)	(200)
	18,072	1,294	211	19,577
				12,419

The above table includes profit receivables of BD 385 thousands (2016: BD 115 thousands).

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31 RISK MANAGEMENT (continued)**31.2 Credit risk (continued)****vi) Assets under conversion**

	2017			2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
Good (R1-R4)	2,864	-	-	13,198
Satisfactory (R5-R7)	-	-	-	229
Default (D8-D10)	-	-	-	22,745
Total allowance for credit losses	(93)	-	-	(1,714)
	2,771	-	-	34,458

vii) Financial contracts under other assets

	2017			2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
Good (R1-R4)	2,434	-	-	8,853
Satisfactory (R5-R7)	1,887	372	-	358
Default (D8-D10)	-	-	24,773	8,700
Total allowance for credit losses	(149)	(41)	(7,874)	(2,416)
	4,172	331	16,899	15,495

The above table includes profit receivables of BD 333 thousands (2016: BD 18 thousands) and related allowance for credit losses of BD 5 thousands (2016: BD nil).

viii) Financing commitments and financial guarantee contracts

	2017			2016
	Stage 1: 12-month ECL BD '000	Stage 2: Lifetime ECL not credit-impaired BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Total BD '000
Good (R1-R4)	85,533	5,594	-	94,005
Satisfactory (R5-R7)	-	3,138	-	38,211
Total allowance for credit losses	(523)	(322)	-	-
	85,010	8,410	-	132,216

The maximum credit risk, without taking into account the fair value of any collateral and Shari'a-compliant netting agreements, is limited to the amounts on the consolidated statement of financial position plus commitments to customers disclosed in note 30 except capital commitments.

During the year BD 8,345 thousands (2016: BD 17,803 thousands) of financing facilities were renegotiated. Most of the renegotiated facilities are performing and are secured.

For the purpose of computing capital adequacy in accordance with Basel III requirements, the amount of credit exposure in excess of 15% of the Group's regulatory capital to individual counterparties as at 31 December 2017 was BD nil (2016: BD nil).

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31 RISK MANAGEMENT (continued)**31.3 Legal risk and claims**

Legal risk is the risk arising from the potential that unenforceable contracts, lawsuits or adverse judgments can disrupt or otherwise negatively affect the operations of the Group. The Group has developed controls and procedures to identify legal risks and believes that losses will be minimised.

As at 31 December 2017, legal suits amounting to BD 545 thousands (2016: BD 4,925 thousands) were pending against the Group. Based on the opinion of the Group's legal counsel, the total estimated liability arising from these cases is not considered to be material to the Group's consolidated financial position as the Group has also filed counter cases against these parties.

32 CONCENTRATIONS

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location. The Group manages its exposure through diversification of financing activities to avoid undue concentrations of risks with customers in specific locations or businesses.

The distribution of assets, liabilities and equity of investment account holders by geographic region and industry sector was as follows:

	Liabilities, equity of investment account holders and equity			Liabilities, equity of investment account holders and equity		
	Contingent liabilities and Commitments			Contingent liabilities and Commitments		
	Assets 2017 BD '000	Assets 2017 BD '000	Assets 2017 BD '000	Assets 2016 BD '000	Assets 2016 BD '000	Assets 2016 BD '000
Geographic region						
GCC	1,441,831	1,153,987	121,365	1,492,594	1,192,331	174,196
Arab World	63,454	58,224	-	38,355	50,222	13,377
Europe	33,589	61,912	47	49,583	95,056	427
Asia Pacific	15,247	609	1,263	52,459	893	2,138
North America	15,982	1,607	-	9,535	314	-
Others	19,157	9,084	-	38,767	17,578	-
	1,589,260	1,285,423	122,675	1,681,293	1,356,394	190,138
Equity	-	303,837	-	-	324,899	-
	1,589,260	1,589,260	122,675	1,681,293	1,681,293	190,138
	Liabilities, equity of investment account holders and equity			Liabilities, equity of investment account holders and equity		
	Contingent liabilities and Commitments			Contingent liabilities and Commitments		
	Assets 2017 BD '000	Assets 2017 BD '000	Assets 2017 BD '000	Assets 2016 BD '000	Assets 2016 BD '000	Assets 2016 BD '000
Industry sector						
Government and public sector	520,127	173,783	12,704	525,865	148,798	33,417
Banks and financial institutions	230,163	321,778	1,445	362,504	310,634	16,582
Real estate	366,733	124,572	57,814	382,136	192,038	72,566
Trading and manufacturing	76,251	16,086	17,496	100,405	64,371	23,395
Aviation	509	6	-	10,245	14,918	-
Individuals	213,518	414,134	20,525	200,220	461,909	8,412
Others	181,959	235,064	12,691	99,918	163,726	35,766
	1,589,260	1,285,423	122,675	1,681,293	1,356,394	190,138
Equity	-	303,837	-	-	324,899	-
	1,589,260	1,589,260	122,675	1,681,293	1,681,293	190,138

