

**WARBA BANK K.S.C.P.**

**CONSOLIDATED  
FINANCIAL STATEMENTS**

**31 DECEMBER 2018**



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## **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 2018, and the consolidated statement of profit or loss, 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 2018, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (“IFRS”), as adopted for use by the State of Kuwait.

#### *Basis for Opinion*

We conducted our audit in accordance with International Standards on Auditing (“ISA”). 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* (the *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 the matter below, our description of how our audit addressed the matter is provided in that context.

#### *Credit losses of financing receivables*

The recognition of credit losses on financing receivables from customers is the higher of Expected Credit Loss (“ECL”) determined under International Financial Reporting Standard 9: Financial Instruments (“IFRS 9”), according to Central Bank of Kuwait (the “CBK”) guidelines, and the provision required by the CBK instructions as disclosed in the accounting policies and in Note 2.1 and 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)*

*Credit losses of financing receivables (continued)*

Recognition of ECL under IFRS 9, according to the CBK guidelines, is a new and complex accounting policy, which requires considerable judgement in its implementation. ECL is dependent on management's judgement in assessing significant increase in credit risk and classification of credit facilities into various stages, determining when a default has occurred, development of models for assessing the probability of default of customers and estimating cash flows from recovery procedures or realization of collateral. Recognition of specific provision on impaired facility under the CBK instructions is based on the rules prescribed by the CBK on the minimum provision to be recognized together with any additional provision to be recognised based on management estimate of expected cash flows related to that credit facility.

Due to the significance of credit facilities and the related estimation uncertainty and judgement in the impairment calculation, this was considered as a key audit matter.

Our audit procedures included assessing the design and implementation of controls over, inputs and assumptions used by the Group in developing the models, its governance and review controls performed by the management in determining the adequacy of credit losses.

With respect to the ECL based on IFRS 9, according to the CBK guidelines, we have selected a samples of credit facilities outstanding as at the reporting date and checked the appropriateness of the Group's determination of significant increase in credit risk and the resultant basis for classification of the credit facilities into various stages. For a sample of credit facilities, we have checked the appropriateness of the Group's staging criteria, Exposure at Default ("EAD") Probability of Default ("PD") and Loss Given Default ("LGD") including the eligibility and value of collateral considered in the ECL model used by the Group to determine ECL. We have also checked the consistency of various inputs and assumptions used by the Group's management to determine ECL.

Further, for the CBK provision requirements, we have assessed the criteria for determining whether there is a requirement to calculate any credit loss in accordance with the related regulations and, if required, it has been computed accordingly. For the samples selected, we have verified whether all impairment events have been identified by the Group's management. For the selected samples which also included impaired credit facilities, we have assessed the valuation of collateral and checked the resultant provision calculations.

*Other information included in the Group's 2018 Annual Report*

Management is responsible for the other information. Other information consists of the information included in Group's 2018 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 2018 Annual Report after the date of our Auditors' report.

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

**Report on the Audit of Consolidated Financial Statements (continued)**

*Other information included in the Group's 2018 Annual Report (continued)*

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.

*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.

**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)*

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- 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, as amended, 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, as amended, have occurred during the year ended 31 December 2018 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 2018 that might have had a material effect on the business of the Bank or on its financial position.



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



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

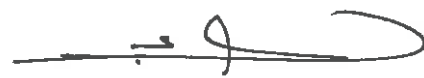
30 January 2019  
Kuwait

Warba Bank K.S.C.P.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2018

	Notes	2018 KD'000	2017 KD'000 (Restated)	1 January 2017 KD'000 (Restated)
<b>ASSETS</b>				
Cash and balances with banks	3	19,738	13,201	5,480
Placements with banks and the CBK		256,486	246,484	166,940
Financing receivables	4	1,606,542	1,263,322	827,872
Financial assets at fair value through profit or loss	5	41,500	-	-
Financial assets at fair value through other comprehensive income	6	148,585	-	-
Available-for-sale investments	7	-	165,921	99,825
Investments in joint ventures	8	52,498	31,660	-
Investment properties	9	22,867	24,611	15,632
Other assets		26,495	23,347	6,387
Property and equipment		18,358	5,999	5,643
<b>TOTAL ASSETS</b>		<b>2,193,069</b>	<b>1,774,545</b>	<b>1,127,779</b>
<b>LIABILITIES AND EQUITY</b>				
<b>LIABILITIES</b>				
Due to banks and other financial institutions	10	835,063	572,864	274,131
Depositors' accounts	11	1,053,178	1,006,614	747,433
Other liabilities		33,900	18,108	10,626
<b>TOTAL LIABILITIES</b>		<b>1,922,141</b>	<b>1,597,586</b>	<b>1,032,190</b>
<b>EQUITY</b>				
Share capital	12	150,000	100,000	100,000
Share premium	12	40,000	-	-
Statutory reserve	12	1,353	-	-
Fair value reserve		(4,646)	(214)	(430)
Foreign currency translation reserve		79	251	-
Retained earnings (accumulated losses)		7,779	559	(3,981)
<b>EQUITY ATTRIBUTABLE TO SHAREHOLDERS OF THE BANK</b>		<b>194,565</b>	<b>100,596</b>	<b>95,589</b>
Perpetual Tier 1 Sukuk	13	76,363	76,363	-
<b>TOTAL EQUITY</b>		<b>270,928</b>	<b>176,959</b>	<b>95,589</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>2,193,069</b>	<b>1,774,545</b>	<b>1,127,779</b>

  
 Abdulwahab A. Al Houti  
 Chairman

  
 Shaheen H. Al Ghanem  
 Chief Executive Officer

The accompanying notes 1 to 25 form an integral part of these consolidated financial statements.



Warba Bank K.S.C.P.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2018

	<i>Notes</i>	<b>2018</b> <b>KD'000</b>	<b>2017</b> <b>KD'000</b> <i>(Restated)</i>
Placements and financing income		73,105	51,704
Finance costs and distribution to depositors		(38,979)	(23,061)
<b>Net financing income</b>		<b>34,126</b>	<b>28,643</b>
Net investment income	14	10,924	6,387
Net fees and commission income	15	3,793	2,178
Other income		20	303
Foreign exchange gain		689	601
<b>Operating income</b>		<b>49,552</b>	<b>38,112</b>
Staff costs		(12,309)	(11,640)
General and administrative expenses		(5,509)	(5,092)
Depreciation		(1,141)	(1,270)
<b>Operating expenses</b>		<b>(18,959)</b>	<b>(18,002)</b>
<b>Net operating profit before provision for impairment</b>		<b>30,593</b>	<b>20,110</b>
Provision for impairment	16	(17,064)	(12,318)
<b>Net profit for the year before deductions</b>		<b>13,529</b>	<b>7,792</b>
Contribution to Kuwait Foundation for the Advancement of Sciences (KFAS)		(122)	-
National Labor Support Tax (NLST)		(410)	(184)
Zakat		(159)	(74)
Directors' remuneration		(100)	(80)
<b>Net profit for the year</b>		<b>12,738</b>	<b>7,454</b>
<b>Basic and diluted earnings per share</b>	17	<b>7.06 fils</b>	<b>4.61 fils</b>

The accompanying notes 1 to 25 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 2018

	Note	2018 KD'000	2017 KD'000 (Restated)
<b>Net profit for the year</b>		<u>12,738</u>	<u>7,454</u>
<b>Other comprehensive (loss) income:</b>			
<i>Other comprehensive (loss) income that are or may be reclassified to profit or loss in subsequent periods:</i>			
Available-for-sale investments (IAS 39)			
- Change in fair value		-	563
- Gain on sale of available-for-sale investments	14	-	(347)
<b>Net gain on available-for-sale investments</b>		<u>-</u>	<u>216</u>
Change in fair value of debt instruments at fair value through other comprehensive income		(7,111)	-
Realised loss on sale of debt instruments at fair value through other comprehensive income	14	651	-
Exchange differences on translation of foreign operations		(172)	251
Net profit from hedging cash flows		57	-
		<u>(6,575)</u>	<u>251</u>
		<u>(6,575)</u>	<u>467</u>
<i>Other comprehensive income that will not be reclassified to statement of profit or loss in subsequent periods:</i>			
Change in the fair value of equity investments at fair value through other comprehensive income		849	-
<b>Total other comprehensive (loss) income</b>		<u>(5,726)</u>	<u>467</u>
<b>Total comprehensive income</b>		<u>7,012</u>	<u>7,921</u>

The accompanying notes 1 to 25 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 2018

	Share capital KD'000	Share premium KD'000	Statutory reserve KD'000	Fair value reserve KD'000	Foreign currency translation reserve KD'000	Retained earnings / (accumulated losses) 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 2018	100,000	-	-	(214)	251	559	100,596	76,363	176,959
Transitional adjustment on adoption of IFRS 9 at 1 January 2018 (Note 2.2)	-	-	-	1,122	-	915	2,037	-	2,037
Balance at 1 January 2018 after the transitional adjustment on adoption of IFRS 9	100,000	-	-	908	251	1,474	102,633	76,363	178,996
Net profit for the year	-	-	-	-	-	12,738	12,738	-	12,738
Other comprehensive loss	-	-	-	(5,554)	(172)	-	(5,726)	-	(5,726)
Total comprehensive (loss) income	-	-	-	(5,554)	(172)	12,738	7,012	-	7,012
Increase in share capital (Note 12)	50,000	40,000	-	-	-	-	90,000	-	90,000
Costs directly related to increase in share capital	-	-	-	-	-	(172)	(172)	-	(172)
Transferred to the statutory reserve	-	-	1,353	-	-	(1,353)	-	-	-
Profit paid on Perpetual Tier 1 Sukuk (Note 13)	-	-	-	-	-	(4,908)	(4,908)	-	(4,908)
<b>Balance at 31 December 2018</b>	<b>150,000</b>	<b>40,000</b>	<b>1,353</b>	<b>(4,646)</b>	<b>79</b>	<b>7,779</b>	<b>194,565</b>	<b>76,363</b>	<b>270,928</b>
Balance at 1 January 2017	100,000	-	-	(430)	-	(4,798)	94,772	-	94,772
Impact of the change in the accounting policy (Note 25)	-	-	-	-	-	817	817	-	817
Balance at 1 January 2017 (restated)	100,000	-	-	(430)	-	(3,981)	95,589	-	95,589
Net profit for the year (restated)	-	-	-	-	-	7,454	7,454	-	7,454
Other comprehensive income (restated)	-	-	-	216	251	-	467	-	467
Total comprehensive income (restated)	-	-	-	216	251	7,454	7,921	-	7,921
Issue of Perpetual Tier 1 Sukuk (Note 13)	-	-	-	-	-	-	-	76,363	76,363
Transaction costs on issue of Perpetual Tier 1 Sukuk (Note 13)	-	-	-	-	-	(463)	(463)	-	(463)
Profit paid on Perpetual Tier 1 Sukuk (Note 13)	-	-	-	-	-	(2,451)	(2,451)	-	(2,451)
Balance at 31 December 2017 (restated)	100,000	-	-	(214)	251	559	100,596	76,363	176,959

