

**ALUBAF Arab International Bank B.S.C. (c)**

**REPORT OF THE BOARD OF DIRECTORS,  
INDEPENDENT AUDITOR'S REPORT  
AND FINANCIAL STATEMENTS**

**31 DECEMBER 2017**

## **Board of Directors' Report**

It is a great pleasure and privilege for me to address the Annual General meeting of the shareholders' of Alubaf Arab international Bank , Bahrain. On behalf of the Board of Directors', I am delighted to present Alubaf's Annual report and audited financial statements for the year ended 31 December 2017.

The year 2017 has been another challenging year for the Banking industry, due to global geopolitical risks and uncertainty, in particular, in the region we operate. Amid such challenging environment, Alubaf stood resilient and adapted to the dynamics and complexity of challenges that impact the Banking sector.

The Bank delivered improved financial performance for the year ended 31 December 2017 and resulted in a Net profit of US\$ 10.8 million, as compared to a net loss of US\$ 14.7 million last year 2016, which is an increase of 174%, year on year.

Net profit for the quarter ended 31 December 2017 was US\$ 4.7 million, as compared to US\$ 2.3 million for the same period, last year 2016.

This increase in profit for 2017, was achieved, mainly due to improved asset quality and reduction on high risk weighted exposures. With gradual reduction on stressed assets and improved asset quality parameters, the income streams stabilized from performing assets.

Interest income for 2017 was US\$ 40 million, almost in line with last year 2016, however, interest expenses increased by 19%, from US\$ 8.6 million to US\$ 10.2 million , due to hike in libor rates for the year 2017. This resulted in reduction of Net interest income to US\$ 29.3 million in 2017, compared to US\$ 31 million in 2016.

Non- interest income from fee, commission and other income, had decreased by 30% for the year ended 31 December 2017, as compared to last year ended 2016, mainly due to decline in fee and commission. This decline is attributed to strategic moves to exit from high risk weighted exposures and to reduce delinquencies from such exposures.

On the expenses front, the staff costs grew by 37% for 2017, as compared to 2016, in order to align rewards for performance in 2017. As for other operating expenses, the increase evidenced is 42% year on year, primarily expensed to strengthen control and processes that comply with regulatory requirements and obligations, thus, Cost to gross income ratio stood at 38% at yearend 31 December 2017.

The underlying main driver for profit for the year 2017 was significant reduction on impairment provision on loans, which reduced by 72%, as compared to last year 2016, which reflects the improved asset risk profile. Further, the Bank improved its provision (specific and general) coverage ratio to 102% in 2017 from 84% in 2016.

The Bank achieved a Return on average equity of 4% for the year ended 2017, from a negative return for last year 2016. The Bank's liquid assets to total assets stood at 66% and Capital adequacy ratio stood at 37% at 31 December 2017, signifying the Bank's strengthened capital and liquidity position.

In continuing with Alubaf's commitment to its valued shareholders, the Board of directors are pleased to propose a dividend of US\$ 1 per share, at 2% of paid up share capital, i.e., US\$5 million for the year 2017, after due appropriation of US\$ 1million from Net profit for the year 2017, towards transfer to Statutory reserve. This Proposed dividend for the year 2017, is subject to regulatory and shareholders' approval in Annual general meeting.

Looking ahead, despite the continued global geopolitical risks, the results for the year 2017 are encouraging that reinforces confidence in growth prospects, given our strong capital and persistent commitment to dynamically adapt to complex economic scenario and position better to sustain a consistent growth to our shareholders in the years ahead.

Finally, I would like to thank all the members of the Board, the Shareholders, the Ministry of Industry, Commerce and Tourism in the Kingdom of Bahrain, Central Bank of Bahrain and all Correspondent Banks and our Customers for their continued support, cooperation and guidance.

I also extend my appreciation and thanks to all the employees for their professionalism and commitment for the Bank's continued growth and progress.



**Moraja G. Solaiman**  
Chairman

## **INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF ALUBAF ARAB INTERNATIONAL BANK B.S.C. (c)**

### **Report on the Audit of the Financial Statements**

#### *Opinion*

We have audited the accompanying financial statements of ALUBAF Arab International Bank B.S.C. (c) ("the Bank"), which comprise the statement of financial position as at 31 December 2017, and the statements of profit or loss, comprehensive income, changes in equity and cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

#### *Basis for Opinion*

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

#### *Other information*

Other information consists the Board of Directors' report, set out on pages 1 to 2 that was obtained at the date of this auditor's report. The Board of Directors is responsible for the other information.

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

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

#### *Responsibilities of the Board of Directors for the Financial Statements*

The Board of Directors is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as the Board of Directors determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

## **INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF ALUBAF ARAB INTERNATIONAL BANK B.S.C. (c)**

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

#### *Responsibilities of the Board of Directors for the Financial Statements (continued)*

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

#### *Auditor's Responsibilities for the Audit of the Financial Statements*

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.
- Conclude on the appropriateness of the Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

**INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF  
ALUBAF ARAB INTERNATIONAL BANK B.S.C. (c)**

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

*Auditor's Responsibilities for the Audit of the Financial Statements (continued)*

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

**Report on Other Legal and Regulatory Requirements**

As required by the Bahrain Commercial Companies Law and (Volume 1) of the Central Bank of Bahrain (CBB) Rule Book, we report that:

- a) the Bank has maintained proper accounting records and the financial statements are in agreement therewith;
- b) the financial information contained in the Report of the Board of Directors is consistent with the financial statements;
- c) we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2017 that might have had a material adverse effect on the business of the Bank or on its financial position; and
- d) satisfactory explanations and information have been provided to us by Management in response to all our requests.



ALUBAF Arab International Bank B.S.C. (c)

STATEMENT OF FINANCIAL POSITION

As at 31 December 2017

	Note	2017 US\$ '000	2016 US\$ '000
<b>ASSETS</b>			
Cash and balances with central bank and other banks	4	298,349	289,802
Deposits with banks and other financial institutions	5	409,496	437,992
Investments held for trading	6	20,462	22,413
Non-trading investments	7	221,374	203,767
Loans and advances	8	150,256	208,041
Property, equipment and software	9	10,371	11,149
Interest receivable		6,744	6,134
Other assets		1,591	1,638
<b>TOTAL ASSETS</b>		<b>1,118,643</b>	<b>1,180,936</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Liabilities</b>			
Deposits from banks and other financial institutions	10.1	569,557	586,824
Due to banks and other financial institutions	10.2	133,417	156,315
Due to customers	11	93,805	129,755
Interest payable		1,086	981
Other liabilities	12	6,927	4,784
<b>Total liabilities</b>		<b>804,792</b>	<b>878,659</b>
<b>Equity</b>			
Share capital	13	250,000	250,000
Statutory reserve	13	21,257	20,174
Retained earnings		40,399	35,652
Fair value reserve		(2,805)	(3,549)
Proposed dividend	14	5,000	-
<b>Total equity</b>		<b>313,851</b>	<b>302,277</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>1,118,643</b>	<b>1,180,936</b>



Hasan Khalifa Abulhasan  
Chief Executive Officer



Anthony C. Mallis  
Director



Moraja G. Solaiman  
Chairman

The attached notes 1 to 26 form part of these financial statements.

ALUBAF Arab International Bank B.S.C. (c)


STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2017

	Note	2017 US\$ '000	2016 US\$ '000
Interest and similar income	15	39,541	39,605
Interest expense	16	(10,212)	(8,577)
<b>Net interest and similar income</b>		<b>29,329</b>	<b>31,028</b>
Fee and commission income	17	4,254	5,598
Trading gain/(loss)	18	18	(30)
Loss on non-trading investments - net		(153)	-
Foreign exchange gain - net		683	1,365
Dividend income		9	7
Other income		90	75
<b>OPERATING INCOME</b>		<b>34,230</b>	<b>38,043</b>
Provision for impairment of loans and advances	8	(10,537)	(37,467)
Settlement of legal claim	20	-	(5,737)
<b>NET OPERATING INCOME (LOSS)</b>		<b>23,693</b>	<b>(5,161)</b>
Staff costs		7,533	5,504
Depreciation	9	1,082	1,022
Other operating expenses	19	4,248	2,998
<b>OPERATING EXPENSES</b>		<b>12,863</b>	<b>9,524</b>
<b>NET PROFIT (LOSS) FOR THE YEAR</b>		<b>10,830</b>	<b>(14,685)</b>



Hasan Khalifa Abulhasan  
Chief Executive Officer



Anthony C. Mallis  
Director



Moraja G. Solaiman  
Chairman



**ALUBAF Arab International Bank B.S.C. (c)****STATEMENT OF COMPREHENSIVE INCOME**

For the year ended 31 December 2017

	<b>2017</b> <b>US\$ '000</b>	<b>2016</b> <b>US\$ '000</b>
<b>NET PROFIT (LOSS) FOR THE YEAR</b>	<b>10,830</b>	<b>(14,685)</b>
<b>Other comprehensive income</b>		
<i>Other comprehensive income to be reclassified to profit or loss in subsequent periods:</i>		
Unrealised fair value gain (loss) on available-for-sale investments - net	<b>744</b>	<b>(308)</b>
<b>Net other comprehensive income to be reclassified to profit or loss in subsequent periods and other comprehensive income (loss) for the year</b>	<b>744</b>	<b>(308)</b>
<b>TOTAL COMPREHENSIVE INCOME (LOSS) FOR THE YEAR</b>	<b>11,574</b>	<b>(14,993)</b>

The attached notes 1 to 26 form part of these financial statements.

