**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES**

بـنـك بـوبـيـان
Boubyan Bank

**CONSOLIDATED FINANCIAL STATEMENTS**

**AND INDEPENDENT AUDITORS' REPORT**

**FOR THE YEAR ENDED 31 DECEMBER 2019**

INDEX

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

## Report on the Audit of the Consolidated Financial Statements

*Opinion*

We have audited the consolidated financial statements of Boubyan Bank K.S.C.P (the "Bank") and its subsidiaries (together, the "Group"), which comprise the consolidated statement of financial position as at 31 December 2019, and the related consolidated statement of profit or loss, consolidated statement of other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2019, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs), as adopted for use by the State of Kuwait.

*Basis for Opinion*

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

*Key Audit Matters*

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

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

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

*Key Audit Matters (continued)*

We have identified the following key audit matters:

*Credit losses on Islamic financing to customers*
The recognition of credit losses on Islamic financing ("credit facilities") to customers is the higher of Expected Credit Loss ("ECL") under International Financial Reporting Standard 9: Financial Instruments ("IFRS 9"), determined in accordance with Central Bank of Kuwait (the "CBK") guidelines, and the provision required by the CBK rules on classification of credit facilities and calculation of their provision ("the CBK rules") as disclosed in the accounting policies and in Note 3.4 to the consolidated financial statements.

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

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

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

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

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

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

*Key Audit Matters (continued)*

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

*Other information included in the Group's 2019 Annual Report*
Management is responsible for the other information. Other information consists of the information included in Group's 2019 Annual Report, other than the consolidated financial statements and our auditors' report thereon. We obtained the report of the Bank's Board of Directors, prior to the date of our auditor's report, and we expect to obtain the remaining sections of the Group's 2019 Annual Report after the date of our auditor's report.

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

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

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

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

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

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

*Auditors' Responsibilities for the Audit of the Consolidated Financial Statements*

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.

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

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

*Auditors' Responsibilities for the Audit of the Consolidated Financial Statements (continued)*
We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

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

**Report on Other Legal and Regulatory Requirements**
Furthermore, in our opinion proper books of account have been kept by the Bank and the consolidated financial statements, together with the contents of the report of the Bank's Board of Directors relating to these consolidated financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the consolidated financial statements incorporate all information that is required by the Capital Adequacy Regulations and Financial Leverage Ratio Regulations issued by the Central Bank of Kuwait ("CBK") as stipulated in CBK Circular Nos. 2/RB, RBA/336/2014 dated 24 June 2014 and 2/I.B.S. 343/2014 dated 21 October 2014 respectively, the Companies Law No 1 of 2016, as amended, and its executive regulations, as amended, and by the Bank's Memorandum of Incorporation and Articles of Association, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of the Capital Adequacy Regulations and Financial Leverage Ratio Regulations issued by the CBK as stipulated in CBK Circular Nos. 2/RB, RBA /336/2014 dated 24 June 2014 and 2/I.B.S. 343/2014 dated 21 October 2014 respectively, the Companies Law No 1 of 2016, as amended, and its executive regulations, as amended, or of the Bank's Memorandum of Incorporation and Articles of Association, have occurred during the year ended 31 December 2019 that might have had a material effect on the business of the Bank or on its financial position.

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

**Report on Other Legal and Regulatory Requirements (continued)**

We further report that, during the course of our audit, we have not become aware of any violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the CBK and the organisation of banking business, and its related regulations during the year ended 31 December 2019 that might have had a material effect on the business of the Bank or on its financial position.

| | |
|---|---|
| WALEED A. AL OSAIMI | BADER A. AL-WAZZAN |
| LICENCE NO. 68 A | LICENCE NO. 62 A |
| EY | DELOITTE & TOUCHE |
| (AL-AIBAN, AL-OSAIMI & PARTNERS) | AL WAZZAN & CO. |

5 January 2020
Kuwait

| | Notes | **2019** KD '000s | 2018 KD '000s |
|---|---|---|---|
| **Income** | | | |
| Murabaha and other Islamic financing income | 5 | **207,629** | 182,942 |
| Finance cost and distribution to depositors | | **(88,170)** | (62,636) |
| **Net financing income** | | **119,459** | 120,306 |
| Net investment income | 6 | **4,155** | 1,051 |
| Net fees and commission income | 7 | **16,428** | 13,436 |
| Share of results of associates | 16 | **2,040** | 1,917 |
| Net foreign exchange gain | | **3,687** | 3,011 |
| **Operating income** | | **145,769** | 139,721 |
| Staff costs | | **(36,094)** | (33,633) |
| General and administrative expenses | | **(17,078)** | (18,834) |
| Depreciation | | **(7,892)** | (4,288) |
| **Operating expenses** | | **(61,064)** | (56,755) |
| **Operating profit before provision for impairment** | | **84,705** | 82,966 |
| Provision for impairment | 8 | **(18,711)** | (23,839) |
| **Operating profit before taxation and board of directors' remuneration** | | **65,994** | 59,127 |
| Taxation | 9 | **(2,867)** | (2,557) |
| Board of directors' remuneration | | **(450)** | (360) |
| **Net profit for the year** | | **62,677** | 56,210 |
| **Attributable to:** | | | |
| Equity holders of the Bank | | **62,647** | 56,108 |
| Non-controlling interests | | **30** | 102 |
| **Net profit for the year** | | **62,677** | 56,210 |
| **Basic and diluted earnings per share attributable to the equity holders of the Bank (fils)** | 10 | **20.40** | 19.17 |

The notes from 1 to 32 form an integral part of these consolidated financial statements.

| | 2019<br>KD '000s | 2018<br>KD '000s |
|---|---|---|
| **Net profit for the year** | **62,677** | 56,210 |
| **Other comprehensive income/(loss)** | | |
| **Items that are or may be reclassified to consolidated statement of profit or loss in subsequent periods:** | | |
| Change in fair value of debt investments at fair value through other comprehensive income | **6,303** | (454) |
| Foreign currency translation adjustments | **429** | (641) |
| **Items that will not be reclassified to consolidated statement of profit or loss in subsequent periods:** | | |
| Change in fair value of equity investments at fair value through other comprehensive income | **(9,675)** | (660) |
| **Other comprehensive loss for the year** | **(2,943)** | (1,755) |
| **Total comprehensive income for the year** | **59,734** | 54,455 |
| **Attributable to:** | | |
| Equity holders of the Bank | **59,704** | 54,353 |
| Non-controlling interests | **30** | 102 |
| **Total comprehensive income for the year** | **59,734** | 54,455 |

The notes from 1 to 32 form an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2019

| | Notes | 2019 KD '000s | 2018 KD '000s |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with banks | 11 | **232,393** | 83,805 |
| Deposits with Central Bank of Kuwait | | **306,156** | 244,685 |
| Deposits with other banks | 12 | **427,347** | 237,088 |
| Islamic financing to customers | 13 | **3,728,772** | 3,262,285 |
| Investment in Sukuk | 14 | **306,315** | 309,339 |
| Other investment securities | 14 | **101,215** | 73,500 |
| Investments in associates | 16 | **33,144** | 28,916 |
| Investment properties | 17 | **46,555** | 24,036 |
| Other assets | 18 | **32,422** | 24,088 |
| Property and equipment | | **86,229** | 57,036 |
| **Total assets** | | **5,300,548** | 4,344,778 |
| | | | |
| **Liabilities and Equity** | | | |
| **Liabilities** | | | |
| Due to banks | | **236,480** | 97,216 |
| Depositors' accounts | | **4,347,226** | 3,720,935 |
| Other liabilities | 19 | **63,661** | 40,667 |
| **Total liabilities** | | **4,647,367** | 3,858,818 |
| **Equity** | | | |
| Share capital | 20 | **288,407** | 238,847 |
| Share premium | 21 | **156,942** | 62,896 |
| Proposed bonus shares | 22 | **14,420** | 11,942 |
| Treasury shares | 23 | **(54)** | (643) |
| Statutory reserve | 24 | **31,848** | 25,251 |
| Other reserves | 25 | **22,114** | 19,165 |
| Retained earnings | | **35,817** | 31,707 |
| Proposed cash dividends | 22 | **25,954** | 19,092 |
| **Equity attributable to equity holders of the Bank** | | **575,448** | 408,257 |
| Perpetual Tier 1 Sukuk | 26 | **75,388** | 75,388 |
| Non-controlling interests | | **2,345** | 2,315 |
| **Total equity** | | **653,181** | 485,960 |
| **Total liabilities and equity** | | **5,300,548** | 4,344,778 |

Mahmoud Yousef Al-Fulaij
Chairman

Adel Abdul Wahab Al Majed
Vice Chairman & Chief Executive Officer

The notes from 1 to 32 form an integral part of these consolidated financial statements.

| | Share capital | Share premium | Proposed bonus shares | Treasury shares | Statutory reserve | Other reserves (note 25) | Retained earnings | Proposed cash dividends | Equity attributable to equity holders of the Bank | Perpetual Tier 1 Sukuk | Non-controlling interests | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | KD '000s | KD '000s | KD '000s | KD '000s | KD '000s | KD '000s | KD '000s | KD '000s | KD '000s | KD '000s | KD '000s | KD '000s |
| **Balance at 1 January 2019** | **238,847** | **62,896** | **11,942** | **(643)** | **25,251** | **19,165** | **31,707** | **19,092** | **408,257** | **75,388** | **2,315** | **485,960** |
| Profit for the year | - | - | - | - | - | - | 62,647 | - | 62,647 | - | 30 | 62,677 |
| Other comprehensive loss | - | - | - | - | - | (2,943) | - | - | (2,943) | - | - | (2,943) |
| Total comprehensive (loss) / income for the year | - | - | - | - | - | (2,943) | 62,647 | - | 59,704 | - | 30 | 59,734 |
| Increase in share capital (note 20) | 37,618 | 94,046 | - | - | - | - | - | - | 131,664 | - | - | 131,664 |
| Cost directly related to increase in Share capital | - | - | - | - | - | - | (108) | - | (108) | - | - | (108) |
| Transfer of gain on disposal of equity investments at FVOCI to retained earnings | - | - | - | - | - | (4) | 4 | - | - | - | - | - |
| Transfer to reserves | - | - | - | - | 6,597 | 6,310 | (12,907) | - | - | - | - | - |
| Issue of bonus shares (note 22) | 11,942 | - | (11,942) | - | - | - | - | - | - | - | - | - |
| Cash dividend paid (note 22) | - | - | - | - | - | - | (27) | (19,092) | (19,119) | - | - | (19,119) |
| Profit  paid on Perpetual Tier 1 Sukuk | - | - | - | - | - | - | (5,125) | - | (5,125) | - | - | (5,125) |
| Proposed bonus shares (note 22) | - | - | 14,420 | - | - | - | (14,420) | - | - | - | - | - |
| Sales of treasury shares | - | - | - | 589 | - | (414) | - | - | 175 | - | - | 175 |
| Proposed cash dividends (note 22) | - | - | - | - | - | - | (25,954) | 25,954 | - | - | - | - |
| **Balance at 31 December 2019** | **288,407** | **156,942** | **14,420** | **(54)** | **31,848** | **22,114** | **35,817** | **25,954** | **575,448** | **75,388** | **2,345** | **653,181** |