The accompanying notes 1 to 25 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 2018

	Notes	2018 KD'000	2017 KD'000 (Restated)
<b>OPERATING ACTIVITIES</b>			
Net profit for the year		12,738	7,454
Adjustments for:			
Net investment income	14	(10,924)	(6,387)
Provision for end of service benefits		618	888
Depreciation		1,141	1,270
Provision for impairment	16	17,064	12,318
		<u>20,637</u>	<u>15,543</u>
<i>Changes in operating assets and liabilities:</i>			
Placements with banks and the CBK		31,752	(22,684)
Financing receivables		(356,425)	(447,224)
Other assets		(3,012)	(17,051)
Due to banks and other financial institutions		261,950	298,342
Depositors' accounts		46,564	256,116
Other liabilities		11,057	10,724
		<u>12,523</u>	<u>93,766</u>
<b>INVESTING ACTIVITIES</b>			
Purchase of financial assets at fair value through profit of loss		(17,279)	-
Proceed from sale and redemption of financial assets at fair value through profit of loss		290	-
Purchase of financial assets at fair value through other comprehensive income		(128,460)	-
Proceed from sale of financial assets at fair value through other comprehensive income		118,453	-
Purchase of available-for-sale investments		-	(149,646)
Proceed from sale and redemption of available-for-sale investments		-	82,318
Additions to investment in joint ventures	8	(19,853)	(31,686)
Purchase of investment property	9	-	(8,891)
Purchase of property and equipment		(13,965)	(1,651)
Dividend received from financial assets		1,927	1,535
Sukuk income received		6,053	3,709
Other investment income received		191	148
Dividend received from joint ventures	8	2,331	392
Rental income received		1,432	1,138
		<u>(48,880)</u>	<u>(102,634)</u>
<b>FINANCING ACTIVITIES</b>			
Proceeds from increase in share capital	12	90,000	-
Costs directly related to increase in share capital		(172)	-
Perpetual Tier 1 Sukuk issuing costs	13	-	(463)
Proceeds from issue of Perpetual Tier 1 Sukuk	13	-	76,363
Profit paid to holders of Perpetual Tier 1 Sukuk	13	(4,908)	(2,451)
		<u>84,920</u>	<u>73,449</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>		<b>48,563</b>	<b>64,581</b>
Cash and cash equivalents at 1 January		181,086	116,505
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>	<b>3</b>	<b>229,649</b>	<b>181,086</b>

The accompanying notes 1 to 25 form an integral part of these consolidated financial statements.

## 1 CORPORATE INFORMATION

Warba Bank K.S.C.P. (the “Bank”) is a Kuwaiti public shareholding company, incorporated on 17 February 2010 in the State of Kuwait by virtue of Amiri Decree No. 289/2009. The Bank 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 and its shares are publicly traded on the Boursa Kuwait. 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 is primarily involved in investment, corporate and retail banking activities in accordance with the principles of Islamic 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 2018 were authorized for issue in accordance with a resolution of the Board of Directors on 14 January 2019. The shareholders of the Bank have the power to amend these consolidated financial statements in the Annual General Assembly Meeting.

### 2.1 BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with the regulations for financial services institutions as issued by the Central Bank of Kuwait (“CBK”) in the State of Kuwait. These regulations require expected credit loss (“ECL”) to be measured at the higher of the ECL on financing facilities computed under IFRS 9 according to the CBK guidelines or the provisions as required by CBK instructions; the consequent impact on related disclosures; and the adoption of all other requirements of International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (“IASB”) (collectively referred to as IFRS, as adopted for use by the State of Kuwait).

The consolidated financial statements have been prepared under the historical cost convention except for the measurement at fair value of financial assets at fair value through profit or loss, financial assets at fair value through other comprehensive income, investment properties and profit rate swaps.

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

### 2.2 CHANGES IN ACCOUNTING POLICIES

On 1 January 2018, the Group elected to change the method of valuing its investment properties to the fair value method as permitted by IAS 40 - Investment Properties, whereas during prior periods, investment properties were valued using the cost method. The management believes that the application of the fair value method in measurement of investment properties provides reliable and relevant information for the users of the consolidated financial statements and this aligns with the widely accepted policy of valuing investment properties. Therefore, comparative information of prior years has been adjusted in order to apply the new accounting method retrospectively as detailed in Note 25.

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 change in the above mentioned accounting policy and the adoption of IFRS 9: Financial Instruments and IFRS 15: Revenue from Contracts with Customers. The nature and the impact of each amendment is described below:

#### *IFRS 15 – Revenue from Contracts with Customers*

IFRS 15 was issued in May 2014 and is effective for annual periods commencing on or after 1 January 2018. IFRS 15 outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue guidance, which is found currently across several Standards and Interpretations within IFRS. It established a new five-steps model that will apply to revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

Adoption of IFRS 15 had no significant impact on the consolidated financial statements of the Group.

#### *IFRS 9 – Financial Instruments*

The Group has adopted IFRS 9 - *Financial Instruments* issued in July 2014 with a date of initial application of 1 January 2018, with the exception of requirements of the expected credit losses on financing facilities as noted above in Note 2.1. The requirements of IFRS 9 represent a significant change from IAS 39 *Financial Instruments: Recognition and Measurement*. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

2.2 CHANGES IN ACCOUNTING POLICIES (continued)

*IFRS 9 – Financial Instruments (continued)*

*Classification of financial assets*

To determine their classification and measurement category, IFRS 9 requires all financial assets, except equity investments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories of financial assets (fair value through profit or loss ("FVTPL"), available for sale ("AFS"), held-to-maturity ("HTM") and amortised cost) have been replaced by:

- (1) Financial assets at amortised cost
- (2) Financial assets at fair value through other comprehensive income ("FVOCI")
- (3) Financial assets at FVTPL

1) *Financial assets at amortised cost*

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- (a) The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- (b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and profit (SPPP).

Financial assets at amortised cost are subsequently measured at amortised cost using the effective profit method. The amortised cost is reduced by the ECL. Financing income, foreign exchange gains or losses, ECLs and gain or loss on de-recognition are recognised in the consolidated statement of profit or loss.

Cash, balances with banks, placements with banks, balances with the Central Bank of Kuwait, financing receivables and other assets are classified as financial assets at amortised cost.

2) *Financial assets at FVOCI*

a) Debt instruments (Sukuk) measured at FVOCI

The Group applies the new category under IFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets; and
- The contractual terms of the financial instrument meet the SPPP test

Debt instruments at FVOCI are subsequently measured at fair value, for which resulting gains or losses arising from changes in fair value are recognised in OCI. Financing income, foreign exchange gains or losses and ECLs are recognised in the consolidated statement of profit or loss. On de-recognition, cumulative gains or losses previously recognized in OCI will be reclassified from equity to the consolidated statement of profit or loss.

The management of the Group classifies and carries certain quoted and unquoted Sukuk within Financial assets instruments at FVOCI in the consolidated statement of financial position.

b) Equity instruments at FVOCI

Upon initial recognition, the Group may elect to classify irrevocably some of its equity investments (Equity) as equity instruments at FVOCI when they meet the definition of Equity under IAS 32 Financial Instruments: Presentation and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

Equity instruments at FVOCI are subsequently measured at fair value. Changes in fair values including foreign exchange component are recognised in OCI and are presented within the cumulative changes in fair value as a part of equity. Cumulative gains or losses previously recognized as OCI are transferred to retained earnings on de-recognition and are not recognized in the consolidated statement of profit or loss.

## 2.2 CHANGES IN ACCOUNTING POLICIES (continued)

### *IFRS 9 – Financial Instruments (continued)*

#### *Classification of financial assets (continued)*

##### b) Equity instruments at FVOCI (continued)

Dividend income on equity investments at FVOCI is recognised in the consolidated statement of profit or loss unless it clearly represents a recovery of part of the cost of the investment in which case it is recognised in other comprehensive income. Equity investments at FVOCI are not subject to impairment assessment.

The management of the Group classifies and carries certain unquoted equity within Financial assets instruments at FVOCI in the consolidated statement of financial position.

##### 3) *Financial assets at fair value through profit or loss (FVTPL)*

The Group records and measures financial assets at fair value through profit or loss in the consolidated statement of financial position at fair value. In addition, on initial recognition, the Group may irrevocably designate a financial asset at FVTPL even if it meets the requirements to be measured at amortised cost or at FVOCI and by doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Changes in fair value, financing income and dividend are recorded in the consolidated statement of profit or loss according to the terms of the contract, or when the right to payment has been established.

Included in this classification are certain equity securities and funds that have been acquired principally for the purpose of selling or repurchasing in the near term.

#### *Business model assessment*

The Group determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objectives. The Group's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model is evaluated and reported to the entity's key management personnel;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected). The expected frequency, value and timing of sales are also important aspects of the management's assessment.

The business model assessment is based on reasonably expected scenarios without taking the 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Group's original expectations, the Group does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

#### *The SPPP test*

As a second step of its classification process the Group assesses the contractual terms of financial asset to identify whether they meet the SPPP test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition that may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of profit within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPP assessment, the Group applies judgement and considers relevant factors such as the currency in which the financial asset is denominated and the period for which the profit rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and profit on the amount outstanding. In such cases, the financial asset is required to be measured at FVTPL.

**2.2 CHANGES IN ACCOUNTING POLICIES (continued)**

***IFRS 9 – Financial Instruments (continued)***

***Reclassification of financial assets***

The Group does not reclassify its financial assets subsequent to their initial recognition apart in the exceptional circumstances in which the Group acquires, disposes of or terminates a business line.

***Impairment of financial assets***

IFRS 9 replaces the ‘incurred loss’ model in IAS 39 with an ‘expected credit loss’ (ECL) model. The new impairment model applies to financial assets measured at amortised cost, contract assets and financing investments at FVOCI, but not to investments in equity. Under IFRS 9, credit losses are recognised earlier than under IAS 39. The credit losses are based on ECL associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since initial recognition. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the credit loss is based on the change in ECL over the life of the asset.