33 MARKET RISK

Market risk arises from fluctuations in global yields on financial contracts and foreign exchange rates that could have an indirect effect on the Group's assets value and equity prices. The Board has set limits on the risk that may be accepted. This is monitored on a regular basis by the Audit and Risk Committee as well as ALCO of the Group.

33.1 Equity price risk

Equity price risk arises from fluctuations in equity prices. The Board has set limits on the overall investment exposure of the Bank. This is monitored on an ongoing basis by the Group's Investment Committee and Risk Management.

The effect on income (as a result of changes in the fair values of non-trading investments held at fair value through profit or loss and fair value through equity investments) solely due to reasonably possible changes in equity prices, is as follows:

2017				
10% increase		10% decrease		
Effect on net profit	Effect on equity	Effect on net profit	Effect on equity	
BD '000	BD '000	BD '000	BD '000	
Quoted:				
Saudi Arabia	590	-	(590)	-
Unquoted	10,349	329	(10,349)	(329)
2016				
10% increase		10% decrease		
Effect on net profit	Effect on equity	Effect on net profit	Effect on equity	
BD '000	BD '000	BD '000	BD '000	
Quoted:				
Bahrain	-	166	(166)	-
Saudi Arabia	776	-	(776)	-
Singapore	-	231	(231)	-
Unquoted	10,765	270	(10,765)	(270)

33.2 Profit return risk

Profit rate risk arises from the possibility that changes in profit rates will affect the future profitability or the fair values of financial assets. The Board has set limits on the risk that may be accepted. This is monitored on a regular basis by the Audit and Risk Committee as well as ALCO of the Group.

The Group manages exposures to the effects of various risks associated with fluctuations in the prevailing levels of market profit rates on its financial position and cash flows.

The effect on income solely due to reasonably possible immediate and sustained changes in profit return rates, affecting both floating rate assets and liabilities and fixed rate assets and liabilities with maturities less than one year are as follows:

2017				
Change in rate	Effect on net profit	Change in rate	Effect on net profit	
%	BD '000	%	BD '000	
Bahraini dinars	0.10	192	(0.10)	(192)
US dollars	0.10	201	(0.10)	(201)
2016				
Change in rate	Effect on net profit	Change in rate	Effect on net profit	
%	BD '000	%	BD '000	
Bahraini dinars	0.10	380	(0.10)	(380)
US dollars	0.10	193	(0.10)	(193)

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33 MARKET RISK (continued)**33.3 Currency risk**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on positions by currency. Positions are monitored on a periodic basis by the Audit and Risk Committee as well as ALCO to ensure positions are maintained within established limits.

Substantial portion of the Group's assets and liabilities are denominated in Bahraini Dinars, US Dollars or Saudi Riyals. As the Bahraini Dinar and Saudi Riyals are pegged to the US Dollars, positions in these currencies are not considered to represent significant currency risk as of 31 December 2017 and 2016.

