Notes to the Consolidated Financial Statements

31 December 2017

1. REPORTING ENTITY

Bahrain Islamic Bank B.S.C. (the "Bank") was incorporated in the Kingdom of Bahrain in 1979 by Amiri Decree No.2 of 1979 and registered with the Ministry of Industry and Commerce ("MOIC") under Commercial Registration (CR) number 9900, to carry out banking and other financial trading activities in accordance with the teachings of Islam (Shari'a). The Bank operates under an Islamic retail banking license issued by the Central Bank of Bahrain ("CBB"). The Bank's Shari'a Supervisory Board is entrusted to ensure the Bank's adherence to Shari'a rules and principles in its transactions and activities. The Bank is listed on the Bahrain Bourse.

The Bank's registered office is at Building 722, Road 1708, Block 317, Manama, Kingdom of Bahrain.

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

The consolidated financial statements include the results of the Bank and its wholly owned subsidiary (together the "Group"). The Bank holds 100% of the share capital of Abaad Real Estate Company B.S.C. (c).

Abaad Real Estate Company B.S.C. (c) ("Abaad")

Abaad was incorporated in the Kingdom of Bahrain on 8 April 2003 with an authorised and fully paid-up share capital of BD 25 million. Abaad started operations in 2007. The main activity of Abaad is investment in real estate (in accordance with the Islamic Shari'a rules and principles).

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors issued on 12 February 2018.

2. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting polices applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been consistently applied by the Group and are consistent with those used in the previous years.

a. New standards, amendments, and interpretations

New standards, amendments, and interpretations effective from 1 January 2017:

There are no AAOIFI accounting standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2017 that would be expected to have a material impact on the Group.

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

FAS 30 – Impairment, credit losses and onerous commitments

AAOIFI has issued FAS 30 Impairment, credit losses and onerous commitments in 2017. FAS 30 will replace FAS 11 Provisions and reserves and parts of FAS 25 Investment in Sukuk, shares and similar instruments that deals with impairment. The objective of this standard is to establish the principles of accounting and financial reporting for the impairment and credit losses on various Islamic financing, investment and certain other assets of Islamic financial institutions (the institutions), and provisions against onerous commitments enabling in particular the users of financial statements to fairly assess the amounts, timing and uncertainties with regard to the future cash flows associated with such assets and transactions.

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

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

i. Assets and exposures subject to credit risk (subject to credit losses approach):
- Receivables; and
- Off-balance sheet exposures.

ii. Inventories (subject to net realizable value approach); and

iii. Other financing and investment assets and exposures subject to risks other than credit risk (subject to impairment approach) , excluding inventories.

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

Notes to the Consolidated Financial Statements

31 December 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

a. New standards, amendments, and interpretations (Continued)

New standards, amendments and interpretations issued but not yet effective (Continued)

FAS 30 – Impairment, credit losses and onerous commitments (Continued)

Expected Credit Losses (ECL)

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

- Determining criteria for Significant Increase in Credit Risk (SICR);
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Identifying groups of similar financial assets for the purpose of measuring ECL.

The standard shall be effective from the financial periods beginning on or after 1 January 2020. Early adoption is permitted. As mandated by the regulator, all Islamic banks are required have to early adopt FAS 30 from 1 January 2018.

The Group estimates the FAS 30 transition amount will reduce shareholders' equity by approximately BD 13.7 million as at 1 January 2018. The estimated impact relates primarily to the increase in the allowance for credit losses under the new impairment requirements. The Group continues to revise, refine and validate the impairment models and related process controls which may change the actual impact on adoption.

Early adoption

The Group did not early adopt any new standards during the year.

b. Statement of Compliance

The consolidated financial statements are prepared in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"), and the Bahrain Commercial Companies Law. In accordance with the requirements of AAOIFI, for matters for which no AAOIFI standard exists, the Group uses guidance from the relevant International Financial Reporting Standards ("IFRS") issued by International Accounting Standards Board.

c. Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis, except for "investment in real estate" and "equity type instruments carried at fair value through equity" that have been measured at fair value.

The preparation of consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and the Group's consolidated financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 2.cc.

The consolidated financial statements have been presented in Bahraini Dinars ("BD"), which is also the functional currency of the Group's operations. All the values are rounded to the nearest BD thousand except when otherwise indicated.

d. Basis of consolidation

Subsidiaries are all entities (including special purpose entities) controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group to the date that control seizes.

The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies.

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

e. Cash and cash equivalents

For the purpose of the consolidated cash flows statement, "cash and cash equivalents" consist of cash on hand, balances with the Central Bank of Bahrain excluding mandatory reserve deposits, balances with banks and other financial institutions and placements with financial institutions with original maturities of 90 days or less when acquired.

Notes to the Consolidated Financial Statements

31 December 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f. Placements with and borrowings from financial institutions

Placements with financial institutions

Placements with financial institutions comprise of Commodity Murabaha receivables and Wakala receivables. Commodity Murabaha receivables are stated at amortised cost net of deferred profits and provision for impairment, if any. Wakala receivables are stated at amortised cost less provision for impairment, if any.

Borrowings from financial institutions

Borrowings from financial institutions comprise borrowings obtained through murabaha contract recognized on the origination date and carried at amortized cost.

g. Financing assets

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

h. Murabaha financing

Murabaha financing consist mainly of deferred sales transactions which are stated net of deferred profits and provisions for impairment, if any.

Murabaha financing are sales on deferred terms. The Group arranges a Murabaha transaction by buying a commodity (which represents the object of the Murabaha) and then resells this commodity to a Murabeh (beneficiary) after computing a margin of profit over cost. The sale price (cost plus profit margin) is repaid in installments by the Murabeh over the agreed period.

i. Musharaka financing

Musharaka financing are stated at the fair value of consideration given less impairment, if any.

Musharaka financing are a form of capital partnership. Musharaka financing capital provided by the Group at inception in kind (if other than cash) is measured at the fair value of the assets. If the valuation of the assets results in a difference between fair value and book value, such difference is recognised as profit or loss to the Group.

j. Investment securities

Investment securities comprise debt type instruments carried at amortised cost and equity type instruments carried at fair value through equity.

All investments securities, are initially recognised at fair value, being the value of the consideration given including transaction costs directly attributable to the acquisition.

Debt type instruments carried at amortised cost

These are investments which have fixed or determinable payments of profit and capital. Subsequent to initial recognition, these are measured at amortised cost using the effective profit rate method less impairment, if any. Any gain or loss on such instruments is recognised in the consolidated income statement when the instruments are de-recognised or impaired.

Equity type instruments carried at fair value through equity

Equity-type instruments are investments that do not exhibit features of debt-type instruments and include instruments that evidence residual interest in the assets of entity after reducing all its liabilities. On initial recognition, equity-type instruments that are not designated to fair value through the consolidated income statement are classified as investments at fair value through equity.

Subsequent to acquisition, these are remeasured at fair value, with unrealised gains and losses recognised in a separate component of equity until the investment is derecognised or the investment is considered as impaired. On derecognition or impairment, the cumulative gain or loss previously recorded in equity is recognised in the consolidated income statement for the year.

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

Notes to the Consolidated Financial Statements

31 December 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

k. Measurement principles

Fair value measurement

For investments traded in organised financial markets, fair value is determined by reference to quoted market bid prices at the close of business on the reporting date.

For investments where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument, which is substantially the same or is based on the assessment of future cash flows. The cash equivalent values are determined by the Group at current profit rates for contracts with similar terms and risk characteristics.

Investments classified at fair value through equity where there is no quoted price or the Bank is unable to determine a reliable measure of fair value on a continuing basis are stated at cost less impairment allowances.

Amortised cost

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

l. Investment in associates

Associates are all entities in which the Group holds, between 20% and 50% of the voting rights and exercises significant influence, but not control or joint control, over the financial and operating policies of the entities. Investment in associates are accounted for using the equity method of accounting.

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

The Group determines at each reporting date whether there is any objective evidence that the investments in associates are impaired. If this is the case, the Group calculates the amount of impairment as being the difference between the recoverable amount of the associates and the carrying value and recognises this amount in the consolidated income statement.