**ALUBAF Arab International Bank B.S.C. (c)**

**STATEMENT OF CASH FLOWS**

For the year ended 31 December 2017

	Note	2017 US\$ '000	2016 US\$ '000
<b>OPERATING ACTIVITIES</b>			
Net profit (loss) for the year		10,830	(14,685)
Adjustments for:			
Provision for impairment of loans and advances	8	10,537	37,467
Depreciation	9	1,082	1,022
Changes in fair value of investments held for trading	18	26	68
Amortisation of non-trading investments		515	545
Amortisation of assets reclassified as "loans and advances" from trading investments		(779)	(715)
Operating profit before changes in operating assets and liabilities		<u>22,211</u>	<u>23,702</u>
Changes in operating assets and liabilities:			
Deposits with banks and other financial institutions		46,702	120,849
Loans and advances		48,027	115,383
Investments held for trading		1,925	(1,004)
Interest receivable		(610)	447
Other assets		47	310
Deposits from banks and other financial institutions		(17,267)	(283,577)
Due to banks and other financial institutions		(22,898)	(46,044)
Due to customers		(35,950)	98,183
Interest payable		105	(321)
Other liabilities		2,143	(2,819)
Net cash flows from operating activities		<u>44,435</u>	<u>25,109</u>
<b>INVESTING ACTIVITIES</b>			
Purchase of non-trading investments		(25,378)	(199,741)
Proceeds from disposal of non-trading investments		8,000	139,410
Purchase of property, equipment and software	9	(304)	(278)
Net cash flows used in investing activities		<u>(17,682)</u>	<u>(60,609)</u>
<b>FINANCING ACTIVITY</b>			
Dividends paid	14	-	(12,500)
Net cash flows used in financing activities		<u>-</u>	<u>(12,500)</u>
<b>NET MOVEMENT IN CASH AND CASH EQUIVALENTS</b>		<b>26,753</b>	<b>(48,000)</b>
Cash and cash equivalents at 1 January		<u>651,092</u>	<u>699,092</u>
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>	<b>4</b>	<b><u>677,845</u></b>	<b><u>651,092</u></b>

The attached notes 1 to 26 form part of these financial statements.

**ALUBAF Arab International Bank B.S.C. (c)**

**STATEMENT OF CHANGES IN EQUITY**

For the year ended 31 December 2017

	Note	Share capital US\$ '000	Statutory reserve US\$ '000	Retained earnings US\$ '000	Fair value reserve US\$'000	Proposed dividend US\$'000	Total US\$ '000
Balance as of 1 January 2017		250,000	20,174	35,652	(3,549)	-	302,277
Net profit for the year		-	-	10,830	-	-	10,830
Other comprehensive income		-	-	-	744	-	744
Total comprehensive income for the year		-	-	10,830	744	-	11,574
Dividends proposed for 2017	14	-	-	(5,000)	-	5,000	-
Transfer to Statutory reserve		-	1,083	(1,083)	-	-	-
<b>Balance as of 31 December 2017</b>		<b>250,000</b>	<b>21,257</b>	<b>40,399</b>	<b>(2,805)</b>	<b>5,000</b>	<b>313,851</b>
Balance as of 1 January 2016		250,000	20,174	62,837	(3,241)	-	329,770
Net loss for the year		-	-	(14,685)	-	-	(14,685)
Other comprehensive income		-	-	-	(308)	-	(308)
Total comprehensive income for the year		-	-	(14,685)	(308)	-	(14,993)
Dividends paid for 2015	14	-	-	(12,500)	-	-	(12,500)
Balance as of 31 December 2016		250,000	20,174	35,652	(3,549)	-	302,277

The attached notes 1 to 26 form part of these financial statements.

## 1 ACTIVITIES

ALUBAF Arab International Bank B.S.C. (c) (the "Bank") is a closed Bahraini joint stock company incorporated in the Kingdom of Bahrain and registered with the Ministry of Industry, Commerce and Tourism under Commercial Registration (CR) number 12819. The Bank operates under a wholesale banking license issued by the Central Bank of Bahrain (the "CBB"). The Bank's registered office is at Building 854, Road 3618, Avenue 436, Alubaf Tower, Al-Seef District, PO Box 11529, Manama, Kingdom of Bahrain.

The Bank is majority owned by Libyan Foreign Bank, a bank registered in Libya (refer to note 13 for more details).

The financial statements of the Bank for the year ended 31 December 2017 were authorised for issue in accordance with a resolution of the Board of Directors on 18 February 2018.

## 2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

### 2.1 Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and are in conformity with the Bahrain Commercial Companies Law ("BCCL") the Central Bank of Bahrain ("CBB") and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and the relevant CBB directives.

#### *Basis of measurement*

The financial statements have been prepared on a historical cost basis, except for derivative financial instruments, trading investments and available-for-sale (AFS) financial assets that have been remeasured at fair value.

#### *Functional and presentation currency*

The financial statements are presented in United States Dollars (US\$), being the Bank's functional currency. All values are rounded to the nearest thousand (US\$ '000), except when otherwise indicated.

### 2.2 Significant accounting policies

#### **Financial instruments – initial recognition and subsequent measurement**

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

#### **Financial assets and financial liabilities**

Financial assets of the Bank comprise cash and balances with banks, deposits with banks and other financial institutions, investments held for trading, non-trading investments, loans and advances, interest receivable and other assets. Financial liabilities of the Bank comprise deposits from banks and other financial institutions, due to banks and other financial institutions, due to customers, interest payable and other liabilities.

The specific accounting policies relating to various financial assets and liabilities are set out below:

**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.2 Significant accounting policies (continued)**

**Financial assets and financial liabilities (continued)**

*i) Financial assets*

*Initial recognition and measurement*

Financial assets are classified, at initial recognition, as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available for sale financial assets, or as derivative instruments, as appropriate. All financial assets are recognised initially at fair value plus, in the case of financial assets not recorded at fair value through profit or loss, transaction costs that are attributable to the acquisition of the financial asset.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognised on the trade date, i.e., the date that the Bank commits to purchase or sell the asset.

*Subsequent measurement*

For purposes of subsequent measurement financial assets are classified in four categories:

- At fair value through profit or loss
- Loans and receivables
- Held-to-maturity
- Available-for-sale

*a) Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss include financial assets held for trading. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. These are subsequently measured at fair value with any realised and unrealised gains and losses arising from changes in fair values being included in the statement of profit or loss in the period in which they arise. Interest earned and dividends received in respect of financial assets at fair value through profit or loss are included in 'interest and similar income' and 'dividend income' respectively.

*b) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate (EIR) method, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included in 'interest and similar income' in the statement of profit or loss. The losses arising from impairment of loans and receivables are recognised in the statement of profit or loss.

*c) Held-to-maturity*

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity when the Bank has the positive intention and ability to hold them to maturity. After initial measurement, held-to-maturity financial assets are measured at amortised cost using the EIR, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as 'interest and similar income' in the statement of profit or loss. The losses arising from impairment are recognised in the statement of profit or loss.

**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.2 Significant accounting policies (continued)**

**Financial assets and financial liabilities (continued)**

*i) Financial assets (continued)*

*d) Available-for-sale*

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

After initial measurement, available-for-sale financial assets are subsequently measured at fair value with unrealised gains or losses recognised in other comprehensive income and credited in the fair value reserve until the investment is derecognised, at which time the cumulative gain or loss is recognised in other operating income, or the investment is determined to be impaired, when the cumulative loss is reclassified from the fair value reserve to the statement of profit or loss.

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

For a financial asset reclassified from the available-for-sale category, the carrying amount at the date of reclassification becomes its new amortised cost and any previous gain or loss on the asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the EIR. Any difference between the new amortised cost and the maturity amount is also amortised over the remaining life of the asset using the EIR. If the asset is subsequently determined to be impaired, then the amount recorded in equity is reclassified to the statement of profit or loss.

**Derecognition**

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognised (i.e., removed from the Bank's statement of financial position) when:

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

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

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

**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.2 Significant accounting policies (continued)**

**Financial assets and financial liabilities (continued)**

*i) Financial assets (continued)*

**Impairment of financial assets**

The Bank assesses, at each reporting date, whether there is objective evidence that a financial asset or a group of financial assets is impaired. An impairment loss exists if one or more events that has occurred since the initial recognition of the asset (an incurred 'loss event'), has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and observable data indicating that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

The impairment assessment of different categories of financial assets are discussed below:

*a) Financial assets carried at amortised cost*

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

The amount of any impairment loss identified is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account and the loss is recognised in the statement of profit or loss. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Financial assets carried at amortised cost, together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a write-off is later recovered, the recovery is credited in the statement of profit or loss.

*b) Available-for-sale*

For available-for-sale financial assets, the Bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. 'Significant' is evaluated against the original cost of the investment and 'prolonged' against the period in which the fair value has been below its original cost. When there is evidence of impairment, 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 the statement of profit or loss – is removed from other comprehensive income and recognised in the statement of profit or loss. Impairment losses on equity investments are not reversed through profit or loss; increases in their fair value after impairment are recognised in other comprehensive income.

**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.2 Significant accounting policies (continued)**

**Financial assets and financial liabilities (continued)**

***i) Financial assets (continued)***

**Impairment of financial assets (continued)**

***b) Available-for-sale (continued)***

The determination of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the Bank evaluates, among other factors, the duration or extent to which the fair value of an investment is less than its cost.

In the case of debt instruments classified as available-for-sale, the impairment is assessed based on the same criteria as financial assets carried at amortised cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that investment previously recognised in the statement of profit or loss.

Future interest income continues to be accrued based on the reduced carrying amount of the asset, using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the statement of profit or loss, the impairment loss is reversed through the statement of profit or loss.

***ii) Financial liabilities***

All financial liabilities are recognised initially at fair value.

***Subsequent measurement***

After initial recognition, financial liabilities are subsequently measured at amortised cost using the EIR method.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as finance costs in the statement of profit or loss.

***Derecognition***

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the statement of profit or loss.

***iii) Offsetting of financial instruments***

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, to realise the assets and settle the liabilities simultaneously.

**Derivative financial instruments**

The Bank makes use of derivative instruments, such as forward foreign exchange contracts.

Derivatives are initially recognised, and subsequently measured, at fair value with transaction costs taken directly to the statement of profit or loss. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative. Derivatives with positive fair values (unrealised gains) are included in other assets and derivatives with negative fair values (unrealised losses) are included in other liabilities in the statement of financial position.



**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.2 Significant accounting policies (continued)**

**Cash and cash equivalents**

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash and balances with banks, treasury bills and deposits with banks and other financial institutions with original maturities of 90 days or less.

**Property, equipment and software**

Property, equipment and software are stated at cost, net of accumulated depreciation and accumulated impairment losses, if any. Expenditure incurred to replace a component of an item of property, equipment and software that is accounted for separately is capitalised and the carrying amount of the component that is replaced is written off. When significant parts of property, equipment and software are required to be replaced at intervals, the Bank depreciates them separately based on their specific useful lives. Land and capital work in progress are not depreciated. Repairs and maintenance costs are recognised in the statement of profit or loss as incurred.

Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, as follows:

<b>Assets</b>	<b><i>Estimated useful life in years</i></b>
Building	15
Furniture, equipment and vehicles	3 to 5
Software	3 to 5

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

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

**Impairment of non-financial assets**

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount, with the difference being recognised as an impairment in the statement of profit or loss.

**Renegotiated loans**

In the ordinary course of its business, the Bank seeks to restructure loans. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.2 Significant accounting policies (continued)**

**Financial guarantees**

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit and guarantees.

Financial guarantees are initially recognised in the financial statements at fair value, being the commission received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the un-amortised commission and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

**Provisions**

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expense relating to a provision is presented in the statement of profit or loss net of any reimbursement.

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, when appropriate, the risks specific to the liability. When discounting is used, the increase in the provision due to the passage of time is recognised in the statement of profit or loss.

**Employees' end of service benefits**

The Bank provides end of service benefits to its non - Bahraini employees. The entitlement to these benefits is based upon the employee's final salary and length of service. The expected costs of these benefits are accrued over the period of employment. The Bank also makes contributions to the Social Insurance Organisation (SIO) Scheme calculated as a percentage of the employees' salaries. The Bank's obligations are limited to these contributions, which are expensed when due.

**Contingent liabilities**

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

**Share capital, statutory reserve and dividend**

*Share capital*

Ordinary shares issued by the Bank are classified as equity. The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instruments.

*Statutory reserve*

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

*Dividend*

The Bank recognises a liability to make cash or non-cash distributions to equity holders when the distribution is authorised and the distribution is no longer at the discretion of the Bank. As per the Bahrain Commercial Companies Law, a distribution is authorised when it is approved by the shareholders. A corresponding amount is recognised directly in equity.

**Fair value measurement**

The Bank measures financial instruments, such as investments and derivatives at fair value at the date of statement of financial position. Fair value related disclosures for financial instruments and non-financial assets that are measured at fair value or where fair values are disclosed, are disclosed in note 22.5.

**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.2 Significant accounting policies (continued)**

**Fair value measurement (continued)**

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

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

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

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

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

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

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

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

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

**Revenue recognition**

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment. The following specific recognition criteria must also be met before revenue is recognised:

*Interest income*

For all financial instruments measured at amortised cost and interest-bearing financial assets classified as available-for-sale, interest income is recorded using the effective interest rate (EIR). EIR is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability. The recognition of interest income is suspended when the loans become impaired, such as when overdue by more than 90 days.

**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.2 Significant accounting policies (continued)**

**Revenue recognition (continued)**

*Fee and commission income*

Fee and commission income are recognised when earned.

*Dividend income*

Dividend income is recognised when the Bank's right to receive the payment is established, which is generally when shareholders approve the dividend.

**Share based payments**

*Cash-settled share based payments*

The cost of cash-settled share based payment transactions is measured initially at fair value at the grant date using an appropriate valuation model. This fair value is expensed over the period until the vesting date with recognition of a corresponding liability. The liability is remeasured to fair value at each reporting date up to, and including the settlement date, with changes in fair value recognised in the statement of income.

**Foreign currencies**

The Bank's financial statements are presented in United States Dollars (US\$), which is the Bank's functional currency.

Transactions in foreign currencies are initially recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency spot rates of exchange at the reporting date. Differences arising on settlement or translation of monetary items are recognised in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined. The gain or loss arising on translation of non-monetary items measured at fair value is treated in line with the recognition of the gain or loss on the change in fair value of the item (i.e., translation differences on items whose fair value gain or loss is recognised in other comprehensive income (OCI) or profit or loss are recognised in OCI or profit or loss, respectively).

**2.3 Changes in accounting policies and disclosures**

**i) New and amended standards and interpretations effective as of 1 January 2017**

The accounting policies adopted are consistent with those of the previous financial year, except for the following IASB's new and amended standards and interpretations which are effective as of 1 January 2017. The adoption of these standards and interpretations did not have any effect on the Bank's financial position, financial performance or disclosures.

*IAS 7 Statement of Cash Flows (Amendments): The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes; and*

*IAS 12 Income Taxes (Amendments): The amendments, Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12), clarify how to account for deferred tax assets related to debt instruments measured at fair value.*

**Annual Improvements 2014-2016 Cycle**

*IFRS 12 Disclosure of Interests in Other Entities: Clarification of the scope of the disclosure requirements in IFRS 12 apply to an entity's interest in a subsidiary, a joint venture or an associate that is classified as held for sale.*

**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.3 Changes in accounting policies and disclosures (continued)**

**ii) Standards issued but not yet effective**

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. This listing is of standards and interpretations issued, which the Bank reasonably expect to be applicable at a future date. The Bank intends to adopt these standards, if applicable, when they become effective.

***IFRS 9 Financial Instruments***

**Introduction**

In July 2014, the IASB issued IFRS 9 Financial Instruments (IFRS 9), the standard that will replace IAS 39 Financial instruments: recognition and measurement for annual periods on or after 1 January 2018, with early adoption permitted. The Bank set up a multidisciplinary working team ('the Working Team') with members from its Risk, Finance and Credit Unit teams to prepare for IFRS 9 implementation ('the Project'). The Project is sponsored by the Head of Risk and Financial Control, who regularly report to the Bank's Board Risk Committee and is managed within the Bank's transformation framework. The Project has clear individual work streams. The Bank is currently in final testing stage of IFRS 9 implementation project with initial assessment, design and build stage already completed.

Based on 31 December 2017 data and the current implementation status of IFRS 9 as described in further detail below, the Bank estimates the adoption of IFRS 9 to lead to an overall reduction in the Bank's total shareholders' equity of approximately US\$ 10.3 million. This reduction is predominately driven by the impairment requirements of IFRS 9.

**Classification and measurement**

From a classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics. The IAS 39 measurement categories will be replaced by: fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVOCI), and amortised cost. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortised cost or FVOCI instruments as FVTPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the statement of profit or loss.

The accounting for financial liabilities will largely be the same as the requirements of IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVTPL. Such movements will be presented in OCI with no subsequent reclassification to the statement of profit or loss, unless an accounting mismatch in profit or loss would arise.

Having completed its assessment, the Bank has concluded that:

- The majority of placement with banks and other financial institutions, loans and advances to customers and securities bought under repurchase agreements that are classified as loans and receivables under IAS 39 are expected to be measured at amortised cost under IFRS 9;
- Financial assets and liabilities held for trading and financial assets designated at FVTPL are expected to continue to be measured at FVTPL;
- The majority of the debt securities classified as available for sale under IAS 39 are expected to be measured at FVOCI. Some securities, however, will be classified as FVTPL, either because of their contractual cash flow characteristics or the business model within which they are held; and
- Debt securities classified as held to maturity are expected to continue to be measured at amortised cost.

## 2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.3 Changes in accounting policies and disclosures (continued)

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

##### **Hedge accounting**

IFRS 9's hedge accounting requirements are designed to align the accounting more closely to the risk management framework; permit a greater variety of hedging instruments; and remove or simplify some of the rule-based requirements in IAS 39. The elements of hedge accounting: fair value, cash flow and net investment hedges are retained. There is an option in IFRS 9 for an accounting policy choice to continue with the IAS 39 hedge accounting framework; the Bank currently anticipates not applying this option. The Bank is not expecting significant changes due to new hedge requirements.

##### **Impairment of financial assets**

###### *Overview*

IFRS 9 will also fundamentally change the loan loss impairment methodology. The standard will replace IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. The Bank will be required to record an allowance for expected losses for all loans and other debt type financial assets not held at FVTPL, together with loan commitments and financial guarantee contracts. The allowance is based on the ECL associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case, the allowance is based on the probability of default over the life of the asset.

The Bank has established a policy to perform an assessment at the end of each reporting period of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument.

- To calculate ECL, the Bank will estimate the risk of a default occurring on the financial instrument during its expected life. ECLs are estimated based on the present value of all cash shortfalls over the remaining expected life of the financial asset, i.e., the difference between: the contractual cash flows that are due to the Bank under the contract, and the cash flows that the Bank expects to receive, discounted at the effective interest rate of the loan.

In comparison to IAS 39, the Bank expects the impairment charge under IFRS 9 to be more volatile than under IAS 39 and to result in an increase in the total level of current impairment allowances.

The Bank groups its loans into Stage 1, Stage 2 and Stage 3, based on the applied impairment methodology, as described below:

- Stage 1 – Performing loans: when loans are first recognised, the Bank recognises an allowance based on 12-month ECL.
- Stage 2 – Underperforming loans: when a loan shows a significant increase in credit risk, the Bank records an allowance for the lifetime ECL.
- Stage 3 – Impaired loans: the Bank recognises the lifetime ECL for these loans.

The Bank will record impairment for FVOCI debt securities, depending on whether they are classified as Stage 1, 2, or 3, as explained above. However, the ECL will not reduce the carrying amount of these financial assets in the statement of financial position, which will remain at fair value. Instead, an amount equal to the allowance that would arise if the asset were measured at amortised cost will be recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss.

**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.3 Changes in accounting policies and disclosures (continued)**

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

**Impairment of financial assets (continued)**

***Overview (continued)***

For 'low risk' FVOCI debt securities and loans and advances, the Bank intends to apply a policy which assumes that the credit risk on the instrument has not increased significantly since initial recognition and will calculate ECL as explained in Stage 1 below. Such instruments will generally include investment grade securities / loans where the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. The Bank will not consider instruments / loans to have low credit risk simply because of the value of collateral.

**Stage 1**

Under IAS 39 the Bank has been recording collective provision based on regulatory guidelines. These are designed to reflect impairment losses that had been incurred in the performing portfolio but have not been identified. Under IFRS 9, the impairment of financial assets that are not considered to have suffered a significant increase in their credit risk will be measured on a 12-month ECL basis.

**Stage 2**

IFRS 9 requires financial assets to be classified in Stage 2 when their credit risk has increased significantly since their initial recognition. For these assets, a loss allowance needs to be recognised based on their lifetime ECLs. Since this is a new concept compared to IAS 39, it will result in increased allowance as most such assets are not considered to be credit-impaired under IAS 39.