***Policy applicable from 1 January 2018***

The Group recognises ECL for financing receivables, non-cash credit facilities in the form of bank guarantees, letters of guarantee, documentary letters of credit, undrawn cash and non-cash credit facilities (revocable and irrevocable) (together “financing facilities”), placements with banks and investment in debt instruments measured at FVOCI.

Balances with the CBK and Sukuk issued by the CBK and Government of Kuwait is fully recoverable and hence no ECL is measured. Equity investments are not subject to ECL.

The Group provides for credit losses on financing facilities according to the CBK guidelines and records the impairment of financing facilities at the higher of ECL under IFRS 9 according to the CBK guidelines, and the provisions required by the CBK instructions (described in policy applicable before 1 January 2018 below).

***Expected Credit Losses***

The Group applies a three-stage approach to measure the ECL as described below:

**Stage 1: 12-month ECL**

The Group measures loss allowances at an amount equal to 12-month ECL on financial assets where there has not been a significant increase in credit risk since their initial recognition or on exposures that are determined to have a low credit risk at the reporting date. The Group considers a financial asset to have low credit risk when its credit risk rating is equivalent to the globally understood definition of ‘investment grade’.

**Stage 2: Lifetime ECL – not credit impaired**

The Group measures loss allowances at an amount equal to lifetime ECL on financial assets where there has been a significant increase in credit risk since initial recognition but are not credit impaired.

**Stage 3: Lifetime ECL – credit impaired**

The Group measures loss allowances on financial assets determined as a credit impaired based on an objective evidence on impairment at an amount equal to lifetime ECL.

Lifetime ECL is ECL that result from all possible default events over the remaining expected life of a financial instrument. The 12 month ECL is the portion of lifetime expected credit loss that result from default events that are possible within the 12 months after the reporting date. Both lifetime ECL and 12 month ECL are calculated on either an individual basis or a collective basis depending on the nature of the underlying portfolio of financial instruments.

***Determining the stage of impairment***

At each reporting date, the Group assesses whether there has been significant increase in credit risk since initial recognition by comparing the risk of default occurring over the remaining expected life from the reporting date with the risk of default at the date of initial recognition. The quantitative criteria used to determine a significant increase in credit risk is a series of relative and absolute thresholds. All financial assets that are 30 days past due are deemed to have significant increase in credit risk since initial recognition and migrated to stage 2 even if other criteria do not indicate a significant increase in credit risk.

**2.2 CHANGES IN ACCOUNTING POLICIES (continued)**

*IFRS 9 – Financial Instruments (continued)*

*Impairment of financial assets (continued)*

*Policy applicable from 1 January 2018 (continued)*

*Determining the stage of impairment (continued)*

At each reporting date, the Group also assesses whether a financial asset or group of financial assets is credit impaired. The Group considers a financial asset to be credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred or when contractual payments are 90 days past due. All credit impaired financial assets are classified as stage 3 for ECL measurement purposes. Evidence of credit impairment includes observable data about the following:

- Significant financial difficulty of the borrower or issuer
- A breach of contract such as default or past due event
- The lender having granted to the borrower a concession, that the lender would otherwise not consider, for economic or contractual reasons relating to the borrower’s financial difficulty
- The disappearance of an active market for a security because of financial difficulties
- Purchase of a financial asset at a deep discount that reflects the incurred credit loss

At the reporting date, if the credit risk of a financial asset or group of financial assets has not increased significantly since initial recognition or not credit impaired, these financial assets are classified as stage 1.

*Measurement of ECL*

ECL is the probability weighted estimate of credit losses and is measured as the present value of all cash shortfalls discounted at the effective profit rate of the financial instrument. Cash shortfall represents the difference between cash flows due to the Group in accordance with the contract and the cash flows that the Group expects to receive. The key elements in the measurement of ECL include probability of default (“PD”), loss given default (“LGD”) and exposure at default (“EAD”). The Group estimates these elements using appropriate credit risk models taking into consideration the internal and external credit ratings of the assets, nature and value of collaterals, forward looking macroeconomic scenarios as well as other factors.

*Presentation of allowance for ECL in the consolidated statement of financial position*

Loss allowances for ECL are presented as a deduction from the gross carrying amount of the financial assets for financial assets carried at amortised cost. In the case of debt instruments measured at FVOCI, the Group recognises the ECL charge in the consolidated statement of profit or loss and a corresponding amount is recognised in other comprehensive income with no reduction in the carrying amount of the financial asset in the consolidated statement of financial position.

*Policy applicable before 1 January 2018*

*Provisions for credit losses in accordance with the CBK instructions*

The Group is required to calculate provisions for credit losses on financing receivables in accordance with the CBK instructions with respect to financing receivables and the calculation of provisions. Financing receivables are classified as past due when a payment has not been received on its contractual payment date or if the facility is in excess of pre-approved limits. A financing receivable is classified as past due and impaired when the profit or a principal instalment is past due for more than 90 days and if the carrying amount of the facility is greater than its estimated recoverable value. Past due and past due and impaired financing receivables are managed and monitored as irregular facilities and are classified into the following four categories which are then used to determine the provisions:

<b>Category</b>	<b>Criteria</b>	<b>Specific provision</b>
Watch list	Irregular for a period up to 90 days	-
Substandard	Irregular for a period of 91- 180 days	20%
Doubtful	Irregular for a period of 181- 365 days	50%
Bad	Irregular for a period exceeding 365 days	100%

**2.2 CHANGES IN ACCOUNTING POLICIES (continued)**

*IFRS 9 – Financial Instruments (continued)*

*Impairment of financial assets (continued)*

*Policy applicable before 1 January 2018 (continued)*

*Provisions for credit losses in accordance with the CBK instructions (continued)*

The Group may also include a credit facility in one of the above categories based on management's judgement of a customer's financial and/or non-financial circumstances.

Minimum general provisions of 1% on cash facilities and 0.5% on non-cash facilities are made on all applicable financing receivables (net of certain restricted categories of collateral) which are not subject to specific provisioning.

*Hedge accounting*

The general hedge accounting requirements of IFRS 9 retain the three types of hedge accounting mechanisms in IAS 39. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify as hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, changes have been introduced to the effectiveness test and has been replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is no longer required.

The hedging requirements of IFRS 9 did not have a significant impact on Group's consolidated financial statements.

*Transition*

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below:

- a) Comparative periods have not been restated. Differences in the carrying amounts of financial assets resulting from the adoption of IFRS 9 are recognised in retained earnings and respective reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.
- b) The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.
  - The determination of the business model within which a financial asset is held;
  - The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL;
  - The designation of certain investments in equity instruments not held for trading as at FVOCI; and
  - If a debt instrument had low credit risk at the date of initial application of IFRS 9, then the Group has assumed that credit risk on the asset had not increased significantly since its initial recognition.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

## 2.2 CHANGES IN ACCOUNTING POLICIES (continued)

*IFRS 9 – Financial Instruments (continued)**Transition (continued)**Impact of Adopting IFRS 9*

The impact of this change in accounting policy as at 1 January 2018 has been to increase the fair value reserve by KD 1,122 thousand, and to increase the retained earnings by KD 915 thousand as follows:

	<i>Fair value reserve KD'000</i>	<i>Retained earnings KD'000</i>
Closing balance under IAS 39 at 31 December 2017 ( <i>restated</i> )	(214)	559
<i>Impact on reclassification and re-measurement:</i>		
Investments in financial instruments (funds and equity) from available-for-sale to FVTPL	135	2,541
Investments in financial instruments (equity) from available-for-sale to FVOCI	535	-
<i>Total impact of reclassification and re-measurement on the opening balance</i>	<u>670</u>	<u>2,541</u>
<i>Impact on recognition of Expected Credit Losses (ECL) on financial assets:</i>		
ECL under IFRS 9 for investments in debt instruments (Sukuk) from available-for-sale to FVOCI	452	(452)
ECL under IFRS 9 for financial assets at amortised cost (placements with banks)	-	(322)
ECL under IFRS 9 for financing receivables	-	(852)
<i>Total impact of ECL on the opening balance</i>	<u>452</u>	<u>(1,626)</u>
<i>Total impact on IFRS 9 application at 1 January 2018</i>	<u>1,122</u>	<u>915</u>
<b>Opening balance under IFRS 9 as at 1 January 2018</b>	<u><u>908</u></u>	<u><u>1,474</u></u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

## 2.2 CHANGES IN ACCOUNTING POLICIES (continued)

## IFRS 9 – Financial Instruments (continued)

## Transition (continued)

## Impact of Adopting IFRS 9 (continued)

## Classification of financial assets on the date of initial application of IFRS 9

The following table shows reconciliation of original measurement categories and carrying value in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Group's financial assets as at 1 January 2018.

	<i>Original classification under IAS 39</i>	<i>New classification under IFRS 9</i>	<i>Original carrying amount under IAS 39 KD'000</i>	<i>Re- measurements ECL KD'000</i>	<i>Re- measurements Others KD'000</i>	<i>New carrying amount under IFRS 9 KD'000</i>
<b>Financial assets</b>						
Cash and balances with banks	Loans and receivables	Amortised Cost	13,201	-	-	13,201
Placements with banks and the CBK	Loans and receivables	Amortised Cost	246,484	(322)	-	246,162
Financing receivables	Loans and receivables	Amortised Cost	1,263,322	(852)	-	1,262,470
Investment securities – Sukuk	AFS	FVOCI	140,140	-	-	140,140
Investment securities – funds and other securities (unquoted)	AFS	FVTPL	20,927	-	2,676	23,603
Investment securities – Unquoted equity	AFS	FVOCI	4,098	-	535	4,633
Investment securities – Quoted equity	AFS	FVTPL	756	-	-	756
Other assets	Loans and receivables	Amortised Cost	23,347	-	-	23,347
<b>Total financial assets</b>			<b>1,712,275</b>	<b>(1,174)</b>	<b>3,211</b>	<b>1,714,312</b>

Adoption of IFRS 9 did not result in any change in classification or measurement of financial liabilities.

The following table reconciles the closing impairment allowance for financial assets in accordance with IAS 39 as at 31 December 2017 to the opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2018.

	<i>Impairment allowance under IAS 39 at 31 December 2017 KD'000</i>	<i>Re- measurements KD'000</i>	<i>ECL under IFRS 9 at 1 January 2018 KD'000</i>
Investment in financial instruments (Sukuk) from available for sale to FVOCI	-	452	452
Financial assets at amortised cost	20,376	1,174	21,550
<b>Total ECL</b>	<b>20,376</b>	<b>1,626</b>	<b>22,002</b>

Other amendments to IFRSs which are effective for annual accounting period starting from 1 January 2018 did not have any material impact on the accounting policies, financial position or performance of the Group.

