

WARBA BANK K.S.C.P.

**CONSOLIDATED
FINANCIAL STATEMENTS**

31 DECEMBER 2017



Ernst & Young
Al Aiban, Al Oseimi & Partners
P.O. Box 74
18-21st Floor, Baitak Tower
Ahmed Al Jaber Street
Safat Square 13001, Kuwait

Tel: +965 2295 5000
Fax: +965 2245 6419
kuwait@kw.ey.com
ey.com/mena



KPMG Safi Al-Mutawa & Partners
Al Hamra Tower, 25th Floor
Abdulaziz Al Saqr Street
P.O. Box 24, Safat 13001
State of Kuwait
Tel : + 965 2228 7000
Fax + 965 2228 7444

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF WARBA BANK K.S.C.P.

Report on the Audit of Consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of Warba Bank K.S.C.P. (the "Bank") and its subsidiaries (collectively "the Group"), which comprise the consolidated statement of financial position as at 31 December 2017, and the consolidated statement of income, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs), as adopted for use by the State of Kuwait.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the '*Auditors' Responsibilities for the Audit of the Consolidated Financial Statements*' section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (IESBA Code)*, and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

Impairment of financing receivables

Financing receivables are accounted for at amortised cost less any impairment charges. Impairment of financing receivables is a highly subjective area due to the level of judgment applied by management in determining provisions and the management is required to identify those financing receivables that are deteriorating, make an objective assessment for evidence of impairment, the value of collateral and its assessment and future cash flows expected from financing receivables..

Due to significance of financing receivables and the related estimation uncertainty, this is considered a key audit matter. The basis of the impairment provision policy is presented in the accounting policies and the management's assessment of the credit risk and their responses to such risks, including the management's risk management policies, is set out in note 2.4 to the consolidated financial statements.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF WARBA BANK K.S.C.P. (continued)

Report on the Audit of Consolidated Financial Statements (continued)

Key Audit Matters (continued)

Impairment of financing receivables (continued)

Our audit procedures included assessment of controls over the granting, booking and monitoring processes of financing receivables and the impairment provisioning process, to confirm the operating effectiveness of the key controls in place which identify the impaired financing receivables and the required provisions against them.

In addition to testing the key controls, we selected samples of financing receivables outstanding as at the reporting date and assessed the criteria for determining whether an impairment event had occurred and therefore, whether there was a requirement to calculate an impairment provision. For the samples selected, we also verified whether impairment events identified by us had also been identified by management. Our selected samples also included impaired financing receivables, where we assessed management's forecast of cash flows, valuation of collaterals, estimates of recovery on default and other sources of repayment. For the unimpaired financing receivables, we assessed whether any indicators existed of default risk.

Other information included in the Group's 2017 Annual Report

Management is responsible for the other information. Other information consists of the information included in Group's 2017 Annual Report, other than the consolidated financial statements and our auditors' report thereon. We obtained the report of the Bank's Board of Directors, prior to the date of our Auditors' report, and we expect to obtain the remaining sections of the Group's 2017 Annual Report after the date of our Auditors' report.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this Auditors' report, we conclude that there is a material misstatement of this other information; we are required to report that fact. We have nothing to report in this regard.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF WARBA BANK K.S.C.P. (continued)

Report on the Audit of Consolidated Financial Statements (continued)

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs as adopted for use by the State of Kuwait, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an Auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF
WARBA BANK K.S.C.P. (continued)**

Report on the Audit of Consolidated Financial Statements (continued)

**Auditors' Responsibilities for the Audit of the Consolidated Financial Statements
(continued)**

- Conclude on the appropriateness of management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our Auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our Auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our Auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF
WARBA BANK K.S.C.P. (continued)**

Report on Other Legal and Regulatory Requirements

Furthermore, in our opinion proper books of account have been kept by the Bank and the consolidated financial statements, together with the contents of the report of the Bank's Board of Directors relating to these consolidated financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the consolidated financial statements incorporate all information that is required by the Capital Adequacy Regulations and Financial Leverage Ratio Regulations issued by the Central Bank of Kuwait ("CBK") as stipulated in CBK Circular Nos. 2/RB, RBA/336/2014 dated 24 June 2014 and 2/I.B.S. 343/2014 dated 21 October 2014 respectively, the Companies Law No 1 of 2016, as amended, and its executive regulations, as amended, and by the Bank's Memorandum of Incorporation and Articles of Association, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of the Capital Adequacy Regulations and Financial Leverage Ratio Regulations issued by the CBK as stipulated in CBK Circular Nos. 2/RB, RBA /336/2014 dated 24 June 2014 and 2/I.B.S. 343/2014 dated 21 October 2014 respectively, the Companies Law No 1 of 2016, as amended, and its executive regulations, as amended, or of the Bank's Memorandum of Incorporation and Articles of Association, have occurred during the year ended 31 December 2017 that might have had a material effect on the business of the Bank or on its financial position.

We further report that, during the course of our audit, we have not become aware of any violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the CBK and the organisation of banking business, and its related regulations during the year ended 31 December 2017 that might have had a material effect on the business of the Bank or on its financial position.



WALEED A. AL OSAIMI
LICENCE NO. 68 A
EY
(AL-AIBAN, AL-OSAIMI & PARTNERS)



SAFI A. AL-MUTAWA
LICENSE NO 138 "A"
OF KPMG SAFI AL-MUTAWA & PARTNERS
MEMBER FIRM OF KPMG INTERNATIONAL


14 January 2018
Kuwait


Warba Bank K.S.C.P.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2017

	<i>Notes</i>	<i>2017 KD'000</i>	<i>2016 KD'000</i>
ASSETS			
Cash and balances with banks	3	13,201	5,480
Placements with banks and CBK		246,484	166,940
Financing receivables	4	1,263,322	827,872
Available-for-sale investments	5	165,921	99,825
Investments in joint ventures	6	31,102	-
Investment properties	7	23,666	14,815
Other assets		23,347	6,387
Property and equipment		5,999	5,643
TOTAL ASSETS		1,773,042	1,126,962
LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks and other financial institutions	8	572,864	274,131
Depositors' accounts	9	1,008,853	750,498
Other liabilities		15,869	7,561
TOTAL LIABILITIES		1,597,586	1,032,190
EQUITY			
Share capital	10	100,000	100,000
Accumulated losses		(944)	(4,798)
Fair value reserve		(214)	(430)
Foreign currency translation reserve		251	-
EQUITY ATTRIBUTABLE TO SHAREHOLDERS OF THE BANK		99,093	94,772
Perpetual Tier 1 Sukuk	11	76,363	-
TOTAL EQUITY		175,456	94,772
TOTAL LIABILITIES AND EQUITY		1,773,042	1,126,962


Abdulwahab A. Al Houti
Chairman


Shaheen H. Al Ghanem
Chief Executive Officer

Warba Bank K.S.C.P.

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2017

	<i>Notes</i>	2017 KD'000	2016 KD'000
Placements and financing income		51,704	31,094
Finance costs and distribution to depositors		(23,061)	(14,678)
Net financing income		28,643	16,416
Net investment income	12	6,259	4,439
Net fees and commission income	13	2,178	1,583
Other income		303	234
Foreign exchange gain		601	261
Operating income		37,984	22,933
Staff costs		(11,640)	(9,304)
General and administrative expenses		(5,092)	(4,067)
Depreciation		(1,270)	(1,631)
Operating expenses		(18,002)	(15,002)
Operating profit before provision for impairment		19,982	7,931
Provision for impairment	14	(12,876)	(5,212)
Profit before deductions		7,106	2,719
National Labor Support Tax (NLST)		(184)	(64)
Zakat		(74)	(20)
Directors' remuneration		(80)	(60)
Net profit for the year		6,768	2,575
Basic and diluted earnings per share	15	4.32 fils	2.58 fils

The accompanying notes 1 to 21 form an integral part of these consolidated financial statements.

Warba Bank K.S.C.P.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2017

	Note	2017 KD'000	2016 KD'000
Net profit for the year		6,768	2,575
Other comprehensive income (loss) :			
<i>Items that are or may be reclassified subsequently to consolidated statement of income:</i>			
Change in fair value of available-for-sale investments		563	(39)
Gain on sale of available-for-sale investments realized during the year, transferred to consolidated statement of income	12	(347)	(44)
Foreign currency translation adjustment		251	-
Other comprehensive income (loss) for the year		467	(83)
Total comprehensive income for the year		7,235	2,492

The accompanying notes 1 to 21 form an integral part of these consolidated financial statements.

Warba Bank K.S.C.P.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017

	Share capital KD'000	Accumulated losses KD'000	Fair value reserve KD'000	Foreign currency translation reserve KD'000	Equity attributable to shareholders of the Bank KD'000	Perpetual Tier 1 Sukuk KD'000	Total equity KD'000
Balance at 1 January 2017	100,000	(4,798)	(430)	-	94,772	-	94,772
Net profit for the year	-	6,768	-	-	6,768	-	6,768
Other comprehensive income for the year	-	-	216	251	467	-	467
Total comprehensive income for the year	-	6,768	216	251	7,235	-	7,235
Issue of Perpetual Tier 1 Sukuk (Note 11)	-	-	-	-	-	76,363	76,363
Transaction costs on issue of Perpetual Tier 1 Sukuk (Note 11)	-	(463)	-	-	(463)	-	(463)
Profit paid on Perpetual Tier 1 Sukuk (Note 11)	-	(2,451)	-	-	(2,451)	-	(2,451)
Balance at 31 December 2017	100,000	(944)	(214)	251	99,093	76,363	175,456
Balance at 1 January 2016	100,000	(7,373)	(347)	-	92,280	-	92,280
Net profit for the year	-	2,575	-	-	2,575	-	2,575
Other comprehensive loss for the year	-	-	(83)	-	(83)	-	(83)
Total comprehensive income for the year	-	2,575	(83)	-	2,492	-	2,492
Balance at 31 December 2016	100,000	(4,798)	(430)	-	94,772	-	94,772

The accompanying notes 1 to 21 form an integral part of these consolidated financial statements.