The Bank considers whether there has been a significant increase in credit risk of an asset by comparing the probability of default upon initial recognition of the asset against the risk of a default occurring on the asset as at the end of each reporting period. In each case, this assessment is based on forward-looking assessment that takes into account a number of economic scenarios, in order to recognise the probability of higher losses associated with more negative economic outlooks. In addition, a significant increase in credit risk is assumed if the borrower falls more than 30 days past due in making its contractual payments, or if the Bank expects to grant the borrower forbearance or facility has been restructured owing to credit related reasons, or the facility is placed on the Bank's watch list. Further, any facility having an internal credit risk rating of 8 will also be subject to stage 2 ECL calculation.

It is the Bank's policy to evaluate additional available reasonable and supportive forward-looking information as further additional drivers.

When estimating lifetime ECLs for undrawn loan commitments, the Bank will:

- Estimate the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment; and
- Calculate the present value of cash shortfalls between the contractual cash flows that are due to the entity if the holder of the loan commitment draws down that expected portion of the loan and the cash flows that the entity expects to receive if that expected portion of the loan is drawn down.

For financial guarantee contracts, the Bank will estimate the lifetime ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the guarantor expects to receive from the holder, the debtor or any other party. If a loan is fully guaranteed, the ECL estimate for the financial guarantee contract would be the same as the estimated cash shortfall estimate for the loan subject to the guarantee.

For revolving facilities such as overdrafts, the Bank measures ECLs by determining the period over which it expects to be exposed to credit risk, taking into account the credit risk management actions that it expects to take once the credit risk has increased and that serve to mitigate losses.

**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.3 Changes in accounting policies and disclosures (continued)**

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

**Impairment of financial assets (continued)**

**Stage 3**

Financial assets will be included in Stage 3 when there is objective evidence that the loan is credit impaired. The criteria of such objective evidence are the same as under the current IAS 39 methodology. Accordingly, the Bank expects the population to be generally the same under both standards.

Loans in Stage 3, where the Bank calculated the IAS 39 impairment on an individual basis will continue to be calculated on the same basis.

Other than originated credit-impaired loans, loans will be transferred from out of Stage 3 if they no longer meet the criteria of credit-impaired after a probation period of 12 months.

***Forward looking information***

The Bank will incorporate forward-looking information in both the assessment of significant increase in credit risk and the measurement of ECLs.

The Bank considers forward-looking information such as macroeconomic factors (e.g., GDP growth, oil prices, fiscal deficit, government spending, unemployment, and interest rates) and economic forecasts. To evaluate a range of possible outcomes, the Bank intends to formulate three scenarios: a base case, a unlikely and a likely case. The base case scenario represents the more likely outcome resulting from the Bank's normal financial planning and budgeting process, while the likely and unlikely case scenarios represent more optimistic or pessimistic outcomes. For each scenario, the Bank will derive an ECL and apply a probability weighted approach to determine the impairment allowance.

The Bank will use internal information coming from internal economic experts, combined with published external information from government and private economic forecasting services. Both the Risk and Finance management teams will need to approve the forward-looking assumptions before they are applied for different scenarios.

***Limitation of estimation techniques***

The models applied by the Bank may not always capture all characteristics of the market at a point in time as they cannot be recalibrated at the same pace as changes in market conditions. Interim adjustments are expected to need to be made until the base models are updated. Although the Bank will use data that is as current as possible, models used to calculate ECLs will be based on data that is one month in arrears and adjustments will be made for significant events occurring prior to the reporting date to. The governance over such adjustments is still in development.

***Capital management***

The Bank is in the process of evaluating how the new ECL model will impact the Bank's ongoing regulatory capital structure and further details will be provided in next quarter financial statements.



**2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.3 Changes in accounting policies and disclosures (continued)**

**IFRS 15** *IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognising revenue. The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2018 with early adoption permitted. The Bank has currently assessed that there is no material impact of IFRS 15 on the Bank as all its income is derived either from interest which is calculated by using effective interest rate system or from fee and commission income from letter of credit contracts which are short term in nature and mature within 90 to 180 days;*

**IFRS 2** *Share-based Payment Transactions: Classification and Measurement of Share-based Payment (Amendments) (effective for annual periods beginning on or after 1 January 2018). Early application is permitted;*

**IFRS 16** *Leases - Revised guidance on single model accounting for leases (effective for annual periods beginning on or after 1 January 2019, with earlier adoption permitted if IFRS 15 'Revenue from Contracts with Customers' has also been applied; and*

**IFRIC 22** *Foreign Currency: Transactions and Advance Consideration (effective for annual periods beginning on or after 1 January 2018).*

**Annual Improvements 2014-2016 Cycle**

**IFRS 1** *First-time Adoption of International Financial Reporting Standards: Deletion of short-term exemptions for first-time adopters (effective from 1 January 2018); and*

**IAS 28** *Investments in Associates and Joint Ventures: Clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice (the amendments should be applied retrospectively and are effective from 1 January 2018, with earlier application permitted).*

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

**3 SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS**

The preparation of the Bank's financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the accompanying disclosures, and the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

In the process of applying the Bank's accounting policies, management has made the following judgments, estimates and assumptions which have the most significant effect on the amounts recognised in the financial statements.

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The Bank based its assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising that are beyond the control of the Bank. Such changes are reflected in the assumptions when they occur.

*Going concern*

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

*Impairment and uncollectability of financial assets*

Financial assets not carried at fair value are reviewed at each statement of financial position date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, any impairment loss is recognised in the statement of profit or loss. For assets carried at amortised cost, impairment is based on estimated future cash flows discounted at the original effective interest rate.

*Classification of investments*

Management decides on acquisition of a financial asset whether it should be classified as "fair value through profit or loss", "available-for-sale" or "held to maturity". The classification of each investment reflects management's intention in relation to each investment and is subject to different accounting treatments based on such classification.

**4 CASH AND BALANCES WITH CENTRAL BANK AND OTHER BANKS**

	2017 US\$ '000	2016 US\$ '000
Treasury bills - balances with Central Bank	248,492	234,444
Money at call and short notice	49,852	55,349
Cash	5	9
<b>Cash and balances with central bank and other banks</b>	<b>298,349</b>	<b>289,802</b>
Deposits with banks and other financial institutions with original maturities of 90 days or less (note 5)	379,496	361,290
<b>Cash and cash equivalents</b>	<b>677,845</b>	<b>651,092</b>

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

**5 DEPOSITS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS**

Deposits with banks and other financial institutions represent interest bearing money market deposits held with banks and other financial institutions as at the statement of financial position date as follows:

	2017 US\$ '000	2016 US\$ '000
Deposits with original maturities of 90 days or less (note 4)	379,496	361,290
Deposits with original maturities of over 90 days	30,000	76,702
	<u>409,496</u>	<u>437,992</u>

**6 INVESTMENTS HELD FOR TRADING**

	2017 US\$ '000	2016 US\$ '000
<i>Quoted:</i>		
- Debt securities	20,335	22,203
- Equity securities	127	210
	<u>20,462</u>	<u>22,413</u>

**7 NON-TRADING INVESTMENTS**

	2017 US\$ '000	2016 US\$ '000
<b>Held-to-maturity:</b>		
Debt securities:		
- Sovereign	42,420	45,677
- Banks and corporates	62,644	62,902
Wakala units	-	3,000
<b>Total held-to-maturity</b>	<u>105,064</u>	<u>111,579</u>
<b>Available-for-sale:</b>		
Debt securities:		
- Sovereign	95,501	82,061
- Banks and corporates	20,809	10,127
<b>Total available-for-sale</b>	<u>116,310</u>	<u>92,188</u>
<b>Total non-trading investments</b>	<u>221,374</u>	<u>203,767</u>

**8 LOANS AND ADVANCES**

Loans and advances are stated net of provision for impairment. The table below discloses the gross loans and provisions for impairment excluding interest in suspense amounting to US\$ 14,190 thousand as of 31 December 2017 (2016: US\$ 7,721 thousand).

	2017 US\$ 000	2016 US\$ 000
Sovereign loans	84,693	91,427
Commercial loans	69,652	50,575
Letters of credit - financing	57,168	117,411
Factoring	19,370	18,080
	<u>230,883</u>	<u>277,493</u>
Provision for impairment	(80,627)	(69,452)
	<u>150,256</u>	<u>208,041</u>

ALUBAF Arab International Bank B.S.C. (c)

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

8 LOANS AND ADVANCES (continued)

Movements in provision for impairment were as follows:

	<b>2017</b>		
	<i>Specific provision US\$ '000</i>	<i>Collective provision US\$ '000</i>	<i>Total US\$ '000</i>
At 1 January	65,952	3,500	69,452
Provided during the year	10,239	2,500	12,739
Write back during the year	(2,202)	-	(2,202)
Recoveries during the year	-	-	-
Net charge for the year	8,037	2,500	10,537
Transfer to specific provision	2,263	(2,263)	-
Write off during the year	(92)	-	(92)
Exchange difference	730	-	730
At 31 December	<b>76,890</b>	<b>3,737</b>	<b>80,627</b>

	<b>2016</b>		
	<i>Specific provision US\$ '000</i>	<i>Collective provision US\$ '000</i>	<i>Total US\$ '000</i>
At 1 January	28,443	3,765	32,208
Provided during the year	37,467	-	37,467
Recoveries during the year	-	-	-
Net charge for the year	37,467	-	37,467
Transfer to specific provision	265	(265)	-
Write off during the year	-	-	-
Exchange difference	(223)	-	(223)
At 31 December	<b>65,952</b>	<b>3,500</b>	<b>69,452</b>

The total value of collateral held by the Bank against its loans and advances exposure amounts to US\$ 4,977 thousand as at 31 December 2017 (31 December 2016: US\$ 25,927 thousand) out of which US\$ 3,177 thousand is held as cash collateral (2016: US\$ 23,427 thousand).

**Impaired loans during the year**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	<b>78,748</b>	<b>82,388</b>

**Facilities renegotiated during the year**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Sovereign and commercial loans (gross)	-	46,651

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

**8 LOANS AND ADVANCES (continued)****Reclassification of financial assets**

In October 2008, the IASB issued amendments to IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures" titled "Reclassification of Financial Assets". The amendments to IAS 39 permit reclassification of financial assets from the "trading investment" category to "loans and advances" category in certain circumstances.