34 LIQUIDITY RISK

Liquidity risk is the risk that the Group will be unable to meet its liabilities as they fall due. Liquidity risk can be caused by market disruptions or credit downgrades which may impact certain sources of funding. To mitigate this risk, management has diversified funding sources and assets are managed with liquidity in mind, maintaining an adequate balance of cash, cash equivalents and readily convertible marketable securities. Liquidity position is monitored on an ongoing basis by the Risk and Audit Committee as well as ALCO of the Group.

The table below summarises the expected maturity profile of the Group's assets and liabilities as at 31 December 2017 and 2016:

	31 December 2017				
	Up to 3 months BD '000	3 months to 1 year BD '000	1 to 5 years BD '000	Over 5 years BD '000	Total BD '000
ASSETS					
Cash and balances with banks and Central Bank	66,351	-	-	-	66,351
Sovereign Sukuk	8,155	28,956	150,521	170,146	357,778
Murabaha and Wakala receivables from banks	143,803	-	-	-	143,803
Corporate Sukuk	1,871	3,121	5,332	-	10,324
Murabaha financing	34,395	84,444	30,048	48,493	197,380
Mudaraba financing	38,205	86,338	95,689	87,861	308,093
Ijarah Muntahia Bittamleek	4,820	1,494	98,459	107,375	212,148
Musharaka	93	10,337	5,558	3,204	19,192
Assets under conversion	1,562	61	108	1,040	2,771
Non-trading investments	1,931	-	109,394	-	111,325
Investments in real estates	-	-	52,431	-	52,431
Development properties	-	-	6,448	-	6,448
Investment in associates	-	-	16,835	-	16,835
Other assets	20,534	1,073	35,389	1,414	58,410
Goodwill	-	-	-	25,971	25,971
	321,720	215,824	606,212	445,504	1,589,260
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS					
Murabaha and Wakala payables to banks	147,178	7,463	-	-	154,641
Wakala payables to non-banks	59,785	59,785	478,178	100	597,848
Current accounts	70,281	86,345	127,260	-	283,886
Liabilities under conversion	-	239	2,447	43	2,729
Murabaha term financing	14,892	45,904	16,779	2,211	79,786
Other liabilities	8,871	14,500	24,166	115	47,652
Equity of investment accountholders	25,702	35,078	58,101	-	118,881
	326,709	249,314	706,931	2,469	1,285,423

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2017

34 LIQUIDITY RISK (continued)

	31 December 2016				
	Up to 3 months BD '000	3 months to 1 year BD '000	1 to 5 years BD '000	Over 5 years BD '000	Total BD '000
ASSETS					
Cash and balances with banks and Central Bank	120,623	4,800	6,567	-	131,990
Sovereign Sukuk	3,091	23,371	140,624	191,183	358,269
Murabaha and Wakala receivables from banks	182,452	-	-	-	182,452
Corporate Sukuk	8,731	3,910	16,293	-	28,934
Murabaha financing	68,416	41,165	36,673	67,433	213,687
Mudaraba financing	27,913	79,141	72,199	73,554	252,807
Ijarah Muntahia Bittamleek	2,689	1,615	79,273	104,908	188,485
Musharaka	66	-	8,811	3,427	12,304
Assets under conversion	-	-	27,688	9,328	37,016
Non-trading investments	1,947	-	120,126	-	122,073
Investments in real estates	-	-	48,930	2,933	51,863
Development properties	2,943	-	14,838	-	17,781
Investment in associates	-	-	7,531	3,030	10,561
Other assets	13,066	1,182	6,267	6,745	27,260
Goodwill	-	-	-	25,971	25,971
Assets held-for-sale	19,840	-	-	-	19,840
	<u>451,777</u>	<u>155,184</u>	<u>585,820</u>	<u>488,512</u>	<u>1,681,293</u>
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS					
Murabaha and Wakala payables to banks	-	124,635	7,397	-	132,032
Wakala payables to non-banks	72,344	72,344	578,751	-	723,439
Current accounts	64,542	85,984	129,083	-	279,609
Liabilities under conversion	217	-	-	-	217
Murabaha term financing	48,889	-	33,744	9,204	91,837
Other liabilities	9,809	14,713	24,521	-	49,043
Liabilities relating to assets classified as held-for-sale	11,421	-	-	-	11,421
Equity of investment accountholders	14,758	20,454	33,584	-	68,796
	<u>221,980</u>	<u>318,130</u>	<u>807,080</u>	<u>9,204</u>	<u>1,356,394</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2017