Warba Bank K.S.C.P.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2017

	Notes	2017 KD'000	2016 KD'000
OPERATING ACTIVITIES			
Net profit for the year		6,768	2,575
Adjustments for:			
Realised gain on sale of available-for-sale investments	12	(347)	(44)
Dividend income	12	(1,535)	(1,759)
Sukuk income	12	(3,500)	(1,873)
Share of results from investments in joint ventures	12	67	-
Net rental income from investment properties	12	(796)	(659)
Other investment income	12	(148)	(104)
Provision for end of service benefits		888	368
Depreciation		1,270	1,631
Provision for impairment	14	12,876	5,212
		<u>15,543</u>	<u>5,347</u>
<i>Changes in operating assets and liabilities:</i>			
Placements with banks		(22,684)	(46,351)
Financing receivables		(447,224)	(289,064)
Other assets		(16,903)	(1,489)
Due to banks and other financial institutions		298,342	29,798
Depositors' accounts		258,355	317,033
Other liabilities		8,485	426
		<u>93,914</u>	<u>15,700</u>
INVESTING ACTIVITIES			
Purchase of available-for-sale investments		(149,646)	(45,673)
Proceed from sale and redemption of available-for-sale investments		82,318	14,919
Purchase of investment in joint ventures		(31,686)	-
Dividend received from joint ventures	6	392	-
Purchase of investment property	7	(8,891)	-
Purchase of property and equipment		(1,651)	(898)
Dividend income received		1,535	1,759
Sukuk income received		3,709	2,099
Rental income received		1,138	963
		<u>(102,782)</u>	<u>(26,831)</u>
FINANCING ACTIVITIES			
Perpetual Tier 1 Sukuk issuing costs	11	(463)	-
Proceeds from issue of Perpetual Tier 1 Sukuk	11	76,363	-
Profit paid on perpetual Tier 1 Sukuk	11	(2,451)	-
		<u>73,449</u>	<u>-</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS			
Cash and cash equivalents at 1 January		116,505	127,636
		<u>64,581</u>	<u>(11,131)</u>
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	3	<u>181,086</u>	<u>116,505</u>

The accompanying notes 1 to 21 form an integral part of these consolidated financial statements.

1. CORPORATE INFORMATION

Warba Bank K.S.C.P. (the “Bank”) is a Kuwaiti shareholding company public incorporated on 17 February 2010 in the State of Kuwait by Amiri Decree No. 289/2009 and is registered as an Islamic banking institution in accordance with the rules and regulations of the Central Bank of Kuwait (the “CBK”) on 7 April 2010. The Bank’s registered office is at Sanabil Tower, 26th – 28th floor, Abdullah Al Ahmed Street, P.O. Box 1220, Safat 13013, State of Kuwait.

The Bank’s shares were listed on the Kuwait Stock Exchange on 3 September 2013.

The Bank is primarily involved in investment, corporate and retail banking activities in accordance with the principles of Sharia’h, as approved by the Bank’s Sharia’h Supervisory Board.

The consolidated financial statements of the Bank and its wholly owned special purpose vehicles (collectively the “Group”) for the year ended 31 December 2017 were authorized for issue in accordance with a resolution of the Board of Directors on 14 January 2018. The Annual General Assembly of the shareholders has the power to amend these consolidated financial statements after issuance.

2.1 BASIS OF PREPARATION

Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board, as adopted for use by the State of Kuwait for financial services institutions regulated by the CBK. These regulations require adoption of all IFRS except for the International Accounting Standard (“IAS”) 39 requirement for collective provision, which has been replaced by the CBK’s requirement for a minimum general provision as described under the accounting policy for impairment of financial assets.

Basis of preparation

The consolidated financial statements are prepared under the historical cost convention modified to include the measurement at fair value of available-for-sale investments.

The consolidated financial statements have been presented in Kuwaiti Dinars (“KD”) which is the Bank’s functional currency, rounded to the nearest thousand except when otherwise stated.

2.2 CHANGES IN ACCOUNTING POLICIES

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in the previous financial year, except for the adoption of the amendments to the existing standards relevant to the Group, effective as of 1 January 2017. The nature and the impact of each amendment is described below:

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosure of changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses).

2.3 STANDARDS ISSUED BUT NOT YET EFFECTIVE

Standards and amendments to standards issued but not yet effective up to the date of issuance of the Group's consolidated financial statements which are relevant to the Group are listed below. The Group intends to adopt those standards when they become effective.

IFRS 9: Financial Instruments

The IASB issued the final version of IFRS 9 Financial Instruments in July 2014, that replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

The Group will avail of the exemption allowing it not to restate comparative information for prior periods. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 will be recognised in opening retained earnings and reserves as at 1 January 2018.

During the year 2017, the Group has performed a detailed impact assessment of IFRS 9. This assessment is based on currently available information and may be subject to changes arising from further reasonable and supportable information being made available to the Group, until the Group presents its first consolidated financial statements that include the date of initial application.

(a) Classification and measurement

IFRS 9 contains a new classification and measurement approach for financial assets that reflect the business model in which assets are managed and their cash flow characteristics. IFRS 9 contains three classification categories for financial assets: measured at Amortised Cost, Fair Value through Other Comprehensive Income ("FVOCI") (with and without recycling of gains or losses to profit or loss on derecognition of debt and equity instruments, respectively) and Fair Value Through Profit or Loss ("FVTPL"). The standard eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available for sale.

The Group has evaluated the classification and measurement criteria to be adopted for various financial assets considering the IFRS 9 requirements with respect to the business model and contractual cash flow characteristics ("CCC") / Solely payment of principal and interest ("SPPI"). The impact from the adoption of classification and measurement approach of IFRS 9 is as follows:

- The Group does not expect a significant impact on its consolidated statement of financial position from applying the classification and measurement requirements of IFRS 9 except for certain financial assets held as available-for-sale mainly representing Bank's investment in open-ended funds and certain equity investments will, instead, be measured at FVTPL.
- At 31 December 2017, the Group has equity securities classified as available-for-sale held for long term strategic purposes. Under IFRS 9, the Group has designated these investments as measured at FVOCI. Consequently, all fair value gains and losses will be reported in other comprehensive income, no impairment losses will be recognised in consolidated income statement and no gains or losses will be classified to consolidated income statement on disposal.
- Debt securities (sukuk), currently classified as "available-for-sale", are expected to be measured at FVOCI under IFRS 9 as the Group expects to hold these assets under the business model to collect contractual cash flows or to sell a significant amount on a relatively frequent basis.
- Financing receivables will continue to be held under the business model to collect contractual cash flows and are expected to give rise to cash flows representing solely payments of principal and interest, except for Qard Hassan which will be reclassified to FVTPL. The Group analysed the contractual cash flow characteristics of those instruments and concluded that they meet the criteria for amortised cost measurement under IFRS 9. Therefore, reclassification for these instruments is not required.

2.3 STANDARDS ISSUED BUT NOT YET EFFECTIVE (continued)

IFRS 9: Financial Instruments (continued)

(a) Classification and measurement (continued)

- There will be no impact on the Group's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit or loss and the Group does not have any such liabilities. The derecognition rules have been transferred from IAS 39 Financial Instruments: Recognition and Measurement and have not been changed.
- Upon adoption of the new classification and measurement principles under IFRS 9 as noted above, the fair value reserve will increase approximately by KD 670 thousand and decrease in the Accumulated losses by KD 2,443 thousand as at 1 January 2018.

(b) Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' ("ECL") model. This will require considerable judgement about how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis.

Under IFRS 9, the impairment requirements apply to financial assets measured at amortised cost, debt instruments classified as fair value through other comprehensive income and certain financing facilities and financial guarantee contracts. At initial recognition, allowance is required for expected credit losses ('ECL') resulting from default events that are possible within the next 12 months ('12-month ECL'). In the event of a significant increase in credit risk, allowance is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL').

The Bank will determine the potential impact of the expected provision for credit losses in accordance with IFRS 9 during the period ended 31 March 2018. The Bank will also comply with instructions of Central Bank of Kuwait in this regard.

(c) Hedge accounting

As at 31 December 2017, the Group does not have any hedge relationships. Hence, the hedging requirements of IFRS 9 will not have a significant impact on Group's consolidated financial statements.

(d) Disclosure

The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Group's disclosures about its financial instruments particularly in the year of the adoption of the new standard. The Group's assessment included an analysis to identify data gaps against current process and the Group is in process of implementing the system and controls changes that it believes will be necessary to capture the required data.

IFRS 15 – Revenue from Contracts with customers

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers, effective for periods beginning on 1 January 2018 with early adoption permitted. IFRS 15 defines principles for recognising revenue and will be applicable to all contracts with customers. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (e.g., IFRS 9, and IFRS 16 Leases). Revenue under IFRS 15 will need to be recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard will also specify a comprehensive set of disclosure requirements regarding the nature, extent and timing as well as any uncertainty of revenue and corresponding cash flows with customers. The Group is in the process of evaluating the effect of IFRS 15 on the amounts reported and disclosed in the Group's consolidated financial statements.

2.3 STANDARDS ISSUED BUT NOT YET EFFECTIVE (continued)

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17. IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs.