The amendments to IFRS 7 introduce additional disclosure requirements if an entity has reclassified financial assets in accordance with the IAS 39 amendments. The amendments are effective retrospectively from 1 July 2008.

In accordance with the amendments to IAS 39 and IFRS 7, "Reclassification of Financial Assets" the Bank reclassified investments in Iraq Notes with a carrying value of US \$ 40.2 million, effective 1 July 2008 from 'trading investment' to 'loans and advances' pursuant to the amendment to IAS 39 and IFRS 7 issued by IASB in October 2008 and considering the global financial crisis as a rare circumstance in the financial sector.

The carrying values and fair values of the assets reclassified are as follows:

	2017 US\$ '000	2016 US\$ '000
Carrying value	45,394	44,615
Fair value	53,143	45,642

Additional fair value gain that would have been recognised in the statement of profit or loss for the year ended 31 December 2017 had the trading investment not been reclassified amounts to US\$ 7,749 thousand (2016: gain of US\$ 1,027 thousand).

The Bank earns an effective interest rate of 8.89% (2016: 8.89%) and expects to recover US \$ 45,394 thousand (2016: US \$ 44,615 thousand) on this reclassified financial asset.

**9 PROPERTY, EQUIPMENT AND SOFTWARE**

	<i>Land</i> US\$ '000	<i>Building</i> US\$ '000	<i>Furniture, equipment and motor vehicles</i> US\$ '000	<i>Software</i> US\$ '000	<i>Capital work in progress</i> US\$ '000	<i>Total</i> US\$ '000
<b>Cost:</b>						
At 1 January 2017	4,233	7,652	3,691	1,069	30	16,675
Additions/transfers during the year	-	-	171	145	(12)	304
Disposal during the year	-	-	-	-	-	-
<b>At 31 December 2017</b>	<b>4,233</b>	<b>7,652</b>	<b>3,862</b>	<b>1,214</b>	<b>18</b>	<b>16,979</b>
<b>Depreciation:</b>						
At 1 January 2017	-	2,014	2,691	821	-	5,526
Charge for the year	-	514	492	76	-	1,082
Relating to disposal	-	-	-	-	-	-
<b>At 31 December 2017</b>	<b>-</b>	<b>2,528</b>	<b>3,183</b>	<b>897</b>	<b>-</b>	<b>6,608</b>
<b>Net book value:</b>						
<b>At 31 December 2017</b>	<b>4,233</b>	<b>5,124</b>	<b>679</b>	<b>317</b>	<b>18</b>	<b>10,371</b>
At 31 December 2016	4,233	5,638	1,000	248	30	11,149

The land relates to the building on which the Banks' premises is constructed.

# ALUBAF Arab International Bank B.S.C. (c)

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

### 10 DEPOSITS FROM AND DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

#### 10.1 Deposits from banks and other financial institutions

Deposits from banks and other financial institutions represent interest bearing money market deposits held with the Bank as at the statement of financial position date.

#### 10.2 Due to banks and other financial institutions

Due to banks and other financial institutions comprise the following current account balances and cash collateral held with the Bank in relation to the letters of credit and letters of guarantee issued as at the statement of financial position date:

	2017 US\$ '000	2016 US\$ '000
Current account balances	58,645	72,940
Cash collateral held	74,772	83,375
	<u>133,417</u>	<u>156,315</u>

### 11 DUE TO CUSTOMERS

Due to customers represent current account balances and cash collateral of corporate customers held with the Bank in relation to the letters of credit and letters of guarantee as at the statement of financial position date.

	2017 US\$ '000	2016 US\$ '000
Current account balances	73,668	76,974
Cash collateral held	20,137	52,781
	<u>93,805</u>	<u>129,755</u>

### 12 OTHER LIABILITIES

	2017 US\$ '000	2016 US\$ '000
Accrued expenses	5,509	1,950
Due to former directors and employees	316	1,394
Agency fee payable	647	539
Unearned fee income	50	378
Others	405	523
	<u>6,927</u>	<u>4,784</u>

Accrued expenses include US\$ 239 thousand (2016: US\$ 388 thousand) of liability relating to cash settled share based payments.

The Bank has established an Employee Phantom Share Scheme (EPSS) in compliance with the sound remuneration rules issued by the Central Bank of Bahrain. Under the scheme, certain eligible employees of the Bank become entitled to share based compensation. Under the EPSS, each eligible employee is issued with a phantom share award which entitles the holder to receive one phantom share at the delivery date. The share awards will vest over 3 years with one third award vesting at the end of the subsequent 3 years. The eligible employee has to retain the shares for a period of 6 months post the award date prior to encashing the vested awards. Phantom units are ultimately cash settled based on the audited net book value of the Bank at the vesting dates.

# ALUBAF Arab International Bank B.S.C. (c)

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

### 12 OTHER LIABILITIES (continued)

The cost of the phantom units are initially measured at net-book-value per share of the Bank at the grant date and expensed in the statement of income with a corresponding liability being recognised. The liability is remeasured to its net-book-value per share of the Bank at each reporting date up to the date of settlement with changes in fair value recognised in the statement of profit or loss.

### 13 SHARE CAPITAL

	2017 US\$ '000	2016 US\$ '000
<b>Authorised:</b>		
10,000,000 (2016: 10,000,000) ordinary shares of US\$ 50 each	<u>500,000</u>	<u>500,000</u>
	2017 US\$ '000	2016 US\$ '000
<b>Issued and fully paid up :</b>		
5,000,000 (2016: 5,000,000) ordinary shares of US\$ 50 each	<u>250,000</u>	<u>250,000</u>

#### Shareholders

	2017		2016	
	Percentage holding (%)	US\$ '000	Percentage holding (%)	US\$ '000
Libyan Foreign Bank	99.50	248,750	99.50	248,750
National Bank of Yemen	0.28	689	0.28	689
Yemen Bank for Reconstruction and Development	0.22	561	0.22	561
	<u>100.00</u>	<u>250,000</u>	<u>100.00</u>	<u>250,000</u>

#### Statutory reserve

As required by the Bahrain Commercial Companies Law and the Bank's articles of association, a statutory reserve has been created by transfer of 10% of its annual profit. The Bank may resolve to discontinue such transfers when the reserve totals 50% of the paid up capital. The reserve is not distributable except in such circumstances as stipulated in the BCCL and following approval of the Central Bank of Bahrain.

### 14 PROPOSED DIVIDEND

During the year, the dividend for the year ended 31 December 2017 amounting to US\$ 5 million (US\$ 1 per share) is proposed subject to regulatory approvals and the approval of the shareholders in the Annual General Meeting (no dividend was proposed for the year ended 31 December 2016).

### 15 INTEREST AND SIMILAR INCOME

	2017 US\$ '000	2016 US\$ '000
Loans and advances	15,872	21,796
Non-trading investments	11,163	8,517
Deposits with banks, other financial institutions and balance with central bank	11,455	8,218
Investments held for trading	1,051	1,074
	<u>39,541</u>	<u>39,605</u>

**ALUBAF Arab International Bank B.S.C. (c)****NOTES TO THE FINANCIAL STATEMENTS**

As at 31 December 2017

**16 INTEREST EXPENSE**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Deposits from and due to banks and other financial institutions	<b>10,051</b>	<b>8,497</b>
Due to customers	<b>161</b>	<b>80</b>
	<b>10,212</b>	<b>8,577</b>

**17 FEE AND COMMISSION INCOME**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Commission income on letters of credit	<b>2,736</b>	<b>4,310</b>
Loan and agency fees	<b>1,383</b>	<b>989</b>
Commission income on letters of guarantee	<b>135</b>	<b>299</b>
	<b>4,254</b>	<b>5,598</b>

**18 TRADING INCOME**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Changes in fair value of investments held for trading	<b>(26)</b>	<b>(68)</b>
Trading gains (losses) - net	<b>44</b>	<b>38</b>
	<b>18</b>	<b>(30)</b>

**19 OTHER OPERATING EXPENSES**

	<b>2017</b>	<b>2016</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Administration and marketing expenses	<b>1,500</b>	<b>1,540</b>
Professional services	<b>1,686</b>	<b>1,247</b>
Fees and other charges	<b>215</b>	<b>159</b>
Board of Directors' remuneration and expenses (note 24)	<b>847</b>	<b>52</b>
	<b>4,248</b>	<b>2,998</b>

**20 LEGAL CONTINGENCY**

During 2016, the Bank was defendant in legal proceedings where the counterparty was pursuing a claim based on a document, which management believed, did not commit the Bank. On 30 June 2016, a judgement was issued by the relevant Court that required the Bank to pay compensation of US\$ 5,737 thousand to the claimant. In August 2016, the Bank paid the compensation into a separate escrow account to be paid to the claimant, which has been expensed in the statement of profit or loss for the year ended 31 December 2016. The matter was fully settled in October 2017.



As at 31 December 2017

**21 COMMITMENTS AND CONTINGENT LIABILITIES**

	2017 US\$ '000	2016 US\$ '000
<b>Credit related contingencies</b>		
Letters of credit	29,462	57,947
Letters of guarantee	61	13,199
Undrawn loan commitments	-	10,605
	<u>29,523</u>	<u>81,751</u>
<b>Other</b>		
Forward foreign exchange contracts (note 23)	11,749	1,875
	<u>41,272</u>	<u>83,626</u>

**22 RISK MANAGEMENT****22.1 Introduction**

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

**a) Risk management structure****Board of Directors**

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

**Audit Risk and Compliance Committee**

The Audit Risk and Compliance Committee (ARCC) of the Board is responsible for assessing the quality and integrity of financial reporting, effectiveness of systems monitoring financial and disclosure compliance with legal and regulatory requirements, supervision of compliance function and soundness of internal controls. The ARCC also obtains regular updates from management and the Bank's compliance officer regarding compliance matters, which may have a material impact on the Bank's financial statements and reviews the findings of any examinations by regulatory agencies.

**Management Risk Committee**

The Management Risk Committee has the overall responsibility for establishing the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

**Asset Liability Management Committee**

The Asset Liability Management Committee's (ALCO) objective is to prudently direct and manage asset and liability allocation to achieve the Bank's strategic goals. The ALCO monitors the Bank's liquidity risks by ensuring that the Bank's activities are in line with the risk/reward guidelines approved by the Board.