34 LIQUIDITY RISK (continued)

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2017 and 2016 based on contractual undiscounted payment obligation:

	31 December 2017					
	On demand BD '000	Up to 3 months BD '000	3 months to 1 year BD '000	1 to 5 years BD '000	Over 5 years BD '000	Total BD '000
LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS, COMMITMENTS AND CONTINGENT LIABILITIES						
Murabaha and Wakala payables to banks	-	145,466	9,175	-	-	154,641
Wakala payables to non-banks	-	265,043	261,076	71,629	100	597,848
Current accounts	283,886	-	-	-	-	283,886
Equity of investment accountholders	-	118,881	-	-	-	118,881
Liabilities under conversion	-	-	239	2,447	43	2,729
Murabaha term financing	-	14,892	45,904	16,779	2,211	79,786
Unutilised commitments	-	6,809	28,329	36,516	19,881	91,535
Contingent liabilities	-	46,922	12,406	12,801	-	72,129
Other financial liabilities	-	5,637	2,634	928	115	9,314
Profit on financial liabilities	-	848	4,763	5,248	23	10,882
	283,886	604,498	364,526	146,348	22,373	1,421,631

	31 December 2016					
	On demand BD '000	Up to 3 months BD '000	3 months to 1 year BD '000	1 to 5 years BD '000	Over 5 years BD '000	Total BD '000
LIABILITIES, EQUITY OF INVESTMENT ACCONTHOLDERS, COMMITMENTS AND CONTINGENT LIABILITIES						
Murabaha and Wakala payables to banks	-	124,635	7,397	-	-	132,032
Wakala payables to non-banks	-	313,518	328,513	81,408	-	723,439
Current accounts	279,609	-	-	-	-	279,609
Equity of investment accountholders	28,067	40,729	-	-	-	68,796
Liabilities under conversion	217	-	-	-	-	217
Murabaha term financing	-	48,889	-	33,744	9,204	91,837
Unutilised commitments	8,999	12,122	46,577	44,729	25,372	137,799
Contingent liabilities	35,318	24,531	5,980	10,318	-	76,147
Other financial liabilities	-	7,985	6,246	528	-	14,759
Profit on financial liabilities	-	761	5,015	6,329	-	12,105
Liabilities relating to assets classified as held-for-sale	-	11,421	-	-	-	11,421
	352,210	584,591	399,728	177,056	34,576	1,548,161

35 SEGMENT INFORMATION**Primary segment information**

For management purposes, the Group is organised into four major business segments:

Banking	Principally managing Shari'a compliant profit sharing investment accounts, and offering Shari'a compliant financing contracts and other Shari'a-compliant products. This segment comprises corporate banking, retail banking, private banking and wealth management.
Treasury	Principally handling Shari'a compliant money market, trading and treasury services including short-term commodity Murabaha.
Investments	Principally the Group's proprietary portfolio and serving clients with a range of investment products, funds and alternative investments.
Capital	Manages the undeployed capital of the Group by investing it in high quality financial contracts, incurs all expenses in managing such investments and accounts for the capital governance related expenses.

Transactions between segments are conducted at estimated market rates on an arm's length basis. Transfer charges are based on a pool rate which approximates the cost of funds.

Segment information is disclosed as follows:

	31 December 2017				
	Banking	Treasury	Investments	Capital	Total
	BD '000	BD '000	BD '000	BD '000	BD '000
Operating income	30,757	22,030	8,526	877	62,190
Segment result	645	17,540	(1,064)	934	18,055
Segment assets	744,264	612,414	198,249	34,333	1,589,260
Segment liabilities, and equity	915,779	330,513	16,954	326,014	1,589,260

Goodwill resulting from BMI acquisition is allocated to banking segment.

