

KHALEEJI COMMERCIAL BANK BSC
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2016

Commercial registration	:	55133 (registered with Central Bank of Bahrain as a retail Islamic bank).
Office	:	Bahrain Financial Harbour East Tower PO Box 60002, Manama, Kingdom of Bahrain
Directors	:	Dr. Ahmed Khalil Al Mutawa, <i>Chairman</i> Abdulrahman Mohamed Jamsheer, <i>Vice Chairman</i> Abdulla Abdulkarim Showaiter Bashar Mohamed Al Mutawa Hisham Ahmed Al Rayes Khalid Rashid Al-Thani Mosobah Saif Al-Mutairy Tariq Qassim Fakhroo
Chief Executive Officer	:	Khalil Ismaeel Al-Meer
Company secretary	:	Mohammed Abdulla Saleh
Auditors	:	KPMG Fakhroo, Bahrain

CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

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CHAIRMAN'S REPORT
for the year ended 31 December 2016

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

Dear Shareholders,

On behalf of the Board of Directors, it is my pleasure to present the annual financial statements of Khaleeji Commercial Bank (the "Bank") for the year ended 31 December 2016. This year has noticed significant economic variations and geopolitical developments that affected growth rates on a global and regional scale. It has seen the GCC region enter into an era with several austerity measures to reduce the government deficits, introducing taxes and reducing yields due to the continued low price levels of oil. Moreover, the United States presidential election results and the passing of JASTA law infused more uncertainty and fears in global markets. Meanwhile the 'BREXIT' event was considered to be the most significant global event during the year 2016. And finally, the OPEC agreement to freeze oil production towards end of the year is considered as a major development that the oil market have witnessed. These represent the most important global economic events for the year 2016 which its effects are expected to span and spill over to the year 2017.

Despite the challenges that the banking sector faces at present due to the instability of the regional and world markets the Bank was able to achieve a good result. In spite of this, we have shown tremendous success in implementing our strategies according to well-thought out plans and clear objectives based on our market study of the current economic situation and the constant evaluation of our performance. Our priorities have been exemplified and we continue to improve our business to enhance our pioneering reputation amongst the other Islamic banks in the Kingdom. This is mainly achieved through enhancing our services network and launching new and innovative products that cater to the needs of our clients.

Overall Performance

Despite the adverse market and economic challenges the Bank, with efforts of the management and support of the shareholders, was able to achieve tangible success by adopting a combination of prudent and conservative management during the year 2016. The Bank has focused on diversifying and expanding its business while maintaining conservative liquidity and capital positions.

Positive indicators of the Bank performance show a growth in total assets from BD 654 million in 2015 to BD 765 million in 2016, i.e. 17.0% growth from last year. Total net income decreased since last year, i.e. BD 5.3 million in 2016 compared to BD 8 million reported in 2015. It is worth mentioning that although the Bank has reduced its weighted average profit distributed to depositors, results show that these deposits has actually grown by 19.7%, from BD 485.4 million in 2015 to BD 581.1 million in 2016, which confirm our customer's loyalty and their confidence in the Bank's products and services. Financing assets overall increased by 16.2% over 2015, reaching BD 450.8 million; with Consumer Finance Portfolio reaching BD 165.3 million, a 33.9% growth over 2015. Total Income from Commercial Banking comprises 72.9% of total income as a result of a significant increase in Consumer Finance activities.

CHAIRMAN'S REPORT**for the year ended 31 December 2016** *(continued)*

As the Bank continued to execute its strategic plan, the Board and the Management conducted a review to ensure that assets, especially those acquired prior to the new business model reflect realisable and fair value. Based on this review the Board decided to take an amount of BD 8.9 as provisions for the year ended 31 Dec 2016, such conservative approach has been taken in dealing with the assets which were impaired or likely to be impaired in the short to medium term and is in-line with the Bank's strategy implementation.

Consequently, in 2016 the Bank reported a net profit of BD 5.3 million compared to a net profit of BD 8 million in 2015. 33.8% decrease from 2015. These results will provide considerable stability for the business in the future and will pave the way forward to achieving acceptable results. It is worth mentioning that, the Bank continues to maintain strong liquidity (with 27.2% of the Bank's assets being liquid) and adequate capital (the Bank has a regulatory capital adequacy ratio of 18.4% compared to a minimum regulatory mandated 12.5%), both comfortably in excess of regulatory requirements.

The Bank is working steadily towards strengthening its position as the pioneering Islamic Bank in the Kingdom and confirms this by receiving a variety of prestigious awards during the first- half of 2016. The Bank received the award "the fastest growing bank in Bahrain" granted by CPI Financial Banker Middle East and Africa, in addition to being named amongst the Top 4 Best CEOs in the Middle East, the first in the Kingdom of Bahrain. The CEO of the Bank was named amongst the top 4, in a list with 100 best performing Managers and Chief Executive Officers in the GCC and Arab countries, announced by the Trends Magazine and Insead Business School.

These awards come as a result of the strong financial results and the deeply-rooted growth achieved by the bank during the last period including the net income, liabilities, revenues, return on equity and return on assets, where the bank's results were compared to the competitor's results in the Kingdom of Bahrain.

The year 2016 was filled with achievements, this is coupled with the recent rating exercise undertaken by Moody's, an international bond credit rating business, which confirmed its rating of the bank's long-term counterparty risk assessment at a rate of '**Ba2**'. The report indicated that this rating was driven by the bank's improved profitability standards and stable balance sheet, supported by adequate capital and healthy liquidity levels, which contributed to strengthening the bank's financial performance, in turn strengthening the bank's long-term credit risk.

Also during 2016, SHUAA Capital, the UAE's premier financial services firm, concluded a 14% (147,106,849 shares) acquisition of ownership stake in the Bank. This acquisition is expected to positively affect the Bank's results through the support from Shuaa Capital based on the pioneering reputation that the new shareholder possesses.

CHAIRMAN'S REPORT
for the year ended 31 December 2016 *(continued)*

Looking Ahead

The Board believes that the recent global challenges the Bank faced during 2016 and its effects are expected to span and spill over to year 2017 which the Bank is exposed. Despite the previous, the Board foresees several growth opportunities for the Bank products and services catering Individuals and medium to small institutions. In the last five years, the Bank has taken several steps to diversify its assets, revenue streams and widen its customer base. The launch of the Bank's range of consumer finance products and expansion of the branch network will further support this endeavour.

The key challenge in the medium term would be to build the scale necessary for the Bank to become a leading player in the local and regional market. The Bank will continue to aggressively grow its commercial and retail banking business while exploring other options; which includes viable acquisitions of other entities and asset portfolios as well as forming strategic alliances or merger with other financial institutions. The Board will also continue to expand the Bank's network of branches and distribution channels to reach wider and a larger number of customers.

In addition, the Bank believes continuation of investment in the human resource aspect is key towards achieving and overcoming the upcoming challenges, as such resource is considered as the main focal point and backbone of the institution.

The Board believes that the Bank has established a solid foundation from which to execute the new Strategic Plan and capitalise on opportunities currently available in the market.

Appreciation

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

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

Allah the almighty is the purveyor of all success.

Dr. Ahmed Khalil Al Mutawa
Chairman



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

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Khaleeji Commercial Bank B.S.C. ("the Bank") and its subsidiaries (together the "Group"), which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statements of income, the changes in equity, cash flows, changes in restricted investment accounts and sources and uses of zakah and charity fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Respective responsibilities of board of directors and auditors

These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a rules and principles are the responsibility of the board of directors of the Bank. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

Basis of opinion

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2016 and of its consolidated results of operations, its consolidated cash flows, its consolidated changes in equity, its consolidated changes in restricted investment accounts and its consolidated sources and uses of zakah and charity fund for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

Report on other regulatory requirements

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

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

KPMG Fakhroo
Partner Registration No. 100
8 February 2017

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

as at 31 December 2016

BD 000's

	Note	31 December 2016	31 December 2015
ASSETS			
Cash and bank balances	3	56,006	41,286
Placements with financial institutions	4	78,714	43,953
Financing assets	5	355,377	318,714
Investment in sukuk	6	74,154	63,533
Assets acquired for leasing	7	92,839	67,811
Lease rentals receivables	7	2,573	1,289
Investment in equity securities	8	55,121	67,801
Investment in real estate	9	21,508	19,071
Development property		6,003	6,952
Other assets		14,496	15,280
Property and equipment	10	8,208	8,285
Total assets		764,999	653,975
LIABILITIES			
Placements from financial institutions		59,079	47,007
Placements from non-financial institutions and individuals	11	100,649	48,311
Customers' current accounts		75,814	65,848
Other liabilities	12	8,311	9,837
Total liabilities		243,853	171,003
Equity of investment account holders	13	404,651	371,271
OWNERS' EQUITY			
Share capital	14	105,000	100,000
Statutory reserve		7,962	7,411
Treasury shares		(8,832)	(8,136)
Employee share incentive scheme		(182)	(284)
Investment fair value reserve		-	(86)
Retained earnings		8,751	8,998
Total equity attributable to shareholders of the parent (page 7)		112,699	107,903
Non-controlling interest		3,796	3,798
Total liabilities, equity of investment account holders and owners' equity		764,999	653,975