### 2.3 STANDARDS ISSUED BUT NOT YET EFFECTIVE

Standards and amendments to standards issued but not 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 16 - Leases*

In January 2016, the IASB issued IFRS 16 '*Leases*' with an effective date of annual periods beginning on or after 1 January 2019 and it replaces IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 *Operating Leases-Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. 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 financing 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 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under IAS 17 '*Leases*'. Lessees will recognise a 'right of use' asset and a corresponding financial liability on the consolidated statement of financial position. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. The Group is in the process of assessing the impact of adopting IFRS 16 on the Group's consolidated financial statements.

IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17.

The Group plans to adopt the new standard on the required effective date but does not expect any significant impact of this standard on its consolidated financial statements.

### 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### **Basis of consolidation**

The consolidated financial statements comprise the financial statements 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 to or an accrual of 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

**2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Basis of consolidation (continued)**

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.

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 is de-recognised at fair value at the date of loss of control.

The wholly owned special purpose vehicles of the Bank are as follows:

<i>Name of company</i>	<i>Principal activities</i>	<i>Country of incorporation</i>	<i>Effective interest as at 31 December 2018</i>	<i>Effective interest as at 31 December 2017</i>
Abyat Real Estate Company L.L.C.	Real Estate	Oman	100%	100%
Themar Al Omania Company L.L.C.	Real Estate	Oman	100%	100%
Al Kout Holdings Limited	Real Estate	Jersey	100%	100%
Warba Tier 1 Sukuk Limited	Financial Securities	Cayman Islands	100%	100%

**Financial instruments***Date of recognition*

Financial assets and liabilities, with the exception of financing receivable and depositors' accounts, are initially recognised on the trade date, i.e., the date that the Group becomes a party to the contractual provisions of the instrument. This includes regular way trades: purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place. Financing to customers are recognised when funds are transferred to the customers' accounts. The Group recognises depositors' accounts when funds are transferred to the Group.

*Initial measurement of financial instruments*

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value except in the case of financial assets and liabilities recorded at FVTPL, transaction costs are added to, or subtracted from, this amount.

*Day 1 profit or loss*

When the transaction price of the instrument differs from the fair value at origination and the fair value is based on a valuation technique using only inputs observable in market transactions, the Group recognises the difference between the transaction price and fair value in the investment income. In those cases where fair value is based on models for which some of the inputs are not observable, the difference between the transaction price and the fair value is deferred and is only recognised in profit or loss when the inputs become observable, or when the instrument is derecognised.

*Determining the classification and measurement of financial assets*

The Group has determined the classification and measurement of its financial assets as follows:

## i. 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 whose original maturity is within 3 months". Cash and cash equivalents are carried at amortised cost using effective profit rate.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial instruments (continued)

*Determining the classification and measurement of financial assets (continued)*

ii. Placement with banks and financing receivables

These are 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:

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 and an 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.

Placement with banks, financing receivables are stated in the consolidated statement of financial position at amortised cost using the effective profit method less provision for impairment. The amount payable will be paid on installments or on a deferred basis.

iii. Financial investments

Group's financial investments consist of investment in Sukuk, equity securities, funds and other securities. Sukuk and unquoted equity securities were classified as financial assets at fair value through other comprehensive income. Quoted equity securities, funds (unquoted) and other securities (unquoted) were classified as financial assets as FVTPL.

iv. Financial Assets Available-for-sale (AFS) – Policy applicable before 1 January 2018

Available-for-sale investments included equity investments and debt instruments (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 instruments 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 profit or loss, or the investment is determined to be impaired, when the cumulative loss is reclassified from the fair value reserve to the consolidated statement of profit or loss. Profit earned, whilst holding the available-for-sale investments, is reported as investment income (using the effective profit rate method of debt instruments).

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 acceptance. Financial guarantees are initially recognised in the consolidated financial statements at fair value, being the premium received, in other liabilities. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the statement of profit or loss, and from 1 January 2018 the higher of ECL under IFRS 9 according to the CBK guidelines, and the provisions required by the CBK.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Financial instruments (continued)

#### *De-recognition of financial assets and financial liabilities*

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

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

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if and to what extent it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all of the risks and rewards of the asset, nor transferred control of the asset, the Group continues to recognise the transferred asset to the extent of the Group's continuing involvement. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

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

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. 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. The difference in the respective carrying amounts is recognised in the consolidated statement of profit or loss.

#### *De-recognition due to substantial modification or terms and conditions*

The Group derecognises a financial asset, such as financing receivables, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new finance, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised financing receivables are classified as Stage 1 for ECL measurement purposes, unless they are deemed to be credit impaired.

When assessing whether or not to derecognise a financing receivable, amongst others, the Group considers the following factors:

- Change in currency of the financing
- Introduction of an equity instrument feature
- Change in counterparty

If the modifications are such that, the instrument would no longer meet the SPPP criterion

If the modifications do not result in cash flows that are substantially different, they result in derecognition. Based on the change in cash flows discounted at original effective profit rate, the Group records a modification gain or loss, to the extent that an impairment loss has not already been recorded.

#### *Offsetting*

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated 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 so as to realize the assets and liabilities simultaneously.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Financial instruments (continued)

#### *Derivative financial instruments and hedge accounting*

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge.

Beginning 1 January 2018, the documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the Group will assess whether the hedging relationship meets the hedge effectiveness requirements (including the analysis of sources of hedge effectiveness and how the hedge ratio is determined). A hedging relationship qualifies for hedge accounting if it meets all of the following effectiveness requirements:

- There is 'an economic relationship' between the hedge item and the hedging instrument.
- The effect of the credit risk does not 'dominate the value changes' that result from that economic relationship; and
- The hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the Group actually hedges and the quantity of the hedging instrument that the Group actually uses to hedge that quantity of hedged item.

#### *Cash flow hedges*

The cash flow hedges hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability, a highly probable transaction or foreign exchange risks within an unrecognised firm commitment.

The effective portion of the gain or loss on the hedging instrument is recognised in the consolidated statement of other comprehensive income, while any ineffective portion is recognised immediately in the consolidated statement of profit or loss. The cash flow hedge reserve is adjusted to the lower of cumulative gain or loss on the hedging instrument and the cumulative changes in fair value of the hedged item.

When a hedging instrument expires, is sold, terminated, exercised, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss that has been recognised in the consolidated statement of other comprehensive income at that time remains in the consolidated statement of other comprehensive income and is recognised when the hedged forecast transaction is ultimately recognised in the consolidated statement of profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in the consolidated statement of other comprehensive income is immediately transferred to the consolidated statement of profit or loss.

#### **Incorporation of forward looking information**

The Group incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. The Group has performed historical analysis and identified the key economic variables impacting credit risk and ECL. Relevant macro-economic adjustments are applied to capture variations from economic scenarios. These reflect reasonable and supportable forecasts of future macro-economic conditions that are not captured within the base ECL calculations. Macro-economic factors taken into consideration include, but are not limited to, gross domestic product, commodity price index and equity price index and require an evaluation of both the current and forecast direction of the macro-economic cycle. Incorporating forward-looking information increases the degree of judgement required as to how changes in these macro-economic factors will affect ECL. The methodologies and assumptions including any forecasts of future economic conditions are reviewed regularly.

#### *Renegotiated financing receivables*

In the event of a default, the Group seeks to restructure financing to customers rather than take possession of collateral. This may involve extending the payment arrangements and the agreement of new financing conditions. When the financing to customers has been renegotiated or modified but not derecognised, any impairment is measured using the original effective yield method as calculated before the modification of terms. Management continually reviews renegotiated financing to ensure that all criteria are met and that future payments are likely to occur. Management also assesses whether there has been significant increase in credit risk or the facility should be classified in stage 3.

**2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Financial instruments (continued)**

**Impairment of financial assets**

*Policy applicable before 1 January 2018*

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 (an incurred 'loss event') 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.

With respect to 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.

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 profit or loss.

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 the CBK instructions, a minimum general provision on all financing facilities net of certain categories of collateral, to which the 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 profit or loss is removed from fair value reserve and recognised in the consolidated statement of profit or loss. Impairment losses on equity investments are not reversed through the consolidated statement of profit or loss; 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.

**Write-offs**

The Group's accounting policy under IFRS 9 remains the same as it was under IAS 39. Financial assets are written off either partially or in their entirety. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to expected credit losses.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 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 ventures 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 profit or loss 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.

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 profit or loss.

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 profit or loss.

### 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 fair value, which reflects market conditions at the reporting date. Gains or losses arising from changes in the fair values of investment properties are included in the consolidated statement of profit or loss in the period in which they arise. Fair values are determined based on an annual evaluation performed by accredited independent valuers using recognised valuation techniques.

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 profit or loss in the year of derecognition.

### 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 profit or loss during the financial year in which they are incurred.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Property and equipment (continued)

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

An item of property, and equipment and any significant part initially recognised is derecognised upon disposal (i.e., at the date the recipient obtains control) or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of profit or loss when the asset is derecognised.

The residual values, useful lives and methods of depreciation of property and equipment are reviewed at each financial year end and adjusted prospectively, if appropriate.

Lands do not have a specified useful life and accordingly they are not depreciated.

### 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 recoverable 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 profit or loss. 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 for end of service benefits to all of its employees as per the Kuwaiti Labor Law. The entitlement to the benefits is based upon the employee's final salary and length of service, subject to the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

### 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.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 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 profit or loss.

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 profit or loss and within debt instruments, foreign exchange differences are recognised in the consolidated statement of profit or loss.

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 profit or loss 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 profit or loss.

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.

#### *Provision of 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.

### Contingent assets and liabilities

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.

**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:

*Classification of financial assets - applicable from 1 January 2018*

The Group determines the classification of financial assets based on the assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and profit.

*Impairment of financial assets available-for-sale - applicable before 1 January 2018*

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.

*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.

*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.

**Estimation uncertainty**

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk that may cause a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

*Impairment of investment in joint ventures*

The Group calculates the amount of impairment as the difference between the recoverable amount and its carrying value if there is any objective evidence that the investment in joint ventures are impaired. The estimation of recoverable amount requires the Group to make an estimate of the expected future cash flows and selection of appropriate inputs for valuation.