Accounting policies of the associates are consistent with the policies adopted by the Group.

m. Ijarah Muntahia Bittamleek

Ijarah Muntahia Bittamleek are stated at cost less accumulated depreciation and any impairment in value. Under the terms of lease, the legal title of the asset passes to the lessee at the end of the lease term, provided that all lease installments are settled. Depreciation is calculated on a straight line basis at rates that systematically reduce the cost of the leased assets over the period of the lease. The Group assesses at each reporting date whether there is objective evidence that the assets acquired for leasing are impaired. Impairment losses are measured as the difference between the carrying amount of the asset (including lease rental receivables) and the estimated recoverable amount. Impairment losses, if any, are recognised in the consolidated income statement.

n. Investment in real estate

Properties held for rental, or for capital appreciation purposes, or both, are classified as investment in real estate. Investments in real estate are initially recorded at cost, being the fair value of the consideration given and acquisition charges associated with the property. Subsequent to initial recognition, investments in real estate are re-measured to fair value and changes in fair value (only gains) are recognised in a property fair value reserve in the consolidated statement of changes in owners' equity.

Losses arising from changes in the fair values of investment in real estate are firstly adjusted against the property fair value reserve to the extent of the available balance and then the remaining losses are recognised in the consolidated income statement. If there are unrealised losses that have been recognised in the consolidated income statement in previous financial periods, the current period unrealised gain shall be recognised in the consolidated income statement to the extent of crediting back such previous losses in the consolidated income statement. When the property is disposed of, the cumulative gain previously transferred to the property fair value reserve, is transferred to the consolidated income statement.

Notes to the Consolidated Financial Statements

31 December 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

o. Property and equipment

Property and equipment is recognised at cost. The cost of additions and major improvements are capitalised; maintenance and repairs are charged to the consolidated income statement as incurred. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets as follows;

Buildings	25 to 35 years
Fixtures and fittings	5 years
Equipment	5 years
Furniture	5 years

p. Equity of investment accountholders

Equity of investment account holders are funds held by the Bank in unrestricted investment accounts, which it can invest at its own discretion. The investment account holder authorises the Bank to invest the account holders' funds in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested. The Bank charges management fee (Mudarib fees) to investment account holders. Of the total income from investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions, reserves (profit equalisation reserve and investment risk reserve) and deducting the Bank's share of income as a Mudarib. The allocation of income is determined by the management of the Bank within the allowed profit sharing limits as per the terms and conditions of the investment accounts. Administrative expenses incurred in connection with the management of the funds are borne directly by the Bank and are not charged separately to investment accounts. Only profits earned on pool of assets funded from IAH are allocated between the owners' equity and IAH.

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

q. Investment risk reserve

Investment risk reserves are amounts appropriated out of the income of equity of investment accountholders, after allocating the Mudarib share, in order to cater for future losses for equity of investment accountholders.

r. Profit equalisation reserve

The Group appropriates a certain amount in excess of the profit to be distributed to equity of investment accountholders after taking into consideration the Mudarib share of income. This is used to maintain a certain level of return on investment for equity of investment accountholders.

s. Zakah

Zakah is calculated on the Zakah base of the Group in accordance with FAS 9 issued by AAOIFI using the net invested funds method. Zakah is paid by the Group based on the consolidated figures of statutory reserve, general reserve and retained earning balances at the beginning of the year. The remaining Zakah is payable by individual shareholders. Payment of Zakah on equity of investment accountholders and other accounts is the responsibility of investment accountholders.

t. Provisions

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

u. Dividends and board remuneration

Dividends are recognised as liabilities in the year in which they are declared / approved by the shareholders.

Notes to the Consolidated Financial Statements

31 December 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

v. Derecognition of financial assets and liabilities

Financial assets

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

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

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

Financial liabilities

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

w. Treasury shares

These are own equity instruments of the Group which are reacquired through its own broker. Treasury shares are deducted from equity and accounted for at weighted average cost. Consideration paid or received on the purchase or sale of the Group's own equity instruments is recognised directly in equity. No gain or loss is recognised in consolidated income statement on the purchase, sale, issue or cancellation of own equity instruments.

x. Earnings prohibited by Shari'a

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity fund where the Group uses these funds for social welfare activities.

y. Offsetting

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

z. Income recognition

Murabaha and Wakala

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

Musharaka

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

Sukuk

Income from Sukuk is recognised using the effective profit rate over the term of the instrument.

Placements with financial institutions

Income on placements from financial institutions is recognised proportionately over the period of the contract based on the principal amounts outstanding and the profit agreed with clients.

Ijarah Muntahia Bittamleek

Income from Ijarah Muntahia Bittamleek is recognised proportionately over the lease term.

Dividend income

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

Notes to the Consolidated Financial Statements

31 December 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

z. Income recognition (Continued)

Fee and commission income

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

aa. Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into Bahraini Dinars at the rate of exchange ruling at the consolidated statement of financial position date. All differences are taken to the consolidated income statement.

Translation gains or losses on non-monetary items carried at fair value are included in owners' equity as part of the fair value adjustment.

bb. Impairment of financial assets

An assessment is made at each consolidated financial position date to determine whether there is objective evidence that a specific financial asset or a group of financial assets may be impaired. Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of financing facility or advance by the Group on the terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrower or issuers in the group or economic conditions that correlate with the defaults in the group. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the assessment by the Group of the estimated cash equivalent value, is recognised in the consolidated income statement. Specific provisions are created to reduce all impaired financial contracts to their realisable cash equivalent value. Financial assets are written off only in circumstances where effectively all possible means of recovery have been exhausted. Impairment is determined as follows:

i. For equity-type securities carried at fair value through equity, a significant or prolonged decline in fair value below its cost is an objective evidence of impairment. If such evidence exists, impairment is measured as the difference between acquisition cost and current fair value, less any impairment loss previously recognised in the consolidated income statement.

For equity type instruments carried at fair value through equity, impairment losses recognised in the consolidated income statement are subsequently reversed through equity.

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

ii. For assets carried at amortised cost, impairment is the difference between carrying amount and the present value of future cash flows discounted at the original effective profit rate.

These include debt-type instruments, financing assets and receivables. Losses are recognised in the consolidated income statement and reflected in an allowance account. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the consolidated income statement. The Group considers evidence of impairment for financial assets carried at amortised cost at both a specific assets and collective level. When the Group considers that there are no realistic prospects of recovery of the asset, the relevant accounts are written off. If the amount of impairment loss subsequently decreases and the decrease can be related objectively to an event occurring after impairment was recognized, then the previously recognised impairment loss is reversed through the consolidated income statement.

All individually significant financial assets are assessed for specific impairment. All individually significant financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Financial assets that are not individually significant are collectively assessed for impairment by grouping together assets with similar credit risk characteristics. In assessing collective impairment, the Group uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Notes to the Consolidated Financial Statements

31 December 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

cc. Use of estimates and judgements in preparation of the consolidated financial statements

In the process of applying the Group’s accounting policies, management has made estimates and judgements in determining the amounts recognised in the consolidated financial statements. The most significant use of judgements and estimates are as follows:

Going concern

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

Classification of investments

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

Impairment of equity investments

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

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

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

Impairment of financing assets

Financing assets are evaluated for impairment on a basis described in accounting policy [refer to note 2.bb]. Each counterparty exposure is evaluated individually for impairment and is based upon management’s best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty’s financial situation and the net realisable value of any underlying assets/ collaterals. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently evaluated by the Risk Management Department.

For the purposes of a collective evaluation of impairment, financing assets are grouped on the basis of similar credit risk characteristics (that is, on the basis of the Group’s grading process that considers asset type, collateral type, past-due status and other relevant factors). The methodology and assumptions used for the grading process and estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

In view of the management, the current level of provisioning is adequate and no additional impairment allowances are required on a collective basis.

dd. Trade date accounting

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

ee. Customers’ current accounts

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

Notes to the Consolidated Financial Statements

31 December 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ff. Employees' benefits

i. Short-term benefits

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

ii. Post-employment benefits

Pension and other benefits for Bahraini employees are covered by Social Insurance Organisation Scheme, which is a "defined contribution scheme" in nature, and to which employees and employers contribute monthly on a fixed percentage of salaries basis. Contributions by the Bank are recognised as an expense in the consolidated income statement when they are due.

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

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

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

iii. Share based employee incentive scheme

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

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

gg. Financial guarantees

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

hh. Repossessed assets

In certain circumstances, property is repossessed following the foreclosure on financing facilities that are in default. Repossessed properties are measured at the lower of carrying amount and fair value less costs to sell and reported within 'other assets'.

ii. Statutory reserve

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

jj. URIA protection scheme

Investment accounts held within the Bank's Bahrain operations are covered by the regulation protecting URIA issued by the Central Bank of Bahrain in accordance with Resolution No (34) of 2010. The scheme applies to all eligible accounts held with Bahrain offices of the Bank subject to specific exclusions, maximum total amount entitled and other regulations governing the establishment of a URIA Protection Scheme and a URIA Protection Board.