The notes from 1 to 32 form an integral part of these consolidated financial statements.

| | Share capital | Share premium | Proposed bonus shares | Treasury shares | Statutory reserve | Other reserves (note 25) | Retained earnings | Proposed cash dividends | Equity attributable to equity holders of the Bank | Perpetual Tier 1 Sukuk | Non-controlling interests | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** |
| **Balance at 1 January 2018 (as originally stated)** | 227,473 | 62,896 | 11,374 | (1,122) | 19,349 | 14,764 | 24,122 | 15,900 | 374,756 | 75,388 | 2,213 | 452,357 |
| Impact of adopting IFRS 9 at 1 January 2018 | - | - | - | - | - | 798 | (831) | - | (33) | - | - | (33) |
| Balance at 1 January 2018 *(restated)* | 227,473 | 62,896 | 11,374 | (1,122) | 19,349 | 15,562 | 23,291 | 15,900 | 374,723 | 75,388 | 2,213 | 452,324 |
| Profit for the year | - | - | - | - | - | - | 56,108 | - | 56,108 | - | 102 | 56,210 |
| Other comprehensive loss | - | - | - | - | - | (1,755) | - | - | (1,755) | - | - | (1,755) |
| Total comprehensive (loss) / income for the year | - | - | - | - | - | (1,755) | 56,108 | - | 54,353 | - | 102 | 54,455 |
| Transfer to reserves | - | - | - | - | 5,902 | 5,648 | (11,550) | - | - | - | - | - |
| Issue of bonus shares | 11,374 | - | (11,374) | - | - | - | - | - | - | - | - | - |
| Cash dividend paid | - | - | - | - | - | - | - | (15,900) | (15,900) | - | - | (15,900) |
| Profit paid on Perpetual Tier 1 Sukuk | - | - | - | - | - | - | (5,108) | - | (5,108) | - | - | (5,108) |
| Share based payment (note 25) | - | - | - | - | - | 48 | - | - | 48 | - | - | 48 |
| Proposed bonus shares (note 22) | - | - | 11,942 | - | - | - | (11,942) | - | - | - | - | - |
| Sales of treasury shares | - | - | - | 479 | - | (338) | - | - | 141 | - | - | 141 |
| Proposed cash dividends (note 22) | - | - | - | - | - | - | (19,092) | 19,092 | - | - | - | - |
| **Balance at 31 December 2018** | 238,847 | 62,896 | 11,942 | (643) | 25,251 | 19,165 | 31,707 | 19,092 | 408,257 | 75,388 | 2,315 | 485,960 |

The notes from 1 to 32 form an integral part of these consolidated financial statements.

| | Notes | **2019**<br>**KD '000s** | 2018<br>KD '000s |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Net profit for the year | | **62,677** | 56,210 |
| **Adjustments for:** | | | |
| Provision for impairment | 8 | **18,711** | 23,839 |
| Depreciation | | **7,892** | 4,288 |
| Foreign currency translation adjustments | | **11,997** | 6,456 |
| Unrealised gain from financial assets at fair value through profit or loss | | **(1,128)** | (279) |
| Gain on deemed acquisition in an associate | | **(982)** | - |
| Share of results of associates | | **(2,040)** | (1,917) |
| Dividend income | | **(2,405)** | (1,416) |
| Net unrealized loss from change in fair value of investment properties | | **1,074** | 1,500 |
| Net gain on sale of investment properties | | **(43)** | - |
| Net gain from sale of investment at fair value through profit or loss | | **(85)** | - |
| Loss on derecognition of investment in associates | | **-** | 404 |
| Share based payment reserve | | **-** | 48 |
| **Operating profit before changes in operating assets and liabilities** | | **95,668** | 89,133 |
| **Changes in operating assets and liabilities:** | | | |
| Deposits with Central Bank of Kuwait | | **97,674** | 65,735 |
| Deposits with other banks | | **(153,071)** | 86,696 |
| Islamic financing to customers | | **(484,406)** | (400,346) |
| Other assets | | **(8,334)** | (7,509) |
| Due to banks | | **139,264** | 29,742 |
| Depositors' accounts | | **626,291** | 310,812 |
| Other liabilities | | **15,151** | 10 |
| **Net cash generated from operating activities** | | **328,237** | 174,273 |
| **INVESTING ACTIVITIES** | | | |
| Purchase of investment securities | | **(213,602)** | (241,219) |
| Proceeds from sale/redemption of investment securities | | **174,085** | 98,583 |
| Dividends received from associates | | **83** | 202 |
| Purchase of investment in associates | | **-** | (36) |
| Proceeds from sale of investment properties | | **3,702** | 29,300 |
| Purchase of investment properties | | **(27,342)** | (1,296) |
| Purchase of property and equipment | | **(30,085)** | (6,967) |
| Dividend income received | | **2,405** | 1,416 |
| **Net cash used in investing activities** | | **(90,754)** | (120,017) |
| **FINANCING ACTIVITES** | | | |
| Proceeds from increase in share capital | | **131,664** | - |
| Cost directly related to increase in share capital | | **(108)** | - |
| Profit distribution on perpetual Tier 1 Sukuk | | **(5,125)** | (5,108) |
| Proceeds from exercise of share options | | **175** | 141 |
| Dividends paid | | **(19,119)** | (15,900) |
| **Net cash generated from/(used in) financing activities** | | **107,487** | (20,867) |
| Net increase in cash and cash equivalents | | **344,970** | 33,389 |
| Cash and cash equivalents at the beginning of the year | | **164,767** | 131,378 |
| **Cash and cash equivalents at the end of the year** | 11 | **509,737** | 164,767 |

The notes from 1 to 32 form an integral part of these consolidated financial statements.

## 1. INCORPORATION AND ACTIVITIES

Boubyan Bank K.S.C.P ("the Bank") is a Kuwaiti public shareholding company incorporated on 21 September 2004, in accordance with the Commercial Companies Law in the State of Kuwait, by Amiri Decree No. 88 published on April 18th 2004, in accordance with the rules and regulations of the Central Bank of Kuwait ("CBK"). The Bank's shares were listed on the Kuwait Stock Exchange on 15 May 2006.

The Bank was was licensed by the Central Bank of Kuwait to do business on 28 November 2004.

The Bank is principally engaged in providing banking services, in accordance with Codes of the Islamic Sharia'a, as approved by the Bank's Sharia'a Supervisory Board. On 17 May 2015, the Bank's Articles of Incorporation were amended by adding a new activity, namely, offering securities or selling the same for their issuer, its affiliate or obtaining securities from the issuer or its affiliate for remarketing (issuance management).

The Bank is a subsidiary of National Bank of Kuwait S.A.K.P ("the Parent Company").

The total number of employees in the Group was **1,728** employees as at 31 December 2019 (1,546 employees as at 31 December 2018).

The address of the Bank's registered office is P.O. Box 25507, Safat 13116, State of Kuwait.

The consolidated financial statements were authorised for issue by the Board of Directors on 5 January 2020 and the shareholders have the power to amend these consolidated financial statements at the annual assembly meeting.

## 2. BASIS OF PREPARATION

### 2.1 Statement of compliance

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

### 2.2 Basis of measurement

The consolidated financial statements have been prepared under the historical cost basis except for the measurement at fair value of financial assets at fair value through other comprehensive income, financial asset at fair value through profit or loss, investment properties and derivatives. The Bank presents its consolidated statement of financial position in order of liquidity.

### 2.3 Functional and presentation currency

These consolidated financial statements are presented in Kuwaiti Dinars ("KD"), which is the Bank's functional currency. All financial information presented in Kuwaiti Dinars ("KD") has been rounded to the nearest thousands, except when otherwise indicated.

### 2.4 Changes in accounting policies and disclosures

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in the previous year except for the adoption of IFRS 16 Leases, effective from 1 January 2019.

**IFRS 16 'Leases'**

IFRS 16 supersedes IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model.

Lessor accounting under IFRS 16 is substantially unchanged under IAS 17. Lessors will continue to classify leases as either operating or finance leases using similar principles as in IAS 17. Therefore, IFRS 16 did not have an impact for leases where the Group is the lessor.

The Group adopted IFRS 16 using the modified retrospective method of adoption with the date of initial application of 1 January 2019. Under this method, the standard is applied retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application. The Group elected to use the transition practical expedient allowing the standard to be applied only to contracts that were previously identified as leases applying IAS 17 and IFRIC 4 at the date of initial application. The Group also elected to use the recognition exemptions for lease contracts that, at the commencement date, have a lease term of 12 months or less and do not contain a purchase option ('short-term leases'), and lease contracts for which the underlying asset is of low value ('low-value assets').

**2. BASIS OF PREPARATION (CONTINUED)**

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

**IFRS 16 'Leases' (continued)**
Upon adoption of IFRS 16, the Group has recognised right-of-use assets representing the right to use the underlying assets under property and equipment and the corresponding lease liabilities to make lease payments under other liabilities.

**a) Nature of the effect of adoption of IFRS 16**
Before the adoption of IFRS 16, the Group classified its leases (as lessee) at the inception date as operating lease. In an operating lease, the leased property was not capitalised and the lease payments were recognised as rent expense in profit or loss on a straight-line basis over the lease term. Any prepaid rent and accrued rent were recognised under other assets and other liabilities, respectively.

Upon adoption of IFRS 16, the Group applied a single recognition and measurement approach for all leases that it is the lessee, except for short-term leases and leases of low-value assets. Refer to Note 3.9 Leases – Group as a lessee for the accounting policy beginning 1 January 2019.

*Leases previously classified as finance leases*
As at 1 January 2019, the Group did not have any lease classified as finance lease.

*Leases previously accounted for as operating leases*
The Group recognised right-of-use assets and lease liabilities for those leases previously classified as operating leases, except for short-term leases and leases of low-value assets. The right-of-use assets were recognised based on the amount equal to the lease liabilities, adjusted for any related prepaid and accrued lease payments previously recognised.

**2.5 New standards and interpretations not yet adopted**

The standards and interpretations issued, but not yet effective, up to the date of issuance of the Group's financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

**Amendments to IFRS 3: *Definition of a Business***
In October 2018, the IASB issued amendments to the definition of a business in IFRS 3 Business Combinations to help entities determine whether an acquired set of activities and assets is a business or not. They clarify the minimum requirements for a business, remove the assessment of whether market participants are capable of replacing any missing elements, add guidance to help entities assess whether an acquired process is substantive, narrow the definitions of a business and of outputs, and introduce an optional fair value concentration test. New illustrative examples were provided along with the amendments.

Since the amendments apply prospectively to transactions or other events that occur on or after the date of first application, the Group will not be affected by these amendments on the date of transition.

**Amendments to IAS 1 and IAS 8: *Definition of Material***
In October 2018, the IASB issued amendments to IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to align the definition of 'material' across the standards and to clarify certain aspects of the definition. The new definition states that, 'Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general-purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

The amendments to the definition of material is not expected to have a significant impact on the Group's consolidated financial statements.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in this consolidated financial statements, and have been applied consistently by all of the Group's entities.