*Impairment of financial instruments*

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

**2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Estimation uncertainty (continued)**

*Impairment of financial instruments - applicable from 1 January 2018*

The Group's ECL calculations are outputs of complex model with a number of underlying assumptions regarding the choice of variable inputs and their dependencies. Elements of the ECL model that are considered accounting judgements and estimates include:

- The Group's internal credit rating model, which assigns PDs to the individual grades;
- The Group's criteria for assessing if there has been a significant increase in credit risk so allowances for financial assets should be measured on a lifetime ECL basis and qualitative assessment;
- The segmentation of financial assets when their ECL is assessed on a collective basis;
- Development of ECL models, including various formulas and choice of inputs;
- Determination of associations between macroeconomic scenarios and, economic inputs, and the effect on PDs, EADs and LGDs; and
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

The Group has the policy to regularly review its model in the context of actual loss experience and adjust when necessary.

*Impairment losses on financing receivables – applicable before 1 January 2018*

The Group reviews its financing receivables on a regular basis to assess whether an impairment loss should be recorded in the consolidated statement of profit or loss. 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.

*Valuation of unquoted equity investments, unquoted funds and other securities*

Valuation of unquoted equity investments, unquoted funds and other securities is normally based on one of the following:

- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same;
- an earnings multiple;
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics; or
- other valuation models.

The determination of the cash flows and discount factors for unquoted equity investments, unquoted funds and unquoted other securities requires significant estimation. There are a number of investments where this estimation cannot be reliably determined.

**3 CASH AND CASH EQUIVALENTS**

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i>
Cash	3,766	1,700
Current account with the CBK	9,254	6,206
Current accounts with commercial banks	6,718	5,295
Cash and balances with banks	<u>19,738</u>	<u>13,201</u>
Placements with the CBK whose original maturity is within 3 months	60,125	17,053
Placements with banks whose original maturity is within 3 months	149,786	150,832
Cash and cash equivalents	<u><u>229,649</u></u>	<u><u>181,086</u></u>

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

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**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.

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i>
Murabaha receivables	1,495,594	1,181,210
Ijara receivables	222,979	165,243
Others	12,673	8,007
Less: deferred profit	(94,366)	(70,762)
Financing receivables before provision for impairment	<u>1,636,880</u>	<u>1,283,698</u>
Less: provision for impairment	-	(20,376)
Less: expected credit losses	(30,338)	-
	<u><u>1,606,542</u></u>	<u><u>1,263,322</u></u>

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

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i>
Corporate	1,028,352	809,004
Individuals	608,528	474,694
Financing receivables before provision for impairment	<u>1,636,880</u>	<u>1,283,698</u>
Less: provision for impairment	-	(20,376)
Less: expected credit losses	(30,338)	-
	<u><u>1,606,542</u></u>	<u><u>1,263,322</u></u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**4 FINANCING RECEIVABLES (continued)**

An analysis of changes in the gross carrying amount and the corresponding expected credit losses in relation to financing receivables are as follows:

<i>2018</i>	<i>Stage 1 KD '000</i>	<i>Stage 2 KD '000</i>	<i>Stage 3 KD '000</i>	<i>Total KD '000</i>
Financing receivables gross carrying value as at 1 January 2018 under IFRS 9	1,213,046	52,102	18,550	1,283,698
New assets originated or purchased net of repayments during the year	355,521	1,166	204	356,891
Transfer between stages	39,436	(44,715)	5,279	-
Amounts written off net of exchange Movements	-	(706)	(3,003)	(3,709)
<b>At 31 December 2018</b>	<b>1,608,003</b>	<b>7,847</b>	<b>21,030</b>	<b>1,636,880</b>
<i>2018</i>	<i>Stage 1 KD '000</i>	<i>Stage 2 KD '000</i>	<i>Stage 3 KD '000</i>	<i>Total KD '000</i>
Expected credit losses as at 1 January 2018 under IFRS 9	7,650	2,580	10,146	20,376
Charge during the year (Note 16)	11,637	504	211	12,352
Impact due to transfer between stages	(8,132)	(1,761)	9,893	-
Amounts written off net of exchange movements	-	(56)	(2,334)	(2,390)
<b>At 31 December 2018</b>	<b>11,155</b>	<b>1,267</b>	<b>17,916</b>	<b>30,338</b>

The increase in ECLs of the lending portfolio was driven by an increase in the gross size of the portfolio and movements between stages as a result of increases in credit risk and a deterioration in economic conditions.

An analysis of the charge for expected credit losses for the year 2018 is as follows:

<i>2018</i>	<i>12m ECL Stage 1 KD 000's</i>	<i>Life time ECL Stage 2 KD 000's</i>	<i>Life time ECL Stage 3 KD 000's</i>	<i>Total ECL charge KD 000's</i>
Cash facilities (Note 16)	11,638	503	211	12,352
Non cash facilities (Note 16)	43	(6)	3,753	3,790
<b>Charge for Expected credit losses for credit Facilities</b>	<b>11,681</b>	<b>497</b>	<b>3,964</b>	<b>16,142</b>

The expected credit losses calculated as per IFRS 9 according to the CBK guidelines as at 31 December 2018 amounted to KD 34,642 thousand, which is higher than provisions computed as required by the CBK guidelines amounting to KD 31,638 thousand.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

## 4 FINANCING RECEIVABLES (continued)

Movement in provision for impairment for the year ended 31 December 2017 is as follows:

	2017		
	<i>Specific provision KD'000</i>	<i>General provision KD'000</i>	<i>Total KD'000</i>
<i>Cash facilities</i>			
Balance at 1 January	2,696	9,998	12,694
Provision charged during the year (Note 16)	6,811	4,962	11,773
Written off balances during the year	(4,078)	-	(4,078)
Foreign currency movement	24	(37)	(13)
Balance at 31 December	5,453	14,923	20,376
<i>Non-cash facilities</i>			
Balance at 1 January	-	251	251
Provision charged during the year (Note 16)	-	263	263
Balance at 31 December	-	514	514
<i>Total facilities</i>			
Balance at 1 January	2,696	10,249	12,945
Provision charged during the year	6,811	5,225	12,036
Written off balances during the year	(4,078)	-	(4,078)
Foreign currency movement	24	(37)	(13)
Balance at 31 December	5,453	15,437	20,890

The available provision balance on non-cash facilities of KD 4,304 thousand (2017: KD 514 thousand) is included under other liabilities.

The fair values of financing receivables do not materially differ from their respective carrying values.

## 5 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2018 KD'000	2017 KD'000
Quoted equity instruments	7,159	-
Funds (unquoted)	26,430	-
Other securities (unquoted)	7,911	-
	41,500	-

On initial application of IFRS 9, the Group's management re-classified its investments in quoted equity instruments, unquoted funds and unquoted other securities from available-for-sale investments to financial assets at fair value through profit or loss (Note 7). The impact resulting from adoption of IFRS 9 has been disclosed in Note 2.2.

The hierarchy for determining and disclosing the fair values of financial instruments by valuation techniques are presented in Note 23.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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6 FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i>
Quoted Sukuk	141,093	-
Unquoted Sukuk	2,000	-
Unquoted equity instruments	5,492	-
	<u>148,585</u>	<u>-</u>
Expected credit losses	<u>953</u>	<u>-</u>

On initial application of IFRS 9, the Group's management re-classified its investments in quoted Sukuk, unquoted Sukuk, and unquoted equity instruments from available-for-sale investments to financial assets at fair value through other comprehensive income (Note 7). The impact resulting from adoption of IFRS 9 has been disclosed in Note 2.2.

During the year ended 31 December 2018, the management has performed a review of the financial assets at fair value through other comprehensive income to assess the Expected Credit Losses. Based on the assessment, the management has recognized expected credit losses of KD 501 thousand in the consolidated statement of profit or loss for the year (Note 16).

The hierarchy for determining and disclosing the fair values of financial instruments by valuation techniques are presented in Note 23.

Investments in debt instruments are subject to Expected Credit Losses. An analysis of changes in the gross carrying amount and the corresponding Expected Credit Losses in relation to investment in debt instruments is as follows:

<b>2018</b>	<i>Stage 1</i> <i>KD'000</i>	<i>Stage 2</i> <i>KD'000</i>	<i>Stage 3</i> <i>KD'000</i>	<i>Total</i> <i>KD'000</i>
Gross carrying amount as at 1 January 2018	140,140	-	-	140,140
Assets purchased/derecognised during the year -Net	2,241	-	-	2,241
Transfer between stages	(5,844)	5,844	-	-
Exchange movements	682	30	-	712
<b>At 31 December 2018</b>	<u>137,219</u>	<u>5,874</u>	<u>-</u>	<u>143,093</u>
	<i>Stage 1</i> <i>KD'000</i>	<i>Stage 2</i> <i>KD'000</i>	<i>Stage 3</i> <i>KD'000</i>	<i>Total</i> <i>KD'000</i>
ECL allowance as at 1 January 2018	452	-	-	452
Impact due to purchase/de-recognition	356	-	-	356
Impact due to transfer between stages	(194)	194	-	-
Re-measurement of ECL	145	-	-	145
<b>At 31 December 2018</b>	<u>759</u>	<u>194</u>	<u>-</u>	<u>953</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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7 AVAILABLE-FOR-SALE INVESTMENTS

	2018 KD'000	2017 KD'000
Quoted Sukuk	-	138,140
Quoted equity instruments	-	756
Unquoted Sukuk	-	2,000
Unquoted equity instruments	-	4,098
Funds and other securities (unquoted)	-	20,927
	<u>-</u>	<u>165,921</u>

As of 31 December 2017, all available for sale investments were recorded at fair value except for unquoted investments with a carrying value of KD 25,025 thousand, which are recorded at cost less impairment.

During prior year ended 31 December 2017, the 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 (Note 16) in the consolidated statement of profit or loss for the year in respect of available for sale investments.

On initial application of IFRS 9, the Group's management re-classified its investments in quoted equity instruments, unquoted funds and unquoted other securities from available-for-sale investments to financial assets at fair value through profit or loss (Note 5) and its investments in quoted and unquoted Sukuk, and unquoted equity instruments from available-for-sale investments to financial assets at fair value through other comprehensive income (Note 6). The impact resulting from adoption of IFRS 9 has been disclosed in Note 2.2.

8 INVESTMENTS IN JOINT VENTURES

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

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

	2018 KD'000	2017 KD'000 (Restated)
As at 1 January	31,660	-
Additions	19,853	31,686
Share of results	3,180	491
Dividends received	(2,331)	(392)
Foreign currency translation adjustment	136	(125)
As at 31 December	<u>52,498</u>	<u>31,660</u>

The joint ventures have capital commitments amounting to KD 5,333 thousand as at 31 December 2018 (2017: Nil).