Notes to the Consolidated Financial Statements

31 December 2017

3. CASH AND BALANCES WITH BANKS AND CENTRAL BANK

	2017 BD'000	2016 BD'000
Cash on hand	**13,042**	12,829
Balances with CBB, excluding mandatory reserve deposits	**3,654**	3,877
Balances with banks and other financial institutions	**17,765**	12,737
	34,461	29,443
Mandatory reserve with CBB	**35,205**	33,765
	69,666	63,208

The mandatory reserve with CBB is not available for use in the day-to-day operations.

Balances with banks and other financial institutions include an amount of BD 2,512 thousand which is not available for use in the day-to-day operations.

4. PLACEMENTS WITH FINANCIAL INSTITUTIONS

	2017 BD'000	2016 BD'000
Commodity Murabaha	**53,519**	43,511
Deferred profits	**(5)**	(27)
	53,514	43,484
Wakala	**27,331**	20,321
	80,845	63,805

5. FINANCING ASSETS

	2017 BD'000	2016 BD'000
Murabaha (note 5.1)	**455,501**	396,917
Musharaka (note 5.2)	**106,321**	109,539
	561,822	506,456

5.1 Murabaha

	2017 BD'000	2016 BD'000
Tasheel	**206,855**	225,868
Tawarooq	**195,474**	136,348
Altamweel Almaren	**64,912**	48,174
Letters of credit refinance	**27,229**	29,198
Motor vehicles Murabaha	**9,625**	13,058
Credit cards	**17,992**	15,894
Others	**58**	70
	522,145	468,610
Qard fund	**71**	65
Gross receivables	**522,216**	468,675
Deferred profits	**(52,695)**	(45,781)
Provision for impairment	**(14,020)**	(25,977)
	455,501	396,917

Non-performing Murabaha financing outstanding as at 31 December 2017 amounted to BD 34,436 thousand (2016: BD 30,951 thousand). The Group considers the promise made in the Murabaha to the purchase orderer as obligatory.

The composition of the Murabaha financing portfolio net of deferred profit and before provision for impairment by sector is as follows:

	2017 BD'000	2016 BD'000
Commercial	**95,128**	73,780
Financial institutions	**32,693**	16,214
Others including retail	**341,700**	332,900
	469,521	422,894

The Group exposures of Murabaha financing portfolio is concentrated in the Middle East.

Notes to the Consolidated Financial Statements
31 December 2017

5. FINANCING ASSETS (CONTINUED)
5.2 Musharaka

	2017 BD'000	2016 BD'000
Musharaka in real estate	**107,468**	110,263
Provision for impairment	**(1,147)**	(724)
	106,321	109,539

Non-performing Musharaka financing outstanding as at 31 December 2017 amounted to BD 3,678 thousand (2016: BD 4,731 thousand).

6. INVESTMENT SECURITIES

	2017 BD'000	2016 BD'000
a. Debt type instruments		
*Quoted Sukuk - carried at amortised cost**		
Balance at the beginning of the year	**61,626**	20,486
Acquisitions	**70,043**	41,254
Disposals and redemptions	**(2,374)**	(114)
Balance at the end of the year	**129,295**	61,626
Unquoted Sukuk - carried at amortised cost		
Balance at the beginning of the year	**60,763**	80,295
Acquisitions	**49,503**	10,427
Disposals and redemptions	**(223)**	(29,959)
Foreign currency translation changes	**49**	-
	110,092	60,763
Provision for impairment	**(11,481)**	(9,106)
Balance at the end of the year	**98,611**	51,657
b. Equity type instruments		
Quoted shares - at fair value through equity		
Balance at the beginning of the year	**2,392**	2,392
Provision for impairment	**(1,704)**	(1,704)
Disposals	**(688)**	-
Balance at the end of the year	**-**	688
Unquoted shares - at cost less impairment		
Balance at the beginning of the year	**17,592**	24,963
Provision for impairment	**(1,267)**	(7,371)
Balance at the end of the year	**16,325**	17,592
Unquoted managed funds - at cost less impairment		
Balance at the beginning of the year	**14,168**	14,444
Foreign currency translation changes	**-**	(36)
Write off	**-**	(240)
Balance at the end of the year	**14,168**	14,168
Total net investment securities	**258,399**	145,731

* Includes sukuk of BD 25,057 thousand pledged against medium term borrowings of BD 63,488 thousand.

Notes to the Consolidated Financial Statements

31 December 2017

7. INVESTMENT IN ASSOCIATES

	2017 BD'000	2016 BD'000
At 1 January	**26,487**	28,116
Share of results of associates, net	**(1,103)**	(437)
Share of changes in investee's equity	**17**	(92)
Disposals	**(1,431)**	-
Foreign currency translation changes	**89**	-
Provision for impairment	**(320)**	(1,100)
At 31 December	**23,739**	26,487

Summarised financial information of associates that have been equity accounted in these consolidated financial statements, not adjusted for percentage of ownership held by the Group:

	2017 BD'000	2016 BD'000
Total assets	**200,373**	209,079
Total liabilities	**80,925**	79,670
Total revenues	**5,086**	5,925
Total net loss	**(810)**	(856)

Investment in associates comprise of:

Name of associate	Ownership %	Country of incorporation	Nature of business
Takaful International Company B.S.C.	22.75%	Bahrain	Takaful International Company B.S.C. was incorporated in 1989, and carries out Takaful and Retakaful activities in accordance with the teachings of Islamic Shari'a under a license issued by the Central Bank of Bahrain, the regulator. The Group has disposed off its shares in this associate during 2017.
Liquidity Management Centre B.S.C. (c)	25.00%	Bahrain	Liquidity Management Centre B.S.C. (c) was incorporated in 2002 as a bank, licensed and regulated by the Central Bank of Bahrain to facilitate the creation of an Islamic inter-bank market that allow Islamic financial services institutions to effectively manage their assets and liabilities.
Arabian C Real Estate Company	19.00%	Kuwait	Arabian C Real Estate Company is a Kuwaiti Shareholding Company incorporated in accordance with the Kuwaiti Commercial Companies law. The company's activity focuses on real estate development and the overall management of a variety of strategic investments in the real estate and infrastructure sectors in GCC/MENA region.
Al Dur Energy Investment Company	29.41%	Bahrain	Al Dur Energy Investment Company is an exempt company with limited liability incorporated in the Cayman Islands on 10 June 2009 and operates under registration number 227032. The company operates in the Kingdom of Bahrain with the sole purpose of holding a 15% indirect interest in a power and water plant project company, Al Dur Power and Water Company B.S.C.(c), in the Kingdom of Bahrain.

Notes to the Consolidated Financial Statements

31 December 2017

8. IJARAH MUNTAHIA BITTAMLEEK

	2017				2016			
	Properties BD'000	Aviation related assets BD'000	Others BD'000	Total BD'000	Properties BD'000	Aviation related assets BD'000	Others BD'000	Total BD'000
Cost:								
At 1 January	**178,374**	**7,540**	**2,503**	**188,417**	147,165	7,540	3,253	157,958
Additions	**36,238**	**-**	**-**	**36,238**	47,648	-	-	47,648
Settlements / adjustments	**(10,549)**	**-**	**(2,503)**	**(13,052)**	(16,439)	-	(750)	(17,189)
At 31 December	**204,063**	**7,540**	**-**	**211,603**	178,374	7,540	2,503	188,417
Accumulated depreciation:								
At 1 January	**33,936**	**226**	**2,503**	**36,665**	35,087	7,540	1,393	44,020
Charge for the year	**17,014**	**887**	**-**	**17,901**	10,495	-	1,110	11,605
Settlements / adjustments	**(4,857)**	**-**	**(2,503)**	**(7,360)**	(11,646)	(7,314)	-	(18,960)
At 31 December	**46,093**	**1,113**	**-**	**47,206**	33,936	226	2,503	36,665
Net Book Value	**157,970**	**6,427**	**-**	**164,397**	144,438	7,314	-	151,752

9. IJARAH RENTAL RECEIVABLES

	2017 BD'000	2016 BD'000
Gross Ijarah rental receivables	**27,658**	21,888
Provision for impairment	**(13,175)**	(13,270)
	14,483	8,618

Non-performing Ijarah rental receivables as at 31 December 2017 is BD 16,814 thousand (2016: BD 17,630 thousand).