	31 December 2016				
	Banking	Treasury	Investments	Capital	Total
	BD '000	BD '000	BD '000	BD '000	BD '000
Operating income	27,951	13,369	20,319	1,361	63,000
Segment result	(10,062)	11,957	14,723	(522)	16,096
Segment assets	706,572	678,896	236,338	59,487	1,681,293
Segment liabilities, and equity	1,021,629	317,079	50,312	292,273	1,681,293

Goodwill resulting from BMI acquisition is allocated to banking segment.

Secondary segment information

The Group primarily operates in the GCC and derives substantially all its operating income and incurs all operating expenses in the GCC.

36 FIDUCIARY ASSETS

Funds under management at the year end amounted to BD 70,484 thousands (2016: BD 105,174 thousands). These assets are held in a fiduciary capacity, measured at cost and are not included in the consolidated statement of financial position.

37 SHARI'A SUPERVISORY BOARD

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

38 FAIR VALUE OF FINANCIAL ASSETS

The fair value of sovereign sukuk is BD 361,172 thousands having a carrying value of BD 357,778 thousands and the fair value of corporate sukuk is BD 10,339 thousands having a carrying value of BD 10,324 thousands. The estimated fair values of other financial assets are not materially different to their carrying values as of 31 December 2017 and 2016.

39 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

During the year, the Group received Shari'a prohibited income totalling BD 397 thousands (2016: BD 412 thousands). These include income earned from the conventional financing and investments due to acquiring BMI and BSB, penalty charges from customers and interest on current account balances held with correspondent banks. These funds were allocated to charitable contributions after deducting recovery expenses of these funds.

40 SOCIAL RESPONSIBILITY

The Group discharges its social responsibility through charity fund expenditures and donations to individuals and organisations which are used for charitable purposes. During the year, the Group paid an amount of BD 328 thousands (2016: BD 267 thousands) on account of charitable donations.

41 ZAKAH

Pursuant to a resolution of the shareholders in an Extra-ordinary General Meetings (EGM) held on 12 November 2009, it was resolved to amend the articles of association of the Bank to inform the shareholders of their obligation to pay Zakah on income and net worth. Consequently, Zakah is not recognized in the consolidated income statement as an expense. The total Zakah payable by the shareholders for 2017 has been determined by the Shari'a supervisory board as 2.5 fils (2016: 2.5 fils) per share.

42 CAPITAL ADEQUACY

The primary objectives of the Group's capital management policies are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value. Capital adequacy for each of the group companies is also managed separately at individual company level. The Group does not have any significant restrictions on its ability to access or use its assets and settle its liabilities other than any restrictions that may result from the supervisory frameworks within which the banking subsidiaries operate.

42 CAPITAL ADEQUACY (continued)

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

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

	2017	2016
	BD '000	BD '000
Common equity Tier 1 capital	253,469	273,576
Additional Tier 1 capital	9	5
Tier 2 capital	39,861	29,873
Total capital	293,339	303,454
Credit risk-weighted exposures	1,261,939	1,314,315
Market risk-weighted exposures	2,331	8,053
Operational risk-weighted exposures	104,310	85,710
Total risk-weighted assets	1,368,580	1,408,078
Investment risk reserve	-	2
Total adjusted risk weighted exposures	1,368,580	1,408,076
Total capital ratio	21.43%	21.55%
Minimum requirement	12.5%	12.5%

43 DEPOSIT PROTECTION SCHEME

Certain customers' deposits of the Group are covered by deposit protection schemes established by the CBB. Customers' deposits held with the Bank in the Kingdom of Bahrain are covered by the Regulation Protecting Deposits and Equity of unrestricted investment accounts issued by the CBB in accordance with Resolution No.(34) of 2010. This scheme covers eligible 'natural persons' (individuals) up to a maximum of BD 20,000 as set out by CBB requirements. A periodic contribution as mandated by the CBB is paid by the Group under this scheme.

44 COMPARATIVE FIGURES

Certain of the prior year figures have been reclassified to conform to the current year presentation. Such reclassifications did not affect previously reported net profit, total assets, total liabilities and total equity of the Group.