In 2018, the Group will continue to assess the potential effect of IFRS 16 on its consolidated financial statements.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The consolidated financial statements comprise the financial information of the Bank and its wholly owned special purpose vehicles (investees which are controlled by the Bank). Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee)
- Exposure, or rights, to variable returns from its involvement with the investee, and
- The ability to use its power over the investee to affect its returns

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement with the other vote holders of the investee
- Rights arising from other contractual arrangements
- The Group's voting rights and potential voting rights

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a wholly owned special purpose vehicle begins when the Group obtains control over the wholly owned special purpose vehicle and ceases when the Group loses control of the wholly owned special purpose vehicle. Assets, liabilities, income and expenses of a wholly owned special purpose vehicle acquired or disposed off during the year are included in the Group's consolidated financial statements from the date the Group gains control until the date the Group ceases to control the wholly owned special purpose vehicle.

When necessary, adjustments are made to the financial information of wholly owned special purpose vehicles to bring their accounting policies into line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

A change in the ownership interest of a wholly owned special purpose vehicle, without a loss of control, is accounted for as an equity transaction.

If the Group loses control over a wholly owned special purpose vehicle, it derecognises the related assets, liabilities, non-controlling interest and other components of equity while any resultant gain or loss is recognised in profit or loss. Any investment retained is recognised at fair value at the date of loss of control.

The principal operating wholly owned special purpose vehicles of the Group are as follows:

<i>Name of company</i>	<i>Principal activities</i>	<i>Country of incorporation</i>	<i>Effective interest as at 31 December 2017</i>	<i>Effective interest as at 31 December 2016</i>
Abyat Real Estate Company L.L.C.	Real Estate	Oman	100%	100%
Thamer Al Omania Company L.L.C.	Real Estate	Oman	100%	100%
Al Kout Holdings Limited	Real Estate	Jersey	100%	-
Warba Tier 1 Sukuk Limited	Financial Securities	Cayman Islands	100%	-

Financial instruments

Classification of financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. The Group classifies financial instruments as “placement with banks and CBK”, “finance receivables”, “investment securities”, and “financial liabilities other than at fair value through profit or loss”. Investment securities comprise of “available-for-sale investments”. Management determines the appropriate classification of each instrument at the time of acquisition.

Recognition

A financial asset or a financial liability is recognised when the Group becomes a party to the contractual provisions of the instrument. All regular way purchase and sale of financial assets are recognised using settlement date accounting. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulations or conventions in the market place.

De-recognition

A financial asset (in whole or in part) is derecognised either when:

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

Where the Group has transferred its right to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group would be required to pay.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired. Where an existing financial liability is replaced by another from the same financier on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability and the difference in the respective carrying amounts is recognised in the consolidated statement of income.

Measurement

All financial assets or financial liabilities are initially measured at fair value. Transaction costs are added to the cost of all financial instruments except for financial assets classified as investments at fair value through profit or loss. Transaction costs on financial assets classified as investments at fair value through profit or loss are recognised in the consolidated statement of income.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Category of financial instruments

Placement with banks and financing receivables

These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group offers Sharia'h compliant products and services only, such as Wakala, Murabaha and Ijara. Placement with banks and financing receivables are stated in the consolidated statement of financial position at amortised cost using effective profit method, less impairment. The amount due is settled either by installments or on a deferred payment basis.

Wakala is an agreement whereby the Group provides a sum of money to a customer under an agency agreement, who invests it according to specific conditions in return for a fee. The customer is obliged to return the amount in case of default, negligence or violation of any terms and conditions of the Wakala.

Murabaha is a sale agreement for commodities and real estate to "a promise to buy" customer, at a price comprising of cost plus agreed profit, after the Group has acquired the asset.

Ijara is an agreement whereby the Group (lessor) purchases or constructs an asset for lease according to the customer's request (lessee), based on a promise to lease the asset for a specific period and against certain rent installments. Ijara could end by transferring the ownership of the asset to the lessee.

Available-for-sale investments

Available-for-sale investments include equity investments and debt securities (i.e. sukuk). Equity investments classified as available-for-sale are those, which are neither classified as held for trading nor designated at fair value through profit or loss. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions.

After initial measurement, available-for-sale investments are subsequently measured at fair value with unrealized gains or losses recognised in other comprehensive income and included in the fair value reserve until the investment is derecognised, at which time the cumulative gain or loss is recognised in the consolidated statement of income, or the investment is determined to be impaired, when the cumulative loss is reclassified from the fair value reserve to the consolidated statement of income. Profit earned, whilst holding the available-for-sale investments, is reported as investment income using the effective profit rate method.

The Group evaluates whether the ability and intention to sell its available-for-sale financial assets in the near term is still appropriate. When, in rare circumstances, the Group is unable to trade these financial assets due to inactive markets, the Group may elect to reclassify these financial assets if the management has the ability and intention to hold the assets for foreseeable future or until maturity.

Financial liabilities other than at fair value through profit or loss

These financial liabilities are subsequently measured at amortised cost using the effective profit method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective profit rate.

Due to banks and other financial institutions, depositors' accounts and other liabilities are classified as "financial liabilities other than at fair value through profit or loss".

Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the consolidated financial statements at fair value, being the premium received, in other liabilities. The premium received is recognised in the consolidated statement of income in 'net fees and commission income' on a straight-line basis over the life of the guarantee. The guarantee liability is subsequently measured as the higher of the amount initially recognised less amortisation or the best estimate of the expenditure required to settle the present obligation at the reporting date.

Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognised amounts and the Group intends to settle on a net basis.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset or liability; or
- in the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible by the Group.

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

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — Quoted (unadjusted) prices in active markets for identical assets or liabilities
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For financial instruments quoted in an active market, fair value is determined by reference to quoted market prices. Mid prices are used for assets.

For financial instruments carried at amortised cost, the fair value is estimated by discounting future cash flows at the current market rate of return for similar financial instruments.

For investments in instruments, where a reasonable estimate of fair value cannot be determined, the investment is carried at cost less impairment.

For assets and liabilities that are recognised in the consolidated financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

For the purpose of fair value disclosures, the Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

Impairment of financial assets

The Group assesses at each reporting date whether there is any objective evidence that an individually significant financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets are impaired if and only if, there is objective evidence of impairment as a result of one or more loss events that has occurred after the initial recognition of the financial asset and that the loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets. For the purpose of assessing impairment, the financial assets are grouped at the lowest levels for which there are separately identifiable cash flows.

For financing receivables, the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of financial assets (continued)

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial asset's original effective profit rate.

The carrying amount of the asset is reduced by the amount of impairment and the amount of impairment loss is recognised in the consolidated statement of income.

Financial guarantees and letter of credit are assessed and provisions are made in a similar manner as for financing receivables.

In addition, in accordance with CBK instructions, a minimum general provision on all financing facilities net of certain categories of collateral, to which CBK instructions are applicable and not subject to specific provision, is made.

For available-for-sale equity investments, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired. Objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. 'Significant' is to be evaluated against the original cost of the investment and 'prolonged' against the period in which the fair value has been below its original cost. Where there is evidence of impairment, the impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated statement of income is removed from fair value reserve and recognised in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income; increases in their fair value after impairment are recognised directly in other comprehensive income.

Other assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less cost of sale and value in use.

Cash and cash equivalents

For purposes of the consolidated statement of cash flows, cash and cash equivalents comprise "Cash and balances with commercial banks and the CBK" and Placements with banks and the CBK maturing within 3 months of contract date.

Investments in joint venture

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The Group's investments in its joint venture are accounted for using the equity method.

Under the equity method, the investment in joint venture is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the joint venture since the acquisition date. Goodwill relating to the joint venture is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The consolidated statement of income reflects the Group's share of the results of operations of the joint venture. Any change in other comprehensive income of those investees is presented as part of the Group's other comprehensive income. In addition, when there has been a change recognised directly in the equity of the investee, the Group recognises its share of any changes, when applicable, in the consolidated statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the joint venture are eliminated to the extent of the interest in the joint venture.

The aggregate of the Group's share of profit or loss of joint venture is recognized in the consolidated statement of income.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments in joint venture (continued)

After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investment joint venture. At each reporting date, the Group determines whether there is objective evidence that the investment in joint venture is impaired.

If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the joint venture and its carrying value, then recognises the loss as 'Impairment loss on joint venture' in the consolidated statement of income.

Upon loss of significant influence over the joint control over the joint venture, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the joint venture upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in consolidated statement of income.

Investment properties

Investment properties are measured initially at cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met and excludes the costs of day to day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at depreciated cost less impairment. Investment properties are derecognised when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. The difference between the net disposal proceeds and the carrying amount of the asset is recognised in the consolidated statement of income in the year of derecognition.

Depreciation is provided on a straight-line basis over the estimated useful lives of properties other than freehold land which is deemed to have an indefinite life.

Depreciation on the building is calculated using the straight-line method to allocate their cost, net of their residual values, over their estimated useful lives that range from 20 to 40 years.

Property and equipment

Property and equipment is stated at historical cost less accumulated depreciation and any impairment in value. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the consolidated statement of income during the financial year in which they are incurred.

Land is not depreciated. Depreciation of other property and equipment items is calculated using the straight-line method to allocate their cost, net of their residual values, over their estimated useful lives, as follows:

- Buildings 20-40 years
- Furniture, fixtures and equipment 3-5 years

Depreciation methods, useful lives and residual values are reassessed at each reporting date.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of non-financial assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets and then its recoverable amount is assessed as part of the cash-generating unit to which it belongs. Where the carrying amount of an asset (or cash-generating unit) exceeds its recoverable amount, the asset (or cash-generating unit) is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset (or cash-generating unit). In determining fair value less costs to sell an appropriate valuation model is used. These calculations are corroborated by available fair value indicators.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. The increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the consolidated statement of income. After such a reversal, the depreciation charge is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

End of service indemnity

The Group provides end to service benefits to its employees. The entitlement to the benefits is based upon the employee's final salary and length of service. The expected costs of these benefits are accrued over the period of employment.