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

	2018 KD'000	2017 KD'000 (Restated)
<b>Joint ventures' statement of financial position:</b>		
Current assets	418	1,656
Non-current assets	52,101	30,922
Current liabilities	(21)	(918)
Net assets	<u>52,498</u>	<u>31,660</u>
Profit for the year	<u>3,180</u>	<u>491</u>
Revenues	<u>3,397</u>	<u>335</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

9 INVESTMENT PROPERTIES

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i> <i>(Restated)</i>
Balance at 1 January	24,611	15,632
Additions	-	8,891
Unrealised loss on change of fair value	(1,207)	(669)
Foreign currency translation adjustment	(537)	757
Balance at 31 December	<u>22,867</u>	<u>24,611</u>

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>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i> <i>(Restated)</i>
Rental income from investment properties	1,468	1,234
Direct operating expenses	(253)	(199)
Net rental income from investment properties (Note 14)	<u>1,215</u>	<u>1,035</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 capitalisation approach is used. The determination of the fair value using the income capitalisation approach is based on the normal operating income arising from the property which is divided over the capitalization rate (discount).

Investment properties amounting to KD 22,867 thousand (2017: KD 24,611 thousand) are classified under level 3 of the fair value hierarchy.

10 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.

11 DEPOSITORS' ACCOUNTS

Depositors' accounts of the Group 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 Group guarantees to pay the related balances on demand. Accordingly, these deposits are considered Qard Hasan from depositors to the Group.
- 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

12 EQUITY

*Share capital and share premium*

The extraordinary general assembly meeting of the shareholders of the Bank held on 31 October 2018 approved an increase in the authorized, issued and paid share capital by 50% by offering 500,000 thousand rights shares for subscription to the Bank's shareholders for 180 fils per share (100 fils par value and 80 fils share premium). The increase in share capital has been registered in the commercial register on 4 November 2018 with registration number 334402. Accordingly, the authorised, issued and fully paid-up share capital at 31 December 2018 comprises of 1,500,000 thousand shares (31 December 2017: 1,000,000 thousand shares) of a par value of 100 fils each.

*Share capital*

	<i>2018</i>	<i>2017</i>
	<i>KD'000</i>	<i>KD'000</i>
Authorized, issued and fully paid :		
1,500,000 thousand (2017: 1,000,000 thousand) shares with a par value of 100 fils each	<u>150,000</u>	<u>100,000</u>

*Statutory reserve*

In accordance with the Companies' Law, and the Bank's Memorandum of Incorporation and Articles of Association, a minimum of 10% of the profit for the year before contribution to KFAS, NLST, Zakat and Directors' remunerations shall be transferred to the statutory reserve. The Annual General Assembly of the Bank may resolve to discontinue such transfer when the reserve exceeds 50% of the issued share capital. The reserve may only be used to offset losses or enable the payment of a dividend up to 5% of paid-up share capital in years when profit is not sufficient for the payment of such dividend due to absence of distributable reserves. Any amounts deducted from the reserve shall be refunded when the profits in the following years suffice, unless such reserve exceeds 50% of the issued share capital.

An amount of KD 1,353 thousand was transferred to the statutory reserve during the current year (2017: Nil).

*Voluntary reserve*

In accordance with the Bank's Articles of Association and Memorandum of Incorporation, a percentage is deducted for voluntary reserve based on proposal of the Board of Directors and subject to approval of the Annual General Assembly. Such transfers may be discontinued by a resolution of the ordinary general assembly upon a proposal by the Board of Directors and the CBK approval.

In accordance with the Companies' Law, a maximum of 10% of the profit for the year before contribution to KFAS, NLST, Zakat and Directors' remuneration, is eligible to be transferred to the voluntary reserve by a resolution of the Annual General Assembly upon a proposal by the Board of Directors in order to accumulate a voluntary reserve allocated for purposes specified by the Annual General Assembly.

Based on the proposal of the Board of Directors, no transfer has been made to the voluntary reserve in the current year and prior year.

13 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 payments during the year on 12 March and 10 September 2018.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

**14 NET INVESTMENT INCOME**

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i> <i>(Restated)</i>
Realised loss on sale of debt instruments at fair value through other comprehensive income	(651)	-
Realised gain on sale of available-for-sale investments	-	347
Dividend income	2,001	1,535
Sukuk income	6,118	3,500
Share of results of investments in joint ventures (Note 8)	3,180	491
Net rental income from investment properties (Note 9)	1,215	1,035
Unrealised gain on financial assets at fair value through profit or loss	77	-
Unrealised loss on change in fair value of investment properties (Note 9)	(1,207)	(669)
Other investment income	191	148
	<u>10,924</u>	<u>6,387</u>

**15 NET FEES AND COMMISSION INCOME**

Net fees and commission income includes financing syndication fees earned on the successful completion of syndicated deals by the Group amounting to KD 1,975 thousand (2017: KD 991 thousand).

**16 PROVISION FOR IMPAIRMENT**

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i> <i>(Restated)</i>
Expected credit losses for financing receivables (Note 4)	12,405	-
Expected credit losses for non-cash facilities (Note 4)	3,790	-
Expected credit losses for investments in Sukuk (Note 6)	501	-
Reversal of expected credit losses for placements with banks	(50)	-
Impairment on financing receivables (Note 4)	-	11,815
Recovery of written-off financing receivables (Note 4)	(53)	(42)
Impairment on available-for-sale investments (Note 7)	-	215
Impairment on property and equipment	466	25
Impairment on other assets	5	42
Impairment on non-cash facilities (Note 4)	-	263
	<u>17,064</u>	<u>12,318</u>

**17 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>2018</i>	<i>2017</i> <i>(Restated)</i>
Net profit for the year (KD'000)	12,738	7,454
Less: profit payment on Perpetual Tier 1 Sukuk (KD'000)	(4,908)	(2,451)
	<u>7,830</u>	<u>5,003</u>
Weighted average number of shares outstanding ('000)	<u>1,109,652</u>	<u>1,084,615</u>
Basic and diluted earnings per share (fils)	<u>7.06</u>	<u>4.61</u>

The comparative basic and diluted earnings per share have been restated as a result of the shares issued to the shareholders of the Bank.

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 2018

**18 RELATED PARTIES**

Related parties comprise the major shareholders, board of directors, entities controlled by them or under their joint control, associates, key management personnel and their close family members. Balances with related parties arise from commercial transactions in the normal course of business on terms approved by the management.

**18.1 Remuneration of the Bank's key management personnel:**

Key management personnel are those individuals who have the authority and responsibility for planning and exercising power to directly or indirectly control the activities of the Bank and its employees. The Bank considers the members of the Board of Directors (and its sub-committees) and Executive Committee to be key management personnel for the purposes of IAS 24 *Related Party Disclosures*.

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i>
Salaries and short-term benefits	2,166	2,048
End of service benefits	175	146
Directors' remuneration	207	166
	<u>2,548</u>	<u>2,360</u>

Board of directors' remuneration is subject to the approval of the annual general assembly meeting (AGM).

**18.2 Transactions with Bank's Key management personnel:**

The Bank enters into transactions, arrangements and agreements involving senior management and their controlled business, or close family members, in the ordinary course of business under the same commercial and market terms, profit and commission rates that apply to non-related parties.

The following table shows the total amount of transactions, which have been entered into with key management personnel for the relevant financial year which are included in the consolidated statement of financial position:

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i>
Financing facilities	1,469	1,065
Credit cards	7	7
Depositors' accounts	706	560

The number of the board members and executive officers is as follows:

	<i>2018</i>	<i>2017</i>
Financing facilities	7	7
Credit cards	6	6
Depositors' accounts	38	16

The transactions with related parties which are included in the consolidated statement of profit or loss are as follows:

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i>
Placements and financing income	38	94
Finance costs and distributions to depositors	49	1

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18 RELATED PARTIES (continued)

18.3 Transactions with major shareholders and other related parties:

In addition to transactions with key management, the Bank enters into transactions with major shareholders and other entities which the Bank has direct or indirect control, including common control, joint control and significant influence.

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

	<i>Outstanding balances as at</i>			
	<i>Major shareholders KD'000</i>	<i>Other related parties KD'000</i>	<i>Total 31 December 2018 KD'000</i>	<i>Total 31 December 2017 KD'000</i>
Finance facilities	-	-	-	23
Credit cards	-	-	-	1
Depositors' accounts	861,627	323	861,950	676,515

The number of major shareholders and other related parties is as follows:

	<i>No. of major shareholders</i>	<i>No. of other related parties</i>
<b>2018</b>		
Finance facilities	-	-
Credit cards	-	1
Depositors' accounts	2	47
<b>2017</b>		
Finance facilities	-	2
Credit cards	-	2
Depositors' accounts	2	26

Transactions with related parties recorded in the consolidated statement of profit or loss are as follows:

	<i>Transactions values during the year ended</i>			
	<i>Major shareholders KD'000</i>	<i>Other related parties KD'000</i>	<i>Total 31 December 2018 KD'000</i>	<i>Total 31 December 2017 KD'000</i>
Placements and financing income	-	2	2	20
Finance costs and distributions to depositors	17,790	1	17,791	9,820

The above-mentioned outstanding balances arose from the ordinary course of business. The profit rates charged to, and by, related parties are at normal commercial rates. Outstanding balances at the year-end are unsecured. There have been no guarantees provided or received for any related party receivables or payables during the year ended 31 December 2018.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

## 19 COMMITMENTS AND CONTINGENT LIABILITIES

	2018 KD'000	2017 KD'000
Acceptances and letters of credit	33,210	39,788
Letter of guarantees	91,209	62,865
<b>Contingent liabilities</b>	<u>124,419</u>	<u>102,653</u>
<b>Capital commitments</b>	<u>223</u>	<u>232</u>
<b>Operating lease rental commitments – the Group as a lessee</b>		
Future minimum lease payments:		
Within one year	1,833	1,485
Within two to five years	7,147	5,992
	<u>8,980</u>	<u>7,477</u>
<b>Operating lease rental commitments – the Group as a lessor</b>		
Future minimum lease receivable:		
Within one year	1,435	1,526
Within two to five years	5,944	5,976
	<u>7,379</u>	<u>7,502</u>

## 20 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.

**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.

**20 RISK MANAGEMENT (continued)**

**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 receivables and commitments to extend credit and investment in debt instruments (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 the 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.

**Assessment of expected credit losses (policy applicable from 1 January 2018)**

***Definition of default and cure***

The Group considers a financial asset to be in default and therefore Stage 3 (credit impaired) for ECL calculations when:

- the borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as transferring collateral (if any is held);
- the borrower is past due more than 90 days on any material credit obligation to the Group; or
- borrower is considered as credit impaired based on qualitative assessment for internal credit risk management purposes

Any credit impaired or stressed facility that has been restructured during the year would also be considered as in default. The Group considers externally-rated exposures with ratings 'D' for S&P and Fitch, and 'C' for Moody's as defaulted.