10. PROPERTY AND EQUIPMENT

	2017						
	Lands BD'000	Buildings BD'000	Fixture and fitting BD'000	Equipment BD'000	Furniture BD'000	Work in progress BD'000	Total BD'000
Cost:							
At 1 January	**5,521**	**7,651**	**3,814**	**10,367**	**883**	**558**	**28,794**
Additions	**-**	**-**	**23**	**1,152**	**7**	**11**	**1,193**
At 31 December	**5,521**	**7,651**	**3,837**	**11,519**	**890**	**569**	**29,987**
Depreciation:							
At 1 January	**-**	**1,962**	**3,144**	**8,298**	**743**	**-**	**14,147**
Charge for the year	**-**	**261**	**260**	**989**	**60**	**-**	**1,570**
At 31 December	**-**	**2,223**	**3,404**	**9,287**	**803**	**-**	**15,717**
Net Book Value	**5,521**	**5,428**	**433**	**2,232**	**87**	**569**	**14,270**

Notes to the Consolidated Financial Statements

31 December 2017

10. PROPERTY AND EQUIPMENT (CONTINUED)

	2016						
	Lands BD'000	Buildings BD'000	Fixture and fitting BD'000	Equipment BD'000	Furniture BD'000	Work in progress BD'000	Total BD'000
Cost:							
At 1 January	5,521	7,651	3,695	9,782	869	516	28,034
Additions	-	-	119	585	14	42	760
At 31 December	5,521	7,651	3,814	10,367	883	558	28,794
Depreciation:							
At 1 January	-	1,699	2,853	7,393	683	-	12,628
Charge for the year	-	263	291	905	60	-	1,519
At 31 December	-	1,962	3,144	8,298	743	-	14,147
Net Book Value	5,521	5,689	670	2,069	140	558	14,647

11. INVESTMENT IN REAL ESTATE

	2017 BD'000	2016 BD'000
Land	**27,796**	27,221
Buildings	**2,035**	2,289
	29,831	29,510

	2017 BD'000	2016 BD'000
Movement in investment in real estate:		
At 1 January	**29,510**	45,045
Capitalized expenditure	**28**	-
Disposal	**(372)**	(13,728)
Fair value changes	**665**	(1,807)
At 31 December	**29,831**	29,510

Investment in real estate comprises of properties located in the Kingdom of Bahrain and the United Arab Emirates.

Investment in real estate is stated at fair value, which has been determined based on valuations performed by independent third party property valuers who have the qualification and experience of valuing similar properties in the same location. Fair value of Investments in real estate is classified as category 2 of fair value hierarchy.

12. OTHER ASSETS

	2017 BD'000	2016 BD'000
Repossessed assets	**5,689**	6,916
Receivables	**2,475**	2,228
Staff advances	**1,608**	1,665
Prepaid expenses	**1,138**	945
Other	**285**	39
	11,195	11,793

13. BORROWINGS FROM FINANCIAL INSTITUTIONS

During the year, the Group obtained three medium term Murabaha facilities of BD 63,488 thousand secured by pledge over Sukuk of BD 25,057 thousand maturing on 22 March 2018, 29 March 2018 and 17 May 2018, and a syndicated financing facility of BD 38,088 thousand on a clean basis maturing on 28 September 2018. The average rate of borrowings is 3.12%.

Notes to the Consolidated Financial Statements

31 December 2017

14. OTHER LIABILITIES

	2017 BD'000	2016 BD'000
Managers' cheques	**1,833**	4,748
Payable to vendors	**708**	2,837
Accrued expenses	**3,618**	2,990
Life insurance (Takaful) fees payable	**999**	1,568
Dividends payable	**1,000**	776
Zakah and charity fund	**259**	222
Other	**3,090**	1,738
	11,507	14,879

15. EQUITY OF INVESTMENT ACCOUNTHOLDERS

The Group comingles the Investment Account Holders' (IAH) funds with the owners' equity. In line with its policy, the Group utilizes the funds from IAH to finance assets.

15.1 Equity of investment accountholders balances

	2017 BD'000	2016 BD'000
Type of Equity of Investment Accountholders		
Customer investment accounts		
Balances on demand	**303,345**	313,612
Contractual basis	**490,411**	340,704
	793,756	654,316

15.2 Assets in which IAH funds were invested

Assets in which IAH funds were invested as at 31 December are as follows:

	2017 BD'000	2016 BD'000
Assets		
Cash and balances with banks and Central Bank	**30,334**	31,361
Gross financing assets	**433,168**	374,770
Gross Ijarah Muntahia Bittamleek and rental receivables	**131,545**	126,217
Collective impairment	**(3,778)**	(3,885)
Investment securities	**189,478**	113,750
Investment in real estate	**5,329**	3,196
Other assets	**7,680**	8,907
	793,756	654,316

The Bank temporarily allocates non-performing assets (past due greater than 90 days) from IAH to the equity shareholders and charges the specific impairment provisions to the owners' equity. Amounts recovered from these impaired assets is not subject to allocation between the IAH and owners' equity. The Bank takes remedial action on these non-performing assets and once these assets become performing, the assets and related income are allocated between the IAH and owners' equity.

The Bank charges IAH with their share of collective impairment provisions on financing facilities not past due and past due less than 90 days.

During the year, the Bank did not charge any administration expenses to investment accounts.

Notes to the Consolidated Financial Statements

31 December 2017

15. EQUITY OF INVESTMENT ACCOUNTHOLDERS (CONTINUED)

15.3 Profit distribution by account type

Following is the average percentage of profit allocation between the owner's accounts applied during the year for each type of IAH account as agreed contractually with the customers:

	2017			2016		
	Utilization	Mudarib Share	Profit to IAH	Utilization	Mudarib Share	Profit to IAH
Account type						
Tejoori	**90%**	**96.86%**	**2.90%**	90%	96.95%	2.69%
Savings	**90%**	**96.93%**	**2.83%**	90%	96.84%	2.80%
Vevo	**90%**	**97.13%**	**2.63%**	90%	97.12%	2.53%
IQRA	**100%**	**67.83%**	**31.08%**	100%	65.69%	32.02%
Time deposits	**100%**	**58.11%**	**40.79%**	100%	62.74%	35.03%

During the year, the Group did not increase its percentage of profits as Mudarib. Further, the Group did not receive any incentive from profits of investment account holders.

The Group does not share profits with IAH resulting from investing current accounts and other funds received on the basis other than Mudaraba contract.

Funds from IAH are invested in assets on a priority basis.

15.4 Equity of Investment Accountholders Reserves

	2017 BD'000	Movement BD'000	2016 BD'000
Profit equalisation reserve	**1,245**	**-**	1,245
Investment risk reserve	**1,177**	**420**	757

15.5 Return on equity of investment accountholders

	2017 BD'000	2016 BD'000
Gross return to equity of investment accountholders	**36,430**	30,081
Group's share as a Mudarib	**(24,646)**	(22,170)
Allocation to profit equalization reserve	**-**	(250)
Allocation to investment risk reserve	**(420)**	(530)
Net return on equity of investment accountholders	**11,364**	7,131

Notes to the Consolidated Financial Statements
31 December 2017

16. OWNERS' EQUITY

	2017 BD'000	2016 BD'000
a. Share capital		
i. Authorised		
2,000,000,000 shares (2016: 2,000,000,000 shares) of BD 0.100 each	**200,000**	200,000
ii. Issued and fully paid up		
1,013,389,130 shares (2016: 1,013,389,130 shares) of BD 0.100 each	**101,339**	101,339

	2017		2016
b. Treasury shares	**Number of shares**	**BD'000**	BD'000
At 31 December	**5,576,532**	**864**	563

	2017 BD'000
Cost of treasury shares	**864**
Market value of treasury shares	**781**

The treasury shares as a percentage of total shares in issue is 0.55%

Owners' equity instruments which are reacquired are deducted from equity. No gain or loss is recognised in the consolidated income statement on the purchase, sale, issue or cancellation of the Group's own equity instruments.

c. Reserves

Statutory reserve
A transfer has been made of BD 1,014 thousand (2016: 842 thousand) representing 10% of the profit for the year BD 10,141 thousand (2016: 8,420 thousand). The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of CBB.

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

Real estate fair value reserve
This represents cumulative unrealised revaluation gains on investment in real estate. This reserve is transferred to the consolidated income statement upon sale of the investment in real estate.