The consolidated financial statements, which consist of pages 5 to 65, were approved by the Board of directors on 08 February 2017 and signed on its behalf by:


Dr. Ahmed Khalil Al Mutawa
Chairman


Abdulrahman Mohamed Jamsheer
Vice Chairman


Khalil Ismaeel Al-Meer
Chief Executive Officer

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT
for the year ended 31 December 2016

BD 000's

	Note	2016	2015
Income from financing assets and assets acquired for leasing		26,198	21,447
Income from placements with financial institutions		643	566
Income from sukuk	15	3,002	3,682
Income from equity securities		652	878
Fees and other income		5,422	4,405
Total income before return to investment account holders		35,917	30,978
Less: Return to investment account holders before Bank's share as Mudarib	13	(16,286)	(16,933)
Bank's share as a Mudarib	13	9,130	9,551
Return to investment account holders		(7,156)	(7,382)
Finance expense on placements from financial institutions, non-financial institutions and individuals		(2,976)	(2,292)
Total income		25,785	21,304
Staff cost	16	5,988	5,726
Other operating expenses	17	5,568	5,085
Total expenses		11,556	10,811
Profit for the year before impairment allowances		14,229	10,493
Net impairment charge	18	(8,921)	(2,472)
PROFIT FOR THE YEAR		5,308	8,021
Attributable to:			
Shareholders of the parent		5,310	7,014
Non-controlling interest		(2)	1,007
		5,308	8,021
Earnings per share			
Basic and diluted earnings per share (fils)	23	5.49	6.96

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the year ended 31 December 2016

BD 000's

2016	Note	Equity attributable to shareholders of the parent							Non-Controlling interest	Total Equity	
		Share Capital	Share premium	Statutory reserve	Treasury shares	Employee share incentive scheme	Investment fair value reserve	Retained earnings			Total
Balance at 1 January 2016	14	100,000	-	7,411	(8,136)	(284)	(86)	8,998	107,903	3,798	111,701
Movement in fair value of investments		-	-	-	-	-	322	-	322	-	322
Disposal of equity securities		-	-	-	-	-	(236)	-	(236)	-	(236)
Profit for the year		-	-	-	-	-	-	5,310	5,310	(2)	5,308
Total recognised income and expense for the year							86	5,310	5,396	(2)	5,394
Issue of bonus shares		5,000	-	-	-	-	-	(5,000)	-	-	-
Transfer to statutory reserve		-	-	551	-	-	-	(551)	-	-	-
Net treasury shares purchased		-	-	-	(696)	-	-	-	(696)	-	(696)
Issue of shares under incentive scheme		-	-	-	-	102	-	-	102	-	102
Transfer to Zakah fund		-	-	-	-	-	-	(6)	(6)	-	(6)
Balance at 31 December 2016		105,000	-	7,962	(8,832)	(182)	-	8,751	112,699	3,796	116,495

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the year ended 31 December 2016 (continued)

BD 000's

2015

	Equity attributable to shareholders of the parent							Non-Controlling interest	Total Equity
	Share Capital	Share premium	Statutory reserve	Treasury shares	Employee share incentive scheme	Investment fair value reserve	Retained earnings		
Balance at 1 January 2015 as previously reported	115,416	1,535	6,730	(6,351)	-	-	(14,273)	-	103,057
Impact of consolidation	-	-	-	-	-	-	47	2,791	2,838
Balance at 1 January 2015 (restated)	115,416	1,535	6,730	(6,351)	-	-	(14,226)	2,791	105,895
Movement in fair value of investments	-	-	-	-	-	(86)	-	-	(86)
Profit for the year	-	-	-	-	-	-	7,014	1,007	8,021
Total recognised income and expense for the year	-	-	-	-	-	(86)	7,014	1,007	7,935
Capital reduction	(15,416)	(1,535)	-	-	-	-	16,951	-	-
Transfer to statutory reserve	-	-	681	-	-	-	(681)	-	-
Net treasury shares purchased	-	-	-	(2,237)	-	-	-	-	(2,237)
Issue of shares under incentive scheme	-	-	-	-	135	-	(41)	-	94
Transfer for share incentive scheme	-	-	-	419	(419)	-	-	-	-
Adjustment for shares forfeited	-	-	-	33	-	-	-	-	33
Transfer to Zakah fund	-	-	-	-	-	-	(19)	-	(19)
Balance at 31 December 2015	100,000	-	7,411	(8,136)	(284)	(86)	8,998	3,798	111,701

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
for the year ended 31 December 2016

BD 000's

	Note	2016	2015
OPERATING ACTIVITIES			
Disbursements of financing assets, net		(18,071)	(2,101)
Payment for asset acquired for leasing, net		(26,548)	(26,044)
Receipt of profit on short-term placements		643	566
Returns paid to investment account holders		(7,041)	(7,953)
Net receipts from investment account holders		33,381	32,337
Payment of profit on placements		(2,976)	(2,292)
Payment for expenses		(12,364)	(11,234)
Other receipts		3,970	5,263
Payment for charity		(40)	(193)
Receipts in customers' current accounts		9,965	18,130
Placements from financial institutions, net		12,072	(3,202)
Placements from non-financial institutions and individuals, net		52,338	4,529
Net payment to CBB reserve account		(985)	(1,995)
Net cash generated from operating activities		44,344	5,811
INVESTING ACTIVITIES			
Purchase of sukuk		(32,983)	(67,842)
Purchase of equity securities		(84)	(10,011)
Proceed from redemption / sale of sukuk		21,757	40,300
Proceed from redemption / sale of equity securities		10,236	233
Proceeds from disposal of development property		1,081	-
Proceeds from disposal of Investment in real estate		1,800	-
Receipt of profit from sukuk		2,844	2,424
Receipt of dividends / income from equity securities		708	998
Purchase of property and equipment		(420)	(250)
Net cash generated from / (used in) investing activities		4,939	(34,148)
FINANCING ACTIVITIES			
Payment for treasury shares		(696)	(1,785)
Advances to purchase treasury shares		(91)	-
Net cash used in financing activities		(787)	(1,785)
Net increase / (decrease) in cash and cash equivalents		48,496	(30,122)
Cash and cash equivalents at 1 January		66,369	96,491
Cash and cash equivalents at 31 December		114,865	66,369
Cash and cash equivalent comprise:			
Cash and bank balances (excluding CBB reserve)	3	36,151	22,416
Placements with financial institutions	4	78,714	43,953
		114,865	66,369

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS
for the year ended 31 December 2016

BD 000's

2016

	Balance at 1 January 2016			Movements during the year						Balance at 31 December 2016		
	No of units (000's)	Average value per share BD	Total BD 000's	Investment (withdrawals) BD 000's	Revalua- tion BD 000's	Gross income/ (loss) BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Adminstra- tion expenses BD 000's	No of units (000's)	Average value per share BD	Total BD 000's
Safana Investment WLL (RIA 1) and NS12	8,313	1.00	8,313	(2,009)	-	-	-	-	-	6,304	1.00	6,304
Janayen Holding Limited (RIA 4)	48,082	0.18	8,500	(8,524)	-	24	-	-	-	-	-	-
Shaden Real Estate Investment WLL (RIA 5)	3,728	1.00	3,728	(76)	-	-	-	-	-	3,652	1.00	3,652
Locata Corporation Pty Ltd (RIA 6)	2,633	0.38	993	-	-	-	-	-	-	2,633	0.38	993
			21,534	(10,609)	-	24	-	-	-			10,949

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS
for the year ended 31 December 2016 *(continued)*

BD 000's

2015

	Balance at 1 January 2015			Movements during the year						Balance at 31 December 2015		
	No of units (000's)	Average value per share BD	Total BD 000's	Investment (withdrawals) BD 000's	Revalua- tion BD 000's	Gross income/ (loss) BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Adminstra- tion expenses BD 000's	No of units (000's)	Average value per share BD	Total BD 000's
Safana Investment WLL (RIA 1)	8,313	1.00	8,313	-	-	-	-	-	-	8,313	1.00	8,313
Janayen Holding Limited (RIA 4)	48,082	0.09	4,560	-	22	4,048	-	-	(130)	48,082	0.18	8,500
Shaden Real Estate Investment WLL (RIA 5)	8,100	1.00	8,100	(4,372)	-	-	-	-	-	3,728	1.00	3,728
Locata Corporation Pty Ltd (RIA 6)	2,633	0.38	993	-	-	-	-	-	-	2,633	0.38	993
			21,966	(4,372)	22	4,048	-	-	(130)			21,534