### 3.1 Basis of consolidation

The consolidated financial statements comprise the Bank and its principal operating subsidiaries (collectively "the Group") - Boubyan Takaful Insurance Company K.S.C (Closed) and Boubyan Capital Investment Company K.S.C (Closed), as at 31 December 2019 and which are controlled by the Bank as set out in note 15.

### 3.1.1 Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group. The Group controls an investee if and only if the Group has:

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

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

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

The Group measures goodwill at the acquisition date as:

- The fair value of the consideration transferred; plus
- The recognised amount of any non-controlling interests in the acquiree; plus
- If the business combination is achieved in stages, the fair value of the pre-existing equity interest in the acquiree; less
- The fair value of the identifiable assets acquired and liabilities assumed including contingent liabilities.

When the excess is negative, a bargain purchase gain is recognised immediately in the consolidated statement of profit or loss.

Transactions costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

### 3.1.2 Non-controlling interests

Interest in the equity of subsidiaries not attributable to the Group is reported as non-controlling interest in the consolidated statement of financial position. Non-controlling interest in the acquiree is measured at the proportionate share in the recognized amount of the acquiree's identifiable net assets. Losses are allocated to the non-controlling interest even if they exceed the non-controlling interest's share of equity in the subsidiary. Transactions with non-controlling interests are treated as transactions with equity owners of the Group. Gains or losses on disposals of non-controlling interests without loss of control are recorded in equity.

### 3.1.3 Subsidiaries

Subsidiaries are entities controlled by the Group. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with those used by the Bank.

### 3.1.4 Loss of control

On loss of control, the Group derecognises the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on loss of control is recognised in the consolidated statement of profit or loss. If the Group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently it is accounted for as an equity-accounted investee or as a financial asset depending on the level of influence retained.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.1 Basis of consolidation (continued)

#### 3.1.5 Investments in associates (equity-accounted investees)

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20% and 50% of the voting rights.

Investments in associates are accounted for using the equity method and are recognised initially at cost. The cost of the investment includes transaction costs.

The Group recognises in the consolidated statement of profit or loss its share of the total recognised profit or loss of the associate from the date that significant influence effectively commences until the date that it effectively ceases. Distributions received from the associate reduce the carrying amount of the investments. Adjustments to the carrying amount may also be necessary for changes in Group's share in the associate arising from changes in the associate's equity and other comprehensive income. The Group's share of those changes is recognised directly in equity or in other comprehensive income as appropriate.

When the Group's share of losses exceeds its interest in an equity-accounted investee, the carrying amount of the investment, including any long-term interests that form part thereof, is reduced to zero, and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the investee. Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets and liabilities of the associate at the date of acquisition is recognized as goodwill within the carrying amount of the associates.

Any excess of the Group's share of the net fair value of the identifiable assets and liabilities over the cost of acquisition, after reassessment, is recognized immediately in the consolidated statement of profit or loss.

Unrealised gains arising from transactions with associates are eliminated against the investment to the extent of the Group's interest in the associate. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

#### 3.1.6 Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

### 3.2 Foreign currency

The individual financial statements of each Group entity are presented in the currency of the primary economic environment in which the entity operates (its functional currency).

Foreign currency transactions are recorded in the functional currency at the rate of exchange prevailing at the date of the transaction.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are included in the consolidated statement of profit or loss for the year. Exchange differences arising on the translation of non-monetary items carried at fair value are included in the consolidated statement of profit or loss for the year, except for differences arising on the translation of non-monetary items in respect of which gains and losses are recognised directly in other comprehensive income. For such non-monetary items, any exchange component of that gain or loss is also recognised directly in other comprehensive income.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are expressed in KD using exchange rates prevailing on the reporting date. Income and expense items are translated at the average exchange rates for the year. Exchange differences arising, if any, are classified as other comprehensive income and transferred to the Group's foreign currency translation reserve. Such translation differences are recognised in the consolidated statement of profit or loss in the year in which the foreign operation is disposed off.

### 3.3 Revenue recognition

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

- Income from Murabaha, Wakala, and Leased assets is recognized on a pattern reflecting a constant periodic return on the outstanding net investment.
- Dividend income is recognized when the right to receive payment is established.
- Fees and commission income is recognized at the time the related services are provided.
- Rental income from investment properties is recognised on a straight line basis over the lease period.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.4 Financial instruments

#### 3.4.1 Financial assets

**a) Trade and settlement date accounting**
All regular way purchase and sale of financial assets are recognized using settlement date accounting. Changes in the fair value between trade date and settlement date are recognized in the consolidated statement of profit or loss for FVTPL and are recognized in other comprehensive income for FVOCI. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulations or conventions in the market place.

**b) Recognition and derecognition of financial assets**
Financial assets are recognised when the Group becomes party to contractual provisions of the instrument and are initially measured at fair value. Transaction costs are included only for those financial instruments that are not measured at fair value through profit or loss.

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and also recognizes a liability for the proceeds received.

**c) Classification and Measurement of Financial assets**
The Group has determined the classification and measurement of its financial assets as follows:

**Cash and cash equivalents**
Cash and cash equivalents consist of cash in hand, current account with other banks and placements with banks maturing within seven days.

**Deposits with Banks and Islamic financing to customers**
Deposits with banks and Islamic financing to customers are financial assets with fixed or determinable payments that are not quoted in an active market.

**Murabaha**
Murabaha is an agreement relating to the sale of commodities at cost plus an agreed upon profit margin, whereby the seller informs the buyer of the price at which the deal will be completed and also the amount of profit to be recognized. Murabaha is a financial asset originated by the Group and is stated at amortized cost net of provision for impairment.

**Wakala**
Wakala is an agreement involving Al-Muwakkil (the Principal) who wishes to appoint Al-Wakil (the Agent) to be his agent with respect to the investment of Al-Muwakkil's fund, in accordance with regulations of the Islamic Sharia'a. Wakala is a financial asset originated by the Group and is stated at amortized cost net of provision for impairment.

**Leased assets - the Group as a lessor**
Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating lease. Leased assets are stated at amortized cost net of provision for impairment.

**Renegotiated finance facilities**
In the event of a default, the Group seeks to restructure facilities rather than take possession of collateral. This may involve extending the payment arrangements and the agreement of new facility conditions. When the terms and conditions of these finance facilities are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether these facilities remain past due. Management continually reviews renegotiated facilities to ensure that all criteria are met and that future payments are likely to occur. The facility continues to be subject to an individual or collective impairment assessment.

**Financial assets at FVTPL and FVOCI**
Group's financial investments consists of investment in debt instruments (Sukuk), equity investments and other investments. Sukuk are classified at fair value through other comprehensive income based on the business model in which these securities are managed. Equity investments are generally carried at fair value through profit or loss except for those specific investments for which the Group has made an election to classify at fair value through other comprehensive income. Other investments are carried at fair value through profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.4 Financial instruments (continued)

### 3.4.1 Financial assets (continued)

#### c) Classification and Measurement of Financial assets (continued)

**Business model assessment**

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

- The stated policies and objectives for the portfolio and the operation of those policies in practice
- The risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed; and
- The frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity.

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

**Assessment of whether contractual cashflows are solely payments of principal and profit (SPPP test)**

The Group assesses the contractual terms of financial assets to identify whether they meet the SPPP test. 'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset. Profit within a basic lending arrangement are typically as consideration for time value of money and for the credit risk associated with the principal, the most significant element of other basic lending risks and costs as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and profit, the Group considers whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. The Group considers:

- Contingent events that would change the amount and timing of cash flows;
- Leverage features;
- Prepayment and extension terms;
- Terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- Features that modify consideration of the time value of money – e.g. periodical reset of profit rates.

Contractual terms that introduce a more than minimum exposure to risks or volatility in the contractual cashflows that are unrelated to a basic lending arrangement do not give rise to contractual cashflows that are solely payment of principal and profit. In such cases, the financial asset is measured at fair value through profit or loss.

The Group classifies its financial assets upon initial recognition into the following categories:

- Financial assets measured at amortised cost
- Financial assets measured at fair value through other comprehensive income (FVOCI)
- Financial assets measured at fair value through profit or loss (FVTPL)

*(i) Financial assets measured at amortised cost:*

A financial asset is measured at amortised cost if it meets both of the following conditions:

- It is held within a business model whose objective is to hold assets to collect contractual cash flows ; and
- its contractual terms give rise, on specified dates, to cash flows that are solely payments of principal and profit on the principal amount outstanding

Financial assets measured at amortised cost are subsequently measured at amortised cost using the effective yield method. Finance income, foreign exchange gains and losses and charge for expected credit losses are recognised in the consolidated statement of profit or loss. Any gain or loss on de-recognition is recognised in the consolidated statement of profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.4 Financial instruments (continued)

### 3.4.1 Financial assets (continued)

**c) Classification and Measurement of Financial assets (continued)**

*(ii) Financial assets measured at fair value through other comprehensive income (FVOCI):*

**(i) Debt Securities (Sukuk) at FVOCI**

A debt investment is measured at FVOCI if it meets both of the following conditions and is not designated at FVTPL:

- It is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- Its contractual terms give rise on specified dates to cash flows that are solely payments of principal and profit on the principal amount outstanding.

Debt Securities (Sukuk) at FVOCI are subsequently measured at fair value. Sukuk income is calculated using the effective yield method, foreign exchange gains and losses and impairment losses are recognised in the consolidated statement of profit or loss. Fair value changes which are not part of an effective hedging relationship are recognised in other comprehensive income and presented in the fair value reserves as part of equity until the asset is derecognised or reclassified. When the financial asset is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to the consolidated statement of profit or loss.

**(ii) Equity investments at FVOCI**

Upon initial recognition, the Group makes an irrevocable election to classify some of its equity investments as equity investments at FVOCI if they meet the definition of Equity under IAS 32 Financial Instruments: Presentation and are not held for trading .Such classification is determined on an instrument by instrument basis.

Equity investments at FVOCI are subsequently measured at fair value. Changes in fair values including foreign exchange component are recognised in other comprehensive income and presented in the fair values reserves as part of equity. Cumulative profits and losses previously recognised in other comprehensive income are transferred to retained earnings on derecognition and are not recognised in the consolidated statement of profit or loss. Dividend income on equity investments at FVOCI are recognised in the consolidated statement of profit or loss unless they clearly represent a recovery of part of the cost of the investment in which case they are recognised in other comprehensive income. Equity investments at FVOCI are not subject to impairment assessment.

*(iii) Financial assets measured at FVTPL:*

Financial assets in this category are those assets which have been either designated by management upon initial recognition or are mandatorily required to be measured at fair value under IFRS 9. Management designates an instrument at FVTPL that otherwise meet the requirements to be measured at amortised cost or at FVOCI only if it eliminates, or significantly reduces, an accounting mismatch that would otherwise arise. Financial assets with contractual cashflows not representing solely payment of principal and profit are mandatorily required to be measured at FVTPL.

Financial assets at FVTPL are subsequently measured at fair value. Changes in fair value are recognised in the consolidated statement of profit or loss. Dividend income from equity investments measured at FVTPL is recognised in the consolidated statement of profit or loss when the right to the payment has been established.