With respect to its national employees, the Group makes contribution to Public Institution for Social Security as a percentage of the employees' salaries.

The Group's obligation is limited to these contribution, which are expensed as accrued.

Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:

- (i) Placement and financing income is income from Wakala, Murabaha and Ijara investments and is determined by using the effective profit method. The effective profit method is a method of calculating the amortised cost of a financial asset and of allocating the financing income over the relevant period.
- (ii) Rental income from investment properties is recognized on an accrual basis.
- (iii) Dividend income is recognized when the right to receive payment is established.
- (iv) Fee and commission income is recognized at the time the related services are provided.

Foreign currency

Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

Transactions in foreign currencies are initially recorded at the spot rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the spot rate of exchange ruling at the reporting date. Any resultant gains or losses are recognised in the consolidated statement of income.

Non-monetary assets and liabilities in foreign currencies that are stated at fair value are translated to respective entity's functional currency at the foreign exchange rates ruling on the dates that the values were determined. In case of non-monetary assets whose change in fair values are recognised directly in other comprehensive income, foreign exchange differences are recognised directly in other comprehensive income and for non-monetary assets whose change in fair value are recognised directly in the consolidated statement of income, foreign exchange differences are recognised in the consolidated statement of income.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign currency (continued)

As at the reporting date, the assets and liabilities of wholly owned special purpose vehicles are translated into the Bank's presentation currency (KD) at the rate of exchange ruling on the reporting date, and their statement of incomes are translated at the average exchange rates for the year. Exchange differences arising on translation are taken directly to other comprehensive income. On disposal of a foreign wholly owned special purpose vehicle, the deferred cumulative amount recognised in other comprehensive income relating to that particular wholly owned special purpose vehicle is recognised in the consolidated statement of income.

Any goodwill or fair value adjustments to the carrying amounts of assets and liabilities arising on acquisition are treated as assets and liabilities of the respective wholly owned special purpose vehicles and translated at the rate of exchange ruling on the reporting date.

Taxation

National Labour Support Tax (NLST)

The Group calculates the NLST in accordance with Law No. 19/2000 and the Ministry of Finance resolution No. 24/2006 at 2.5% of taxable profit for the year. As per the law, cash dividends from listed companies which are subjected to NLST has to be deducted from the profit for the year.

Kuwait Foundation for the Advancement of Sciences (KFAS)

The Group calculates the contribution to KFAS at 1% of profit for the year in accordance with the modified calculation based on the Foundation's Board of Directors resolution, which states that the transfer to statutory reserve should be excluded from profit for the year when determining the contribution.

Zakat

Contribution to Zakat is calculated at 1% of the Group of the Group in accordance with the Ministry of Finance resolution No. 58/2007 effective from 10 December 2007.

Segment information

A segment is a distinguishable component of the Group that engages in business activities from which it earns revenue and incurs costs. The operating segments are used by the management of the Group to allocate resources and assess performance. Operating segments exhibiting similar economic characteristics, products and services, classes of customers where appropriate are aggregated and reported as reportable segments.

Provisions

Provisions are recognised when, as a result of past events, it is probable that an outflow of economic resources will be required to settle a present, legal or constructive obligation and the amount can be reliably estimated.

Contingencies

Contingent assets are not recognised in the consolidated financial statements, but are disclosed when an inflow of economic benefit is probable.

Contingent liabilities are not recognised in the consolidated financial statements, but are disclosed unless the possibility of an outflow of resources embodying economic benefit is remote.

Use of estimates

In accordance with the accounting principles contained in IFRS, management is required to make estimates and assumptions that may affect the carrying values of financing receivables.

The basis used by management in determining the carrying values of financing receivables and the underlying risks therein are discussed below:

Impairment losses on financing receivables

The Group reviews its financing receivables on a regular basis to assess whether an impairment loss should be recorded in the consolidated statement of income. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required.

Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Judgments

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which have the most significant effect on the amounts recognised in the consolidated financial statements.

Fair value measurement

When the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be measured based on quoted prices in active markets, their fair value is measured using valuation techniques including the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgement is required in establishing fair values. Judgements include considerations of inputs such as liquidity risk, credit risk and volatility. Any changes in these estimates as well as the use of different, but equally reasonable estimates may have an impact on their carrying amounts.

Considerable judgement by management is required in the estimation of the fair value of the assets acquired and liabilities assumed as a result of business combination including intangibles and contingent liabilities.

Impairment of available-for-sale equity investments

The Group treats investments available-for-sale as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgment and involves evaluating factors including industry and market conditions, future cash flows and discount factors.

Classification of property

Management decides on acquisition of a real estate property whether it should be classified as investment property or property and equipment. The Group classifies property as "investment property" if it is acquired to generate rental income or for capital appreciation or for an undetermined future use.

3. CASH AND CASH EQUIVALENTS

	<i>2017</i> <i>KD'000</i>	<i>2016</i> <i>KD'000</i>
Cash	1,700	1,616
Current account with the CBK	6,206	352
Current accounts with commercial banks	5,295	3,512
	<hr/>	<hr/>
Cash and balances with banks	13,201	5,480
Placements with the CBK whose original maturity is within 3 months	17,053	44,054
Placements with banks whose original maturity is within 3 months	150,832	66,971
	<hr/>	<hr/>
Cash and cash equivalents	181,086	116,505
	<hr/> <hr/>	<hr/> <hr/>

Placements with banks represent placements placed with highly reputed and good credit rating banks in accordance with Wakala and Murabaha agreements.

4. FINANCING RECEIVABLES

Financing receivables mainly comprise of facilities extended to the customers of the Group in the form of Murabaha and Ijara contracts. Wherever necessary, financing receivables are secured by acceptable forms of collateral to mitigate the related credit risk.

Warba Bank K.S.C.P.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

4. FINANCING RECEIVABLES (continued)

	2017 KD'000	2016 KD'000
Murabaha receivables	1,181,210	747,578
Ijara receivables	165,243	143,198
Others	8,007	1,585
Less: deferred profit	(70,762)	(51,795)
Financing receivables before provision for impairment	1,283,698	840,566
Less: provision for impairment	(20,376)	(12,694)
	<u>1,263,322</u>	<u>827,872</u>

Further analysis of financing receivables, net of deferred profit, based on customer type is given below:

	2017 KD'000	2016 KD'000
Corporate	809,004	479,597
Individuals	474,694	360,969
Financing receivables before provision for impairment	1,283,698	840,566
Less: provision for impairment	(20,376)	(12,694)
	<u>1,263,322</u>	<u>827,872</u>

Movement in provision for impairment:

	2017			2016		
	Specific provision KD'000	General provision KD'000	Total KD'000	Specific provision KD'000	General provision KD'000	Total KD'000
<i>Cash facilities</i>						
Balance at 1 January	2,696	9,998	12,694	1,808	6,639	8,447
Provision charged during the year (Note 14)	6,853	4,962	11,815	1,631	3,355	4,986
Written off balances during the year	(4,078)	-	(4,078)	(750)	-	(750)
Foreign currency movement	(18)	(37)	(55)	7	4	11
Balance at 31 December	<u>5,453</u>	<u>14,923</u>	<u>20,376</u>	<u>2,696</u>	<u>9,998</u>	<u>12,694</u>
<i>Non-cash facilities</i>						
Balance at 1 January	-	251	251	-	174	174
Provision charged during the year (Note 14)	-	263	263	-	77	77
Balance at 31 December	<u>-</u>	<u>514</u>	<u>514</u>	<u>-</u>	<u>251</u>	<u>251</u>
<i>Total facilities</i>						
Balance at 1 January	2,696	10,249	12,945	1,808	6,813	8,621
Provision charged during the year	6,853	5,225	12,078	1,631	3,432	5,063
Written off balances during the year	(4,078)	-	(4,078)	(750)	-	(750)
Foreign currency movement	(18)	(37)	(55)	7	4	11
Balance at 31 December	<u>5,453</u>	<u>15,437</u>	<u>20,890</u>	<u>2,696</u>	<u>10,249</u>	<u>12,945</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

4. FINANCING RECEIVABLES (continued)

The policy of the Group for calculation of the impairment provision for financing receivables complies in all material respects with the provision requirements of the CBK. According to the CBK instructions, a minimum general provision of 1% for cash facilities and 0.5% for non-cash facilities has been made on all applicable facilities (net of certain categories of collateral), that are not provided for specifically.

5. AVAILABLE FOR SALE INVESTMENTS

	<i>2017</i> <i>KD'000</i>	<i>2016</i> <i>KD'000</i>
Quoted sukuk	138,140	71,820
Quoted equity security	756	837
Unquoted sukuk	2,000	2,000
Unquoted equity security	4,098	4,098
Unquoted funds and portfolio	20,927	21,070
	<u>165,921</u>	<u>99,825</u>

All available for sale investments are recorded at fair value except for unquoted investments with a carrying value of KD 25,025 thousand (2016: KD 25,168 thousand), which are recorded at cost less impairment (if any).

Management has performed a review of the financial assets to assess whether impairment has occurred in the value of these financial assets. Based on the assessment, management has recorded an impairment loss of KD 215 thousand (2016: KD nil) in the consolidated statement of income for the year in respect of available for sale investments.

The hierarchy for determining and disclosing the fair values of financial instruments by valuation techniques are presented in note 21.