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF SOURCES AND USES OF ZAKAH AND CHARITY FUND
for the year ended 31 December 2016

BD 000's

	2016	2015
Sources of zakah and charity fund		
At 1 January	727	859
Contributions by the Bank	7	-
Non-Islamic income	29	61
Total sources	763	920
Uses of zakah and charity fund		
Contributions to charitable organisations	40	193
Total uses	40	193
Undistributed zakah and charity fund at 31 December	723	727

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

1. REPORTING ENTITY

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

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

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

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

Name	Country of incorporation	% holding 2016	% holding 2015	Nature of business
Hawafiz Khaleeji Management Company BSC (c)	Bahrain	100%	100%	To hold shares for the beneficial interest of the employee incentive scheme. (refer note 19)
Harbour West 2 Real Estate SPC	Bahrain	100%	100%	To hold property for the beneficial interest of the Bank.
Harbour West 4 Real Estate SPC	Bahrain	100%	100%	To hold property for the beneficial interest of the Bank.
Surooh Limited	Cayman Islands	19.08%	19.08%	To construct and sell properties at "Oryx Hills".
Eqarat Al Khaleej	Cayman Islands	10%	10%	To buy, sell and let-out income producing properties across the GCC.
True Horse Real Estate L.L.C.	UAE	100%	0%	Buying and selling of real estate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

2. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been consistently applied by the Group and are consistent with those used in the previous year, except for those changes arising from revised/new AAOIFI financial accounting standards.

i. New standards, amendments, and interpretations effective from 1 January 2016

FAS 27 – Investments Accounts

FAS 27 Investments accounts was issued in December 2014 replacing FAS 5 – 'Disclosures of Bases for Profit Allocation between Owner's Equity and Investment Account Holders' and FAS 6 – 'Equity of Investment Account Holders and their Equivalent'. The adoption of this standard expanded the disclosures related to equity of Investment Account Holders. The standard had no significant impact on the consolidated financial statements of the Bank. Refer to note 13 for the additional disclosure.

ii. New standards, amendments and interpretations issued but not yet effective

No new standards, amendments to standards and interpretations that are effective for annual periods beginning on or after 1 January 2017.

(a) Statement of compliance

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

(b) Basis of preparation

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

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

The preparation of consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and the Group's consolidated financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 20.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

2. *SIGNIFICANT ACCOUNTING POLICIES (continued)***(c) Basis of consolidation****(i) Subsidiaries**

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

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

The financial statements of SPE are not included in these consolidated financial statements except when the Group controls the entity. Information about the Group's fiduciary assets under management is set out in note 21.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

2. *SIGNIFICANT ACCOUNTING POLICIES (continued)*

(c) *Basis of consolidation (continued)*

(ii) Associates

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

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

The carrying amount of the equity accounted investment is tested for impairment in accordance with the policy described in note 2 (m).

(iii) Transactions eliminated on consolidation

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

(d) Foreign currency transactions

Items included in the consolidated financial statements of the Group are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Bahraini Dinars, which is the Bank's functional and presentation currency.

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

2. SIGNIFICANT ACCOUNTING POLICIES (continued)**(e) Investment securities**

Investment securities comprise investments in equity securities and investments in sukuk. Investment securities exclude investments in subsidiaries and equity accounted investees (refer note 2(c)).

(i) Classification

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

Debt-type Instruments:

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

All Investments in debt-type instruments are carried at amortised cost , which are only sukuk.

Equity-type investments:

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

2. *SIGNIFICANT ACCOUNTING POLICIES (continued)*

(e) *Investment securities (continued)*

(ii) Recognition and de-recognition

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

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

(iii) Measurement

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

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

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

(iv) Measurement principles

Amortised cost measurement

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

Fair value measurement

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

2 *SIGNIFICANT ACCOUNTING POLICIES (continued)*

(e) Investment securities (continued)

(iv) Measurement principles (continued)

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

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

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

(f) Financing assets

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

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

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

(h) Cash and cash equivalents

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

(i) Assets acquired for leasing

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

(j) Investment in real estate

Real estate properties held for rental, or for capital appreciation purposes, or both, are classified as investment property. Investments in real estate are carried at cost less depreciation and impairment allowances, if any. Cost includes expenditure that is directly attributable to the acquisition of the investment property. Investment in real estate includes plots of land held for capital appreciation purposes, villas and buildings held for earning rentals.

Land is not depreciated. Buildings are depreciated over 25 years.

(k) Development properties

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

2. **SIGNIFICANT ACCOUNTING POLICIES (continued)**

(k) *Development properties (continued)*

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

(l) **Property and equipment**

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

(m) **Impairment of assets**

Financial assets

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

Financial assets carried at amortised cost

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

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

Equity investments classified at fair value through equity (FVTE)

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Impairment of assets (continued)

Non-financial assets

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

In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash generating unit. An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount. Separately recognised goodwill is not amortised and is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on separately recognised goodwill are not reversed. As at December 2016, the Bank did not have any goodwill recognised.

(n) **Customers' current accounts**

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

(o) **Equity of investment account holders**

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

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(p) Restricted investment accounts

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

(q) Financial guarantees

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

(r) Treasury shares

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

(s) Statutory reserve

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

(t) Revenue recognition

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

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

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

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

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

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(u) Earnings prohibited by Shari'a

The Bank is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Bank uses these funds for charitable purposes.

(v) Zakah

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

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

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

(ii) Post-employment benefits

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

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

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

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

(iii) Share-based employee incentive scheme

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(w) Employee benefits (continued)

(iii) Share-based employee incentive scheme (continued)

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

(x) Dividends and board remuneration

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

(y) Trade date accounting

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

(z) Offsetting

Financial assets and liabilities are offset only when there is a legal or Shari'a based enforceable right to set-off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

(aa) Provisions

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

(bb) URIA Protection Scheme

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

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

(cc) Repossessed assets

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

3. CASH AND BANK BALANCES

	31 December 2016	31 December 2015
Cash	6,888	6,520
Balances with banks	17,112	10,386
Balances with the Central Bank:		
- Current account	12,151	5,510
- Reserve account	19,855	18,870
	56,006	41,286

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

4. PLACEMENTS WITH FINANCIAL INSTITUTIONS

	31 December 2016	31 December 2015
Gross Murabaha and Wakala receivable	78,757	43,969
Less: Deferred profits	(43)	(16)
	78,714	43,953

The average profit rate on placement with financial institutions for 2016 was 1.53% per annum (31 December 2015: 1.23% per annum).

5. FINANCING ASSETS

	31 December 2016	31 December 2015
Murabaha	334,632	277,130
Musharaka	8,765	22,412
Wakala	29,386	31,717
Mudharaba	1,155	1,188
Istisna	7	35
	373,945	332,482
Less: Impairment allowances – specific	(15,164)	(10,284)
Less: Impairment allowances – collective	(3,404)	(3,484)
	355,377	318,714

Murabaha financing receivables are net of deferred profits of BD 31,004 thousand (2015: BD 33,583 thousand).

The movement in impairment allowances is as follows:

2016	Specific	Collective	Total
At 1 January 2016	10,284	3,484	13,768
Net charge for the year (note 18)	7,686	(80)	7,606
Write-off	(2,806)	-	(2,806)
At 31 December 2016	15,164	3,404	18,568

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

5. FINANCING ASSETS (continued)

2015

At 1 January 2015
 Net charge for the year
 Write-off

At 31 December 2015

Specific	Collective	Total
10,192	3,477	13,669
1,025	7	1,032
(933)	-	(933)
10,284	3,484	13,768

6. INVESTMENT IN SUKUK

Debt type instruments

- Quoted sukuk (*at amortised cost*)
 - Unquoted sukuk (*at amortised cost*)

31 December 2016	31 December 2015
73,443	51,964
711	11,569
74,154	63,533

Debt type instruments are net of specific impairment allowances of BD 1,021 thousand (2015: BD 431 thousand).

During the year, impairment charge of BD 589 thousand (31 December 2015: BD 131 thousand) was recognised on unquoted debt type instruments carried at amortised cost.

7. ASSETS ACQUIRED FOR LEASING

Cost

At 1 January
 Additions during the year
 Settlements/adjustments during the year

At 31 December

Accumulated depreciation

At 1 January
 Charge for year
 Settlements during the year

At 31 December

Net book value at 31 December

2016	2015
75,326	50,366
40,866	34,430
(11,376)	(9,470)
104,816	75,326
7,515	7,385
7,611	4,515
(3,149)	(4,385)
11,977	7,515
92,839	67,811

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

7 ASSETS ACQUIRED FOR LEASING (continued)

At 31 December 2016, accrued lease rental receivable amounted to BD 2,573 thousand (2015: BD 1,289 thousand). Lease rental receivable is net of collective provision of BD 959 thousand (2015: BD 698 thousand) and specific provision of BD Nil thousand (2015: BD 25 thousand). During the year, an impairment allowance of BD 236 thousand (2015: BD 280 thousand) was made on the lease rental receivables.