**Reclassification of financial assets**

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

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.4 Financial instruments (continued)

#### 3.4.1 Financial assets (continued)

**d) Impairment of financial assets**

The Group computes Expected Credit Losses (ECL) on the following financial instruments that are not measured at fair value through profit or loss:

- Islamic financing to customers including loan commitments
- Letters of credit and financial guarantee contracts including commitments
- Investment in debt securities measured FVOCI (i.e. Investment in Sukuks)
- Balances and deposits with banks

Equity investments are not subject to Expected Credit Losses.

**Impairment of financing facilities**

Financing facilities granted by the Group consists of Islamic financing to customers, letters of credit and financial guarantee contracts and commitments to grant credit facilities. Impairment on financing facilities shall be recognised in the consolidated statement of financial position at an amount equal to the higher of ECL under IFRS 9 according to the CBK guidelines, and the provisions required by the CBK instructions.

**Impairment of financial assets other than financing facilities**

The Group recognises ECL on investment in debt securities at FVOCI and on balances and deposits with banks. Equity investments are not subject to expected credit losses.

**Expected Credit Losses**

The Group applies a three stage approach to measure the expected credit loss as follows. Assets migrate through the following three stages based on the change in credit quality since initial recognition.

**Stage 1: 12-months ECL**

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

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

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

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

The Group measures loss allowances at an amount equal to lifetime ECL on financial assets that are determined to be credit impaired based on objective evidence of impairment.

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

**Determining the stage for impairment**

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

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.4 Financial instruments (continued)

#### 3.4.1 Financial assets (continued)

**d) Impairment of financial assets (continued)**

**Expected Credit Losses (continued)**

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

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

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

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

**Incorporation of forward-looking information**
The Group considers key economic variables that are expected to have an impact on the credit risk and the ECL in order to incorporate forward looking information into the ECL models. These primarily reflect reasonable and supportable forecasts of the future macro-economic conditions. The consideration of such factors increases the degree of judgment in determination of ECL. The management reviews the methodologies and assumptions including any forecasts of future economic conditions on regular basis.

**Modification of Islamic financing to customers**
Under certain circumstances, the Group seeks to restructure Islamic financing to customers rather than taking possession of collateral. This may involve extending the payment arrangements, reduction in the amount of principal or profit and the agreement of new facility or financing conditions. If the modifications are substantial, such a facility is derecognised and a new facility is recognised with substantially different terms and conditions.

The facility will have a loss allowance measured based on 12 month ECL except in rare occasions where the new facility is considered to be originated - credit impaired. Management continuously reviews modified Islamic financing to customers to ensure that all criteria are met and that future payments are likely to occur. Management also assesses whether there has been significant increase in credit risk or the facility should be classified in stage 3. When Islamic financing to customers have been modified but not derecognised, any impairment is measured using the original effective profit rate as calculated before the modification of terms.

**Write off**
The gross carrying amount of a financial asset is written off (either partially or in full) when the Group determines that the debtor does not have assets or sources of income that could generate sufficient cash flows to repay the amounts. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.4 Financial instruments (continued)

### 3.4.1 Financial assets (continued)

**d) Impairment of financial assets (continued)**

**Expected Credit Losses (continued)**

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

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

| **Category** | ***Criteria*** | ***Specific provisions*** |
|---|---|---|
| Watch list | Irregular for a period of 90 days | - |
| Substandard | Irregular for a period of 91- 180 days | 20% |
| Doubtful | Irregular for a period of 181- 365 days | 50% |
| Bad | Irregular for a period exceeding 365 days | 100% |

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

In addition to specific provisions, minimum general provisions of 1% on cash facilities and 0.5% on non-cash facilities are made on all applicable finance facilities (net of certain restricted categories of collateral) which are not subject to specific provisioning.

In March 2007, CBK issued a circular amending the basis of calculating general provisions on facilities changing the rate from 2% to 1% for cash facilities and to 0.5% for non-cash facilities. The required rates were to be applied effective from 1 January 2007 on the net increase in facilities, net of certain categories of collateral, during the reporting period. The general provision in excess of the present 1% for cash facilities and 0.5% for non-cash facilities as of 31 December 2006 would be retained as a general provision until a further directive from the Central Bank of Kuwait is issued.

### 3.4.2 Financial liabilities
All financial liabilities are recognised initially on the settlement date at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost.
The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.
Financial liabilities comprise due to banks, depositors' accounts and other liabilities.

**Due to banks and depositors' accounts**
Depositors' accounts are deposits received from customers under current account, saving investment accounts and fixed term investments accounts. The depositors' accounts of the Bank comprise the following:

i) Non-investment deposits in the form of current accounts. These deposits are not entitled to any profits nor do they bear any risk of loss as the Bank guarantees to pay the related balances on demand. Accordingly, these deposits are considered Qard Hassan from depositors to the Bank under Islamic Sharia'a principals. Investing such Qard Hassan is made at the discretion of the Group, the results of which are attributable to the equity shareholders of the Bank.
ii) Investment deposit accounts include savings accounts, fixed term deposit accounts, and open term deposit accounts.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.4 Financial instruments (continued)

#### 3.4.2 Financial liabilities (continued)

**Saving Investment Accounts**
These are open-term deposits and the client is entitled to withdraw the balances of these accounts or portions thereof at any time.

**Fixed-Term Deposit Investment Accounts**
These are fixed-term deposits based on the deposit contract executed between the Bank and the depositor. These deposits mature monthly, quarterly, semi-annually, or annually.

**Open –Term Deposit Investment Accounts**
These are open-term deposits and are treated as annual deposits renewed automatically for a similar period, unless the depositor notifies the Bank in writing of his/her desire not to renew the deposit.

In all cases, investment accounts receive a proportion of profit, bear a share of loss and are carried at cost plus profit payable.

#### 3.4.3 Offsetting

Financial assets and liabilities are offset and the net amount presented in the consolidated statement of financial position when, and only when, the Group has a legal right to offset the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only if it is so permitted by the accounting standards, or for gains and losses arising from a group of similar transactions.

### 3.5 Fair values

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 in the principal or, in its absence, in the most advantageous market to which the Group has access at that date.

When available, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

If an asset or liability measured at fair value has a bid price and an ask price, then the Group measures assets at a bid price and liabilities at an ask price.

The Group determines whether transfers have occurred between levels in the hierarchy by reassessing 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.

Fair values of investment properties are determined by appraisers having an appropriate recognised professional qualification and recent experience in the location and category of the property being valued and also considering the ability to generate economic benefits by using the property in its highest and best use.

### 3.6 Derivatives

Derivative instruments are initially recognised in the consolidated statement of financial position at cost (including transaction costs) and subsequently measured at their fair value.

The Group enters into foreign exchange forward contracts, currency swaps and profit rate swaps. Derivatives are stated at fair value. The fair value of a derivative includes unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the consolidated statement of financial position.

The resultant gains and losses from derivatives are included in the consolidated statement of profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.7 Investment properties

Investment properties are properties held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the production or supply of goods or services or for administrative purposes. Investment property is measured at cost on initial recognition and subsequently at fair value with any change therein recognised in consolidated statement of profit or loss. Cost includes expenditure that is directly attributable to the acquisition of the investment property.

Any gain or loss on disposal of an investment property (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in consolidated statement of profit or loss.

When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

### 3.8 Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. The initial cost of property and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Subsequent expenditure is capitalised only when it is probable that the future economic benefits associated with the expenditure will flow to the Group. On-going repairs and maintenance is expensed as incurred.

Items of property and equipment are depreciated on a straight-line basis in the consolidated statement of profit or loss over the estimated useful lives of each component.

The estimated useful lives for the current and comparative years of significant items of property and equipment are as follows:

- Furniture and leasehold improvement — 5 years
- Office equipment — 3 - 10 years
- Buildings on leasehold land — 20 years
- Buildings on freehold land — 50 years

Depreciation methods, useful lives and residual values are reviewed periodically and adjusted, if appropriate.

### 3.9 Leases – Group as a lessee

The Group assesses at contract inception whether a contract is, or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

***Policy applicable from 1 January 2019***

The Group applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Group recognises lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

*a) Right-of-use assets*

The Group recognises right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any re-measurement of lease liabilities.
The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Unless the Group is reasonably certain to obtain ownership of the leased asset at the end of the lease term, the recognised right-of-use assets are depreciated on a straight-line basis over the shorter of its estimated useful life and the lease term. Right-of-use assets are subject to impairment. The carrying value of the right-of-use assets are presented under property and equipment in the consolidated statement of financial position.

*b) Lease liabilities*

At the commencement date of the lease, the Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in- substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Group and payments of penalties for terminating a lease, if the lease term reflects the Group exercising the option to terminate. The variable lease payments that do not depend on an index or a rate are recognised as expense in the period on which the event or condition that triggers the payment occurs.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.9 Leases – Group as a lessee (continued)

***Policy applicable from 1 January 2019 (continued)***

*b) Lease liabilities (continued)*

In calculating the present value of lease payments, the Group uses the incremental profit rate at the lease commencement date if the profit rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of profit and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments or a change in the assessment to purchase the underlying asset and are presented under other liabilities in the consolidated statement of financial position.

***Policy applicable before 1 January 2019***

Operating lease payments are recognised as an expense in the consolidated statement of profit or loss on a straight-line basis over the lease term. Contingent rental payable is recognised as an expense in the period in which they are incurred.

### 3.10 Impairment of non- financial assets

At each reporting date, the Group reviews the carrying amounts of its non-financial assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market rates and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in consolidated statement of profit or loss.

For non-financial assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. Where an impairment loss is subsequently reversed, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount and is limited to the carrying amount that would have been determined had no impairment loss been recognized for the asset (cash-generating unit) in prior years. A reversal of impairment loss is recognized immediately in the consolidated statement of profit or loss.

### 3.11 Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are reviewed at each financial reporting date and adjusted to reflect the current best estimate of the expenditure required to settle the obligation at the financial reporting date and are discounted to present value where the effect is material.

### 3.12 Contingent liabilities and contingent assets

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed in the notes of the consolidated financial statements, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognized in the consolidated financial statements but are disclosed when an inflow of economic benefits is probable.

### 3.13 Share based payment

The Bank operates an equity settled share based compensation plan. The fair value of the employee services received in exchange for the grant of options or shares is recognized as an expense, together with a corresponding increase in equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options or shares on the date of grant using the Black Scholes model. At each reporting date, the Group revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the consolidated statement of profit or loss, with a corresponding adjustment to equity.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.14 Segment reporting

Operating segments are identified on the basis of internal reports that are regularly reviewed by the decision makers in order to allocate resources to the segments and to assess their performance. Such operating segments are classified as either business segments or geographical segments.

A business segment is a distinguishable component of the Group that is engaged in providing products or services, which is subject to risks and returns that are different from those of other segments.

A geographic segment is a distinguishable component of the Group that is engaged in providing products or services within a particular economic environment which is subject to risks and returns different from those of segments operating in other economic environments.