Investment fair value reserve
This represents the net unrealised gains or losses on equity investments relating to self financed investments.

d. Additional information on shareholding pattern

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

		2017		2016	
Names	**Nationality**	**Number of shares**	**% holding**	Number of shares	% holding
National Bank of Bahrain	Bahraini	**294,482,159**	**29.06%**	294,482,159	29.06%
Social Insurance Organisation	Bahraini	**147,242,463**	**14.53%**	147,242,463	14.53%
Social Insurance Organisation - Military Pension Fund	Bahraini	**147,242,464**	**14.53%**	147,242,464	14.53%
Islamic Development Bank	Saudi	**146,117,221**	**14.42%**	146,117,221	14.42%
General Council of Kuwaiti Awqaf	Kuwaiti	**72,729,830**	**7.18%**	72,729,830	7.18%

Notes to the Consolidated Financial Statements

31 December 2017

16. OWNERS' EQUITY (CONTINUED)

d. Additional information on shareholding pattern (Continued)

ii. The Group has only one class of shares and the holders of these shares have equal voting rights.

iii. Distribution schedule of shares, setting out the number and percentage of holders in the following categories:

	2017			2016		
	Number of shares	Number of shareholders	% of total outstanding shares	Number of shares	Number of shareholders	% of total outstanding shares
Less than 1%	**145,805,613**	**3,232**	**14.38%**	145,893,657	3,266	14.38%
1% and less than 5%	**59,769,380**	**3**	**5.90%**	59,769,380	3	5.90%
5% and less than 10%	**72,729,830**	**1**	**7.18%**	72,641,786	1	7.18%
10% and less than 50%	**735,084,307**	**4**	**72.54%**	735,084,307	4	72.54%
	1,013,389,130	**3,240**	**100.00%**	1,013,389,130	3,274	100.00%

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

Categories:

	2017		2016	
	Number of shares	Number of directors	Number of shares	Number of directors
Less than 1%	**464,320**	**4**	414,320	3

The following is the number of shares, and percentage of shareholding of Directors, Shari'a supervisory members and senior management (Assistant General Managers and above):

	2017		2016	
	Number of shares	% of Shareholding	Number of shares	% of Shareholding
Directors	**464,320**	**0.046%**	414,320	0.041%
Shari'a supervisory members	**181,731**	**0.018%**	180,823	0.018%
Senior management	**777,167**	**0.077%**	418,496	0.041%
	1,423,218	**0.141%**	1,013,639	0.100%

e. Proposed appropriations

The Board of Directors propose the appropriation for zakah of BD 265 thousand in 2017 (2016: BD 137 thousand), charitable donations of BD 200 thousand in 2017 (2016:BD nil) and bonus shares as dividends amounting to BD 5,039 thousand (2016: cash dividend of 5% amounting to BD 5,051 thousand) which are subject to regulatory and shareholders' approval in the ensuing Annual General Meeting.

Notes to the Consolidated Financial Statements

31 December 2017

17. COMMITMENTS AND CONTINGENT LIABILITIES

Credit related commitments

These include commitments to enter into financing contracts which are designed to meet the requirements of the Group's customers.

Letters of credit and guarantees commit the Group to make payments on behalf of customers.

The Group has the following credit related commitments and contingent liabilities on behalf of customers:

	2017 BD'000	2016 BD'000
Letters of credit and acceptances	**5,470**	6,182
Guarantees	**74,159**	43,966
Credit cards	**30,508**	26,103
Altamweel Almaren	**19,033**	20,180
Operating lease commitments*	**223**	356
	129,393	96,787

*The Group has entered into commercial leases for certain branches. The remaining average period of these leases ranges between 1 month and 3 years with renewal terms included in the contracts. Renewals are at the option of the Bank. There are no restrictions placed upon the lessee by entering into these leases.

Future minimum rentals payable under non-cancellable operating leases as at 31 December are as follows:

	2017 BD'000	2016 BD'000
Within one year	**170**	3
After one year but not more than five years	**53**	353
	223	356

18. CAPITAL ADEQUACY

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

The Group's capital structure primarily consists of its paid-up capital, including share premium and reserves. From a regulatory perspective, a significant amount of the Group's capital is classified as Tier 1 as defined by the CBB, i.e. most of the capital is of a permanent nature.

The Group's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of financing facilities growth expectations for each business group, expected growth in off-balance sheet facilities and future sources and uses of funds.

The Central Bank of Bahrain issued the final regulation to give effect to the Basel III framework which came into effect on 1 January 2015. The Basel III framework significantly revises the definition of regulatory capital. The framework emphasises on common equity as the predominant component of tier 1 capital by adding a minimum Common Equity Tier 1 (CET 1) capital ratio. The Basel III rules also require institutions to hold capital buffers. For the purpose of calculating CET 1 capital, the regulatory adjustments (deductions) including amounts above the aggregate limit for significant investments in financial institutions, mortgage servicing rights, and deferred tax assets from temporary differences, will be deducted from CET1 over a phased manner to be fully deducted by 1 January 2019. The Bank's current capital position is sufficient to meet the new regulatory capital requirements.

The classification of the Group's capital in accordance with the regulatory requirements is as follows:

	2017 BD'000	2016 BD'000
CET 1 Capital before regulatory adjustments	**116,125**	111,111
Less: regulatory adjustments	**-**	-
CET 1 Capital after regulatory adjustments	**116,125**	111,111
T 2 Capital adjustments	**13,283**	11,961
Regulatory Capital	**129,408**	123,072

Notes to the Consolidated Financial Statements

31 December 2017

18. CAPITAL ADEQUACY (CONTINUED)

To assess its capital adequacy requirements in accordance with the CBB requirements, the Group adopts the Standardised Approach for its Credit Risk, Basic Indicator Approach for its Operational Risk and Standardised Approach for its Market Risk. The capital requirements for these risks are as follows:

	2017 BD'000	2016 BD'000
Risk weighted exposure:		
Total Credit Risk Weighted Assets	571,069	527,820
Total Market Risk Weighted Assets	10,702	12,226
Total Operational Risk Weighted Assets	86,085	66,722
Total Regulatory Risk Weighted Assets	667,856	606,768
Investment risk reserve (30% only)	353	227
Profit equalization reserve (30% only)	374	374
Total Adjusted Risk Weighted Exposures	667,129	606,167
Capital Adequacy Ratio	19.40%	20.30%
Tier 1 Capital Adequacy Ratio	17.41%	18.33%
Minimum requirement	12.5%	12.5%

19. INCOME FROM FINANCING

	2017 BD'000	2016 BD'000
Income from Murabaha financing	23,483	20,143
Income from placements with financial institutions	1,093	341
Income from Musharaka financing	6,580	6,300
Income from Ijarah Muntahia Bittamleek	9,351	8,097
	40,507	34,881

20. INCOME FROM INVESTMENT SECURITIES

	2017 BD'000	2016 BD'000
Dividend income	513	739
	513	739

21. INCOME FROM INVESTMENT IN REAL ESTATE

	2017 BD'000	2016 BD'000
Loss on sale	(39)	(843)
Rental income	371	362
Impairment charge	(119)	(82)
	213	(563)

22. OTHER INCOME

	2017 BD'000	2016 BD'000
Recoveries from previously written off financing	1,883	3,499
Foreign exchange gain / (loss)	489	(1,001)
Others	368	2,046
	2,740	4,544

Notes to the Consolidated Financial Statements

31 December 2017

23. OTHER OPERATING EXPENSES

	2017 BD'000	2016 BD'000
Marketing and advertisement expenses	**2,811**	2,670
Information technology related expenses	**1,602**	1,312
Card Centre expenses	**1,951**	1,203
Premises and equipment expenses	**1,150**	1,233
Communication expenses	**920**	952
Professional services	**1,254**	933
Board remunerations	**500**	300
Board of directors sitting fees	**141**	178
Shari'a committee fees & expenses	**111**	85
Others	**1,947**	1,954
	12,387	10,820

24. IMPAIRMENT PROVISIONS

24.1 Impairment provisions on financing

	Specific impairment		Collective impairment		Total	
	2017 BD'000	2016 BD'000	2017 BD'000	2016 BD'000	2017 BD'000	2016 BD'000
At 1 January	**27,537**	29,145	**12,434**	11,326	**39,971**	40,471
Charge for the year	**8,616**	3,924	**-**	1,225	**8,616**	5,149
Recoveries and write backs	**(5,552)**	(3,058)	**(527)**	-	**(6,079)**	(3,058)
	3,064	866	**(527)**	1,225	**2,537**	2,091
Amounts written off against provision	**(13,206)**	(2,474)	**(960)**	(117)	**(14,166)**	(2,591)
At 31 December	**17,395**	27,537	**10,947**	12,434	**28,342**	39,971

The above impairment provision relates to the following:	2017 BD'000	2016 BD'000
Murabaha financing	**14,020**	25,977
Musharaka financing	**1,147**	724
Ijarah Muntahia Bittamleek	**13,175**	13,270
	28,342	39,971

24.2 Impairment provisions on investments

	2017 BD'000	2016 BD'000
At 1 January	**20,689**	14,998
Charge for the year*	**3,913**	7,641
Recoveries and write backs	**(253)**	-
	3,660	7,641
Amounts written off against provision	**(1,450)**	(1,907)
Foreign currency translation changes	**50**	(43)
At 31 December	**22,949**	20,689

*Impairment charge includes BD 320 thousand (2016: BD 1,100 thousand) impairment charge on investment in associates.