Of the total net book value of assets acquired for leasing, consumer financing amounted to BD 88,277 thousand (2015: BD 66,694 thousand).

8. INVESTMENT IN EQUITY SECURITIES

	31 December 2016	31 December 2015
<i>At fair value through income statement</i>		
- Unquoted equity securities (at fair value)	15,148	15,148
<i>At fair value through equity</i>		
- Unquoted equity securities (carried at cost less impairment)*	39,973	49,099
- Listed equity securities (at fair value)	-	3,554
	55,121	67,801

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

During the year, impairment charge of BD 1,852 thousand (31 December 2015: BD 766 thousand) was recognised on equity securities carried at cost and impairment charge of BD nil (31 December 2015: BD 263 thousand) was recognised on listed equity securities carried at fair value through equity.

Unquoted equity securities carried at cost are net of specific impairment allowances of BD 10,493 thousand (2015: BD 15,004 thousand). During the year, the Group has written off impairment allowance of BD 5,111 thousand (2015: BD nil) related to impaired investments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

9. INVESTMENT IN REAL ESTATE

	Land	Building	2016 Total	2015 Total
At 1 January	16,090	4,133	20,223	20,223
Addition	5,088	-	5,088	-
Disposals	(1,558)	(887)	(2,445)	-
At 31 December	19,620	3,246	22,866	20,223
Accumulated Depreciation				
At 1 January	-	1,152	1,152	1,008
Charge for year	-	261	261	144
Disposals	-	(55)	(55)	-
At 31 December	-	1,358	1,358	1,152
Net book value at 31 December	19,620	1,888	21,508	19,071

10. PROPERTY AND EQUIPMENT

	Land	Furniture and fixtures	Computers	Motor vehicle and Other equipment	Work-in- progress	2016 Total	2015 Total
Cost							
At 1 January	6,714	4,415	3,811	453	503	15,896	15,737
Additions		31	46	22	364	463	695
Capitalisation		74	82	20	(176)	-	-
Disposals		(143)	-	-	-	(143)	(536)
At 31 December	6,714	4,377	3,939	495	691	16,216	15,896
Accumulated Depreciation							
At 1 January	-	4,077	3,227	307	-	7,611	7,220
Charge for year	-	141	305	51	-	497	482
Disposals	-	(100)	-	-	-	(100)	(91)
At 31 December	-	4,118	3,532	358	-	8,008	7,611
Net book value at 31 December 2016	6,714	259	407	137	691	8,208	8,285
Net book value at 31 December 2015	6,714	338	584	146	503	8,285	

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

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11. PLACEMENTS FROM NON-FINANCIAL INSTITUTIONS AND INDIVIDUALS

	31 December 2016	31 December 2015
Non-financial institutions	46,077	17,738
Individuals	54,572	30,573
	100,649	48,311

These represent placements in the form of Murabaha and Wakala contracts. These are net of deferred profit of BD 2,501 (2015: BD 910)

12. OTHER LIABILITIES

	31 December 2016	31 December 2015
Mudaraba profit accrual	2,945	2,831
Employee related accruals	251	530
Zakah and charity payable (page 12)	723	727
Payable for Istisna'a contracts	111	113
Other payables and accrued expenses	4,281	5,636
	8,311	9,837

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for the year ended 31 December 2016

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13. EQUITY OF INVESTMENT ACCOUNT HOLDERS

The funds received from investment account holders have been commingled and jointly invested with the Bank in the following asset classes as at 31 December:

	31 December 2016	31 December 2015
Balances with banks	17,112	10,386
CBB reserve account	19,855	18,870
Placements with financial institutions	78,714	43,953
Debt type instruments – sukuk	73,444	63,533
Financing assets	215,526	234,529
	404,651	371,271

As at 31 December 2016, the balance of profit equalisation reserve and investment risk reserve was Nil (2015: Nil).

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

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

	2016		2015	
	Mudarib share	IAH shares	Mudarib share	IAH shares
1 month Mudharaba *	78.46%	21.54%	76.56%	23.44%
3 months Mudharaba	69.23%	30.77%	65.96%	34.04%
6 months Mudharaba	66.79%	33.21%	64.78%	35.22%
12 months Mudharaba	46.83%	53.17%	50.28%	49.72%
18 months Mudharaba	42.56%	57.44%	48.24%	51.76%
24 months Mudharaba	38.41%	61.59%	47.75%	52.25%

* Includes savings, Al Waffer and Call Mudaraba accounts.

During the year, average mudarib share as a percentage of total income allocated to IAH was 53.57% (2015: 55.68%) as against the average mudarib share contractually agreed with IAH. Hence the Bank sacrificed average mudarib fees of 11.23% (2015: 7.13%).

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

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

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for the year ended 31 December 2016

BD 000's

14. SHARE CAPITAL

Authorised:

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

Issued and fully paid up:

1,050,000,000 ordinary shares (2015: 1,000,000,000) of BD 0.100 each

31 December 2016	31 December 2015
300,000	300,000
105,000	100,000

The Bank has only one class of equity shares and the holders of these shares have equal voting rights. At 31 December 2016, the Group holds 83,480,840 as treasury shares (2015: 68,051,325 shares).

The shareholders in their extraordinary general meeting held on 15 March 2016 approved dividend in the form of bonus shares of BD 5,000 thousand, 5 shares for every 100 shares held.

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

	Nationality	Number of shares	% of total outstanding shares
GFH Financial Group *	Bahrain	493,490,918	47
Shuaa Capital PSC	UAE	147,106,849	14.01
Emirates Islamic Bank PJSC	UAE	88,322,425	8.41
Khaleeji Commercial Bank B.S.C	Bahrain	77,203,208	7.35

*As at 31 December 2016, these shares representing 47% were held by KHCB Asset Company on behalf of GFH Financial Group, which is considered as the parent of the Bank for financial reporting purposes.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

15. INCOME FROM SUKUK

	2016	2015
Profit earned on debt-type Sukuk	3,205	3,341
(Loss)/gain on sale of Sukuk	(203)	341
	3,002	3,682

16. STAFF COST

	2016	2015
Salaries and short-term benefits	5,152	4,877
Social insurance expenses	789	711
Other staff expenses	47	138
	5,988	5,726

17. OTHER OPERATING EXPENSES

	2016	2015
Premises cost	1,132	1,101
Advertisement and marketing expenses	1,221	862
Professional fees	513	566
Information technology expenses	430	411
Board expenses	108	196
Communication expenses	257	301
Distribution channel expenses	430	314
Other administrative expenses	980	852
Depreciation expenses	497	482
	5,568	5,085

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

18. NET IMPAIRMENT CHARGE

	2016	2015
Financing assets (note 5)	7,606	1,032
Recoveries from previously written off financing assets	(2,366)	-
Lease rental receivable (note 7)	236	280
Investments at fair value through equity- at cost (note 8)	1,852	766
Investments at fair value through equity- at fair value (note 8)	-	263
Investments at amortised cost (note 6)	589	131
Other assets	1,004	-
	8,921	2,472

19. SHARE-BASED EMPLOYEE INCENTIVE SCHEME

The group has incorporated a special purpose vehicle, Hawafiz Khaleeji Management Company BSC (c) ("Hawafiz"), to hold the beneficial interest of the shares under the scheme.

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

As per the scheme, the share awards from each performance year will vest immediately but will be released over three years period from the date of grant. The share awards are subject to an additional retention period of six months from the date of completion of deferred period, after which the employee is unconditionally allowed to sell the shares in the market. The scheme allows the Bank Nomination, Remuneration and Governance Committee ("BNRGC") to determine that, if appropriate, un-awarded shares can be forfeited or clawed back in certain situations.

As at 31 December 2016, 6,277,632 shares (2015: 6,917,367 shares) were held by Hawafiz. During the year 2,551,770 shares (2015: 2,089,839 shares) shares were awarded to the employees as awards under the terms of the scheme subject to a three year deferment period. During the year the Bank transferred 855,966 shares (2015: 123,464 shares) to the employees.

20. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

Judgements*Classification of investments*

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2016**

BD 000's

20 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES
*(continued)**Judgements (continued)**Special purpose entities*

The Bank sponsors the formation of special purpose entities (SPE's) primarily for the purpose of allowing clients to hold investments. The Bank provides corporate administration, investment management and advisory services to these SPE's, which involve the Group making decisions on behalf of such entities. The Bank administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments.