The Group considers a variety of indicators that may indicate unlikeliness to pay as part of a qualitative assessment of whether a customer is in default. Such indicators include:

- breaches of covenants
- borrower having past due liabilities to public creditors or employees
- borrower is deceased

***Significant increase in credit risk***

The Group continuously monitors all assets subject to ECL. In order to determine whether an instrument or a portfolio of instruments is subject to 12 months ECL or life time ECL, the Group assess whether there has been a significant increase in credit risk since initial recognition. The Group applies a consistent quantitative criterion for internally and externally rated portfolio to assess significant increase in credit risk.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**20 RISK MANAGEMENT (continued)****b) Credit risk (continued)****Assessment of expected credit losses (policy applicable from 1 January 2018) (continued)***Internal rating and PD estimation process*

In managing its portfolio, the Group utilises ratings and other measures and techniques which seek to take account of all aspects of perceived risk. The Group uses Moody's Risk Analyst (MRA) as its internal credit-rating engine. The MRA tool provides the ability to analyze a business and produce risk ratings. The analysis supports the usage of financial factors as well as non-financial subjective factors. The Group also uses external ratings by recognised rating agencies for externally rated portfolios.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Group' rating policy. The attributable risk ratings are assessed and updated regularly.

The standard requires the use of separate PD for a 12-month duration and lifetime duration depending on the stage allocation of the obligor. A PD used for IFRS 9 should reflect the Group's estimate of the future asset quality. The through the cycle (TTC) PDs are generated from MRA based on the internal/external credit ratings. The Group converts the TTC PD to a point in time (PIT) PD term structures using appropriate models and techniques.

The Group assesses the PD for its retail portfolio through behavioural scorecards implemented in the Group. The scorecards are based on logistic regression technique. This enables the evaluation of score and PD associated against each facility. Term structure of PD is based on hazard rate concept. The survival distribution used is exponential distribution. The probability distribution function of an exponentially distributed random variable is used with the hazard rate as the PD evaluated from the Behavioural scorecard.

*Incorporation of forward-looking information*

The Group considers key economic variables that are expected to have an impact on the credit risk and the ECL in order to incorporate forward looking information into the ECL models. These primarily reflect reasonable and supportable forecasts of the future macro-economic conditions. The consideration of such factors increases the degree of judgment in determination of ECL. The Group employs statistical models to incorporate macro-economic factors on historical default rates. The Group considers 3 scenarios (baseline, upside and downside) of forecasts of macro-economic data separately for each geographical segments and appropriate probability weights are applied to these scenarios to derive a probability weighted outcome of expected credit loss. The management reviews the methodologies and assumptions including any forecasts of future economic conditions on a regular basis.

*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-consolidated statement of 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.

	<i>Net maximum exposure</i>	
	<i>2018</i>	<i>2017</i>
	<i>KD'000</i>	<i>KD'000</i>
Balances with banks	15,972	11,501
Placements with banks and the CBK	256,486	246,484
Financing receivables	1,606,542	1,263,322
Financial assets at fair value through other comprehensive income (investment in Sukuk)	143,093	-
Available-for-sale investments (investment in Sukuk)	-	140,140
Other assets	10,227	10,187
	<u>2,032,320</u>	<u>1,671,634</u>
Acceptances and letters of credit	33,044	39,590
Letter of guarantees	87,071	62,549
<b>Total</b>	<u>120,115</u>	<u>102,139</u>
<b>Total credit risk exposure</b>	<u>2,152,435</u>	<u>1,773,773</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

**20 RISK MANAGEMENT (continued)****b) Credit risk (continued)*****Maximum exposure to credit risk without taking account of any collateral (continued)***

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 2018 amounted to KD 47,155 thousand (2017: KD 25,595 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-consolidated statement of financial position items are as follows:

	2018		2017	
	<i>Financial assets KD'000</i>	<i>Off-consolidated statement of financial position items KD'000</i>	<i>Financial assets KD'000</i>	<i>Off-consolidated statement of financial position items KD'000</i>
<i>Geographic region:</i>				
Kuwait	1,497,728	96,941	1,305,642	96,592
Other Middle East	345,006	224	257,236	-
Rest of the World	189,586	22,950	108,756	5,547
	2,032,320	120,115	1,671,634	102,139

	2018		2017	
	<i>Financial assets KD'000</i>	<i>Off-consolidated statement of financial position items KD'000</i>	<i>Financial assets KD'000</i>	<i>Off-consolidated statement of financial position items KD'000</i>
<i>Industry sector:</i>				
Banks and Financial Institutions	501,754	5,809	475,665	5,417
Construction and Real Estate	694,272	58,033	551,531	58,713
Trading and Manufacturing	247,166	43,218	205,196	27,364
Other	589,128	13,055	439,242	10,645
	2,032,320	120,115	1,671,634	102,139

***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 per class of financial assets***

The table below shows the credit quality and the maximum exposure to credit risk for the year ended 31 December 2018 based on year-end stage allocation for statement of financial position lines by class of assets. The amounts presented are gross of impairment allowances.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

20 RISK MANAGEMENT (continued)

b) Credit risk (continued)

*Credit quality per class of financial assets (continued)*

2018	Stage 1 KD 000's	Stage 2 KD 000's	Stage 3 KD 000's	Total KD 000's
Balances with banks	15,972	-	-	15,972
Placements with banks and the CBK	256,758	-	-	256,758
Financing receivables	1,608,077	7,824	20,979	1,636,880
- Corporate	1,009,148	4,409	14,795	1,028,352
- Retail	598,929	3,415	6,184	608,528
Financial assets at fair value through other comprehensive income (investment in Sukuk)	137,219	5,874	-	143,093
Other assets	10,321	-	-	10,321
<b>Total</b>	<b>2,028,347</b>	<b>13,698</b>	<b>20,979</b>	<b>2,063,024</b>

*Credit quality of financial instruments*

For the year ended 31 December 2017, the Group classified 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 worthiness of assets by class and grade before deducting the provision for impairment for the year ended 31 December 2017.

	Neither past due nor impaired		Past due or impaired	Total KD'000
	High quality KD'000	Standard quality KD'000	KD'000	
2017				
Balances with banks	11,501	-	-	11,501
Placements with banks and the CBK	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
	<b>1,135,029</b>	<b>479,429</b>	<b>77,641</b>	<b>1,692,099</b>

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

	Less than 30 days KD'000	31 to 60 days KD'000	61 to 90 days KD'000	Total KD'000
	2018			
Financing receivables	17,653	3,940	2,484	24,077
2017				
Financing receivables	39,435	13,590	5,969	58,994

**20 RISK MANAGEMENT (continued)**

**b) Credit risk (continued)**

**Collateral**

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines initiated by the Group's risk management and credit committee are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral accepted include real estate, securities, cash and bank guarantees. The Group also obtains guarantees from parent companies for finance facilities extended to their subsidiaries.

Management monitors the fair value of collateral and requests additional collateral in accordance with the underlying agreements when necessary.

The fair value of collateral that the Group holds relating to past due or impaired finance facilities as at 31 December 2018 was KD 19,588 thousand (2017: KD 83,292 thousand). The collateral consists of cash, securities, sukuk, letters of guarantee, real estate assets and other collateral.

**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

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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

**20 RISK MANAGEMENT (continued)****c) Market risk (continued)***Market risk management (continued)**Currency risk (continued)*

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).

Currency	2018			2017		
	Change in	Effect on	Effect on	Change in	Effect on	Effect on
	currency rate %	result KD'000	equity KD'000	currency rate %	result KD'000	equity KD'000
USD	+1	(1,000)	525	+1	(557)	320
SAR	+1	(15)	-	+1	(22)	-
GBP	+1	(58)	59	+1	(43)	47

*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 material change in fair value of listed equity instruments. For such investments, a five percent increase in stock prices as at 31 December 2018 would have increased equity by KD 358 thousand (31 December 2017: KD 38 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.

**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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

**20 RISK MANAGEMENT (continued)****d) Liquidity risk (continued)****Liquidity risk management (continued)**

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:

<b>2018</b>	<b>Within 3 months KD'000</b>	<b>3 to 6 months KD'000</b>	<b>6 to 12 months KD'000</b>	<b>Over 1 year KD'000</b>	<b>Total KD'000</b>
<b>Assets</b>					
Cash and balances with banks	19,738	-	-	-	19,738
Placements with banks and the CBK	251,936	4,550	-	-	256,486
Financing receivables	905,647	339,696	56,742	304,457	1,606,542
Financial assets at fair value through profit or loss	-	-	-	41,500	41,500
Financial assets at fair value through other comprehensive income	7,584	4,801	-	136,200	148,585
Investments in joint ventures	-	-	-	52,498	52,498
Investment properties	-	-	-	22,867	22,867
Other assets	11,808	6,003	354	8,330	26,495
Property and equipment	-	-	-	18,358	18,358
	<b>1,196,713</b>	<b>355,050</b>	<b>57,096</b>	<b>584,210</b>	<b>2,193,069</b>
<b>Liabilities</b>					
Due to banks and other financial institutions	184,937	175,791	276,194	198,141	835,063
Depositors' accounts	728,364	206,572	80,502	37,740	1,053,178
Other liabilities	27,672	-	-	6,228	33,900
	<b>940,973</b>	<b>382,363</b>	<b>356,696</b>	<b>242,109</b>	<b>1,922,141</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

**20 RISK MANAGEMENT (continued)****d) Liquidity risk (continued)***Liquidity risk management (continued)*

<i>2017</i>	<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>
<b>Assets</b>					
Cash and balances with banks	13,201	-	-	-	13,201
Placements with banks and the 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	-	-	-	31,660	31,660
Investment properties	-	-	-	24,611	24,611
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>438,937</u>	<u>1,774,545</u>
<b>Liabilities</b>					
Due to banks and other financial institutions	175,788	69,639	61,884	265,553	572,864
Depositors' accounts	692,369	187,206	99,588	27,451	1,006,614
Other liabilities	16,094	-	-	2,014	18,108
	<u>884,251</u>	<u>256,845</u>	<u>161,472</u>	<u>295,018</u>	<u>1,597,586</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>
<b>2018</b>					
Due to banks and other financial institutions	307,875	177,449	281,779	78,664	845,767
Depositors' accounts	729,919	210,759	80,719	41,143	1,062,540
Other liabilities	27,672	-	-	6,228	33,900
	<u>1,065,466</u>	<u>388,208</u>	<u>362,498</u>	<u>126,035</u>	<u>1,942,207</u>
<b>2017</b>					
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	27,483	1,012,666
Other liabilities	13,855	-	-	4,253	18,108
	<u>884,862</u>	<u>259,102</u>	<u>164,078</u>	<u>307,801</u>	<u>1,615,843</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