### 3.15 Treasury shares

Treasury shares consist of the Bank's own shares that have been issued, subsequently reacquired by the Bank and not yet reissued or cancelled. The treasury shares are accounted for using the cost method. Under the cost method, the weighted average cost of the shares reacquired is charged to a contra equity account. When the treasury shares are reissued, gains are credited to a separate account in equity (treasury shares reserve) which is not distributable. Any realised losses are charged to the same account to the extent of the credit balance on that account. Any excess losses are charged to retained earnings then reserves. Gains realised subsequently on the sale of treasury shares are first used to offset any previously recorded losses in the order of reserves, retained earnings and the gain on sale of treasury shares account.

No cash dividends are paid on these shares. The issue of bonus shares increases the number of treasury shares proportionately and reduces the average cost per share without affecting the total cost of treasury shares.

### 3.16 Post-employment benefits

The Group is liable to make defined contributions to State plans and lump sum payments under defined benefit plans to employees at cessation of employment, in accordance with the laws of the place they are employed. The defined benefit plan is unfunded. The present value of the defined benefit obligation is determined annually by actuarial valuations using the projected unit credit method. An actuarial valuation involves making various assumptions such as determination of the discount rate, future salary increases and mortality rates. These assumptions are reviewed at each reporting date.

### 3.17 Kuwait Foundation for the Advancement of Sciences (KFAS)

The Bank calculates the contribution to KFAS at 1% in accordance with the calculation based on the Foundation's Board of Directors resolution.

### 3.18 National Labour Support Tax (NLST)

The Bank calculates the NLST in accordance with Law No. 19 of 2000 and the Minister of Finance Resolution No. 24 of 2006 at 2.5% of taxable profit for the year. Cash dividends from listed companies which are subjected to NLST are deducted from the profit for the year to determine the taxable profit.

### 3.19 Zakat

Effective from 10 December 2007, the Bank has provided for Zakat in accordance with the requirements of Law No. 46 of 2006. The Zakat charge calculated in accordance with these requirements is charged to the consolidated statement of profit and loss.

### 3.20 Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognized as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the reporting date and the amount recognized less cumulative amortization. The liability is measured based on the higher of ECL under IFRS 9 according to the CBK guidelines, and the provision required by CBK.

### 3.21 Fiduciary assets

The Group provides trust and other fiduciary services that result in the holding or investing of assets on behalf of its customers. Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and accordingly are not included in the consolidated statement of financial position. These are disclosed separately in the consolidated financial statements.

## 4. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

### 4.1 Critical judgments in applying the Group's accounting policies

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

**Fair value hierarchy**

As disclosed in note 30.8, the Group is required to determine and disclose the level in the fair value hierarchy into which the fair value measurements are categorized in their entirety, segregating fair value measurements in accordance with the levels defined in IFRS. Differentiating between Level 2 and Level 3 fair value measurements, i.e., assessing whether inputs are observable and whether the unobservable inputs are significant, may require judgement and a careful analysis of the inputs used to measure fair value, including consideration of factors specific to the asset or liability.

**Impairment of investment in associates**

The Group calculates the amount of impairment as the difference between the recoverable amount and its carrying value if there is any objective evidence that the investment in associates are impaired. The estimation of recoverable amount requires the Group to make an estimate of fair value less cost of disposal and selection of appropriate inputs for valuation.

**Classification of financial assets**

The Group determines the classification of financial assets based on the assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and profit on the principal amount outstanding. Judgments are required in determining the business model at an appropriate level that best reflects an aggregated group or portfolio of assets which are managed together to achieve a particular business objective. The Group also applies judgment to assess if there is a change in business model in circumstances when the assets within that business model are realised differently than the original expectations. Refer to Note 3.4 classification of financial assets for more information.

**Determining the lease term of contracts with renewal and termination options - Group as lessee**

The Group determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

The Group has the option, under some of its leases to lease the assets for additional terms. The Group applies judgement in evaluating whether it is reasonably certain to exercise the option to renew. That is, it considers all relevant factors that create an economic incentive for it to exercise the renewal. After the commencement date, the Group reassesses the lease term if there is a significant event or change in circumstances that is within its control and affects its ability to exercise (or not to exercise) the option to renew (e.g., a change in business strategy).

### 4.2 Key sources of estimation uncertainty

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 discussed below.

**Expected Credit Losses on financial assets**

The Group estimates Expected Credit Loss (ECL) for all financial assets carried at amortised cost or fair value through other comprehensive income except for equity instruments.

Significant judgements are required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk
- Choosing appropriate models and assumptions for measurement of ECL
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Establishing group of similar financial assets for the purpose of measuring ECL.

**Impairment losses on Islamic finance facilities**

The Group reviews its irregular Islamic finance facilities on a quarterly basis to assess whether a provision for impairment should be recorded in the consolidated statement of profit or loss. In particular, considerable judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required.

## 4. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

### 4.2 Key sources of estimation uncertainty (continued)

**Impairment losses on Islamic finance facilities (continued)**
Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

**Valuation of unquoted equity investments**
Valuation of unquoted equity investments is based on one of the following:

- Recent arm's length market transactions;
- Current fair value of another instrument that has substantially the same characteristics; or
- Other valuation models.

The determination of the cash flows and discount factors for unquoted equity investments requires significant estimation.

## 5. MURABAHA AND OTHER ISLAMIC FINANCING INCOME

Islamic financing income includes financing income from Islamic financing to customers of **KD 195,238 thousand** (2018: KD 173,954 thousand) and income from Sukuks of **KD 12,391 thousand** (2018: KD 8,988 thousand).

## 6. NET INVESTMENT INCOME

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Dividend income | **2,405** | 1,416 |
| Net rental income from investment properties | **417** | 733 |
| Net gain from financial assets at FVTPL | **1,213** | 768 |
| Net gain from sale of debt investments at FVOCI | **169** | 38 |
| Gain on deemed acquisition in an associate | **982** | - |
| Loss on derecognition of investment in associates | **-** | (404) |
| Unrealized loss from changes in fair value of investment properties | **(1,074)** | (1,500) |
| Net gain on sale of investment properties | **43** | - |
| | **4,155** | 1,051 |

## 7. NET FEES AND COMMISSION INCOME

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Gross fees and commission income | **24,625** | 19,962 |
| Fees and commission expenses | **(8,197)** | (6,526) |
| | **16,428** | 13,436 |

## 8. PROVISION FOR IMPAIRMENT

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Provision for impairment of Islamic financing to customers | **17,432** | 15,053 |
| ECL – Other financial assets | **716** | 344 |
| Impairment loss on investments in associates | **-** | 8,442 |
| Impairment loss on other assets | **563** | - |
| | **18,711** | 23,839 |

The analysis of provision for impairment of Islamic financing to customers based on specific and general provision is as follows:

| | Specific | General | Total |
|---|---|---|---|
| | KD '000s | KD '000s | KD '000s |
| Balance at 1 January 2018 | 7,715 | 52,556 | 60,271 |
| Provided during the year | 14,717 | 336 | 15,053 |
| Recovery of written off balances | 603 | - | 603 |
| Written off balances during the year | (4,710) | - | (4,710) |
| Balance at 31 December 2018 | 18,325 | 52,892 | 71,217 |
| Provided during the year | **13,589** | **3,843** | **17,432** |
| Recovery of written off balances | **1,287** | **-** | **1,287** |
| Written off balances during the year | **(20,725)** | **-** | **(20,725)** |
| Balance at 31 December 2019 | **12,476** | **56,735** | **69,211** |

## 8. PROVISION FOR IMPAIRMENT (CONTINUED)

Further analysis of provision for impairment of finance facilities by category is as follows:

| | Islamic finance to customers<br>KD '000s | Non-cash facilities<br>KD '000s | Total<br>KD '000s |
|---|---|---|---|
| Balance at 1 January 2018 | 58,301 | 1,970 | 60,271 |
| Provided during the year | 14,293 | 760 | 15,053 |
| Recovery of written off balances | 603 | - | 603 |
| Written off balances during the year | (4,710) | - | (4,710) |
| Balance at 31 December 2018 | 68,487 | 2,730 | 71,217 |
| Provided during the year | **16,775** | **657** | **17,432** |
| Recovery of written off balances | **1,287** | **-** | **1,287** |
| Written off balances during the year | **(19,928)** | **(797)** | **(20,725)** |
| Balance at 31 December 2019 | **66,621** | **2,590** | **69,211** |

At 31 December 2019, non-performing finance facilities amounted to **KD 20,409 thousand**, net of provision of **KD 12,476 thousand** (2018: KD 9,983 thousand, net of provision of KD 18,325 thousand). The analysis of specific and general provision stated above is based on Central Bank of Kuwait's instructions.

## 9. TAXATION

| | **2019**<br>**KD '000s** | 2018<br>KD '000s |
|---|---|---|
| Contribution to Kuwait Foundation for the Advancement of Sciences ("KFAS") | **591** | 525 |
| National Labour Support Tax ("NLST") | **1,630** | 1,455 |
| Zakat (Based on Zakat law no: 46/2006) | **646** | 577 |
| | **2,867** | 2,557 |

## 10. BASIC AND DILUTED EARNING PER SHARE

Basic earnings per share are calculated by dividing net profit for the year attributable to the equity holders of the Bank adjusted for profit paid on Perpetual Tier 1 Sukuk by the weighted average number of shares outstanding during the year.

Diluted earnings per share is calculated by dividing the net profit for the year attributable to the equity holders of the Bank by the weighted average number of shares outstanding during the year plus the weighted average number of share that would be issued on the conversion of all the dilutive potential shares into shares. The diluted earnings per share arising from the issue of employee share option does not result in any change from the reported basic earnings per share.

| | **2019** | 2018 |
|---|---|---|
| Net profit for the year attributable to the equity holders of the Bank (KD '000s) | **62,647** | 56,108 |
| Less: profit payment on Perpetual Tier 1 Sukuk (KD '000s) | **(5,125)** | (5,108) |
| | **57,522** | 51,000 |
| Weighted average number of shares outstanding during the year (thousands of shares) | **2,819,723** | 2,659,898 |
| Basic and diluted earnings per share attributable to the equity holders of the Bank (fils) | **20.40** | 19.17 |

Earnings per share for the year ended 2018 was 21.37 fils per share before retroactive adjustment to the number of shares following the bonus issue (see note 22).