The Bank does not consolidate SPE's that it does not have the power to control. In determining whether the Bank has the power to control an SPE, judgements are made about the objectives of the SPE's activities, its exposure to the risks and rewards, as well as about the Group's intention and ability to make operational decisions for the SPE and whether the Group derives benefits from such decisions.

Estimations*Impairment of equity investments*

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

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

For unquoted investments carried at cost, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

Where fair values are not readily available and the investments are carried at cost, the recoverable amount of such investment is estimated to test for impairment.

In making this judgment, the Bank evaluates among other factors, evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

Fair value of unquoted equity securities

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2016**

BD 000's

20 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES
(continued)*Estimations (continued)*

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

The potential effect of using reasonable possible alternative assumptions for valuing the investments resulting in 5% decrease/increase in the market multiple would increase/decrease the reported fair value by BD 757 thousand (31 December 2015: BD 734 thousand). The corresponding impact would be on the profit or loss reported by the Group.

Impairment of financing assets

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

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

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

Estimation of net realisable value of development property

Development property is stated at lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less estimated selling expenses. The management has forecasted the cost of completion of development property and has engaged independent valuers to estimate the residual value of the development property based on estimated market selling prices for similar properties. Net realisable value estimates are made at a specific point in time, based on market conditions and information about the expected use of development property. These estimates involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. There is no certainty about future events. It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the development property.

21. ASSETS UNDER MANAGEMENT

The Bank provides corporate administration, investment management and advisory services to its investment entities, which involve the Group making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the reporting date, the Group had assets under management of BD 234.69 million (31 December 2015: BD 255.21 million). During the year, the Bank has not charged any management fees (2015: BD Nil) for the management of these assets.. The Bank fully redeemed BD 8,493 thousand to the investment holders of Janayen holding Limited (RIA 4) by selling off the underlying assets of RIA. The Bank, in its capacity as an investment administrator, redeemed 8% capital of Global Logistix Navi Mumbai Investment Company of BD 7,540.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

21. ASSETS UNDER MANAGEMENT (continued)

Further, Safana investment WLL (RIA 4) offered an in-kind exit in the form of land parcels to all investors in 2014. Certain land parcels were awarded against the investment in Safana investments WLL, thereby resulting in a partial exit. Land parcels were transferred in a new Company, NS 12 SPC, with the objective to sell and redeem the investors. During the year the Bank held a auction and awarded certain land parcels worth BD 2,012 thousand to certain investors of RIA 4 as a partial redemption. The Bank bought back investment in Shaden Real Estate Investment WLL (RIA 5) from its investors at a profit of 5% amounting to BD 76 thousand (2015: BD 4,372 thousand).

22. RELATED PARTY TRANSACTIONS

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

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

Categories*	Number of Shares	Number of Directors
Less than 1%	1,278,202	3

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

Compensation of key management personnel

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

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

	2016	2015
Board member fees and allowances	93	180
Salaries and other short-term benefits	1,031	603

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

22. RELATED PARTY TRANSACTIONS (continued)

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

31 December 2016	Associates	Key management personnel	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
Financing assets	-	-	-	-	-
Investment in equity securities	127	-	2,284	25,387	27,798
Other assets	4,678	-	-	918	5,596
Liabilities					
Customers' current accounts	10	-	88	1,903	2,001
Equity of investment account holders	446	150	19,935	917	21,448

31 December 2015	Associates	Key management personnel	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
Financing assets	334	-	-	-	334
Investment in equity securities	-	-	2,284	23,845	26,129
Other assets	2,722	-	-	2,494	5,216
Liabilities					
Customers' current accounts	222	-	9,971	7,800	17,993
Equity of investment account holders	110	-	19,943	8,409	28,462

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22. RELATED PARTY TRANSACTIONS (continued)

2016	Associates	Key management personnel	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
Income from financing assets and assets acquired for leasing	6	-	-	-	6
Income from equity securities	-	-	-	-	-
Fees and other income	17	-	1,893	-	1,910
Expenses					
Return to investment account holders	12	2	155	8	177
Staff cost	-	1,031	-	-	1,031
Other expenses	-	-	4	21	25
(Recoveries)/Impairment	-	-	(2,366)	1,852	(514)

2015	Associates	Key management personnel	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
Income from financing assets and assets acquired for leasing	39	-	-	-	39
Income from equity securities	-	-	-	367	367
Fees and other income	1	-	-	-	1
Expenses					
Return to investment account holders	2	-	520	131	653
Staff cost	-	603	-	-	603
Other expenses	-	-	-	110	110

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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BD 000's

23. EARNINGS PER SHARE

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

Basic EPS

	2016	2015
Profit attributable to parent for the year (BD 000's)	5,310	7,014
Weighted average number of equity shares (Nos. in 000's)	967,119	1,007,445
Basic earnings per share (in fils)	5.49	6.96

The Bank does not have any dilutive instruments as of 31 December 2015 and December 2016.

24. SHARI'A SUPERVISORY BOARD

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

25. ZAKAH

Zakah is directly borne by the shareholders on distributed profits and investment account holders. The Bank currently does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually. During the year, the Shari'a Supervisory Board has computed Zakah payable of BD 420 thousand (2015: BD 100 thousand) of which BD 355 thousand (2015: Nil) represents the Zakah computed on the statutory reserve and cumulative retained earnings as at 31 December 2016, payable by the Bank. The remaining Zakah balance amounting to BD 65 thousand or 0.061 fils per share (2015: BD 100 thousand or 0.100 fils per share) is due and payable by the shareholders. The Bank will pay Zakah of BD 5 thousand (2015: BD 7 thousand) on the treasury shares held as of 31 December 2016 based on 0.061 fils per share (Note 31).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

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26. SEGMENT REPORTING

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

Corporate and retail banking

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

Investment banking

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

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

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

The Group primarily operates from Bahrain and does not have any overseas branches/divisions. The geographic concentration of assets and liabilities is disclosed in note 28 (b) to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

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26. **SEGMENT REPORTING (continued)**

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

31 December 2016	Investment Banking	Corporate and Retail Banking	Unallocated	Total
Cash and bank balances	-	56,006	-	56,006
Placements with financial institutions	1,759	76,955	-	78,714
Financing assets	-	355,377	-	355,377
Investment in sukuk	-	74,154	-	74,154
Assets acquired for leasing (including lease rentals receivable)	-	95,412	-	95,412
Investment in equity securities	55,121	-	-	55,121
Investment in real estate	21,508	-	-	21,508
Development property	6,003	-	-	6,003
Other assets	10,659	2,752	1,085	14,496
Property and equipment	-	-	8,208	8,208
Total segment assets	95,050	660,656	9,293	764,999
Placements from financial institutions	-	59,079	-	59,079
Placements from non- financial institutions and individuals	-	100,649	-	100,649
Customers' current accounts	1,759	74,055	-	75,814
Other liabilities	1,745	4,296	2,270	8,311
Total segment liabilities	3,504	238,079	2,270	243,853
Equity of investment account holders	-	404,651	-	404,651
Restricted investment accounts	10,949	-	-	10,949

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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26. *SEGMENT REPORTING (continued)*

2016	Investment Banking	Corporate and Retail Banking	Unallocated	Total
Income from financing assets and assets acquired for leasing	-	26,198	-	26,198
Income from placements with financial institutions	14	629	-	643
Income from sukuk	-	3,002	-	3,002
Income from investment securities	652	-	-	652
Fees and other income	2,369	3,053	-	5,422
Total income before return to investment account holders	3,035	32,882	-	35,917
Less: Return to investment account holders before Bank's share as Mudarib	-	(16,286)	-	(16,286)
Bank's share as a Mudarib	-	9,130	-	9,130
Return to investment account holders	-	(7,156)	-	(7,156)
Less: Expense on placements from financial institutions, non- financial institutions and individuals	-	(2,976)	-	(2,976)
Total segment revenue	3,035	22,750	-	25,785
Staff cost	599	2,395	2,994	5,988
Other expenses	318	1,684	3,566	5,568
Total segment cost	917	4,079	6,560	11,556
Segment results before impairment allowances	2,118	18,671	(6,560)	14,229
Charge of impairment allowances	(1,852)	(7,069)	-	(8,921)
Segment results	266	11,602	(6,560)	5,308

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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BD 000's

26. *SEGMENT REPORTING (continued)*

31 December 2015	Investment Banking	Corporate and Retail Banking	Unallocated	Total
Cash and bank balances	2	41,284	-	41,286
Placements with financial institutions	7,440	36,513	-	43,953
Financing assets	(6,397)	325,111	-	318,714
Investment in sukuk	-	63,533	-	63,533
Assets acquired for leasing (including lease rentals receivable)	-	69,100	-	69,100
Investment in equity securities	67,801	-	-	67,801
Investment in real estate	19,071	-	-	19,071
Development property	6,952	-	-	6,952
Other assets	11,832	2,495	953	15,280
Property and equipment	-	-	8,285	8,285
Total segment assets	106,701	538,036	9,238	653,975
Placements from financial institutions	-	47,007	-	47,007
Placements from non- financial institutions and individuals	-	48,311	-	48,311
Customers' current accounts	7,440	58,408	-	65,848
Other liabilities	1,793	5,614	2,430	9,837
Total segment liabilities	9,233	159,340	2,430	171,003
Equity of investment account holders	8,519	362,752	-	371,271
Restricted investment accounts	21,534	-	-	21,534