**Internal Audit**

Internal control processes throughout the Bank are audited at least annually by the Internal Audit Department, based on the risk-based audit plan approved by the ARCC. Internal audit staff examine both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management and reports its findings and recommendations to the ARCC.

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

**22 RISK MANAGEMENT (continued)****22.1 Introduction (continued)****b) Risk measurement and reporting systems**

Monitoring and controlling risks is primarily performed based on limits approved by the Board. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that it is willing to accept, with additional emphasis on selected industries. The Bank also monitors and measures the overall risk-bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

**c) Credit concentration risk**

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

In order to manage credit concentration risk, the Bank's policies and procedures include guidelines to maintain a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

**22.2 Credit risk**

Credit risk is the risk that a customer or counterparty will fail to meet a commitment, resulting in financial loss to the Bank. Such risk arises from lending, treasury and other activities undertaken by the Bank. Credit risk is actively monitored in accordance with the credit policies which clearly define delegated lending authorities, and procedures. The Bank manages its credit risk by monitoring concentration of exposures by geographic location and adhering to approved limits. The Bank limits its risk on off balance sheet items with adequate collateral.

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

The table below shows the maximum exposure to credit risk for the components of the statement of financial position. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements. The net exposure represents gross exposure net of cash collateral against letters of credit.

	<i>Gross maximum exposure 2017 US\$ '000</i>	<i>Net maximum exposure 2017 US\$ '000</i>	<i>Gross maximum exposure 2016 US\$ '000</i>	<i>Net maximum exposure 2016 US\$ '000</i>
Balances with banks	298,344	298,344	289,793	289,793
Deposits with banks and other financial institutions	409,496	409,496	437,992	437,992
Investments held for trading	20,335	20,335	22,203	22,203
Non-trading investments	221,374	221,374	203,767	203,767
Loans and advances	150,256	147,079	208,041	184,614
Interest receivable	6,744	6,744	6,134	6,134
Other assets	1,243	1,243	1,281	1,281
<b>Total funded credit risk exposure</b>	<b>1,107,792</b>	<b>1,104,615</b>	<b>1,169,211</b>	<b>1,145,784</b>
Unfunded exposure on credit related contingencies	29,523	7,529	81,751	59,874
<b>Total funded and unfunded credit risk exposures</b>	<b>1,137,315</b>	<b>1,112,144</b>	<b>1,250,962</b>	<b>1,205,658</b>

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

**22 RISK MANAGEMENT (continued)****22.2 Credit risk (continued)**

The amount, type and valuation of collateral are based on guidelines specified in the risk management framework. The main types of collaterals accepted include cash collateral, residential and commercial real estate and securities.

**b. Credit quality per class of financial assets**

The table below presents an analysis of the financial assets exposed to credit risk and external rating designation at 31 December 2017 and 31 December 2016. The credit quality is graded based on external credit rating agencies - Standard & Poor, Fitch and Moody's and internal ratings are categorised as follows:

- (i) High standard - Where external credit rating agency ratings are A and above
- (ii) Standard - Where external credit rating agency ratings are below A and unrated.
- (iii) Watch list - Where the facility is not past due but recoverability is being monitored.
- (iv) Past due and impaired - Where interest or principal sum of loan is due for more than 90 days.

	<i>Neither past due nor impaired</i>		<i>Past due but not impaired</i>	<i>Past due and individually impaired</i>	<i>Provision for loan losses</i>	<i>Total</i>
	<i>High standard grade</i>	<i>Standard grade</i>				
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
<b>At 31 December 2017</b>						
Balances with banks	8,450	289,894	-	-	-	298,344
Deposits with banks and other financial institutions	63,000	346,496	-	-	-	409,496
Investments held for trading	3,068	17,267	-	-	-	20,335
Non-trading investments	8,495	212,879	-	-	-	221,374
Loans and advances	-	148,398	-	78,748	(76,890)	150,256
Interest receivable	117	6,627	-	-	-	6,744
Other assets	-	1,243	-	-	-	1,243
<b>Funded exposures</b>	<b>83,130</b>	<b>1,022,804</b>	<b>-</b>	<b>78,748</b>	<b>(76,890)</b>	<b>1,107,792</b>
Credit related contingencies	-	29,523	-	-	-	29,523
<b>Gross unfunded exposures</b>	<b>-</b>	<b>29,523</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>29,523</b>
<b>Net funded and unfunded exposures</b>	<b>83,130</b>	<b>1,052,327</b>	<b>-</b>	<b>78,748</b>	<b>(76,890)</b>	<b>1,137,315</b>

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

## 22 RISK MANAGEMENT (continued)

## 22.2 Credit risk (continued)

## b. Credit quality per class of financial assets (continued)

	<i>Neither past due nor impaired</i>		<i>Past due but not impaired</i>	<i>Past due and individually impaired</i>	<i>Provision for loan losses</i>	<i>Total</i>
	<i>High standard grade</i>	<i>Standard grade</i>				
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
<i>At 31 December 2016</i>						
Balances with banks	25,023	264,770	-	-	-	289,793
Deposits with banks and other financial institutions	50,000	387,992	-	-	-	437,992
Investments held for trading	5,341	16,862	-	-	-	22,203
Non-trading investments	18,534	185,233	-	-	-	203,767
Loans and advances	-	191,697	3,408	82,388	(69,452)	208,041
Interest receivable	212	5,922	-	-	-	6,134
Other assets	-	1,281	-	-	-	1,281
<b>Funded exposure</b>	<b>99,110</b>	<b>1,053,757</b>	<b>3,408</b>	<b>82,388</b>	<b>(69,452)</b>	<b>1,169,211</b>
Credit related contingencies	606	81,145	-	-	-	81,751
<b>Gross unfunded exposures</b>	<b>606</b>	<b>81,145</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>81,751</b>
<b>Net funded and unfunded exposures</b>	<b>99,716</b>	<b>1,134,902</b>	<b>3,408</b>	<b>82,388</b>	<b>(69,452)</b>	<b>1,250,962</b>

## Aging analysis of past due but not impaired financial assets

	<i>Less than 30 days</i>	<i>31 to 60 days</i>	<i>61 to 90 days</i>	<i>More than 90 days</i>	<i>Total</i>
	<i>2017</i>	<i>2017</i>	<i>2017</i>	<i>2017</i>	<i>2017</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Loans and advances	-	-	-	-	-
	<i>Less than 30 days</i>	<i>31 to 60 days</i>	<i>61 to 90 days</i>	<i>More than 90 days</i>	<i>Total</i>
	<i>2016</i>	<i>2016</i>	<i>2016</i>	<i>2016</i>	<i>2016</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Loans and advances	363	-	-	3,045	3,408

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

## 22 RISK MANAGEMENT (continued)

## 22.2 Credit risk (continued)

## c. Concentration of maximum exposure to credit risk

The geographical distribution of gross credit exposures (net of provision for impairment) is presented below:

At 31 December 2017

	Bahrain US\$ '000	Other GCC countries US\$ '000	Other Middle- East and African countries US\$ '000	Europe US\$ '000	Rest of the world US\$ '000	Total US\$ '000
Balances with banks	252,385	1,754	2,004	42,154	47	298,344
Deposits with banks and other financial institutions	232,975	71,000	-	85,521	20,000	409,496
Investments held for trading	13,263	4,072	-	3,000	-	20,335
Non-trading investments	91,901	51,274	20,498	47,796	9,905	221,374
Loans and advances	-	3,129	102,958	44,169	-	150,256
Interest receivable	2,414	499	2,082	1,568	181	6,744
Other assets	930	-	193	120	-	1,243
<b>Gross funded exposures</b>	<b>593,868</b>	<b>131,728</b>	<b>127,735</b>	<b>224,328</b>	<b>30,133</b>	<b>1,107,792</b>
Credit related contingencies	-	11	29,512	-	-	29,523
<b>Gross unfunded exposures</b>	<b>-</b>	<b>11</b>	<b>29,512</b>	<b>-</b>	<b>-</b>	<b>29,523</b>
<b>Gross funded and unfunded exposures</b>	<b>593,868</b>	<b>131,739</b>	<b>157,247</b>	<b>224,328</b>	<b>30,133</b>	<b>1,137,315</b>

At 31 December 2016

	Bahrain US\$ '000	Other GCC countries US\$ '000	Other Middle- East and African countries US\$ '000	Europe US\$ '000	Rest of the world US\$ '000	Total US\$ '000
Balances with banks	238,832	18,287	2,204	30,377	93	289,793
Deposits with banks and other financial institutions	172,771	103,000	-	142,221	20,000	437,992
Investments held for trading	13,462	5,741	-	3,000	-	22,203
Non-trading investments	90,350	51,408	10,045	41,985	9,979	203,767
Loans and advances	-	3,352	138,788	59,087	6,814	208,041
Interest receivable	2,333	458	1,982	1,024	339	6,134
Other assets	1,131	-	64	86	-	1,281
<b>Gross funded exposures</b>	<b>518,879</b>	<b>182,244</b>	<b>153,083</b>	<b>277,780</b>	<b>37,225</b>	<b>1,169,211</b>
Credit related contingencies	-	13,749	61,506	4,204	2,292	81,751
<b>Gross unfunded exposures</b>	<b>-</b>	<b>13,749</b>	<b>61,506</b>	<b>4,204</b>	<b>2,292</b>	<b>81,751</b>
<b>Gross funded and unfunded exposures</b>	<b>518,879</b>	<b>195,993</b>	<b>214,589</b>	<b>281,984</b>	<b>39,517</b>	<b>1,250,962</b>

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

## 22 RISK MANAGEMENT (continued)

## 22.2 Credit risk (continued)

## c. Concentration of maximum exposure to credit risk (continued)

Sectoral classification of gross credit exposures is presented below:

	<i>Sovereign</i> US\$ '000	<i>Banks and financial institutions</i> US\$ '000	<i>Commercial, business and others</i> US\$ '000	<i>Total</i> US\$ '000
<i>At 31 December 2017</i>				
Balances with banks	248,492	49,852	-	298,344
Deposits with banks and other financial institutions	-	409,496	-	409,496
Investments held for trading	13,262	6,371	702	20,335
Non-trading investments	137,921	42,524	40,929	221,374
Loans and advances	84,692	16,410	49,154	150,256
Interest receivable	4,375	1,026	1,343	6,744
Other assets	-	-	1,243	1,243
<b>Gross funded exposures</b>	<b>488,742</b>	<b>525,679</b>	<b>93,371</b>	<b>1,107,792</b>
Credit related contingencies	3,911	25,601	11	29,523
<b>Gross unfunded exposures</b>	<b>3,911</b>	<b>25,601</b>	<b>11</b>	<b>29,523</b>
<b>Gross funded and unfunded exposures</b>	<b>492,653</b>	<b>551,280</b>	<b>93,382</b>	<b>1,137,315</b>
	<i>Sovereign</i> US\$ '000	<i>Banks and financial institutions</i> US\$ '000	<i>Commercial, business and others</i> US\$ '000	<i>Total</i> US\$ '000
<i>At 31 December 2016</i>				
Balances with banks	234,444	55,349	-	289,793
Deposits with banks and other financial institutions	-	437,992	-	437,992
Investments held for trading	13,463	8,341	399	22,203
Non-trading investments	127,738	35,945	40,084	203,767
Loans and advances	108,911	41,128	58,002	208,041
Interest receivable	4,152	1,181	801	6,134
Other assets	-	166	1,115	1,281
<b>Gross funded exposures</b>	<b>488,708</b>	<b>580,102</b>	<b>100,401</b>	<b>1,169,211</b>
Credit related contingencies	6,502	47,304	27,945	81,751
<b>Gross unfunded exposures</b>	<b>6,502</b>	<b>47,304</b>	<b>27,945</b>	<b>81,751</b>
<b>Gross of funded and unfunded exposures</b>	<b>495,210</b>	<b>627,406</b>	<b>128,346</b>	<b>1,250,962</b>

## 22.3 Market risk

Market risk is the risk of potential financial loss that may arise from adverse changes in the value of a financial instrument or portfolio of financial instruments due to movements in interest rates, foreign exchange rates and equity prices. This risk arises from asset - liability mismatches, changes that occur in the yield curve and foreign exchange rates.

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

**22 RISK MANAGEMENT (continued)****22.3 Market risk (continued)****22.3.1 Interest rate risk**

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities that mature or reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through a number of means. The Bank's interest rate sensitivity position as of 31 December, is as follows:

**Sensitivity analysis - Interest rate risk**

	<i>Impact on statement of profit or loss</i>	
	<i>2017</i>	<i>2016</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
<i>25 bps increase/decrease</i>		
US Dollar	± 228	± 1,307
Euro	± 1	± 37
AED	± 76	-

**22.3.2 Currency risk**

Currency risk arise from the movement of the rate of exchange over a period of time. The Bank's currency risk is limited to assets and liabilities denominated in GBP and Euro. The following table demonstrates the sensitivity to a reasonable possible change in foreign exchange rates, with all other variables held constant, on the Bank's statement of profit or loss:

	<i>Change in rate</i>	<i>Effect on statement of profit or loss for the year</i>	
		<i>2017</i>	<i>2016</i>
		<i>US\$ '000</i>	<i>US\$ '000</i>
Euro	± 5%	± 39	± 216
GBP	± 5%	± 367	± 3

As other currency exposures are insignificant and GCC currencies to which the Bank is exposed are pegged to the US Dollar, their balances are not considered to represent significant currency risk.

**22.3.3 Equity price risk**

Equity price risk is the risk that the fair value of equities decreases as a result of changes in the value of individual companies' shares. The effect on profit and equity, as a result of a change in fair value of trading equity instruments, due to a reasonably possible change in equity prices, with all other variables held constant, is as follows:

	<i>Change in equity prices</i>	<i>Effect on net income and equity for the year</i>	
		<i>2017</i>	<i>2016</i>
		<i>US\$ '000</i>	<i>US\$ '000</i>
Investments held for trading	± 10%	13	21

**22.4 Liquidity risk**

Liquidity risk is the risk that the Bank will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind, and monitors liquidity on a daily basis. This incorporates an assessment of expected cash flow and the availability of high grade collateral which would be used to secure additional funding if required.

# ALUBAF Arab International Bank B.S.C. (c)

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

### 22 RISK MANAGEMENT (continued)

#### 22.4 Liquidity risk (continued)

The maturity profile of the assets and liabilities at 31 December 2017 given below reflects the management's best estimates of the maturities of assets and liabilities that have been determined on the basis of the remaining period at the date of the statement of financial position.

	Up to 1 year					Total US\$ '000	More than 1 year US\$ '000	No specific maturity US\$ '000	Total US\$ '000
	Up to 1 month US\$ '000	1 to 3 months US\$ '000	3 to 12 months US\$ '000	Total US\$ '000					
<b>At 31 December 2017</b>									
<b>ASSETS</b>									
Cash, balances with banks and Central Bank	136,575	149,283	12,491	298,349	-	-	298,349		
Deposits with banks and other financial institutions	354,496	55,000	-	409,496	-	-	409,496		
Investments held for trading	20,462	-	-	20,462	-	-	20,462		
Non-trading investments	-	-	1,000	1,000	220,374	-	221,374		
Loans and advances	5,518	31,725	15,013	52,256	98,000	-	150,256		
Property, equipment and software	-	-	-	-	-	10,371	10,371		
Interest receivable	4,087	1,883	774	6,744	-	-	6,744		
Other assets	69	654	63	786	805	-	1,591		
<b>Total assets</b>	<b>521,207</b>	<b>238,545</b>	<b>29,341</b>	<b>789,093</b>	<b>319,179</b>	<b>10,371</b>	<b>1,118,643</b>		
<b>LIABILITIES</b>									
Deposits from banks and other financial institutions	185,094	180,463	4,000	369,557	200,000	-	569,557		
Due to banks and other financial institutions	133,417	-	-	133,417	-	-	133,417		
Due to customers	73,805	20,000	-	93,805	-	-	93,805		
Interest payable	55	240	791	1,086	-	-	1,086		
Other liabilities	803	4,969	-	5,772	1,155	-	6,927		
<b>Total liabilities</b>	<b>393,174</b>	<b>205,672</b>	<b>4,791</b>	<b>603,637</b>	<b>201,155</b>	<b>-</b>	<b>804,792</b>		
<b>Net liquidity gap</b>	<b>128,033</b>	<b>32,873</b>	<b>24,550</b>	<b>185,456</b>	<b>118,024</b>	<b>10,371</b>	<b>313,851</b>		
<b>Cumulative liquidity gap</b>	<b>128,033</b>	<b>160,906</b>	<b>185,456</b>	<b>-</b>	<b>303,480</b>	<b>313,851</b>	<b>-</b>		



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NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

22 RISK MANAGEMENT (continued)

22.4 Liquidity risk (continued)

At 31 December 2016	Up to 1 year				Total US\$ '000	More than 1 year US\$ '000	No specific maturity US\$ '000	Total US\$ '000
	Up to 1 month US\$ '000	1 to 3 months US\$ '000	3 to 12 months US\$ '000	Total US\$ '000				
<b>ASSETS</b>								
Cash, balances with banks and Central Bank	171,615	100,614	17,573	289,802	-	-	289,802	
Deposits with banks and other financial institutions	341,035	74,957	22,000	437,992	-	-	437,992	
Investments held for trading	22,413	-	-	22,413	-	-	22,413	
Non-trading investments	-	-	5,016	5,016	198,751	-	203,767	
Loans and advances	33,973	28,222	45,188	107,383	100,658	-	208,041	
Property, equipment and software	-	-	-	-	-	11,149	11,149	
Interest receivable	3,733	1,387	1,014	6,134	-	-	6,134	
Other assets	51	504	24	579	1,059	-	1,638	
<b>Total assets</b>	<b>572,820</b>	<b>205,684</b>	<b>90,815</b>	<b>869,319</b>	<b>300,468</b>	<b>11,149</b>	<b>1,180,936</b>	
<b>LIABILITIES</b>								
Deposits from banks and other financial institutions	255,528	98,598	232,698	586,824	-	-	586,824	
Due to banks and other financial institutions	100,732	27,791	27,792	156,315	-	-	156,315	
Due to customers	105,932	23,823	-	129,755	-	-	129,755	
Interest payable	181	110	690	981	-	-	981	
Other liabilities	1,709	1,999	-	3,708	1,076	-	4,784	
<b>Total liabilities</b>	<b>464,082</b>	<b>152,321</b>	<b>261,180</b>	<b>877,583</b>	<b>1,076</b>	<b>-</b>	<b>878,659</b>	
<b>Net liquidity gap</b>	<b>108,738</b>	<b>53,363</b>	<b>(170,365)</b>	<b>(8,264)</b>	<b>299,392</b>	<b>11,149</b>	<b>302,277</b>	
<b>Cumulative liquidity gap</b>	<b>108,738</b>	<b>162,101</b>	<b>(8,264)</b>	<b>-</b>	<b>291,128</b>	<b>302,277</b>	<b>-</b>	

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 NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

22 RISK MANAGEMENT (continued)

22.4 Liquidity risk (continued)

The maturity profile of the financial and contingent liabilities as at 31 December 2017 based on contractual undiscounted repayment amounts is as follows:

	Up to 1 year					Total US\$ '000	More than 1 year US\$ '000	No specific maturity US\$ '000	Total US\$ '000
	Up to 1 month US\$ '000	1 to 3 months US\$ '000	3 to 12 months US\$ '000						
<b>At 31 December 2017</b>									
<b>Liabilities</b>									
Deposits from banks and financial institutions	185,239	180,887	4,028		370,154	206,860	-	577,014	
Due to banks and other financial institutions	133,421	-	-		133,421	-	-	133,421	
Due to customers	73,807	20,002	-		93,809	-	-	93,809	
Interest payable	55	240	791		1,086	-	-	1,086	
Other liabilities	803	4,969	-		5,772	1,155	-	6,927	
<b>Total undiscounted liabilities</b>	<b>393,325</b>	<b>206,098</b>	<b>4,819</b>		<b>604,242</b>	<b>208,015</b>	<b>-</b>	<b>812,257</b>	
<b>Derivatives:</b>									
Forward foreign exchange contracts (note 23)	11,749	-	-		11,749	-	-	11,749	
<b>Commitments and contingent liabilities</b>									
Letters of credit	2,611	21,926	4,925		29,462	-	-	29,462	
Letters of guarantee	-	-	61		61	-	-	61	
Undrawn loan commitments	-	-	-		-	-	-	-	
	<b>2,611</b>	<b>21,926</b>	<b>4,986</b>		<b>29,523</b>	<b>-</b>	<b>-</b>	<b>29,523</b>	