## 11. CASH AND CASH EQUIVALENTS

| | **2019**<br>**KD '000s** | 2018<br>KD '000s |
|---|---|---|
| Cash and balances with banks | **232,393** | 83,805 |
| Placement with banks maturing within seven days | **277,344** | 80,962 |
| | **509,737** | 164,767 |

## 12. DEPOSITS WITH OTHER BANKS

The geographical distribution of balances deposits with other banks is as follows:

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Kuwait & Middle East | **361,931** | 219,059 |
| Europe | **65,516** | 18,088 |
| | **427,447** | 237,147 |
| Less: Expected credit losses (ECL) | **(100)** | (59) |
| | **427,347** | 237,088 |

## 13. ISLAMIC FINANCING TO CUSTOMERS

The geographical distribution of Islamic financing to customers is as follows:

| | **Kuwait & Middle East** | **Africa** | **Asia** | **Total** |
|---|---|---|---|---|
| | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** |
| **2019** | | | | |
| Corporate banking | **2,137,575** | **7,654** | **-** | **2,145,229** |
| Consumer banking | **1,650,164** | **-** | **-** | **1,650,164** |
| | **3,787,739** | **7,654** | **-** | **3,795,393** |
| Less: provision for impairment | **(66,544)** | **(77)** | **-** | **(66,621)** |
| | **3,721,195** | **7,577** | **-** | **3,728,772** |
| 2018 | | | | |
| Corporate banking | 1,838,474 | - | 728 | 1,839,202 |
| Consumer banking | 1,491,570 | - | - | 1,491,570 |
| | 3,330,044 | - | 728 | 3,330,772 |
| Less: provision for impairment | (67,972) | - | (515) | (68,487) |
| | 3,262,072 | - | 213 | 3,262,285 |

Provisions for impairment of Islamic financing to customers are as follows:

| | Specific | | General | | Total | |
|---|---|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 | **2019** | 2018 |
| | **KD '000s** | KD '000s | **KD '000s** | KD '000s | **KD '000s** | KD '000s |
| Balance at beginning of the year | **17,781** | 7,715 | **50,706** | 50,586 | **68,487** | 58,301 |
| Provided during the year | **13,007** | 14,173 | **3,768** | 120 | **16,775** | 14,293 |
| Recovery of written off balances | **1,287** | 603 | **-** | - | **1,287** | 603 |
| Written off balances during the year | **(19,928)** | (4,710) | **-** | - | **(19,928)** | (4,710) |
| **Balance at end of the year** | **12,147** | 17,781 | **54,474** | 50,706 | **66,621** | 68,487 |

Further analysis of specific provision based on class of financial assets is given below:

| | Corporate banking | | Consumer banking | | Total | |
|---|---|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 | **2019** | 2018 |
| | **KD '000s** | KD '000s | **KD '000s** | KD '000s | **KD '000s** | KD '000s |
| Balance at beginning of the year | **7,576** | 1,176 | **10,205** | 6,539 | **17,781** | 7,715 |
| Provided during the year | **9,034** | 10,861 | **3,973** | 3,312 | **13,007** | 14,173 |
| Recovery of written off balances | **345** | 237 | **942** | 366 | **1,287** | 603 |
| Written off balances during the year | **(8,170)** | (4,698) | **(11,758)** | (12) | **(19,928)** | (4,710) |
| **Balance at end of the year** | **8,785** | 7,576 | **3,362** | 10,205 | **12,147** | 17,781 |

## 13. ISLAMIC FINANCING TO CUSTOMERS (CONTINUED)

Whenever necessary, Islamic financing to customers is secured by acceptable forms of collateral to mitigate the related credit risks.

Non performing Islamic financing to customers and related specific provisions are as follows:

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Islamic financing to customers | **32,885** | 28,308 |
| Specific provision for impairment | **(12,476)** | (18,325) |
| | **20,409** | 9,983 |

At 31 December 2019, management estimates the fair value of collaterals held against individually impaired Islamic finance facilities to be **KD 24,544 thousand** (2018: KD 1,939 thousand).

The ECL for Islamic financing as at 31 December 2019 is **KD 53,981 thousand** (2018: KD 49,914 thousand) which is lower than the provision for impairment of Islamic finance to customers required by CBK.

## 14. INVESTMENT SECURITIES

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Investment in Sukuk - FVOCI | **306,315** | 309,339 |
| Financial assets at fair value through profit or loss | **80,440** | 42,760 |
| Financial assets at fair value through other comprehensive income | **20,775** | 30,740 |
| | **407,530** | 382,839 |

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| **Financial assets at fair value through profit or loss** | | |
| Investment in unquoted equity funds | **80,440** | 42,760 |
| | **80,440** | 42,760 |

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| **Financial assets at fair value through other comprehensive income** | | |
| Investment in unquoted equity securities | **20,624** | 30,574 |
| Investment in quoted equity securities | **151** | 166 |
| | **20,775** | 30,740 |

## 15. SUBSIDIARIES

Principal operating subsidiaries are as follows:

| Name of subsidiary | Country of incorporation | Principal activity | **2019** | 2018 |
|---|---|---|---|---|
| | | | % Effective ownership | |
| Boubyan Takaful Insurance Company K.S.C. (Closed) | Kuwait | Takaful insurance | **79.49** | 79.49 |
| Boubyan Capital Investment Company K.S.C. (Closed) | Kuwait | Islamic investments | **99.95** | 99.76 |

## 16. INVESTMENTS IN ASSOCIATES

| Name of associate | Country of incorporation | Principal activity | **2019** | 2018 |
|---|---|---|---|---|
| | | | % Effective ownership | |
| Bank of London and the Middle East ("BLME") | United Kingdom | Islamic Banking | **27.91** | 26.44 |
| United Capital Bank | Republic of Sudan | Islamic Banking | **21.67** | 21.67 |
| Saudi Projects Holding Group | Kuwait | Real Estate | **25.02** | 25.02 |

Summarized financial information in respect of Bank of London and the Middle East ("BLME") is set out below:

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Total assets | **557,493** | 428,435 |
| Total liabilities | **(461,166)** | (335,906) |
| Net assets | **96,327** | 92,529 |
| Group's share of net assets | **26,889** | 24,465 |

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Total revenue | **18,881** | 11,375 |
| Net profit | **3,850** | 4,111 |
| Group's share of results | **973** | 1,250 |

## 17. INVESTMENT PROPERTIES

The movement in the investment properties is as follows:

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Balance at the beginning of the year | **24,036** | 53,572 |
| Additions during the year | **27,342** | 1,437 |
| Disposals during the year | **(3,659)** | (29,300) |
| Net unrealized loss from change in fair value of investment properties | **(1,074)** | (1,500) |
| Foreign currency translation adjustments | **(90)** | (173) |
| Balance at the ending of the year | **46,555** | 24,036 |

The fair values were determined based on market approach. There has been no change to the valuation techniques during the year. All of the Group's investment properties are included in Level 2 of fair value hierarchy as at 31 December 2019.

## 18. OTHER ASSETS

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Accrued income | **3,096** | 3,768 |
| Prepayments | **3,196** | 5,708 |
| Others | **26,130** | 14,612 |
| | **32,422** | 24,088 |

## 19. OTHER LIABILITIES

| | **2019** | 2018 |
|---|---|---|
| | **KD ‘000s** | KD ‘000s |
| Creditors and accruals | **13,679** | 11,568 |
| Accrued staff benefits | **9,141** | 8,225 |
| Post Employment Benefit | **8,970** | 7,802 |
| General provision on non-cash facilities | **2,590** | 2,730 |
| Others | **29,281** | 10,342 |
| | **63,661** | 40,667 |

**Post-Employment Benefit**

The present value of defined benefit obligation and the related current and past service cost was determined by actuarial valuations using the projected unit credit method. The significant inputs used in the actuarial valuation were a discount rate of 5%, future salary increases in line with expected consumer price inflation and demographic assumptions of mortality, withdrawal, retirement and disability rates.

## 20. SHARE CAPITAL

| | **2019** | | 2018 | |
|---|---|---|---|---|
| | **Shares** | **KD ‘000s** | Shares | KD ‘000s |
| Shares authorised, issued and paid up of 100 fils each comprised of 2,764,655,880 shares (2018: 2,274,734,860 shares) fully paid in cash and 119,423,580 shares (2018: 113,736,743 shares) issued as bonus shares during the year. | **2,884,079,460** | **288,407** | 2,388,471,603 | 238,847 |

During the year, after obtaining necessary approvals, the Bank increased its share capital through the rights issue of **376,184,277** shares, each with a nominal value of 100 fils and premium of 250 fils. The rights issue has been fully subscribed resulting in an increase in share capital of **KD 37,618** thousand and share premium of **KD 94,046** thousand.

## 21. SHARE PREMIUM

The share premium is not distributable except under specific circumstances as provided by the Companies Law No. 1 of 2016 and its executive regulations, as amended.

## 22. DIVIDEND

The Annual General Assembly meeting of the shareholders held on 10 March 2019 approved 5% bonus shares (2017: 5%) and a cash dividend of 8 fils per share (2017: 7 fils per share) for the year ended 31 December 2018. The bonus shares increased the number of issued and fully paid up shares by 119,423,580 shares (2017: 113,736,743 shares) and increase in share capital by KD 11,942 thousand (2017: KD 11,374 thousand).

The board of directors recommended distribution of cash dividends of **9 fils** per share (2018: 8 fils) and bonus shares of **5%** (2018: 5%) for the year ended 31 December 2019. The proposed dividends, if approved by the shareholders' general assembly, shall be payable to the shareholders after obtaining the necessary regulatory approvals.

## 23. TREASURY SHARES

The Bank held the following treasury shares as at 31 December:

| | **2019** | 2018 |
|---|---|---|
| Number of treasury shares | **331,112** | 2,027,659 |
| Treasury shares as a percentage of total issued shares - % | **0.01148%** | 0.0849% |
| Cost of treasury shares (KD ‘000s) | **54** | 643 |
| Market value of treasury shares (KD ‘000s) | **212** | 1,135 |
| Weighted average of market value per share (fils) | **0.578** | 0.508 |

An amount equivalent to the cost of purchase of the treasury shares have been earmarked as non-distributable from voluntary reserve throughout the holding period of treasury shares.

## 24. STATUTORY RESERVE

In accordance with the Companies Law No. 1 of 2016 and the Bank's Memorandum of Incorporation and Articles of Association, a minimum of 10% profit for the year attributable to the shareholders of the Bank before KFAS, NLST, Zakat and Board of directors' remuneration is transferred to statutory reserve based on the recommendation of the Banks's Board of Directors. The Bank may resolve to discontinue such annual transfers when the reserve equals 50% of the capital. This reserve is not available for distribution except in cases stipulated by law and the Bank's Articles of Association.

## 25. OTHER RESERVES

| | **Voluntary reserve** | **Share based payment reserve** | **Fair value reserve** | **Foreign currency translation reserve** | **Total** |
|---|---|---|---|---|---|
| | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** |
| **Balance at 1 January 2019** | **24,158** | **1,381** | **3,543** | **(9,917)** | **19,165** |
| Other comprehensive loss | **-** | **-** | **(3,372)** | **429** | **(2,943)** |
| Total comprehensive loss for the year | **-** | **-** | **(3,372)** | **429** | **(2,943)** |
| Transfer of gain on disposal of equity investments at FVOCI to retained earnings | **-** | **-** | **(4)** | **-** | **(4)** |
| Transfer to reserves | **6,310** | **-** | **-** | **-** | **6,310** |
| Sales of treasury shares | **-** | **(414)** | **-** | **-** | **(414)** |
| **Balance at 31 December 2019** | **30,468** | **967** | **167** | **(9,488)** | **22,114** |

| | Voluntary reserve | Share based payment reserve | Fair value reserve | Foreign currency translation reserve | Total |
|---|---|---|---|---|---|
| | KD '000s | KD '000s | KD '000s | KD '000s | KD '000s |
| Balance at 1 January 2018 (as originally stated) | 18,510 | 1,671 | 3,859 | (9,276) | 14,764 |
| Impact of adopting IFRS 9 at 1 January 2018 | - | - | 798 | - | 798 |
| Balance at 1 January 2018 | 18,510 | 1,671 | 4,657 | (9,276) | 15,562 |
| Other comprehensive loss | - | - | (1,114) | (641) | (1,755) |
| Total comprehensive loss for the year | - | - | (1,114) | (641) | (1,755) |
| Transfer to reserves | 5,648 | - | - | - | 5,648 |
| Share based payment | - | 48 | - | - | 48 |
| Sales of treasury shares | - | (338) | - | - | (338) |
| Balance at 31 December 2018 | 24,158 | 1,381 | 3,543 | (9,917) | 19,165 |

### Voluntary reserve

As required by the Bank's Articles of Association, a maximum of 10% of the profit for the year attributable to the shareholders of the Bank before Board of directors' remuneration is transferred to the voluntary reserve. Such annual transfers may be discontinued by a resolution of the shareholders' General Assembly upon a recommendation by the Board of Directors.