**20 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>
<b>2018</b>				
Acceptances and letters of credit	26,296	6,914	-	33,210
Letter of guarantees	2,863	35,691	52,655	91,209
Capital commitments	-	223	-	223
	<u>29,159</u>	<u>42,828</u>	<u>52,655</u>	<u>124,642</u>
<b>2017</b>				
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>

**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.

## 21 SEGMENT INFORMATION

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>
<b>2018</b>						
Operating income	30,613	7,682	3,557	7,700	-	49,552
Net profit	14,816	81	3,583	5,784	(11,526)	12,738
Total assets	1,278,293	328,249	256,486	265,450	64,591	2,193,069
Total liabilities	172,869	363,678	1,351,694	-	33,900	1,922,141
<b>2017</b>						
Operating income	24,670	6,361	2,171	4,910	-	38,112
Net profit	13,165	(1,498)	1,880	3,829	(9,922)	7,454
Total assets	1,004,046	259,277	246,484	222,191	42,547	1,774,545
Total liabilities	157,419	324,632	1,097,427	-	18,108	1,597,586

## 22 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 with appropriate risk level.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

**22 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 2018 are calculated in accordance with the CBK Circular number 2/RB, RBA/336/2014 dated 24 June 2014 are shown below:

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i>
<b>Risk weighted assets</b>	<b>1,173,468</b>	<b>826,642</b>
<b>Capital required</b>	<b>152,551</b>	<b>107,463</b>
<b>Capital available</b>		
Common equity Tier 1 "CET1" capital	194,565	100,596
Additional Tier 1 perpetual Sukuk	76,363	76,363
Total Tier 1 capital	270,928	176,959
Total Tier 2 capital	13,803	9,700
<b>Total capital available</b>	<b>284,731</b>	<b>186,659</b>
CET1 capital adequacy ratio: common equity	16.58%	12.17%
Total Tier 1 capital adequacy ratio	23.09%	21.41%
Total capital adequacy ratio	24.26%	%22.58

The Group's financial leverage ratio for the year ended 31 December 2018 is calculated in accordance with the CBK Circular number 2/I.B.S. 343/2014 dated 21 October 2014 and is shown below:

	<i>2018</i> <i>KD'000</i>	<i>2017</i> <i>KD'000</i>
Tier 1 capital	270,928	176,959
Total exposure	2,265,808	1,828,860
Financial leverage ratio	11.96%	9.68%

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

**23 FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS**

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. Financial instruments comprise financial assets and financial liabilities.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

**23 FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (continued)****Fair value hierarchy**

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

**Level 1:** quoted (unadjusted) prices in an active market for identical assets and liabilities;

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

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

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

	<i>Fair value measurement</i>			
	<i>Total</i>	<i>Quoted prices</i>	<i>Significant</i>	<i>Significant</i>
<i>2018</i>	<i>KD'000</i>	<i>in active</i>	<i>observable</i>	<i>unobservable</i>
		<i>markets</i>	<i>inputs</i>	<i>inputs</i>
		<i>(Level 1)</i>	<i>(Level 2)</i>	<i>(Level 3)</i>
		<i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>
<i>Assets measured at fair value</i>				
<i>Financial assets at FVTPL</i>				
Quoted equity instruments	7,159	7,159	-	-
Funds (unquoted)	26,430	-	-	26,430
Other securities (unquoted)	7,911	-	-	7,911
	<u>41,500</u>	<u>7,159</u>	<u>-</u>	<u>34,341</u>
<i>Financial assets at FVOCI</i>				
<i>Quoted Sukuk</i>				
▪ Sovereign Sukuk	43,683	43,683	-	-
▪ Corporate Sukuk	97,410	97,410	-	-
	<u>141,093</u>	<u>141,093</u>	<u>-</u>	<u>-</u>
<i>Unquoted Sukuk</i>				
Unquoted Sukuk	2,000	-	-	2,000
Unquoted equity instruments	5,492	-	-	5,492
	<u>148,585</u>	<u>141,093</u>	<u>-</u>	<u>7,492</u>
<i>Derivative financial instruments (note 24)</i>				
Profit rate swaps	57	57	-	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

23 FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (continued)

2017	Total KD'000	Fair value measurement		
		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				
- Sovereign Sukuk	41,276	41,276	-	-
- Corporate Sukuk	96,864	96,864	-	-
	<u>138,140</u>	<u>138,140</u>	-	-
Quoted equity instrument	756	756	-	-
Unquoted Sukuk	2,000	-	-	2,000
	<u>140,896</u>	<u>138,896</u>	-	<u>2,000</u>

The table above does not include an amount of KD 25,025 thousand related to unquoted available-for-sale investments measured at cost less impairment losses (in accordance with IAS 39) which were not disclosed at fair value as their fair values could not be measured reliably.

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

	At 1 January 2018 KD'000	Transitional adjustment on adoption of IFRS 9 at 1 January 2018 KD'000	Additions KD'000	Sale/ redemption KD'000	Change in fair value KD'000	Exchange rate movements KD'000	At 31 December 2018 KD'000
<b>Financial assets at FVTPL</b>							
Funds (unquoted)	-	16,308	10,003	(290)	409	-	26,430
Other securities (unquoted)	-	7,295	713	-	(97)	-	7,911
	-	<u>23,603</u>	<u>10,716</u>	<u>(290)</u>	<u>312</u>	-	<u>34,341</u>
<b>Financial assets at FVOCI</b>							
Unquoted Sukuk	2,000	-	-	-	-	-	2,000
Unquoted equity instruments	-	4,633	10	-	849	-	5,492
	<u>2,000</u>	<u>4,633</u>	<u>10</u>	<u>-</u>	<u>849</u>	<u>-</u>	<u>7,492</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

**23 FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (continued)**

	<i>At 1 January 2017</i>	<i>Additions</i>	<i>Sale/ redemption</i>	<i>Change in fair value</i>	<i>Exchange rate movements</i>	<i>At 31 December 2017</i>
	<i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>	<i>KD'000</i>
<b>Available for sale</b>						
<b>Investments</b>						
Unquoted Sukuk	2,000	-	-	-	-	2,000
	<u>2,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,000</u>

During the years ended 31 December 2018 and 2017, 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 financial instruments classified under level 3 were altered by 5 per cent.

**24 DERIVATIVE FINANCIAL INSTRUMENTS**

Derivative financial instruments are financial instruments that derive their value by referring to profit rates, foreign exchange rates, index of prices or rates and credit rating or credit index. Notional principal amounts merely represent amounts to which a rate or price is applied to determine the amounts of cash flows to be exchanged and do not represent the potential gain or loss associated with the market or credit risk of such instruments.

Derivative financial instruments are carried at fair value in the consolidated statement of financial position. Positive fair value represents the cost of replacing all transactions with a fair value in the Group's favour had the rights and obligations arising from that instrument been closed in an orderly market transaction at the reporting date. Credit risk in respect of derivative financial instruments is limited to the positive fair value of the instruments. Negative fair value represents the cost to the Group's counter parties of replacing all their transactions with the Group.

The Group deals in profit rate swaps to manage its profit rate risk on profit bearing assets and liabilities and to provide profit rate risk management solutions to customers.

**Profit rate swap**

Profit rate swaps are contractual agreements between two counter-parties to exchange profit payments on a defined principal amount for a fixed period of time. The Group applies cash flow hedge accounting using a profit rate swap to hedge one of its foreign currency deposits with maturity up to 3 years against profit rate fluctuations. The Group implements effectiveness tests at financial position dates for hedge accounting, the effective portions are accounted as part of changes in fair value of derivatives under fair value reserve, whereas the ineffective portion is recognised in consolidated statement of profit or loss. No ineffectiveness from hedges was recognised in consolidated statement of profit or loss during the year.

The fair value of derivative financial instruments included in the financial records, together with their notional amounts is summarised as follows:

	<i>31 December 2018</i>	
	<i>Positive fair value KD'000</i>	<i>Notional KD'000</i>
<i>Profit rate swaps (held as cash flow hedge)</i>	<u>57</u>	<u>120,840</u>
	<u>57</u>	<u>120,840</u>

There were no derivative financial instruments as at 31 December 2017.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the year ended 31 December 2018

**25 COMPARATIVE INFORMATION**

The comparative information for the year ended 31 December 2017 has been restated to reflect the change in accounting policies from the cost model to the fair value model for investment properties. Management takes the view that this policy provides reliable and more relevant information as fair value give users of the financial statements more useful information than cost model. The policy has been applied retrospectively.

The following adjustments have been made to the comparative financial information retrospectively in accordance with IAS 8 "Accounting policies, changes in accounting estimates and errors" and the impact on the consolidated financial statements of prior years is as follows:

<i>Consolidated statement of financial position</i>	<i>As previously reported KD'000</i>	<i>Restated KD'000</i>	<i>Effect of change KD'000</i>
<b>As at 31 December 2017</b>			
<i>Assets</i>			
Investments in joint ventures	31,102	31,660	558
Investment properties	23,666	24,611	945
	<u>          </u>	<u>          </u>	<u>          </u>
<i>Equity</i>			
(Accumulated losses) / retained earnings	(944)	559	1,503
	<u>          </u>	<u>          </u>	<u>          </u>
<b>As at 1 January 2017</b>			
<i>Assets</i>			
Investment properties	14,815	15,632	817
	<u>          </u>	<u>          </u>	<u>          </u>
<i>Equity</i>			
Accumulated losses	(4,798)	(3,981)	817
	<u>          </u>	<u>          </u>	<u>          </u>
<b>Consolidated statement of profit or loss</b>			
	<i>As previously reported KD'000</i>	<i>Restated KD'000</i>	<i>Effect of change KD'000</i>
<b>Year ended 31 December 2017</b>			
Net investment income	6,259	6,387	128
Provision for impairment	(12,876)	(12,318)	558
Net profit for the year	6,768	7,454	686
	<u>          </u>	<u>          </u>	<u>          </u>

A third statement of financial position has been presented to restate a material impact on the opening balances of comparative years ended 31 December 2016 and 2017.

No adjustments have been made to the statutory reserve for the comparative year to reflect the change in accounting policies.