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2016

BD 000's

26. SEGMENT REPORTING (continued)

2015	Investment Banking	Corporate and Retail Banking	Unallocated	Total
Income from financing assets and assets acquired for leasing	-	21,447	-	21,447
Income from placements with financial institutions	96	470	-	566
Income from sukuk	-	3,682	-	3,682
Income from investment securities	878	-	-	878
Fees and other income	2,204	2,201	-	4,405
Total income before return to investment account holders	3,178	27,800	-	30,978
Less: Return to investment account holders before Bank's share as Mudarib	(527)	(16,406)	-	(16,933)
Bank's share as a Mudarib	298	9,253	-	9,551
Return to investment account holders	(229)	(7,153)	-	(7,382)
Less: Expense on placements from financial institutions, non- financial institutions and individuals	(64)	(2,228)	-	(2,292)
Total segment revenue	2,885	18,419	-	21,304
Staff cost	573	2,290	2,863	5,726
Other expenses	183	1,216	3,686	5,085
Total segment cost	756	3,506	6,549	10,811
Segment results before impairment allowances	2,129	14,913	(6,549)	10,493
Charge of impairment allowances	(1,029)	(1,443)	-	(2,472)
Segment results	1,100	13,470	(6,549)	8,021

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27. MATURITY PROFILE

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

31 December 2016	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	56,006	-	-	-	-	56,006
Placements with financial institutions	77,686	-	1,028	-	-	78,714
Financing assets	26,154	16,977	40,784	81,503	189,959	355,377
Investment in sukuk	74,154	-	-	-	-	74,154
Assets acquired for leasing (including lease rental receivable)	148	7	13	1,354	93,890	95,412
Investment in equity securities	-	-	-	55,121	-	55,121
Investment in real estate	-	-	-	-	21,508	21,508
Development property	-	-	-	-	6,003	6,003
Other assets	851	-	41	9,975	3,629	14,496
Property and equipment	-	-	-	-	8,208	8,208
Total assets	234,999	16,984	41,866	147,953	323,197	764,999
Liabilities						
Placements from financial institutions	59,079	-	-	-	-	59,079
Placements from non-financial institutions and individuals	19,127	13,598	63,654	2,553	1,717	100,649
Customers' current account	47,595	10,870	6,448	3,777	7,124	75,814
Other liabilities	2,785	581	824	4,121	-	8,311
Total liabilities	128,586	25,049	70,926	10,451	8,841	243,853
Equity of investment account holders	166,175	42,392	53,392	28,958	113,734	404,651
Restricted investment accounts	-	6,304	-	4,645	-	10,949
Commitments	31,720	17,264	25,836	12,001	1,645	88,466

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27. *MATURITY PROFILE (continued)*

31 December 2015	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	41,286	-	-	-	-	41,286
Placements with financial institutions	43,793	-	160	-	-	43,953
Financing assets	46,713	16,938	34,316	77,869	142,878	318,714
Investment in sukuk	63,533	-	-	-	-	63,533
Assets acquired for leasing (including lease rental receivable)	533	-	-	472	68,095	69,100
Investment in equity securities	-	-	-	67,801	-	67,801
Investment in real estate	-	-	-	-	19,071	19,071
Development property	-	-	-	-	6,952	6,952
Other assets	2,461	-	231	10,916	1,672	15,280
Property and equipment	-	-	-	-	8,285	8,285
Total assets	198,319	16,938	34,707	157,058	246,953	653,975
Liabilities						
Placements from financial institutions	30,510	1,525	-	14,972	-	47,007
Placements from non-financial institutions and individuals	14,210	8,368	22,636	1,504	1,593	48,311
Customers' current account	41,167	11,026	5,075	2,973	5,607	65,848
Other liabilities	2,335	856	1,232	5,414	-	9,837
Total liabilities	88,222	21,775	28,943	24,863	7,200	171,003
Equity of investment account holders	151,165	35,273	47,774	26,517	110,542	371,271
Restricted investment accounts	8,500	-	993	12,041	-	21,534
Commitments	24,790	22,239	26,735	6,099	1,115	80,978

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

(a) Industry sector

31 December 2016

	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	56,006	-	-	56,006
Placements with financial institutions	78,714	-	-	78,714
Financing assets	12,358	88,245	254,774	355,377
Investment in sukuk	1,885	10,058	62,211	74,154
Assets acquired for leasing (including lease rentals receivable)	-	94,488	924	95,412
Investment in equity securities	15,147	36,305	3,669	55,121
Investment in real estate	-	21,508	-	21,508
Development property	-	6,003	-	6,003
Other assets	1,085	5,718	7,693	14,496
Property and equipment	-	6,740	1,468	8,208
Total assets	165,195	269,065	330,739	764,999
Liabilities				
Placements from financial institutions	59,079	-	-	59,079
Placements from non-financial institutions and individuals	-	-	100,649	100,649
Customers' current accounts	3,343	11,849	60,622	75,814
Other liabilities	-	2,752	5,559	8,311
Total liabilities	62,422	14,601	166,830	243,853
Equity of investment account holders	39,683	21,446	343,522	404,651
Restricted investment accounts	-	9,956	993	10,949
Commitments	723	27,571	60,172	88,466

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

(a) *Industry sector (continued)*

31 December 2015

	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	41,286	-	-	41,286
Placements with financial institutions	43,953	-	-	43,953
Financing assets	27,708	87,964	203,042	318,714
Investment in sukuk	1,889	1,640	60,004	63,533
Assets acquired for leasing (including lease rentals receivable)	-	68,093	1,007	69,100
Investment in equity securities	22,471	37,892	7,438	67,801
Investment in real estate	-	19,071	-	19,071
Development property	-	6,952	-	6,952
Other assets	1,261	5,115	8,904	15,280
Property and equipment	-	6,722	1,563	8,285
Total assets	138,568	233,449	281,958	653,975
Liabilities				
Placements from financial institutions	47,007	-	-	47,007
Placements from non-financial institutions and individuals	-	682	47,629	48,311
Customers' current accounts	5,322	14,075	46,451	65,848
Other liabilities	-	2,039	7,798	9,837
Total liabilities	52,329	16,796	101,878	171,003
Equity of investment account holders	940	26,091	344,240	371,271
Restricted investment accounts	-	20,541	993	21,534
Commitments	608	20,943	59,427	80,978

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

(b) Geographic sector

31 December 2016	GCC countries	Europe	America	Asia	Australia	Total
Assets						
Cash and bank balances	47,152	2,790	6,057	7	-	56,006
Placements with financial institutions	78,714	-	-	-	-	78,714
Financing assets	336,485	18,892	-	-	-	355,377
Investment in sukuk	74,154	-	-	-	-	74,154
Assets acquired for leasing (including lease rentals receivable)	95,412	-	-	-	-	95,412
Investment in equity securities	30,985	-	-	20,468	3,668	55,121
Investment in real estate	21,508	-	-	-	-	21,508
Development property	6,003	-	-	-	-	6,003
Other assets	13,777	15	-	704	-	14,496
Property and equipment	8,208	-	-	-	-	8,208
Total assets	712,398	21,697	6,057	21,179	3,668	764,999
Liabilities						
Placements from financial institutions	59,079	-	-	-	-	59,079
Placements from non-financial institutions and individuals	100,649	-	-	-	-	100,649
Customers' current accounts	74,025	1,692	-	97	-	75,814
Other liabilities	8,311	-	-	-	-	8,311
Total liabilities	242,064	1,692	-	97	-	243,853
Equity of investment account holders	401,529	484	-	2,638	-	404,651
Restricted investment accounts	9,956	-	-	-	993	10,949
Commitments	88,414	52	-	-	-	88,466

Concentration by location for financing assets is measured based on the location of the counterparty, which has a high correlation with the location of the collateral for the exposure.