Voluntary reserve is available to be distributed to shareholders at the discretion of the general assembly in ways that may be deemed beneficial to the Bank, except for the amount equivalent to the cost of purchase of the treasury shares (Note 23).

## 25. OTHER RESERVES (CONTINUED)

**Share based payment reserve**
The Bank currently does not operate an equity settled share based compensation plan.

No options were granted during the year. In 2018, the weighted average remaining life of the share options was **360 days** and the weighted average fair value of share options granted was **348 fils**.

The following table shows the movement in number of share options during the year:

| | **2019 Number of share options** | 2018 Number of share options |
|---|---|---|
| Outstanding at 1 January | **1,758,501** | 3,341,369 |
| Granted during the year | **-** | - |
| Cancelled during the year | **(14,084)** | (164,092) |
| Exercised during the year | **(1,744,417)** | (1,418,776) |
| Outstanding at 31 December | **-** | 1,758,501 |

The expense accrued on account of share based compensation plans for the year amounts to **KD Nil** (2018: KD 48 thousand) and is included under staff costs in the consolidated statement of profit or loss. During the year certain employees have exercised their stock options of **1,744 thousand shares** (2018: 1,419 thousands shares) and these shares have been issued from treasury shares held by the Bank.

## 26. PERPETUAL TIER 1 SUKUK

During 2016, the Bank, issued “Tier 1 Sukuk”, through a Sharia’s compliant Sukuk arrangement amounting to USD 250 million. Tier 1 Sukuk is a perpetual security in respect of which there is no fixed redemption date and constitutes direct, unsecured, subordinated obligations (senior only to share capital) of the Bank subject to the terms and conditions of the Mudaraba Agreement. The Tier 1 Sukuk is listed on the Irish Stock Exchange and NASDAQ Dubai and callable by the Bank after five-year period ending May 2021 (the “First Call Date”) or any profit payment date thereafter subject to certain redemption conditions.

The net proceeds of Tier 1 Sukuk are invested by way of Mudaraba with the Bank (as Mudareb) on an unrestricted co-mingling basis, by the Bank in its general business activities carried out through the general Mudaraba pool. Tier 1 Sukuk bears an expected profit rate of 6.75% per annum to be paid semi-annually in arrears until the First Call Date. After that, the expected profit rate will be reset based on then prevailing 5 years U.S Mid Swap Rate plus initial margin of 5.588% per annum.

At the issuer’s sole discretion, it may elect not to make any Mudaraba distributions expected and in such event, the Mudaraba profit will not be accumulated and the event is not considered an event of default.

## 27. RELATED PARTY TRANSACTIONS

Related parties comprise the major shareholders, board of directors, entities controlled by them or under their joint control, associates, key management personnel and their close family members and the Parent Company including their board members, key management personnel, branches, associates and subsidiaries. Balances with related parties arise from commercial transactions in the normal course of business on an arm's length basis and are included within the following financial information captions:

| | Number of board member or executive officers | | Number of related parties | | | |
|---|---|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 | **2019** | 2018 |
| | | | | | **KD '000s** | KD '000s |
| Islamic financing to customers | **7** | 7 | **1** | 2 | **14,469** | 5,157 |
| Depositors' accounts | **5** | 5 | **12** | 9 | **3,801** | 3,028 |
| Murabaha and other Islamic financing income | | | | | **459** | 231 |
| Finance cost and distribution to depositors | | | | | **(98)** | (87) |
| **Parent Company** | | | | | | |
| Due from banks | | | | | **181,080** | 43,139 |
| Due to banks | | | | | **5,735** | 59,140 |
| Murabaha and other Islamic financing income | | | | | **1,405** | 1,617 |
| Finance cost and distribution to depositors | | | | | **(1,170)** | (664) |

The Group holds collaterals against Islamic finance facilities to related parties in the form of shares and real estate. An estimate of the fair value of collaterals held against Islamic finance facilities to related parties amounted to **KD 5,500 thousand** as at 31 December 2019 (2018: KD 21,649 thousand).

**Compensation of key management personnel:**

Details of compensation for key management comprise the following:

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Short-term benefits | **2,198** | 2,061 |
| Post-employment benefits | **413** | 364 |
| Share based compensation | **611** | 580 |
| | **3,222** | 3,005 |

## 28. CONTINGENCIES AND COMMITMENTS

At the financial reporting date there were outstanding contingencies and commitments entered in the ordinary course of business in respect of the following:

| | **2019** | 2018 |
|---|---|---|
| | **KD '000s** | KD '000s |
| Guarantees | **271,839** | 264,940 |
| Acceptances and letters of credit | **90,184** | 91,632 |
| Other commitments | **2,032** | 9,278 |
| | **364,055** | 365,850 |

## 29. SEGMENT REPORTING

Operating segments are identified on the basis of internal reports that are regularly reviewed by the decision makers in order to allocate resources to the segments and to assess their performance. The operating segments are divided as either business segments or geographical segments.

**Business Segments**

For management purposes, the Bank is organized into the following four major business segments:

**Consumer banking**: Provides a diversified range of products and services to individuals and institutional customers. The range includes consumer finance, credit cards, deposits and other branch related services.

**Corporate banking:** Provides Murabaha, Ijarah, trade service and other related services to business and corporate customers.

**Investment banking**: Principally handling direct investments, investment in associates, local and international real estate investment and asset management.

**Treasury:** Principally handling local and international Murabaha and other Islamic financing, primarily with banks, as well as the management of the Bank's funding operations.

**Group centre:** Includes other group activities and residual in respect of transfer pricing and inter segment allocation.

| | Consumer banking | Corporate banking | Investment banking | Treasury | Group centre | Total |
|---|---|---|---|---|---|---|
| **2019** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** |
| Net financing income/(loss) | **67,590** | **35,542** | **(3,543)** | **5,859** | **14,011** | **119,459** |
| Share of results of associates | **-** | **-** | **2,040** | **-** | **-** | **2,040** |
| Operating income | **74,551** | **43,929** | **9,609** | **9,533** | **8,147** | **145,769** |
| Depreciation | **(4,999)** | **(282)** | **(85)** | **(42)** | **(2,484)** | **(7,892)** |
| Net profit/(loss) for the year | **36,261** | **28,080** | **5,059** | **8,943** | **(15,666)** | **62,677** |
| Total assets | **1,652,215** | **2,562,670** | **217,281** | **825,652** | **42,730** | **5,300,548** |
| Total liabilities | **2,337,346** | **364,021** | **62,495** | **1,873,566** | **9,939** | **4,647,367** |
| 2018 | | | | | | |
| Net financing income | 64,924 | 36,858 | (2,896) | 11,350 | 10,070 | 120,306 |
| Share of results of associates | - | - | 1,917 | - | - | 1,917 |
| Operating income/(loss) | 71,525 | 44,503 | 4,248 | 14,361 | 5,084 | 139,721 |
| Depreciation | (2,550) | (87) | (64) | (28) | (1,559) | (4,288) |
| Net profit/(loss) for the year | 38,078 | 31,827 | (8,044) | 13,803 | (19,454) | 56,210 |
| Total assets | 1,489,285 | 2,216,460 | 152,848 | 460,078 | 26,107 | 4,344,778 |
| Total liabilities | 1,991,298 | 219,032 | 16,040 | 1,616,832 | 15,616 | 3,858,818 |

*Geographical segment*

In presenting information on the basis of geographical areas, revenue is based on the geographical location of customers and assets are based on the geographical location of assets.

| | Middle East & North Africa | North America | Europe | Asia | Total |
|---|---|---|---|---|---|
| | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** | **KD '000s** |
| **2019** | | | | | |
| Assets | **5,117,953** | **19,342** | **130,057** | **33,196** | **5,300,548** |
| Non-current assets (excluding financial instruments) | **138,367** | **26,208** | **4,180** | **29,595** | **198,350** |
| Liabilities and equity | **5,299,350** | **-** | **1,188** | **10** | **5,300,548** |
| Segment income | **141,299** | **209** | **4,257** | **4** | **145,769** |
| 2018 | | | | | |
| Assets | 4,143,391 | 4,007 | 74,813 | 122,567 | 4,344,778 |
| Non-current assets (excluding financial instruments) | 101,982 | - | 5,482 | 26,613 | 134,077 |
| Liabilities and equity | 4,344,144 | 66 | 558 | 10 | 4,344,778 |
| Segment income | 134,743 | 2 | 2,691 | 2,285 | 139,721 |

## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

### 30.1 Introduction and overview

Risk is inherent in the Group's activities but is managed in a structured, systematic manner through a Group risk policy that embeds comprehensive risk management into organisational structure, risk measurement and monitoring processes. The overall risk management direction and oversight is provided by the Board of Directors and Board Risk Committee with the support of the Management Executive Committee and the Group's Risk Management functions.

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

In accordance with the Central Bank of Kuwait's directives, the Group has implemented a comprehensive system for the measurement and management of risk. This methodology helps in reflecting both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. Information compiled from all internal business groups are closely examined and analysed to identify, manage and control risks.

Transactions and outstanding risk exposures are quantified and compared against authorised limits, whereas non-quantifiable risks are monitored against policy guidelines and key risk and control indicators. Any discrepancies, excesses or deviations are escalated to management for appropriate action.

As part of its overall risk management, the Group uses financial instruments to manage exposures resulting from market and profit rate risk. Collateral is used to reduce the Group's credit risk.

The Group's comprehensive risk management framework has specific guidelines that focus on maintaining a diversified portfolio to avoid excessive concentration of risks.

### 30.2 Credit risk

#### 30.2.1 Assessment of expected credit losses

Credit risk is the risk that counterparty will cause a financial loss to the Group by failing to discharge an obligation. Credit risk arises in the Group's normal course of business.

All policies relating to credit are reviewed and approved by the Board of Directors.

Credit limits are established for all customers after a careful assessment of their credit worthiness. Standing procedures, outlined in the Group's Credit Policy Manual, require that all credit proposals be subjected to detailed screening by the respective credit risk functions. Whenever necessary, Islamic facilities are secured by acceptable forms of collateral to mitigate the related credit risks.