6. INVESTMENTS IN JOINT VENTURES

The Group has the following investments in joint ventures:

<i>Name of joint ventures</i>	<i>Country of incorporation</i>	<i>* Legal ownership</i>
		<i>2017</i>
MP Property Corporation (Delaware Corp)	USA	99%
Banyan Grove Om LLC (Delaware LLC)	USA	99%
Brazos TX Investors LLC (Delaware Corp)	USA	98%
DCS Parent Corporation (Delaware Corp)	USA	99%

The movement in the carrying value of joint ventures is as follows:

	<i>2017</i> <i>KD'000</i>
As at 1 January	-
Additions	31,686
Share of results	(67)
Dividends received	(392)
Foreign currency translation adjustment	(125)
As at 31 December	<u>31,102</u>

*The Group exercises "joint control" over the above investees, whereby all decisions relating to these joint ventures' activities require "unanimous consent" from all parties of the joint ventures.

Warba Bank K.S.C.P.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

6. INVESTMENTS IN JOINT VENTURES (continued)

The joint ventures have no contingent liabilities or capital commitments as at 31 December 2017 (2016: KD nil).

The following table illustrates summarised financial information of the Group's investment in the joint ventures:

	<i>2017</i> <i>KD'000</i>
<i>Joint ventures' statement of financial position:</i>	
Current assets	1,656
Non-current assets	80,839
Current liabilities	(918)
Non-current liabilities	(49,568)
Net assets	<u>32,009</u>
Loss for the year	<u>(69)</u>
Other comprehensive income	<u>-</u>
Revenue	<u>2,279</u>

7. INVESTMENT PROPERTIES

	<i>2017</i> <i>KD'000</i>	<i>2016</i> <i>KD'000</i>
Balance at 1 January	14,815	15,127
Additions	8,891	-
Depreciation charged for the year	(238)	(212)
Impairment charged for the year (Note 14)	(558)	(100)
Foreign currency translation adjustment	756	-
Balance at 31 December	<u>23,666</u>	<u>14,815</u>

The fair value of the investment properties at the reporting date is KD 24,656 thousand (2016: KD 15,632 thousand). The fair values of the properties are based on valuations performed by accredited independent valuers, who are specialists in valuing these types of investment properties.

	<i>2017</i> <i>KD'000</i>	<i>2016</i> <i>KD'000</i>
Rental income from investment properties	1,234	983
Direct operating expenses and depreciation	(438)	(324)
Net rental income from investment properties (Note 12)	<u>796</u>	<u>659</u>

The Group has no restrictions on the realisability of its investment properties and no contractual obligations to either purchase, construct or develop investment properties or for repairs, maintenance and enhancements.

For the purpose of measuring fair value, the income approach is used where the present value technique is employed to reflect the current market expectations about the future estimated rental value, based on per square meter per month rental rate and annual growth rate in the country in which the investment properties are located.

Fair value hierarchy disclosures for investment properties have been provided in note 21.

8. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

Due to banks and other financial institutions represents deposits received from banks and other financial institutions under Wakala and Murabaha contracts.

9. DEPOSITORS' ACCOUNTS

Depositors' accounts of the Bank comprise of the following:

- a) *Non-investment deposits in the form of current accounts*
These deposits are not entitled to any profits nor do they bear any risk of loss as the Bank guarantees to pay the related balances on demand. Accordingly, these deposits are considered Qard Hasan from depositors to the Bank.
- b) *Investment deposits*
These include Mudaraba, Murabaha and Wakala deposits, which have fixed maturity as specified in the term of the contract except for investment saving accounts which are valid for an unlimited period.

10. EQUITY

Share capital

The authorised, issued and paid up capital of the Bank comprises 1,000 million ordinary shares of 100 fils each (2016: 1,000 million shares of 100 fils each). The share capital has been contributed in cash.

Statutory reserve

In accordance with the Companies Law and the Bank's Articles of Association, 10% of the profit for the year before contribution to KFAS, NLST, Zakat and Directors' remunerations is required to be transferred to a statutory reserve. The Bank may resolve to discontinue such annual transfers when the statutory reserve equals 50% of the paid up share capital. Distribution from this reserve is limited to enable payment of a dividend of 5% of paid up share capital in years when retained earnings are not sufficient for payment of dividends.

No transfer has been made to the statutory reserve in the current year and prior year due to accumulated losses.

Voluntary reserve

In accordance with the Bank's Articles of Association, a percentage of the profit for the year before contribution to KFAS, NLST, Zakat and Directors' remuneration, is required to be transferred to the voluntary reserve. Such annual transfer can be discontinued by a resolution of shareholders in the annual general assembly meeting upon recommendation by the Board of Directors. There are no restrictions on the distribution of this reserve.

No transfer has been made to the voluntary reserve in the current year and prior year due to accumulated losses.

11. PERPETUAL TIER 1 SUKUK

On 14 March 2017, the Bank, through a Sharia's compliant Sukuk arrangement, issued Tier 1 Sukuk amounting to USD 250 million. Tier 1 Sukuk is a perpetual security in respect of which there is no fixed redemption date and constitutes direct, unsecured, subordinated obligations (senior only to share capital) of the Bank subject to the terms and conditions of the Mudaraba Agreement. The Tier 1 Sukuk is listed on the Irish Stock Exchange and NASDAQ Dubai and callable by the Bank after five-year period ending 14 March 2022 (the "First Call Date") or any profit payment date thereafter subject to certain redemption conditions.

The net proceeds of Tier 1 Sukuk are invested by way of Mudaraba with the Bank (as Mudareb), on an unrestricted co-mingling basis, by the Bank in its general business activities carried out through the general Mudaraba pool. Tier 1 Sukuk bears a profit rate of 6.5% per annum to be paid semi-annually in arrears until the First Call Date. After that, the expected profit rate will be reset based on then prevailing 5 years U.S Mid Swap Rate plus initial margin of 4.374% per annum.

At the Bank's sole discretion, it may elect not to make any Mudaraba distributions expected and in such event, the Mudaraba profit will not be accumulated and the event is not considered an event of default. The Bank made profit payment during the year on 13 September 2017.

Warba Bank K.S.C.P.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

12. NET INVESTMENT INCOME

	<i>2017</i> <i>KD'000</i>	<i>2016</i> <i>KD'000</i>
Realised gain on sale of available-for-sale investments	347	44
Dividend income	1,535	1,759
Sukuk income	3,500	1,873
Share of results from investments in joint ventures (Note 6)	(67)	-
Net rental income from investment properties (Note 7)	796	659
Other investment income	148	104
	<u>6,259</u>	<u>4,439</u>

13. NET FEES AND COMMISSION INCOME

Net fees and commission income included financing syndication fees earned on the successful completion of syndicated deals by the Group amounting to KD 991 thousand (2016: KD 1,005 thousand).

14. PROVISION FOR IMPAIRMENT

	<i>2017</i> <i>KD'000</i>	<i>2016</i> <i>KD'000</i>
Impairment on financing receivables (Note 4)	11,815	4,986
Recovery of written-off financing receivables	(41)	-
Impairment of available-for-sale investments (Note 5)	215	-
Impairment of investment properties (Note 7)	558	100
Impairment of property and equipment	25	-
Impairment of non-cash facilities (Note 4)	263	77
Impairment of other assets	41	49
	<u>12,876</u>	<u>5,212</u>

15. BASIC AND DILUTED EARNINGS PER SHARE

Basic and diluted earnings per share are calculated by dividing net profit for the year of the Group adjusted for profit paid on Perpetual Tier 1 Sukuk by the weighted average number of shares outstanding during the year as follows:

	<i>2017</i>	<i>2016</i>
Net profit for the year (KD'000)	6,768	2,575
Less: profit payment on Perpetual Tier 1 Sukuk (KD'000)	(2,451)	-
	<u>4,317</u>	<u>2,575</u>
Weighted average number of shares outstanding ('000)	<u>1,000,000</u>	<u>1,000,000</u>
Basic and diluted earnings per share (fils)	<u>4.32</u>	<u>2.58</u>

As there are no dilutive instruments outstanding, basic and diluted earnings per share are identical.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

16. TRANSACTIONS WITH RELATED PARTIES

These are transactions with certain related parties (major shareholders, directors and executive officers of the Bank, close members of their families and companies in which they are principal owners or over which they are able to exercise significant influence) who were customers of the Group in the ordinary course of business. Such transactions were made on substantially the same terms including profit and collateral as those prevailing at the same time for comparable transactions with unrelated parties and did not involve more than a normal amount of risk.

Balances recorded in the consolidated statement of financial position are as follows:

	<i>Major shareholders KD'000</i>	<i>Board members and executive officials KD'000</i>	<i>Other related parties KD'000</i>	<i>Total 31 December 2017 KD'000</i>	<i>Total 31 December 2016 KD'000</i>
Finance facilities	-	1,065	23	1,088	134
Credit cards	-	7	1	8	49
Depositor's accounts	676,205	560	310	677,075	394,011
		<i>No. of major shareholders</i>	<i>No. of Board members and executive officials</i>		<i>No. of other related parties</i>
2017					
Finance facilities	-	-	-	7	2
Credit cards	-	-	-	6	2
Depositor's accounts	-	26	-	16	26
2016					
Finance facilities	-	-	-	5	2
Credit cards	-	-	-	14	3
Depositor's accounts	-	2	-	8	16

Transactions with related parties recorded in the consolidated statement of income are as follows:

	<i>Major shareholders KD'000</i>	<i>Board members and executive officials KD'000</i>	<i>Other related parties KD'000</i>	<i>Total 31 December 2017 KD'000</i>	<i>Total 31 December 2016 KD'000</i>
Placements and financing income	-	94	20	114	3
Finance costs and distributions to depositors	9,819	1	1	9,821	5,094

Compensation to key management personnel and remuneration of board members:

	<i>2017 KD'000</i>	<i>2016 KD'000</i>
Salaries and other short-term benefits	2,048	1,552
Post-employment benefits	146	137
Remuneration of Board members *	166	126
	2,360	1,815

*Remuneration of Board members includes special compensation for additional contributions related to participation in the executive committees in accordance with Board of Directors' decisions.