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

(b) Geographic sector (continued)

31 December 2015	GCC countries	Europe	America	Asia	Australia	Total
Assets						
Cash and bank balances	33,825	1,495	5,928	38	-	41,286
Placements with financial institutions	43,953	-	-	-	-	43,953
Financing assets	299,006	19,708	-	-	-	318,714
Investment in sukuk	63,533	-	-	-	-	63,533
Assets acquired for leasing (including lease rentals receivable)	69,100	-	-	-	-	69,100
Investment in equity securities	43,754	-	-	20,379	3,668	67,801
Investment in real estate	19,071	-	-	-	-	19,071
Development property	6,952	-	-	-	-	6,952
Other assets	13,785	900	-	595	-	15,280
Property and equipment	8,285	-	-	-	-	8,285
Total assets	601,264	22,103	5,928	21,012	3,668	653,975
Liabilities						
Placements from financial institutions	47,007	-	-	-	-	47,007
Placements from non-financial institutions and individuals	48,311	-	-	-	-	48,311
Customers' current accounts	65,419	348	-	81	-	65,848
Other liabilities	9,837	-	-	-	-	9,837
Total liabilities	170,574	348	-	81	-	171,003
Equity of investment account holders	359,036	488	-	11,747	-	371,271
Restricted investment accounts	20,541	-	-	-	993	21,534
Commitments	80,731	247	-	-	-	80,978

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for the year ended 31 December 2016

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29. FAIR VALUE

a) Fair value of financial instruments

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

The fair values of quoted sukuk carried at amortised cost of BD 73,443 thousand (31 December 2015: BD 51,964 thousand) amounts to BD 72,423 thousand as at 31 December 2016 (31 December 2015: BD 51,472 thousand).

In case of financing assets and lease receivables, the average profit rate of the portfolio is in line with current market rates for similar facilities and hence after consideration of adjustment for prepayment risk and impairment charges it is expected that the current value would not be materially different to fair value of these assets. Other than equity investments carried at cost of BD 39,973 thousand (2015: BD 49,099 thousand), the estimated fair values of the Bank's other financial instruments are not significantly different from their carrying values due to their short-term nature.

b) Fair value hierarchy

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

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

31 December 2016

Investment securities
Equity type instruments carried at
fair value through income statement
Equity type instruments carried at
fair value through equity

Level 1	Level 2	Level 3	Total
-	-	15,148	15,148
-	-	-	-
-	-	15,148	15,148

31 December 2015

Investment securities
Equity type instruments carried at
fair value through income statement
Equity type instruments carried at
fair value through equity

Level 1	Level 2	Level 3	Total
-	-	15,148	15,148
3,554	-	-	3,554
3,554	-	15,148	18,702

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BD 000's

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

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

	2016	2015
At 1 January	15,148	15,148
Total gains or losses		
- In profit or loss	-	-
Purchases	-	-
At 31 December	15,148	15,148

30. RISK MANAGEMENT**Introduction and overview**

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

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

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

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established an Executive Risk Management Committee, which is responsible for developing and monitoring the Bank's risk management policies in the specified areas. The committee also continuously monitors consistent implementation of the Board approved policies in the Bank and reports deviations, if any, to the Board. The committee consists of heads of business and other functional units in the Bank and reports regularly to the Board Audit and Risk Management Committee.

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

30. RISK MANAGEMENT (continued)

CREDIT RISK

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

The Bank monitors the total exposure to assets acquired for leasing (including lease rentals receivable) on a cumulative basis for monitoring of market risk and credit risk.

The Board of Directors has delegated responsibility for the management of credit risk to its Executive Risk Management Committee (ERMC). A separate Risk Management and Credit Management Department (RMD), reporting to the ERMC is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements and submitting the same for approval to the Board of Directors.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are not at present allocated to business units. Smaller exposures are approved by the Executive Credit & Investment Committee. Larger facilities require approval by the Chief Executive Officer, Board Investment and Credit Committee or the full Board, as the case may be.
- Reviewing and assessing credit risk. RMD assesses all credit exposures and signs off on the relevant proposals prior to approval of the facilities by the appropriate authorities. Renewal and review of facilities are subject to the same process.
- Limiting concentrations of exposure to counterparties, countries and industries in respect of financing assets, assets acquired for leasing as well as investments.
- Developing and maintaining the Bank's risk gradings in order to categorise exposures according to the degree of probable risk of financial loss to focus management on the attendant risks. The risk grading system is also used to identify specific exposures for which impairment provisions may be required. The risk grading framework for the Bank's financing portfolio consists of ten grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for setting risk grades lies with the final approving executive/committee as appropriate on the recommendations of the RMD. Risk grades are subject to regular reviews by RMD.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are submitted to the Board on the compliance levels. RMD also provides advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.
- Each business unit is required to implement the Bank credit policies and procedures in respect of exposures assumed by them and are responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, irrespective of the approving authority for the exposure. Regular audits of business units and Bank credit processes are undertaken by Internal Audit.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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BD 000's

30. RISK MANAGEMENT (continued)

CREDIT RISK (continued)

Exposure to credit risk

31 December 2016	Placements with financial institutions	Financing assets	Assets acquired for leasing (including lease rental receivable)	Investment in sukuk	Other financial assets	Total
Impaired						
Grade 8-10	-	42,978	2,793	1,733	-	47,504
Impaired	-	-	-	-	6,740	6,740
Unrated	-	(15,165)	-	(1,021)	(1,957)	(18,143)
Allowance for impairment	-					
Carrying amount	-	27,813	2,793	712	4,783	36,101
Past due but not impaired						
Grade 1-6	-	28,511	10,934	-	-	39,445
Low-Fair Risk	-	2,512	1,716	-	-	4,228
Grade 7 Watch list	-					
Past due comprises:						
Up to 30 days	-	24,490	10,487	-	-	34,977
30-60 days	-	5,521	1,113	-	-	6,634
60-90 days	-	1,012	1,050	-	-	2,062
Carrying amount	-	31,023	12,650	-	-	43,673
Neither past due nor impaired						
Grade 1-6	78,714	286,995	79,697	73,442	-	518,848
Low-Fair Risk	-	12,950	1,231	-	-	14,181
Grade 7 Watch list	-	-	-	-	9,713	9,713
Unrated	-					
Carrying amount	78,714	299,945	80,928	73,442	9,713	542,742
Less:						
Collective impairment provisions	-	(3,404)	(959)	-	-	(4,363)
Total	78,714	355,377	95,412	74,154	14,496	618,153

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30. RISK MANAGEMENT (continued)

CREDIT RISK (continued)

Exposure to credit risk (continued)

31 December 2015	Placements with financial institutions	Financing assets	Assets acquired for leasing (including lease rental receivable)	Investment in sukuk	Other financial assets	Total
<u>Impaired</u>						
Grade 8-10						
Impaired	-	16,341	507	2,001	-	18,849
Unrated	-	-	-	-	7,606	7,606
Allowance for impairment	-	(10,284)	(25)	(431)	(1,676)	(12,416)
Carrying amount	-	6,057	482	1,570	5,930	14,039
<u>Past due but not impaired</u>						
Grade 1-6						
Low-Fair Risk	-	24,282	7,527	-	-	31,809
Grade 7 Watch list	-	27,550	-	-	-	27,550
<u>Past due comprises:</u>						
Up to 30 days	-	8,688	3,414	-	-	12,102
30-60 days	-	11,016	1,400	-	-	12,416
60-90 days	-	8,662	1,335	-	-	9,997
90-180days	-	7,066	859	-	-	7,925
180 days +	-	16,400	519	-	-	16,919
Carrying amount	-	51,832	7,527	-	-	59,359
<u>Neither past due nor impaired</u>						
Grade 1-6						
Low-Fair Risk	43,953	260,480	61,789	61,963	-	428,185
Grade 7 Watch list	-	3,829	-	-	-	3,829
Unrated	-	-	-	-	9,350	9,350
Carrying amount	43,953	264,309	61,789	61,963	9,350	441,364
Less: Collective impairment provisions	-	(3,484)	(698)	-	-	(4,182)
Total	43,953	318,714	69,100	63,533	15,280	510,580

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30. RISK MANAGEMENT (continued)

CREDIT RISK (continued)

Impaired financial assets

Impaired financial assets are those for which the Bank determines that it is probable that it will be unable to collect all or part of the principal and profit due according to the contractual terms of the exposure. Generally these assets fall under risk grades 8, 9 and 10, for other financial assets impairment is assessed on an individual basis for each exposure under the Bank's internal credit risk grading system.

Past due but not impaired exposures

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

Renegotiated facilities

During the year, facilities of BD 28,471 thousands (2015: BD 49,276 thousand) were renegotiated, out of which BD 15,047 thousand (2015: BD 41,500 thousand) are classified as neither past due nor impaired as of 31 December 2016. The renegotiated terms usually require settlement of profits accrued till date on the facility and/or part payment of the principal and/or obtaining of additional collateral coverage. The renegotiated facilities are subject to revised credit assessments and independent review by the RMD. Of the total past due facilities of BD 74,279 thousand (2015: BD 65,898 thousand) only instalments of BD 20,142 thousand (2015: BD 30,204 thousand) are past due as at 31 December 2016.