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As at 31 December 2017

22 RISK MANAGEMENT (continued)

22.4 Liquidity risk (continued)

At 31 December 2016

	Up to 1 year					Total US\$ '000	More than 1 year US\$ '000	No specific maturity US\$ '000	Total US\$ '000
	Up to 1 month US\$ '000	1 to 3 months US\$ '000	3 to 12 months US\$ '000						
<b>Liabilities</b>									
Deposits from banks and financial institutions	255,628	98,714	233,518		587,860	-	-	587,860	
Due to banks and other financial institutions	100,738	27,796	27,807		156,341	-	-	156,341	
Due to customers	105,938	23,827	-		129,765	-	-	129,765	
Interest payable	181	110	690		981	-	-	981	
Other liabilities	1,709	1,999	-		3,708	1,076	-	4,784	
<b>Total undiscounted liabilities</b>	<b>464,194</b>	<b>152,446</b>	<b>262,015</b>		<b>878,655</b>	<b>1,076</b>	<b>-</b>	<b>879,731</b>	
<b>Derivatives:</b>									
Forward foreign exchange contracts (note 23)	1,875	-	-		1,875	-	-	1,875	
<b>Commitments and contingent liabilities</b>									
Letters of credit	3,414	32,265	22,268		57,947	-	-	57,947	
Letters of guarantee	28	6,162	7,009		13,199	-	-	13,199	
Undrawn loan commitments	-	4,103	4,816		8,919	1,686	-	10,605	
	<b>3,442</b>	<b>42,530</b>	<b>34,093</b>		<b>80,065</b>	<b>1,686</b>	<b>-</b>	<b>81,751</b>	

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

**22 RISK MANAGEMENT (continued)****22.5 Fair value of financial instruments***Fair value hierarchy - financial instruments measured at fair value*

The following table provides the fair value measurement hierarchy of the Bank's financial instruments measured at fair value:

**At 31 December 2017**

	<b>Level 1</b> <b>US\$ '000</b>	<b>Level 2</b> <b>US\$ '000</b>	<b>Total</b> <b>US\$ '000</b>
Investments held for trading	20,462	-	20,462
Available-for-sale investments	116,310	-	116,310
Derivative financial instruments	-	(42)	(42)
	<u>136,772</u>	<u>(42)</u>	<u>136,730</u>

**At 31 December 2016**

	<b>Level 1</b> <b>US\$ '000</b>	<b>Level 2</b> <b>US\$ '000</b>	<b>Total</b> <b>US\$ '000</b>
Investments held for trading	22,413	-	22,413
Available-for-sale investments	92,188	-	92,188
Derivative financial instruments	-	16	16
	<u>114,601</u>	<u>16</u>	<u>114,617</u>

The Bank had no investments measured at fair value qualifying for level 3 of fair value hierarchy as at 31 December 2017 and as at 31 December 2016.

**Transfers between level 1, level 2 and level 3**

During the year ended 31 December 2017, there were no transfers between level 1 and level 2 fair value measurements, and no transfers into or out of level 3 fair value measurement (2016: nil).

*Fair value hierarchy - financial instruments not measured at fair value*

The following table provides the fair value measurement hierarchy of the Bank's financial instruments not measured at fair value:

**At 31 December 2017**

	<b>Level 1</b> <b>US\$ '000</b>	<b>Level 2</b> <b>US\$ '000</b>	<b>Level 3</b> <b>US\$ '000</b>	<b>Total fair</b> <b>value</b> <b>US\$ '000</b>	<b>Carrying</b> <b>value</b> <b>US\$ '000</b>
Held-to-maturity investments	106,859	-	-	106,859	105,064
Loans and advances	53,143	-	-	53,143	45,394
	<u>160,002</u>	<u>-</u>	<u>-</u>	<u>160,002</u>	<u>150,458</u>

**At 31 December 2016**

	<b>Level 1</b> <b>US\$ '000</b>	<b>Level 2</b> <b>US\$ '000</b>	<b>Level 3</b> <b>US\$ '000</b>	<b>Total fair</b> <b>value</b> <b>US\$ '000</b>	<b>Carrying</b> <b>value</b> <b>US\$ '000</b>
Held-to-maturity investments	108,478	-	3,000	111,478	111,579
Loans and advances	45,642	-	-	45,642	44,615
	<u>154,120</u>	<u>-</u>	<u>3,000</u>	<u>157,120</u>	<u>156,194</u>

- Except for Level 3 classified held-to-maturity investments, fair values of held-to-maturity investments and loans are determined based on quoted prices in active markets.

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

**22 RISK MANAGEMENT (continued)****22.5 Fair value of financial instruments (continued)**

Balances with banks, deposits with banks and other financial institutions, loans and advances (other than those disclosed in the table above), interest receivable, other assets, deposits from banks and other financial institutions, due to banks and other financial institutions, due to customers, interest payable and other liabilities are generally short term in nature. Management has assessed that the fair values of these approximate their carrying values as of 31 December 2017 and 31 December 2016.

**23 DERIVATIVE FINANCIAL INSTRUMENTS**

In the ordinary course of business, the Bank enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instruments, reference rates or indices.

These include forward exchange contracts which create rights and obligation that have the effect of transferring between the parties of the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, a derivative financial instrument gives one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favourable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instruments, as prices in financial markets change those terms may become either favourable or unfavourable.

The table below shows the net fair values of derivative financial instruments together with the notional amount. These contracts are settled on a net basis. Depending on currency movements, the contracts may result in either a net asset or a net liability. The following table shows the material outstanding contracts as at 31 December:

	2017		2016	
	<i>Notional amount</i> US\$ '000	<i>Gain / (loss)</i> US\$ '000	<i>Notional amount</i> US\$ '000	<i>Gain / (loss)</i> US\$ '000
Forward foreign exchange contracts	11,749	(42)	1,875	16

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**NOTES TO THE FINANCIAL STATEMENTS**

As at 31 December 2017

**24 RELATED PARTY BALANCES AND TRANSACTIONS**

Related parties represent shareholders, directors and key management personnel of the Bank, and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Bank's management.

Transactions with related parties included in the statement of profit or loss and statement of financial position are as follows: The related party balances included in the consolidated financial statements are as follows:

	31 December 2017			31 December 2016			
	Shareholders US\$ '000	management personnel/ Board members US\$ '000	Other related parties US\$ '000	Total US\$ '000	Shareholders US\$ '000	management personnel/ Board members US\$ '000	Other related parties US\$ '000
<b>Statement of profit or loss</b>							
Interest income	-	-	74	74	-	-	127
Interest expense	9,249	-	386	9,635	7,511	-	181
Fee and commission income	948	-	20	968	325	-	9
<b>Statement of financial position</b>							
<b>Assets</b>							
Cash and balances with banks	116	-	28,021	28,137	417	-	12,904
Deposit with banks and financial institutions	-	-	-	-	-	-	21,230
Loans and advances	-	-	4,799	4,799	-	-	110
Interest receivable	-	-	40	40	-	-	1
Other assets	-	58	-	58	25	-	235
<b>Liabilities</b>							
Deposits from banks and other financial institutions	402,821	-	27,367	430,187	397,230	-	437,131
Due to banks and other financial institutions	3,686	-	7,098	10,783	2,089	-	9,318
Interest payable	956	-	15	971	897	-	913
Other liabilities	71	398	-	469	61	314	375
<b>Assets under management (note 25)</b>	<b>23,061</b>	<b>-</b>	<b>-</b>	<b>23,061</b>	<b>20,104</b>	<b>-</b>	<b>20,104</b>
<b>Contingent liabilities</b>							
Letters of credit and letters of guarantee (fully secured by deposits)	46	-	5,975	6,021	1,148	-	1,148
Forward foreign exchange contracts	-	-	5,445	5,445	-	-	-

## NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2017

**24 TRANSACTIONS WITH RELATED PARTIES (continued)****Compensation paid to the Board of Directors and key management personnel:**

	<b>2017</b>	<b>2016</b>
	<b>US\$ 000</b>	<b>US\$ 000</b>
Short term benefits	<b>4,041</b>	2,204
End of term benefits	<b>251</b>	158
<b>Total compensation</b>	<b><u>4,292</u></b>	<b><u>2,362</u></b>

Short term benefits include Board of Directors' sitting fees and provision for bonus accrual of US\$ 680 thousand (2016: US\$ 144 thousand) and reimbursement of travel, accommodation and other expenses amounting to US\$ 128 thousand (2016: US\$ 127 thousand). The accrual is subject to approval by the Bank's shareholders in the next Annual General Meeting.

Short term benefits also include compensation paid to key management personnel as salary, allowances and provision for bonus accrual.

**25 ASSETS UNDER MANAGEMENT**

The Bank provides trade finance services to certain customers, which involve the Bank acting as the custodian of the assets in a fiduciary capacity. Assets that are held in financing capacity are not included in these financial statements. At 31 December 2017, the Bank had fiduciary assets under management of US\$ 35,059 thousand (2016: US\$ 30,564 thousand).

**26 CAPITAL ADEQUACY**

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

In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities.

The risk asset ratio, calculated in accordance with the capital adequacy guidelines, under Basel III, approved by the Central Bank of Bahrain is as follows:

	<b>2017</b>	<b>2016</b>
	<b>US\$ 000</b>	<b>US\$ 000</b>
Capital base:		
Tier 1 capital	<b>313,123</b>	301,849
Tier 2 capital	<b>3,737</b>	3,500
<b>Total capital base (a)</b>	<b><u>316,860</u></b>	<b><u>305,349</u></b>
<b>Risk weighted assets (b)</b>	<b><u>853,781</u></b>	<b><u>766,464</u></b>
<b>Capital adequacy (a/b * 100)</b>	<b><u>37.11%</u></b>	<b><u>39.84%</u></b>
<b>Minimum requirement</b>	<b><u>12.50%</u></b>	<b><u>12.00%</u></b>