The remuneration of Board members is subject to the approval of the Annual General Assembly.

17. COMMITMENTS AND CONTINGENT LIABILITIES

	<i>2017</i> <i>KD'000</i>	<i>2016</i> <i>KD'000</i>
Acceptances and letters of credit	39,788	9,140
Letter of guarantees	62,865	41,156
Contingent liabilities	102,653	50,296
Capital commitments	232	238
Operating lease rental commitments – the Group as a lessee		
Future minimum lease payments:		
Within one year	1,485	1,508
Within two to five years	5,992	6,049
	7,477	7,557
Operating lease rental commitments – the Group as a lessor		
Future minimum lease receivable:		
Within one year	1,526	833
Within two to five years	5,976	3,336
	7,502	4,169

18. RISK MANAGEMENT

Risk is inherent in all activities of the Group and is managed through a process of ongoing identification, measurement, mitigation and monitoring, subject to risk appetite limits and other controls. This process of risk management is critical to the Group's financial health and continuing profitability. The Group's business generates exposure mainly to the following broad risk types from its financial transactions, use of financial instruments and its operations:

- Credit risk
- Market risk
- Liquidity risk
- Operational risk

In addition, there are other risk types that need to be monitored and controlled. This note presents information about the Group's exposure to each of the risks, the Group's framework of policies, models and quantification techniques and processes for identifying, measuring, mitigating, monitoring and managing risk, and the management of Group's capital.

a) Risk management structure

Board of Directors

The Board of Directors (the 'Board') has overall responsibility for the establishment and oversight of Risk Management function. The Board has established a Board Risk Committee (the 'BRC') comprising of members from the Board, to set the framework and monitor the Bank's Risks and Control related requirements covering all risk types like credit, market, liquidity risks and operational risk. The Board Risk Committee is assisted in these functions by the Chief Risk Officer.

The Board has also established a Board Audit Committee (the 'BAC'), as required by the Central Bank of Kuwait, which, amongst other functions, is also required to monitor adherence with the Group's Risk Management principles, policies and procedures, and for reviewing the adequacy of the Risk Management framework. The Group's Audit Committee is assisted in these functions by the Chief Internal Auditor.

18. RISK MANAGEMENT (continued)

a) Risk management structure (continued)

Risk Management Group

An independent Risk Management Group headed by the Chief Risk Officer (the 'CRO') reports to the BRC, responsible for Enterprise-wide risks, to assist the Board and BRC in carrying out the risk oversight responsibility.

Risk management policies are established to identify, quantify, control, mitigate, and analyze the risks faced by the Group to set appropriate risk limits and controls and to monitor risks and ensure adherence to the risk appetite limits. Risk management policies and systems are subject to review regularly, on an ongoing basis, to reflect changes in economic environment, market conditions, products and services offered by the Group.

b) Credit risk

Credit risk is the risk that one party to a financial instrument will fail or delay to discharge an obligation and cause the other party to incur a financial loss. This includes the risk of decline in the credit standing of the customer. While such decline does not imply default, it increases the probability of the customer defaulting. Financial instruments that create credit risk include financing receivable and commitments to extend credit and investment in debt securities (i.e. Sukuk).

For risk management control purposes, the Group considers and consolidates all elements of credit risk exposure such as individual obligor default risk, country risk and sector risk in one measure about the riskiness of an exposure.

Credit risk management

The Group's Board has approved Financing and Investment policies for various business groups and investment asset types. The Board has also approved the Executive Credit and Investment Committee (the 'ECIC') Charter, which is empowered for initial screening of proposals and approval within its delegated authorities. The Board has also constituted the Board Credit and Investment Committee (the 'BCIC') which by virtue of its Charter, is the next level of authority which provides guiding principles and approves the various financing and investment proposals on behalf of the Board of the Group.

The Risk Management Group provides independent opinion and assessment of risk for every financing and investment proposal presented to the approving authorities for decision making.

The Group manages its credit facilities portfolio with the objective of ensuring that it is well diversified and it earns a level of return commensurate with the risks it assumes, at the same time, seeks to ensure the quality of the credit portfolio.

In addition, the Group endeavors to manage the credit exposure by obtaining collateral where appropriate and limiting the tenor of exposure or structures that are beneficial to the overall risk profile of the Bank's credit risk exposure.

As required by CBK, the Group has established a Provisioning Committee, at the executive level which is primarily responsible for the study and evaluation of the existing credit facilities and investments of the Group, to identify any abnormal situations and difficulties associated with a customer's position which may require the exposure to be classified as irregular, and to determine an appropriate provisioning required for impaired/ potential impairment of assets and investments.

Maximum exposure to credit risk without taking account of any collateral

The following table summarizes the maximum exposure to credit risk for the components of the consolidated statement of financial position, including off statement of consolidated financial position items. The maximum exposure is shown net of impairment, before the effect of mitigation through the use of master netting and collateral agreements, where applicable.

Warba Bank K.S.C.P.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

18. RISK MANAGEMENT (continued)

b) Credit risk (continued)

Maximum exposure to credit risk without taking account of any collateral (continued)

	<i>Net maximum exposure</i>	
	<i>2017</i>	<i>2016</i>
	<i>KD'000</i>	<i>KD'000</i>
Balances with banks	11,501	3,864
Placements with banks	246,484	166,940
Financing receivables	1,263,322	827,872
Available-for-sale investments (investment in Sukuk)	140,140	73,820
Other assets	10,187	4,380
	<u>1,671,634</u>	<u>1,076,876</u>
Acceptances and letters of credit	39,590	9,094
Letter of guarantees	62,550	40,951
Total	<u>102,140</u>	<u>50,045</u>
Total credit risk exposure	<u>1,773,774</u>	<u>1,126,921</u>

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

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region or exposed to similar economic environment that would cause their ability to meet contractual obligations and be similarly impacted by changes in economic, political and/or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting similarly connected counterparties.

The maximum credit exposure to a single counterparty as at 31 December 2017 amounted to KD 25,595 thousand (2016: KD 15,192 thousand) before taking account of collateral.

Risk concentrations of the maximum exposure to credit risk

Geographical and industry sector concentrations of financial assets and off- statement of financial position items are as follows:

	<i>2017</i>		<i>2016</i>	
	<i>Financial assets</i>	<i>Off- statement of financial position items</i>	<i>Financial assets</i>	<i>Off- statement of financial position items</i>
	<i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>
<i>Geographic region:</i>				
Kuwait	1,305,642	96,592	870,756	45,357
Other Middle East	257,236	-	175,673	-
Rest of the World	108,756	5,548	30,447	4,688
	<u>1,671,634</u>	<u>102,140</u>	<u>1,076,876</u>	<u>50,045</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

18. RISK MANAGEMENT (continued)

b) Credit risk (continued)

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

	2017		2016	
	<i>Financial assets KD'000</i>	<i>Off- statement of financial position items KD'000</i>	<i>Financial assets KD'000</i>	<i>Off- statement of financial position items KD'000</i>
<i>Industry sector:</i>				
Banks and Financial Institutions	475,665	5,417	288,819	4,688
Construction and Real Estate	551,531	58,713	375,412	32,898
Trading and Manufacturing	205,196	27,364	150,463	8,962
Other	439,242	10,646	262,182	3,497
	<u>1,671,634</u>	<u>102,140</u>	<u>1,076,876</u>	<u>50,045</u>

Credit risk mitigation

Credit risk mitigation techniques that the Group is permitted to use are obtaining collateral where appropriate and limiting the tenor of exposure or structures that are beneficial to the Group's management of risks to an exposure.

Credit quality of financial instruments

The Group classifies the various credit risk exposure which are neither past due nor impaired into two categories of credit quality as under:

High quality: Credit exposures where the ultimate risk of financial loss from the obligor's failure to discharge its obligation is assessed to be low-to-moderate. These include exposures to entities with financial strength and risk factors indicative of capacity to repay all contractual obligations, and those exposures that are significantly collateralized with tangible securities.

Standard quality: All other exposures whose payment performance is fully compliant with contractual conditions and which are not impaired.

The table below shows the credit quality of assets by class and grade before deducting the provision for impairment.

	<i>Neither past due nor impaired</i>		<i>Past due or impaired</i>	<i>Total KD'000</i>
	<i>High quality KD'000</i>	<i>Standard quality KD'000</i>	<i>KD'000</i>	
<i>2017</i>				
Balances with banks	11,501	-	-	11,501
Placements with banks	246,484	-	-	246,484
Financing receivables	747,474	458,583	77,641	1,283,698
Available-for-sale investments (investment in Sukuk)	122,447	17,693	-	140,140
Other assets	7,123	3,153	-	10,276
	<u>1,135,029</u>	<u>479,429</u>	<u>77,641</u>	<u>1,692,099</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

18. RISK MANAGEMENT (continued)**b) Credit risk (continued)*****Credit quality of financial instruments (continued)***

The table below shows the credit quality of assets by class and grade before deducting the provision for impairment.