Allowances for impairment

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

Non-accrual basis

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

Write-off policy

The Bank writes off an asset/security balance (net of any related allowances for impairment losses) when it determines that the asset/security are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the counterparty's financial position such that he can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. During the year, the Bank has written off financing facilities amounting to BD 2,806 thousand (2015: BD 933 thousand) which were fully impaired. The Bank has recovered BD 2,366 thousand from a financing facility written off in previous years.

Collaterals

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

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BD 000's

30. RISK MANAGEMENT (continued)

CREDIT RISK (continued)

Collaterals (continued)

	As at 31 December 2016			As at 31 December 2015		
	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total
<u>Against impaired</u>						
Property	14,585	2,785	17,370	3,540	190	3,730
Other	3,222	-	3,222	463	-	463
<u>Against past due but not impaired</u>						
Property	27,620	17,910	45,530	29,899	8,844	38,743
Other	2,110	-	2,110	4,706	-	4,706
<u>Against neither past due nor impaired</u>						
Property	94,323	77,404	171,727	74,342	61,056	135,398
Equities	398	-	398	298	-	298
Other	32,243	-	32,243	40,258	-	40,258
Total	174,501	98,099	272,600	153,506	70,090	223,596

The average collateral coverage ratio on secured facilities is 114.47% at 31 December 2016 (31 December 2015: 107.80%)

For analysis of concentration of total assets and liabilities refer note 28.

Further, for financing assets and assets acquired for leasing the Bank monitors concentrations of credit risk by sector and by geographic location.

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30. *RISK MANAGEMENT (continued)*

CREDIT RISK (continued)

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

Concentration by Sector	As at 31 December 2016			As at 31 December 2015		
	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total
Banking and finance	12,358	-	12,358	27,708	-	27,708
Real estate:						
- Property	13,231	94,488	107,719	6,474	68,118	74,592
- Infrastructure Development	11,141	-	11,141	19,690	-	19,690
- Land	35,085	-	35,085	23,558	-	23,558
Construction	28,788	-	28,788	37,334	-	37,334
Trading	99,777	-	99,777	112,455	-	112,455
Manufacturing	39,389	-	39,389	13,446	-	13,446
Others	115,608	924	116,532	78,049	982	79,031
Total carrying amount	355,377	95,412	450,789	318,714	69,100	387,814

Settlement risk

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

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

LIQUIDITY RISK

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

Management of liquidity risk

The Bank'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 Bank's reputation.

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

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30. *RISK MANAGEMENT (continued)*

LIQUIDITY RISK (continued)

Management of liquidity risk (continued)

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

Exposure to liquidity risk

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

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

	2016 %	2015 %
At 31 December	25.81	20.95
Average for the period	20.26	26.86
Maximum for the period	26.21	32.30
Minimum for the period	11.81	20.95

For maturity profile of assets and liabilities refer note 27.

MARKET RISK

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

Management of market risks

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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30. RISK MANAGEMENT (continued)

MARKET RISK (continued)

Exposure to profit rate risk–non–trading portfolios

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

A summary of the Bank's profit rate gap position at 31 December 2016 is as follows:

31 December 2016	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	77,686	-	1,028	-	-	78,714
Financing assets	26,154	16,977	40,784	81,503	189,959	355,377
Assets acquired for leasing (including lease rentals receivable)	148	7	13	1,354	93,890	95,412
Investments securities (sukuk)	74,154	-	-	-	-	74,154
Total profit rate sensitive assets	178,142	16,984	41,825	82,857	283,849	603,657
Liabilities and investment accounts						
Placements from financial institutions	44,234	-	-	14,845	-	59,079
Placements from non-financial institutions and individuals	16,270	15,045	53,982	14,447	905	100,649
Customers' current accounts	1,930	-	-	-	-	1,930
Equity of investments account holders	216,220	88,076	84,536	15,819	-	404,651
Total profit rate sensitive liabilities and investment accounts	278,654	103,121	138,518	45,111	905	566,309
Profit rate gap	(100,512)	(86,137)	(96,693)	37,746	282,944	37,348

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

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30. RISK MANAGEMENT (continued)

MARKET RISK (continued)

31 December 2015	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	43,793	-	160	-	-	43,953
Financing assets	46,713	16,938	34,316	77,869	142,878	318,714
Assets acquired for leasing (including lease rentals receivable)	533	-	-	472	68,095	69,100
Investments securities (sukuk)	63,533	-	-	-	-	63,533
Total profit rate sensitive assets	154,572	16,938	34,476	78,341	210,973	495,300
Liabilities and investment accounts						
Placements from financial institutions	30,510	1,525	-	14,972	-	47,007
Placements from non-financial institutions and individuals	14,210	8,368	22,636	1,504	1,593	48,311
Customers' current accounts	7,694	-	-	-	-	7,694
Equity of investments account holders	151,165	35,273	47,774	26,517	110,542	371,271
Total profit rate sensitive liabilities and investment accounts	203,579	45,166	70,410	42,993	112,135	474,283
Profit rate gap	(49,007)	(28,228)	(35,934)	35,348	98,838	21,017

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

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

At 31 December 2016

At 31 December 2015

100bp parallel
increase/
decrease

±373

±210

50bp
increase/
decrease

±187

±105

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

30. RISK MANAGEMENT (continued)

MARKET RISK (continued)

Exposure to foreign exchange risk

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

	2016 BHD Equivalent	2015 BHD Equivalent
US Dollars*	(23,085)	34,563
Other GCC Currencies *	26,783	14,578
Euros	3,580	4,761
Australian Dollars	4,608	4,608
Kuwaiti Dinars	3,074	4,297
Sterling Pounds	984	2,064
Indian Rupee	7	38

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

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

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

	2016 BHD Equivalent	2015 BHD Equivalent
Euros	±179	±238
Australian Dollars	±230	±230
Kuwaiti Dinars	±154	±215
Sterling Pounds	±49	±103
Indian Rupees	-	±2

Exposure to other price risks—non—trading portfolios

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

The Group's unquoted equity securities carried at cost are exposed to risk of changes in equity values. Refer to note 20 for significant estimates and judgments in relation to impairment assessment of unquoted equity investments carried at cost. The Group manages exposure to other price risks by actively monitoring the performance of the equity securities. The performance assessment is performed on a quarterly basis and is reported to the Board Investment and Credit Committee.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

30. RISK MANAGEMENT (continued)

MARKET RISK (continued)

OPERATIONAL RISK

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

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

CAPITAL MANAGEMENT

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

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

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

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

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

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

The regulatory adjustments are subject to limits prescribed by the CBB requirements, these deductions would be effective in a phased manner through transitional arrangements from 2016 to 2018. The regulations prescribe higher risk weights for certain exposures that exceeds materiality thresholds. These regulatory adjustments required for certain items such as goodwill on mortgage service right, deferred tax assets, cash flow hedge reserve, gain on sale of related securitization transactions, defined benefit pension fund assets and liabilities, investment in own shares and reciprocal cross holdings in the capital of Banking and financial entities,

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2016

BD 000's

30. RISK MANAGEMENT (continued)

CAPITAL MANAGEMENT (continued)

investment in the capital of Banking and financial entities that are outside the scope of regulatory consolidation and where the Bank does not own more than 10% of issued common shares capital of the entity and significant investments in the capital of banking and financial entities that are outside the scope of regulatory consolidation.

As at 31 December 2016 the Bank has made regulatory adjustments of BD 10,386 thousand (2015: 10,299 thousands) in line with the CBB requirements.

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

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

	31 December 2016	31 December 2015
Total risk weighted exposure	628,875	585,697
Tier 1 capital:		
- CET 1 capital prior to regulatory adjustments	121,462	116,281
- Less: regulatory adjustments	(10,386)	(10,229)
CET 1 after regulatory adjustments	111,076	106,052
AT 1	-	-
Tier 2 capital:	4,362	4,188
Total regulatory capital	115,438	110,240
Total regulatory capital expressed as a percentage of total risk weighted assets	18.36%	18.11%
Liquidity coverage ratio	154.25%	96.45%
Net stable funding ratio	80.80%	76.14%
Leverage ratio	19.92%	22.86%

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

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for the year ended 31 December 2016

BD 000's

30. RISK MANAGEMENT (continued)

CAPITAL MANAGEMENT (continued)

Capital allocation

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

31. PROPOSED APPROPRIATIONS

The Board of Directors propose the appropriation for zakah of BD 360 thousand in 2016 (2015: BD 7 thousand) and bonus shares nil (2015: 5% (BD 5 million).

32. COMMITMENTS

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

	2016	2015
Undrawn commitments to extend finance	65,797	60,994
Financial guarantees	22,669	19,984
	88,466	80,978

Performance obligations

During the ordinary course of business, the Group may enter into performance obligations in respect of certain of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2016 due to the performance of any of its projects.

33. SOCIAL RESPONSIBILITY

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

34. COMPARITIVES

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