The fair value of collateral that the Group holds relating to non performing facilities at 31 December 2017 amounts to BD 180,740 thousand (31 December 2016: BD 97,468 thousand). The collateral consists of cash, securities and properties. The utilisation of the above collaterals will be on a customer by customer basis and will be limited to the customer's total exposure.

The Group has taken all the specific and investment provisions allocated to the non performing assets against its own capital. Hence the equity of investment accountholders was not charged for any specific and investment provision for impairment.

Notes to the Consolidated Financial Statements

31 December 2017

25.ZAKAH

The total Zakah payable as at 31 December 2017 amounted to BD 1,875 thousand (2016: BD 1,627 thousand) of which the Bank has BD 265 thousand Zakah payable (2016: BD 137 thousand) based on the statutory reserve, general reserve and retained earning as at 1 January 2017. The Zakah balance amounting to BD 1,610 thousand or 1.6 fils per share (2016: BD 1,490 thousand or 1.5 fils per share) is due and payable by the shareholders.

26.EARNINGS PER SHARE

Basic and diluted earnings per share is calculated by dividing the net profit or loss for the year by the weighted average number of shares during the year as follows:

	2017	2016
Profit for the year in BD'000	**10,141**	8,420
Weighted average number of shares	**1,000,414**	1,001,030
Basic and diluted earnings per share (fils)	**10.14**	8.41

Basic and diluted earnings per share are the same since the Group has not issued any instruments that would have a dilutive effect.

27.RELATED PARTY TRANSACTIONS

Related parties comprise of 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 made on commercial terms.

The significant balances and transactions with related parties at 31 December were as follows:

	2017				
	Shareholders BD'000	**Associates and joint ventures BD'000**	**Directors and related entities BD'000**	**Senior management BD'000**	**Total BD'000**
Assets					
Financing assets	**-**	**-**	**1,688**	**84**	**1,772**
Investment in associates	**-**	**23,739**	**-**	**-**	**23,739**
Other assets	**-**	**-**	**-**	**1,060**	**1,060**
Liabilities and Equity of Investment Accountholders					
Borrowings from financial institutions	**38,991**	**-**	**-**	**-**	**38,991**
Customers' current accounts	**-**	**130**	**662**	**280**	**1,072**
Other liabilities	**-**	**-**	**517**	**-**	**517**
Equity of investment accountholders	**47,092**	**-**	**7,819**	**1,499**	**56,410**
Income					
Income from financing	**-**	**-**	**110**	**-**	**110**
Share of results of associates, net	**-**	**(1,103)**	**-**	**-**	**(1,103)**
Return on equity of investment accountholders	**(1,469)**	**-**	**(139)**	**-**	**(1,608)**
Expense on borrowings from financial institutions	**(750)**	**-**	**-**	**(3)**	**(753)**
Expenses					
Other expenses	**-**	**-**	**(753)**	**-**	**(753)**
Staff costs	**-**	**-**	**(39)**	**(1,439)**	**(1,478)**

Notes to the Consolidated Financial Statements

31 December 2017

27. RELATED PARTY TRANSACTIONS (CONTINUED)

	2016				
	Shareholders BD'000	Associates and joint ventures BD'000	Directors and related entities BD'000	Senior management BD'000	Total BD'000
Assets					
Financing assets	-	-	1,615	-	1,615
Investment in associates	-	26,487	-	-	26,487
Other assets	-	-	-	402	402
Liabilities and Equity of Investment Accountholders					
Borrowings from financial institutions	-	-	-	-	-
Customers' current accounts	-	1,719	431	152	2,302
Other liabilities	-	1,568	360	-	1,928
Equity of investment accountholders	65,656	602	1,218	1,142	68,618
Income					
Income from financing	-	-	86	-	86
Share of results of associates, net	-	(437)	-	-	(437)
Return on equity of investment accountholders	(658)	(5)	(15)	(35)	(713)
Expense on placements from financial institutions	(304)	-	-	-	(304)
Expenses					
Other expenses	-	-	(563)	-	(563)
Staff costs	-	-	-	(1,422)	(1,422)

Compensation of the key management personnel is as follows:	**2017 BD'000**	2016 BD'000
Short term employee benefits	**1,178**	1,226
Other long term benefits	**261**	196
	1,439	1,422

Key management personnel includes staff at the grade of assistant general manager or above.

28. RISK MANAGEMENT

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 risks and the processes to mitigate these risks have not significantly changed from the previous year.

The Group is exposed mainly to credit, liquidity, market and operational risks.

Risk management objectives

The risk management philosophy of the Group is to identify, monitor and manage the various dimensions of risk with the objective of protecting asset values and income streams such that the interest of the Group's shareholders (and others to whom the Group owes a liability) are safeguarded, while maximising the returns intended to optimise the Group's shareholder return while maintaining it's risk exposure within self-imposed parameters.

The Group has defined its risk appetite within the parameters of its risk strategy. The Group reviews and realigns its risk appetite as per the evolving business plan of the Group with changing economic and market scenarios. The Group also assesses its tolerance for specific risk categories and its strategy to manage these risks.

Notes to the Consolidated Financial Statements

31 December 2017

28. RISK MANAGEMENT (CONTINUED)

Risk management objectives (Continued)

Risk appetite of the Group is articulated in terms of the following dimensions:

i. Adequate capital level;
ii. Stable profitability and growth;
iii. Sufficient liquidity; and
iv. Sound reputation.

Structure and Organization of the Risk Management Function

risk management Structure includes all levels of authorities, organizational structure, people and systems required for the effective functioning of risk management processes in the Group. The responsibilities associated with each level of the risk management structure and authorities include the following:

The Board retains ultimate responsibility and authority for all risk matters, including:

i. Establishing overall policies and procedures; and
ii. Delegating authority to the Executive Committee, Credit and Investment Committee, Chief Executive Officer and further delegation to the management to approve and review.

Executive Committee (EC): Comprises of four designated members of the Board of Directors. The Executive Committee has delegated authority by the Board to manage the ongoing activities of the Group. Decisions are taken by the Executive Committee either at periodic meetings or if the need arises, by circulation.

Credit and Investment Committee (CIC): As delegated by the Board of Directors and as per approved terms of reference, the Committee has been delegated with authorities and responsibilities including, approving extension or renewal of credit facilities, granting temporary excesses to customers with credit facilities approved by the Board, approving early repayments of facilities, monitoring the performance and quality of the Group's credit portfolio and overseeing the administration and effectiveness of and compliance with, the Group's credit policies through the review of such processes, reports and other information as it deems appropriate.

Risk Measurement and Reporting Systems

Based on the risk appetite, the Group has put in place various limits. These limits have been approved by the Board. Any limit breach is reported by the Risk Management Department (RMD) to the Credit Committee. The limits are reviewed and revised at least annually (or earlier if required).

a. 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.

Credit Risk Mitigation

Credit risk mitigation refers to the use of a number of techniques, such as obtaining collateral and guarantees to mitigate the credit risks that the Group is exposed to. Credit risk mitigants reduce the credit risk by allowing the Group to protect against counterparty non-performance of credit contracts through collaterals, netting agreements and guarantees.

Generally, the Group extends credit facilities only where supported by adequate tangible collateral security and/or audited financial statements. Facilities may be considered without adequate tangible collateral security when audited financial statements reveal satisfactory financial position/repayment ability and the facilities are properly structured and supported by assignments, guarantees, etc. as appropriate.

In general, personal guarantees of the partners/promoters/directors of the borrowing entity are obtained in support of credit facilities. In all cases, a statement of net worth of the guarantor is to be compiled by the Account Officer, so that adequate information is available at a future date in case the guarantees need to be enforced.

Notwithstanding the above, when facilities are extended to family owned limited liability entities, the following is normally obtained;

i. Collateral security, fully covering the exposure; or
ii. Joint and several guarantees of shareholders directly involved in managing the entity as well as of shareholders owing at least 80% of the shares of the entity.

Third party guarantees in support of credit facilities are accepted only after review and approval of appropriate guarantor lines.

Notes to the Consolidated Financial Statements

31 December 2017

28. RISK MANAGEMENT (CONTINUED)

a. Credit Risk (Continued)

Gross maximum exposure to credit risk

The market value of tangible collateral security is properly evaluated by the Group approved surveyors (for properties) or based on publicly available quotations. Only the amount of such security equivalent to the exposure is taken into account while considering credit facilities.