	<i>Neither past due nor impaired</i>		<i>Past due or impaired</i>	<i>Total KD'000</i>
	<i>High quality KD'000</i>	<i>Standard quality KD'000</i>	<i>KD'000</i>	
<i>2016</i>				
Balances with banks	3,864	-	-	3,864
Placements with banks	166,940	-	-	166,940
Financing receivables	523,346	291,921	25,299	840,566
Available-for-sale investments (investment in Sukuk)	59,579	14,241	-	73,820
Other assets	3,850	530	-	4,380
	<u>757,579</u>	<u>306,692</u>	<u>25,299</u>	<u>1,089,570</u>

Ageing analysis of past due but not impaired finance facilities by class of financial assets:

	<i>Less than 30 days KD'000</i>	<i>31 to 60 days KD'000</i>	<i>61 to 90 days KD'000</i>	<i>Total KD'000</i>
<i>2017</i>				
Financing receivables	<u>39,435</u>	<u>13,590</u>	<u>5,969</u>	<u>58,994</u>
<i>2016</i>				
Financing receivables	<u>12,941</u>	<u>5,612</u>	<u>987</u>	<u>19,540</u>

c) Market risk

Market risk emanates from the process of fair value or future cash flows of a financial instrument which fluctuates due to changes in market prices. Market risk may arise from open positions in profit rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market or prices such as profit rates, credit spreads, foreign exchange rates and equity prices.

Market risk management

The Risk Management Group is responsible for development of detailed Market Risk Management framework and for the periodic review of their implementation, while it is the responsibility of the Treasury function to proactively manage and control market risk generated from various market positions in investments, financial instruments and over-the-counter deals.

The market risk framework comprises of the following elements:

- Limits for all market risk parameters and regular limits monitoring to ensure that Group does not exceed aggregate risk and concentration parameters set by the CBK limits and internal limits;
- Mark-to-market valuation based on independently published market data, and continuous review of all open positions; and
- Measuring Value-at-Risk for market sensitive positions and monitoring the same against established limits

18. RISK MANAGEMENT (continued)**c) Market risk (continued)*****Market risk management (continued)***

The Group is required to comply with the guidelines and regulations of the CBK. The Market Risk policies and procedures and the market risk limits are periodically set and reviewed to ensure the implementation of the Group's market risk appetite.

Profit rate risk

Profit rate risk arises from the changes in profit rates affecting future cash flows or the fair value of the underlying financial exposure or instrument. The Group is susceptible to profit rate risk as value of Group's fixed income investments and/ or return on financing are inversely proportional to movement in market rates. Moreover, change in profit rates might also impact Group's net earnings or earnings spread.

Prepayment risk

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier than expected, such as fixed rate financial exposures when profit rates fall. Due to the contractual terms of its Islamic products, the Group is not significantly exposed to prepayment risk.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group is susceptible to currency risk as the Group's base currency is KD and all foreign currencies are revalued against KD. Any long or short open position in any currency exposes the Group to currency risk.

Currency risk is managed on the basis of limits determined by the CBK and a continuous assessment of the Group's open positions and current and expected exchange rate movements.

The tables below indicate the currencies to which the Group had significant exposure at 31 December on its non-trading monetary assets and liabilities and its forecasted cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the KD, with all other variables held constant, on the result and the fair value reserve (due to the change in fair value of available-for-sale investments).

Currency	2017			2016		
	Change in currency rate %	Effect on result KD 000's	Effect on equity KD 000's	Change in currency rate %	Effect on result KD 000's	Effect on equity KD 000's
USD	+1	(557)	320	+1	(201)	8
SAR	+1	(22)	-	+1	(21)	-
GBP	+1	(43)	47	+1	1	-

Equity price risk

Equity price risk is the risk that the fair values of equities decrease as the result of change in the levels of equity prices and/or indices and the value of individual stocks.

The Group conducts sensitivity analysis on regular intervals in order to assess the potential impact of any major change in fair value of listed equity instruments. For such investments classified as available-for-sale, a five percent increase in stock prices as at 31 December 2017 would have increased equity by KD 38 thousand (31 December 2016: KD 42 thousand). An equal change in the opposite direction would have had equal, but opposite effect to the amounts shown above, on the basis that all other variables remain constant.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

18. RISK MANAGEMENT (continued)**d) Liquidity risk**

Liquidity risk arises when the Group may be unable to meet its obligations associated with its financial liabilities. Liquidity risk can be caused by market disruptions, credit downgrades or market perception, which may cause certain sources of funding to dry up immediately. To limit this risk, the Group has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of High Quality Liquid Assets (HQLA) which could be used to secure additional funding and liquidity if and when required. The Group has in place a Contingency Funding Plan (CFP) to ensure required action is implemented in the event of any liquidity contingencies. ALCO is responsible for invoking the CFP.

Liquidity risk management

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

The Risk Management Group and Treasury monitor the Group's liquidity profile daily and take appropriate steps, if required. The Group's liquidity profile is monitored on daily basis; overall assets and liabilities as well as for KD and foreign currencies (FCY), on the Group's position in terms of Statutory Liquidity Ratio (SLR) as well as Lending to Deposit Ratio (LDR) and Liquidity Coverage Rate (LCR). Treasury co-ordinates with all business groups, details of projected cash flows required or arising from potential ensuing business opportunities.

Treasury is required to maintain a portfolio of short-term liquid assets, largely made up of short-term high-quality liquid investment securities and availability of inter-bank lines at short notice, to ensure that sufficient liquidity is maintained with the Group. Treasury's liquidity management is performed with most optimization, taking into account the maturity gaps. The daily liquidity position is monitored and regular stress testing is conducted under a variety of scenarios covering the mild and more severe market conditions. All liquidity policies are subject to review by the ALCO and approved by the BRC. Periodic liquidity profile report, including any exceptions and remedial action required/taken, is reviewed by the ALCO. The Group is governed by the liquidity limits and maturity ladder profile as mandated by the CBK regulations and the CBK approved limits.

The table below summarizes the maturity profile of the Group's assets and liabilities. The maturity profile of the assets and liabilities at the year-end are based on contractual repayment arrangement with the exception of some investments which are bucketed as per the CBK criteria.

The maturity profile of assets and liabilities as at 31 December is as follows:

2017	Within 3 months KD'000	3 to 6 months KD'000	6 to 12 months KD'000	Over 1 year KD'000	Total KD'000
Assets					
Cash and balances with banks	13,201	-	-	-	13,201
Placements with banks and CBK	246,484	-	-	-	246,484
Financing receivables	728,610	256,494	23,710	254,508	1,263,322
Available-for-sale investments	44,021	-	6,019	115,881	165,921
Investments in joint ventures	-	-	-	31,102	31,102
Investment properties	-	-	-	23,666	23,666
Other assets	7,728	9,051	290	6,278	23,347
Property and equipment	-	-	-	5,999	5,999
	<u>1,040,044</u>	<u>265,545</u>	<u>30,019</u>	<u>437,434</u>	<u>1,773,042</u>
Liabilities					
Due to banks and other financial institutions	175,788	69,639	61,884	265,553	572,864
Depositors' accounts	694,608	187,206	99,588	27,451	1,008,853
Other liabilities	13,855	-	-	2,014	15,869
	<u>884,251</u>	<u>256,845</u>	<u>161,472</u>	<u>295,018</u>	<u>1,597,586</u>

Warba Bank K.S.C.P.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

18. RISK MANAGEMENT (continued)

d) Liquidity risk (continued)

Liquidity risk management (continued)

2016	<i>Within 3 months KD'000</i>	<i>3 to 6 months KD'000</i>	<i>6 to 12 months KD'000</i>	<i>Over 1 year KD'000</i>	<i>Total KD'000</i>
Assets					
Cash and balances with banks	5,480	-	-	-	5,480
Placements with banks and CBK	153,346	13,594	-	-	166,940
Financing receivables	483,123	140,640	31,069	173,040	827,872
Available-for-sale investments	31,245	711	-	67,869	99,825
Investments in joint ventures	-	-	-	-	-
Investment properties	-	-	-	14,815	14,815
Other assets	1,708	439	251	3,989	6,387
Property and equipment	-	-	-	5,643	5,643
	<u>674,902</u>	<u>155,384</u>	<u>31,320</u>	<u>265,356</u>	<u>1,126,962</u>
Liabilities					
Due to banks and other financial institutions	116,407	59,849	87,752	10,123	274,131
Depositors' accounts	491,233	136,246	123,019	-	750,498
Other liabilities	6,603	-	-	958	7,561
	<u>614,243</u>	<u>196,095</u>	<u>210,771</u>	<u>11,081</u>	<u>1,032,190</u>

The table below summarizes the maturity profile of the Group's financial liabilities as at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately.

	<i>Within 3 months KD'000</i>	<i>3 to 6 months KD'000</i>	<i>6 to 12 months KD'000</i>	<i>Over 1 year KD'000</i>	<i>Total KD'000</i>
2017					
Due to banks and other financial institutions	176,082	70,128	62,794	276,065	585,069
Depositors' accounts	694,925	188,974	101,284	29,722	1,014,905
Other liabilities	13,855	-	-	2,014	15,869
	<u>884,862</u>	<u>259,102</u>	<u>164,078</u>	<u>307,801</u>	<u>1,615,843</u>
2016					
Due to banks and other financial institutions	116,569	60,404	89,085	10,429	276,487
Depositors' accounts	492,019	137,398	124,828	-	754,245
Other liabilities	6,603	-	-	958	7,561
	<u>615,191</u>	<u>197,802</u>	<u>213,913</u>	<u>11,387</u>	<u>1,038,293</u>

18. RISK MANAGEMENT (continued)

d) Liquidity risk (continued)

Liquidity risk management (continued)

The table below shows the contractual expiry by maturity of the Group's contingent liabilities and commitments:

	<i>Within 3 months KD'000</i>	<i>3 to 12 months KD'000</i>	<i>Over 1 year KD'000</i>	<i>Total KD'000</i>
2017				
Acceptances and letters of credit	26,704	13,084	-	39,788
Letter of guarantees	10,533	27,125	25,207	62,865
Capital commitments	-	232	-	232
	<u>37,237</u>	<u>40,441</u>	<u>25,207</u>	<u>102,885</u>
2016				
Acceptances and letters of credit	6,166	2,974	-	9,140
Letter of guarantees	8,141	13,773	19,242	41,156
Capital commitments	-	238	-	238
	<u>14,307</u>	<u>16,985</u>	<u>19,242</u>	<u>50,534</u>

e) Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, systems failure, human error, or from external events. When controls fail to perform, it can have legal or regulatory implications, or lead to a financial or reputational loss.