The CIC periodically reviews and approves the value of securities. It has also approved a list of acceptable securities.

The table below shows the gross maximum exposure to credit risk for the components of the consolidated statement of financial position, including credit related commitments. The figures represent gross exposure, without taking account of any collateral held or other credit enhancements.

	2017 BD'000	2016 BD'000
Balances with banks and Central Bank	**56,624**	50,379
Placements with financial institutions	**80,845**	63,805
Financing assets	**561,822**	506,456
Ijarah Muntahia Bittamleek and Rental Receivables	**178,880**	160,370
Investment debt securities	**227,906**	113,283
	1,106,077	894,293
Letters of credit, guarantees and acceptances	**79,629**	50,148

Risk concentrations of the maximum exposure to credit risk

Concentrations of credit risk 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 of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location. The Group seeks to manage its credit risk exposure through diversification of financing activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses.

The distribution of the Group's assets, liabilities, equity of investment accountholders, commitments and contingent liabilities by geographic region and industry sector is as follows:

	Assets		Liabilities and equity of investment accountholders		Commitments and contingent liabilities	
	31 December 2017 BD'000	31 December 2016 BD'000	**31 December 2017 BD'000**	31 December 2016 BD'000	**31 December 2017 BD'000**	31 December 2016 BD'000
Geographical region						
Middle East	**1,194,057**	1,001,910	**1,091,639**	924,205	**129,393**	96,787
North America	**10,473**	5,801	**229**	83	**-**	-
Europe	**24,117**	14,296	**13,628**	579	**-**	-
Other	**-**	-	**881**	849	**-**	-
	1,228,647	1,022,007	**1,106,377**	925,716	**129,393**	96,787
Industry sector						
Trading and manufacturing	**105,018**	70,899	**19,022**	42,443	**20,507**	23,278
Aviation	**-**	-	**53,029**	1,977	**-**	820
Real Estate	**211,603**	189,628	**43,352**	22,266	**45,068**	9,904
Banks and financial institutions	**171,187**	135,883	**216,833**	131,837	**3,205**	916
Personal / Consumer	**391,662**	380,532	**472,366**	441,795	**33,085**	27,082
Government Organization	**251,777**	132,360	**165,358**	143,222	**21,081**	500
Others	**97,400**	112,705	**136,417**	142,176	**6,447**	34,287
	1,228,647	1,022,007	**1,106,377**	925,716	**129,393**	96,787

Notes to the Consolidated Financial Statements

31 December 2017

28. RISK MANAGEMENT (CONTINUED)

a. Credit Risk (Continued)

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group using internal classification. The table below shows the credit quality by class of asset, based on the Group's credit rating system. Amounts reported are gross of any collective provision for impairment.

	31 December 2017					
	Balances with banks and Central Bank BD'000	**Placements with financial institutions BD'000**	**Financing assets BD'000**	**Ijarah Muntahia Bittamleek and rental receivables BD'000**	**Investment securities (Sukuk) BD'000**	**Total BD'000**
Past due and impaired	**-**	**-**	**38,112**	**16,814**	**12,550**	**67,476**
Specific impairment	**-**	**-**	**(6,118)**	**(11,277)**	**(11,481)**	**(28,876)**
Carrying value	**-**	**-**	**31,994**	**5,537**	**1,069**	**38,600**
Past due but not impaired:						
Up to 30 days	**-**	**-**	**62,977**	**13,181**	**-**	**76,158**
31 to 60 Days	**-**	**-**	**8,585**	**1,050**	**-**	**9,635**
61 to 90 days	**-**	**-**	**7,468**	**711**	**-**	**8,179**
Carrying value	**-**	**-**	**79,030**	**14,942**	**-**	**93,972**
Neither past due nor impaired	**17,765**	**77,145**	**452,238**	**135,120**	**27,001**	**709,269**
Carrying value	**17,765**	**77,145**	**452,238**	**135,120**	**27,001**	**709,269**
Sovereign	**38,859**	**3,700**	**7,609**	**25,179**	**199,836**	**275,183**
Carrying value	**38,859**	**3,700**	**7,609**	**25,179**	**199,836**	**275,183**
Collective impairment	**-**	**-**	**(9,049)**	**(1,898)**	**-**	**(10,947)**
	56,624	**80,845**	**561,822**	**178,880**	**227,906**	**1,106,077**

	31 December 2016					
	Balances with banks and Central Bank BD'000	Placements with financial institutions BD'000	Financing assets BD'000	Ijarah Muntahia Bittamleek and rental receivables BD'000	Investment securities (Sukuk) BD'000	Total BD'000
Past due and impaired	-	-	52,251	28,608	12,560	93,419
Specific impairment	-	-	(16,560)	(10,977)	(9,106)	(36,643)
Carrying value	-	-	35,691	17,631	3,454	56,776
Past due but not impaired:						
Up to 30 days	-	-	37,962	16,005	-	53,967
31 to 60 Days	-	-	12,041	1,345	-	13,386
61 to 90 days	-	-	9,460	432	-	9,892
Carrying value	-	-	59,463	17,782	-	77,245
Neither past due nor impaired	12,737	63,805	420,918	119,691	27,682	644,833
Carrying value	12,737	63,805	420,918	119,691	27,682	644,833
Sovereign	37,642	-	525	7,559	82,147	127,873
Carrying value	37,642	-	525	7,559	82,147	127,873
Collective impairment	-	-	(10,141)	(2,293)	-	(12,434)
	50,379	63,805	506,456	160,370	113,283	894,293

Restructured facilities during the year amounted to BD 24,586 thousand (2016: BD 20,580 thousand).

Notes to the Consolidated Financial Statements

31 December 2017

28. RISK MANAGEMENT (CONTINUED)

b. Liquidity Risk

Liquidity risk is the risk that the Group will be unable to meet its liabilities when they fall due. Liquidity risk can be caused by market disruptions or credit downgrades which may cause certain sources of funding to cease immediately. To guard against this risk, the Group has a large customer base and assets are managed with liquidity in mind, maintaining a healthy balance of cash and cash equivalents, commodity Murabaha, Wakala receivables, credit lines and quoted investments. The Group has leveraged part of its Sukuk portfolio by obtaining medium term financing maturing in one year.

Maturity profile of Group's assets and liabilities

The table below summarises the maturity profile of the Group's assets and liabilities. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period from the consolidated statement of financial position date to the contractual maturity date and do not take account of the effective maturities as indicated by the Group's retention history of its equity of investment accountholders.

The maturity profile of assets, liabilities and equity of investment accountholders at 31 December 2017 was as follows:

	Up to 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 months to 1 year BD '000	1 to 3 years BD '000	Over 3 years BD '000	No fixed maturity BD '000	Total BD '000
Assets								
Cash and balances with the banks and Central Bank	34,461	-	-	-	-	-	35,205	69,666
Placements with financial institutions	80,845	-	-	-	-	-	-	80,845
Financing assets	23,595	28,150	29,159	63,784	65,411	351,723	-	561,822
Ijarah Muntahia Bittamleek and rental recievables	10,193	8,309	162	56	4,222	155,938	-	178,880
Investment securities	11,295	40,179	27,603	10,167	34,766	103,896	30,493	258,399
Investment in associates	-	-	-	-	-	-	23,739	23,739
Investment in real estate	-	-	-	-	-	-	29,831	29,831
Property and equipment	-	-	-	-	-	-	14,270	14,270
Other assets	5	310	397	357	1,527	8,599	-	11,195
Total assets	160,394	76,948	57,321	74,364	105,926	620,156	133,538	1,228,647
Liabilities and Equity of Investment Accountholders								
Placements from financial institutions	61,086	6,786	-	-	-	-	-	67,872
Borrowings from financial institutions	-	63,488	-	38,088	-	-	-	101,576
Customers' current accounts	26,333	-	-	-	-	105,333	-	131,666
Other liabilities	11,507	-	-	-	-	-	-	11,507
Equity of investment accountholders	206,961	102,475	146,113	72,960	9,334	255,913	-	793,756
Total liabilities and equity of investment accountholders	305,887	172,749	146,113	111,048	9,334	361,246	-	1,106,377
Liquidity gap	(145,493)	(95,801)	(88,792)	(36,684)	96,592	258,910	133,538	122,270
Cumulative liquidity gap	(145,493)	(241,294)	(330,086)	(366,770)	(270,178)	(11,268)	122,270	-

Notes to the Consolidated Financial Statements

31 December 2017

28. RISK MANAGEMENT (CONTINUED)

b. Liquidity Risk (Continued)