Management of operational risk

The Group has a set of policies approved by the Board and are applied to identify, assess and supervise operational risk in addition to other types of risk relating to the banking and financial activities of the Group. Suitable operational risk procedures have been agreed with various groups and departments of the Group and implemented for effectively reporting, monitoring and controlling operational risks.

Operational risk is managed under the Risk Management Group. This group ensures compliance with policies and procedures to identify, assess, supervise and monitor operational risk as part of overall prudent and robust Risk Management Framework.

The Group manages operational risks in line with the CBK instructions regarding "General Guidelines for Internal Control Systems" and directives regarding "Sound Practices for the Management and Control of Operational Risks".

The Group has established its Business Continuity Management ("BCM") policy to meet any internal or external failures and eventualities enabling smooth functioning of the Group's operations.

The Group has established a Disaster Recovery ("DR") site for its IT infrastructure, and ensures that the operational risks from any potential disruption do not adversely impact the banking business. The Group pays special attention to operational risks that may arise from non-compliance to Sharia'h principles and any possible failure in fiduciary responsibilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

19. SEGMENT REPORTING

The Group's operating segments are determined based on the reports reviewed by the decision makers that are used for strategic decisions. These segments are strategic business units that offer different products and services. They are managed separately since the nature of the products and services, class of customers and marketing strategies of these segments are different.

These operating segments meet the criteria for reportable segments and are as follows:

- **Corporate** - comprising of range of banking services and investment products to corporate customers, in addition to providing commodity and real estate Murabaha finance and Ijara facilities.
- **Retail** - comprising of a diversified range of products and services to individual customers. The range includes consumer finance, credit cards, deposits and other branch related services.
- **Treasury** – comprising of Bank's funding operations management, local and international Murabaha and other Islamic financing primarily with banks and financial institutions.
- **Investment** - comprising of investment in direct equity, real estate investment and other investments.
- **Other** – comprising of cost center assets and expenses.

Management monitors the operating segments separately for the purpose of making decisions about resource allocation and performance assessment.

The following table presents operating income, results for the year and total assets information regarding the Group's reportable segments.

	<i>Corporate KD'000</i>	<i>Retail KD'000</i>	<i>Treasury KD'000</i>	<i>Investment KD'000</i>	<i>Other KD'000</i>	<i>Total KD'000</i>
2017						
Operating income	24,670	6,361	2,171	4,782	-	37,984
Net profit	13,165	(1,498)	1,880	3,143	(9,922)	6,768
Total assets	1,004,046	259,277	246,484	220,688	42,547	1,773,042
Total liabilities	157,419	324,632	1,099,666	-	15,869	1,597,586
2016						
Operating income	13,467	4,484	801	4,181	-	22,933
Net profit	8,358	(1,649)	622	3,716	(8,472)	2,575
Total assets	655,687	172,185	166,940	114,640	17,510	1,126,962
Total liabilities	104,295	155,383	764,951	-	7,561	1,032,190

20. CAPITAL MANAGEMENT

The primary objectives of the Group's capital management are to ensure that the Group complies with regulatory capital requirements and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value.

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may review the amount of dividend payment to shareholders or issue capital securities.

A key objective of the Group is to maximize shareholders value with optimal levels of risk and to maintain a strong capital base to support the development of its business.

Warba Bank K.S.C.P.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

20. CAPITAL MANAGEMENT (continued)

Capital adequacy and the use of regulatory capital are monitored regularly by the Group's management and governed by guidelines of Basel Committee on Banking Supervision as adopted by the CBK.

The Group follows Basel III regulations and the Group's regulatory capital and capital adequacy ratios for the year ended 31 December 2017 are calculated in accordance with CBK circular number 2/RB/ RBA/336/2014 dated 24 June 2014 are shown below:

	<i>2017</i> <i>KD'000</i>	<i>2016</i> <i>KD'000</i>
Risk weighted assets	824,081	563,240
Capital required	107,131	73,221
Capital available		
Common equity Tier 1 "CET1" capital	99,093	94,772
Additional Tier 1 perpetual Sukuk	76,363	-
Total Tier 1 capital	175,456	94,772
Total Tier 2 capital	9,672	6,591
Total capital available	185,128	101,363
CET1 capital adequacy ratio	12.02%	16.83%
Total Tier 1 capital adequacy ratio	21.29%	16.83%
Total capital adequacy ratio	22.46%	18.00%

The Group's financial leverage ratio for the year ended 31 December 2017 is calculated in accordance with CBK circular number 2/RBA/343/2014 dated 21 October 2014 and is shown below:

	<i>2017</i> <i>KD'000</i>	<i>2016</i> <i>KD'000</i>
Tier 1 capital	175,456	94,772
Total exposure	1,827,357	1,159,366
Financial leverage ratio	9.60%	8.17%

The disclosure relating to the capital adequacy regulations issued by the CBK as stipulated in CBK circular number 2/RB/RBA/336/2014 dated 24 June 2014 and disclosures related to financial leverage ratio as stipulated in CBK circular number 2/RBA/343/2014 dated 21 October 2014 are included under the 'Risk Management' section in the annual report.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

21. FAIR VALUE MEASUREMENT

The following table provides the fair value measurement hierarchy of the Group's assets.

Quantitative disclosures of fair value measurement hierarchy for assets as at 31 December:

2017	Date of valuation	Fair value measurement			
		Total KD'000	Quoted prices in active markets (Level 1) KD'000	Significant observable inputs (Level 2) KD'000	Significant unobservable inputs (Level 3) KD'000
<i>Assets measured at fair value</i>					
Available-for-sale					
Investments:					
Quoted Sukuk		138,140	138,140	-	-
- Sovereign Sukuk	31 December 2017	41,276	41,276	-	-
- Corporate Sukuk	31 December 2017	96,864	96,864	-	-
Quoted equity security	31 December 2017	756	756	-	-
Unquoted Sukuk	31 December 2017	2,000	-	-	2,000
Managed portfolio	31 December 2017	4,004	-	-	4,004
<i>Assets measured at cost while fair value is disclosed</i>					
Investment properties		24,656	-	-	24,656
- Kuwait	31 December 2017	9,801	-	-	9,801
- Other Middle East	31 December 2017	4,554	-	-	4,554
- Europe	31 December 2017	10,301	-	-	10,301
2016	Date of valuation	Fair value measurement			
		Total KD'000	Quoted prices in active markets (Level 1) KD'000	Significant observable inputs (Level 2) KD'000	Significant unobservable inputs (Level 3) KD'000
<i>Assets measured at fair value</i>					
Available-for-sale					
Investments:					
Quoted Sukuk		71,820	71,820	-	-
- Sovereign Sukuk	31 December 2016	31,009	31,009	-	-
- Corporate Sukuk	31 December 2016	40,811	40,811	-	-
Quoted equity security	31 December 2016	837	837	-	-
Unquoted Sukuk	31 December 2016	2,000	-	-	2,000
Managed portfolio	31 December 2016	4,281	-	-	4,281
<i>Assets measured at cost while fair value is disclosed</i>					
Investment properties		15,632	-	-	15,632
- Kuwait	31 December 2016	10,307	-	-	10,307
- Other Middle East	31 December 2016	5,325	-	-	5,325
- Europe	31 December 2016	-	-	-	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2017

21. FAIR VALUE MEASUREMENT (continued)

The following table shows a reconciliation of the opening and closing amount of Level 3 financial assets.

	<i>At 1 January 2017</i>	<i>Change in fair value</i>	<i>Impairment</i>	<i>Additions</i>	<i>Sale/ redemption</i>	<i>Exchange rate movements</i>	<i>At 31 December 2017</i>
	<i>KD 000's</i>	<i>KD 000's</i>	<i>KD 000's</i>	<i>KD 000's</i>	<i>KD 000's</i>	<i>KD 000's</i>	<i>KD 000's</i>
Available for sale investments							
Unquoted Sukuk	2,000	-	-	-	-	-	2,000
Managed Portfolio	4,281	-	-	-	(277)	-	4,004
	<u>6,281</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(277)</u>	<u>-</u>	<u>6,004</u>

During the years ended 31 December 2017 and 2016, there were no transfer between Level 1, Level 2 and Level 3.

Fair values of remaining financial assets and liabilities carried at amortised cost are estimated using valuation techniques incorporating a range of input assumptions that are appropriate in the circumstances. Carrying value of financial assets and liabilities that are carried at amortised cost are not materially different from their fair values as most of these assets and liabilities are of short term maturities or are repriced immediately based on market movement in profit rates and is only used for disclosure purpose. Fair value of such financial instruments is classified under level 3 determined based on discounted cash flows, with most significant inputs being the discount rate that reflects the credit risk of counterparties.

The impact on the consolidated statement of financial position or the consolidated statement of changes in equity would be immaterial if the relevant risk variables used to fair value the securities classified under level 3 were altered by 5 per cent.