The maturity profile of assets, liabilities and equity of investment accountholders at 31 December 2016 was as follows:

	Up to 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 months to 1 year BD '000	1 to 3 years BD '000	Over 3 years BD '000	No fixed maturity BD '000	Total BD '000
Assets								
Cash and balances with the banks and Central Bank	29,442	-	-	-	-	-	33,766	63,208
Placements with financial institutions	63,805	-	-	-	-	-	-	63,805
Financing assets	23,480	15,488	23,248	49,452	82,910	311,878	-	506,456
Ijarah Muntahia Bittamleek and rental recievables	11,542	2,091	21	63	1,506	145,147	-	160,370
Investments securities	97	1,504	3,798	-	38,685	101,647	-	145,731
Investment in associates	-	-	-	-	-	-	26,487	26,487
Investment in real estate	-	-	-	-	-	-	29,510	29,510
Property and equipment	-	-	-	-	-	-	14,647	14,647
Other assets	379	1,665	-	-	3,044	-	6,705	11,793
Total assets	128,745	20,748	27,067	49,515	126,145	558,672	111,115	1,022,007
Liabilities and Equity of Investment Accountholders								
Placements from financial institutions	84,117	8,337	-	-	-	-	-	92,454
Borrowings from financial institutions	-	-	11,420	-	-	-	-	11,420
Customers' current accounts	132,466	-	-	-	-	-	-	132,466
Other liabilities	14,879	-	-	-	-	-	-	14,879
Equity investment accountholders	433,805	77,119	84,079	50,014	5,003	-	4,296	654,316
Total liabilities and equity of investment accountholders	665,267	85,456	95,499	50,014	5,003	-	4,296	905,535
Liquidity gap	(536,522)	(64,708)	(68,432)	(499)	121,142	558,672	106,819	116,472
Cumulative liquidity gap	(536,522)	(601,230)	(669,662)	(670,161)	(549,019)	9,653	116,472	-

c. Market Risk

The Group has accepted the definition of market risk as defined by CBB as "the risk of losses in on and off balance sheet positions arising from movements in market prices".

i. Profit rate risk

Profit rate risk is the sensitivity of financial products to changes in the profit rates. Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities, and equity of investment accountholders as the repricing of assets, liabilities and equity of investment accountholders occur at similar intervals. The profit distribution to equity of investment accountholders is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

However, the profit sharing agreements will result in displaced commercial risk when the Group's results do not allow the Group to distribute profits in line with the market rates.

ii. Equity price risk

Equity price risk is the sensitivity of financial products to the changes in equity prices. Equity risk arises from holding open positions in equities or equity based instruments, thereby creating exposure to a change in the market price of the equity. In addition to Group performance expectations, equity prices are also susceptible to general economic data and sector performance expectations.

In order to measure the risk of equity on its financial positions, the Group adopts a sensitivity analysis on its quoted equity portfolio for a 10% increase of the portfolio value with all other variables remaining constant. The effect of a similar decrease in equity prices is expected to be equal and opposite to the effect of the increase shown.

Notes to the Consolidated Financial Statements

31 December 2017

28. RISK MANAGEMENT (CONTINUED)

c. Market Risk (Continued)

ii. Equity price risk (Continued)

Equity price risk variation as at 31 December is as follows:

	Increase in equity price %	Sensitivity of profit or loss BD'000	Sensitivity of equity BD'000
2017			
Kuwait Stock Exchange	-	-	-
2016			
Kuwait Stock Exchange	+10	69	-

As at the consolidated statement of financial position date, the Group has unquoted (equities and sukuk) of BD 115 million (31 December 2016: BD 69 million). The impact of changes in the value of these unquoted equities and sukuk and the related impact on equity will only be reflected when the financial instrument is sold or deemed to be impaired.

iii. Foreign exchange risk

Foreign exchange risk is the sensitivity of financial products to changes in spot foreign exchange rates. The value of the Group's portfolio which is denominated in a number of currencies may be exposed to these risks when converted back to the Group's base currency.

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

Currency	Equivalent Long (short) 2017 BD '000	Equivalent Long (short) 2016 BD '000
Pound Sterling	**(1,020)**	(1,016)
Euro	**(985)**	(1,051)
CAD	**(4)**	(3)
JPY	**(6)**	(3)
Kuwaiti Dinars	**(8,659)**	(10,131)

As the Bahraini Dinar is pegged to the US Dollar, positions in US Dollars are not considered to represent significant foreign exchange risk.

Moreover, as the Group does not have significant exposures in other currencies, movement of the currency exchange rates against the Bahraini Dinar with other variables held constant will have an immaterial impact on the consolidated income statement and owners' equity.

iv. Commodity risk

Commodity risk is defined as inherent risk in financial products arising from their sensitivity to changes in commodity prices. Since prices in commodity markets are determined by fundamental factors (i.e. supply and demand of the underlying commodity) these markets may be strongly correlated within particular sector and less correlated across sectors.

d. Operational Risk

Operational risk is the risk of loss arising from system failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

Notes to the Consolidated Financial Statements

31 December 2017

29.SEGMENTAL INFORMATION

For management purposes, the Group is organized into three major business segments;

Corporate	Principally handling equity of corporate investment accountholders', corporate current accounts, and providing Islamic financing facilities to corporate customers.
Retail	Principally handling equity of individual retail customers' investment accountholders', retail current accounts, and providing Islamic financing facilities to individual customers.
Investment	Principally handling equity of banks' and financial institutions' investment accountholders, providing money market, trading and treasury services as well as the management of the Group's investment activities. Investment activities involve handling investments in local and international markets and investment in properties.

These segments are the basis on which the Group reports its primary segment information. 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			
	Corporate BD'000	**Retail BD'000**	**Investment BD'000**	**Total BD'000**
Total net income	**10,732**	**27,170**	**5,004**	**42,906**
Total expenses	**(5,043)**	**(18,154)**	**(3,371)**	**(26,568)**
Provision for impairment	**(7,399)**	**529**	**673**	**(6,197)**
Profit / (loss) for the year	**(1,710)**	**9,545**	**2,306**	**10,141**
Other information				
Segment assets	**330,624**	**455,535**	**442,488**	**1,228,647**
Segment liabilities, and equity	**450,926**	**517,873**	**259,848**	**1,228,647**

	31 December 2016			
	Corporate BD'000	Retail BD'000	Investment BD'000	Total BD'000
Total income	12,928	27,868	876	41,672
Total expenses	(3,791)	(17,140)	(2,589)	(23,520)
Provision for impairment	251	(2,342)	(7,641)	(9,732)
Profit / (loss) for the year	9,388	8,386	(9,354)	8,420
Other information				
Segment assets	256,996	452,746	312,265	1,022,007
Segment liabilities, and equity	284,279	512,642	225,086	1,022,007

The Group operates solely in the Kingdom of Bahrain and, as such, no geographical segment information is presented.

Notes to the Consolidated Financial Statements

31 December 2017

30. FINANCIAL INSTRUMENTS

Fair value hierarchy

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

Fair values of quoted securities / Sukuk are derived from quoted market prices in active markets, if available. In case of financing assets, the average profit rate of the portfolio is in line with current market rates for similar facilities and hence after consideration of adjustment for prepayment risk and impairment charges, it is expected that the current value would not be materially different to fair value of these assets. Other than equity investments and managed funds carried at cost of BD 30,493 thousand (2016: BD 31,760 thousand), the estimated fair values of the Bank's other financial instruments are not significantly different from their carrying values due to their short-term nature.

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

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

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

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

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy at 31 December:

2017	**Level 1 BD'000**	**Level 2 BD'000**	**Level 3 BD'000**	**Total BD'000**
Investments carried at fair value through equity				
Quoted equity securities	**-**	**-**	**-**	**-**
2016				
Investments carried at fair value through equity				
Quoted equity securities	688	-	-	688

Transfers between Level 1, Level 2 and Level 3

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

31. EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a Qard fund account where the Group uses these funds for various charitable purposes. The movements in these funds is shown in the consolidated statement of sources and uses of good faith Qard fund. The non-Islamic income includes the penalties charged on late repayments for Islamic facilities.

32. SHARI'A SUPERVISORY BOARD

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

33. SOCIAL RESPONSIBILITY

The Group discharges its social responsibilities through Zakah and charity fund's expenditures and donations to good faith Qard fund for marriage, refurbishment, medical treatments, etc.

34. COMPARATIVE FIGURES

Certain of the prior year's figures have been reclassified to conform to the presentation adopted in the current year. Such reclassification did not affect previously reported profit for the year or total owners' equity.