In accordance with the instructions of the Central Bank of Kuwait, setting out the rules and regulations regarding the classification of credit facilities, the Group has formed an internal committee comprising competent professional staff and having as its purpose the study and evaluation of the existing credit facilities of each customer of the Group. This committee, which meets regularly throughout the year, is required to identify any abnormal situations and difficulties associated with a customer's position which might cause the debt to be classified as irregular, and to determine an appropriate provisioning level.

The Group further limits risk through diversification of its assets by industry sector. In addition, all credit facilities are continually monitored based on a periodical review of the credit performance and account rating.
The Group considers a financial asset to be in default and therefore Stage 3 (credit impaired) for ECL calculations when:

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

The Group considers investments and interbank balances as in default when the coupon or principal payment is past due .

**30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)**

**30.2 Credit risk (continued)**

**30.2.1 Assessment of expected credit losses (continued)**

The Group considers a financial asset as 'cured' (i.e. no longer be in default) and therefore reclassified out of stage 3 when it is no longer meets any of the default criteria. However, these would be required to meet the scheduled payments (all on current basis) for at least 1 year, or as the reason for such classification has been cured.

**Significant increase in credit risk**

The Group continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12 months ECL or life time ECL, the Group assess whether there has been a significant increase in credit risk of the asset. The quantitative criteria used to determine a significant increase in credit risk is a series of relative and absolute thresholds which are subjected to bank's internal policies and regulatory thresholds.

The Group considers a 2 notch downgrade (without considering modifiers in the rating) as a significant increase in credit risk for externally rated instruments with an "investment grade" rating at inception of the asset whereas for instruments with a below "investment grade" rating at inception, 1 notch downgrade is considered as a significant increase in credit risk. Similarly the Group applies consistent quantitative criteria for internally rated portfolio to assess significant increase in credit risk. In the absence of ratings at inception, the Group considers the earlier available rating to determine if there is significant increase in credit risk.

**Measurement of ECLs**

ECLs are probability weighted estimates of credit losses and are measured as the present value of all cash shortfalls discounted at the effective profit rate of the financial instrument. Cash shortfall represents the difference between cash flows due to the Group in accordance with the contract and the cash flows that the Group expects to receive. The key elements in the measurement of ECL include probability of default (PD), loss given default (LGD) and exposure at default (EAD). The Group estimates these elements using appropriate credit risk models taking into consideration the internal and external credit ratings of the assets, nature and value of collaterals, credit conversion factors for off balance sheet commitments, forward looking macro-economic scenarios etc.

The Group considers expected maturity period of 7 years for credit facilities to corporate customers classified in stage 2 unless these facilities have schedule of repayments with final repayment amount not exceeding 50% of the original credit facilities. The expected maturity period of 5 years is considered for consumer financing and credit cards and 15 years for housing loans.

The Group calculates ECL on credit facilities classified in stage 3 at 100% of the defaulted exposure net of value of eligible collaterals after applying the haircuts prescribed by CBK.

**Incorporation of forward-looking information**

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

**Internal rating and PD estimation process**

In managing its portfolio, the Group utilises ratings and other measures and techniques which seek to take account of all aspects of perceived risk. The Group uses industry standard rating tools for assessing ratings/scores that are leveraged for PD estimation process. The tool provides the ability to analyse a business and produce risk ratings at both the obligor and facility level.

## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.2 Credit risk (continued)

### 30.2.1 Assessment of expected credit losses (continued)

**Internal rating and PD estimation process (continued)**

The analysis supports the usage of financial factors as well as non-financial subjective factors. The Group also uses external ratings by recognised rating agencies for externally rated portfolios.

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

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

**Exposure at default**

Exposure at default (EAD) represents the amount which the obligor will owe to the Group at the time of default. The Group considers variable exposures that may increase the EAD in addition to the drawn credit line. These exposures arise from undrawn limits and contingent liabilities. Therefore, the exposure will contain both on and off balance sheet values. EAD is estimated taking into consideration the contractual terms such as coupon rates, frequency, reference curves, maturity, amortization schedule, credit conversion factors, etc. Credit conversion factors are applied to estimate the future draw downs and compute EAD for credit cards portfolio.

**Loss given default**

Loss given default (LGD) is the magnitude of the likely loss if there is a default. The Group estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. The Group applied minimum LGD floors as prescribed by the Central Bank of Kuwait (CBK).

### 30.2.2 Maximum exposure to credit risk (Net exposure after covered collateral)

An analysis of Islamic financing to customers and contingent liabilities before and after taking account of collateral held or other credit enhancements is as follows:

| | **2019** | | 2018 | |
|---|---|---|---|---|
| | **Gross exposure KD'000's** | **Net exposure KD'000's** | Gross exposure KD'000's | Net exposure KD'000's |
| Islamic financing to customers | **3,728,772** | **2,507,345** | 3,262,285 | 2,153,771 |
| Contingent liabilities and capital commitments | **364,055** | **354,138** | 365,850 | 353,931 |

**Collateral and other credit enhancements**

The amount, type and valuation of collateral are based on guidelines specified in the risk management framework. The main types of collateral accepted includes real estate, shares, cash collateral and bank guarantees. The revaluation and custody of collaterals are performed independent of the business units. The Group may also obtain guarantees from parent companies for financing provided to their subsidiaries.

## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.2 Credit risk (continued)

### 30.2.3 Risk Concentration of the maximum exposure to credit risk

Concentrations of credit risk arise from exposure to customers having similar characteristics in terms of the geographic location in which they operate or the industry sector in which they are engaged, such that their ability to discharge contractual obligations may be similarly affected by changes in political, economic or other conditions.

Credit risk can also arise due to a significant concentration of Group's assets to any single counterparty. This risk is managed by diversification of the portfolio. The 20 largest facilities outstanding as a percentage of gross facilities as at 31 December 2019 are **24.19%** (2018: 23.40%).

The Group's financial assets and off-balance sheet items, before taking into account any collateral held or credit enhancements can be analysed by the following geographic regions:

| | **Middle East & North Africa** | **North America** | **Europe** | **Asia** | **Total** |
|---|---|---|---|---|---|
| | **KD'000's** | **KD'000's** | **KD'000's** | **KD'000's** | **KD'000's** |
| **2019** | | | | | |
| Balances with banks | **168,932** | **22,123** | **2,218** | **181** | **193,454** |
| Deposits with Central Bank of Kuwait | **306,156** | **-** | **-** | **-** | **306,156** |
| Deposits with other banks | **361,831** | **-** | **65,516** | **-** | **427,347** |
| Islamic financing to customers | **3,728,772** | **-** | **-** | **-** | **3,728,772** |
| Investment in Sukuk | **280,386** | **-** | **-** | **25,929** | **306,315** |
| Other assets (excluding accrued income and prepayments) | **26,130** | **-** | **-** | **-** | **26,130** |
| | **4,872,207** | **22,123** | **67,734** | **26,110** | **4,988,174** |
| Contingent liabilities | **356,089** | **-** | **1,090** | **4,844** | **362,023** |
| Commitments | **2,032** | **-** | **-** | **-** | **2,032** |
| Total credit risk exposure | **5,230,328** | **22,123** | **68,824** | **30,954** | **5,352,229** |

| | Middle East & North Africa | North America | Europe | Asia | Total |
|---|---|---|---|---|---|
| | KD'000's | KD'000's | KD'000's | KD'000's | KD'000's |
| 2018 | | | | | |
| Balances with banks | 45,649 | 4,007 | 559 | 51 | 50,266 |
| Deposits with Central Bank of Kuwait | 244,685 | - | - | - | 244,685 |
| Deposits with other banks | 219,000 | - | 18,088 | - | 237,088 |
| Islamic financing to customers | 3,262,072 | - | - | 213 | 3,262,285 |
| Investment in Sukuk | 197,319 | - | 4,612 | 107,408 | 309,339 |
| Other assets (excluding accrued income and prepayments) | 14,613 | - | - | - | 14,613 |
| | 3,983,338 | 4,007 | 23,259 | 107,672 | 4,118,276 |
| Contingent liabilities | 347,276 | - | 1,272 | 8,024 | 356,572 |
| Commitments | 9,278 | - | - | - | 9,278 |
| Total credit risk exposure | 4,339,892 | 4,007 | 24,531 | 115,696 | 4,484,126 |

**30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)**

**30.2 Credit risk (continued)**

**30.2.3 Risk Concentration of the maximum exposure to credit risk (continued)**

The Group's financial assets before taking into account any collateral held or credit enhancements, can be analysed by the following industry sectors:

| | **2019** | 2018 |
|---|---|---|
| | **KD'000's** | KD'000's |
| Trading | **113,502** | 115,257 |
| Manufacturing | **210,831** | 166,755 |
| Banking and other financial institutions | **699,339** | 519,717 |
| Construction | **66,439** | 62,856 |
| Real Estate | **1,011,541** | 899,883 |
| Retail | **1,565,183** | 1,423,554 |
| Government | **615,021** | 397,644 |
| Others | **706,318** | 532,610 |
| | **4,988,174** | 4,118,276 |

**30.2.4 Credit quality per class of financial assets**

In managing its portfolio, the Group utilises ratings and other measures and techniques which seek to take account of relevant aspects of perceived risk. Credit exposures classified as 'High' quality are those where the ultimate risk of financial loss from the obligor's failure to discharge its obligation is assessed to be low. These include facilities to corporate entities with financial condition, risk indicators and capacity to repay which are considered to be good to excellent. Credit exposures classified as 'Standard' quality comprise all other facilities whose payment performance is fully compliant with contractual conditions and which are not impaired. The ultimate risk of possible financial loss on 'Standard' quality is assessed to be higher than that for the exposures classified within the 'High' quality range.

The table below shows the credit quality by class of asset for statement of financial position lines, based on the Group's credit rating system.

| | **Neither past due nor impaired** | | **Past due or impaired** | **Total** |
|---|---|---|---|---|
| | **High** | **Standard** | | |
| | **KD'000's** | **KD'000's** | **KD'000's** | **KD'000's** |
| **2019** | | | | |
| Balances with banks | **193,454** | **-** | **-** | **193,454** |
| Deposits with Central Bank of Kuwait | **306,156** | **-** | **-** | **306,156** |
| Deposits with other banks | **427,347** | **-** | **-** | **427,347** |
| Islamic financing to customers | **3,457,093** | **263,911** | **74,389** | **3,795,393** |
| Investment in Sukuk | **306,315** | **-** | **-** | **306,315** |
| Other assets (excluding accrued income and prepayment) | **26,130** | **-** | **-** | **26,130** |
| | **4,716,495** | **263,911** | **74,389** | **5,054,795** |

| | Neither past due nor impaired | | Past due or impaired | Total |
|---|---|---|---|---|
| | High | Standard | | |
| | KD'000's | KD'000's | KD'000's | KD'000's |
| 2018 | | | | |
| Balances with banks | 50,266 | - | - | 50,266 |
| Deposits with Central Bank of Kuwait | 244,685 | - | - | 244,685 |
| Deposits with other banks | 237,088 | - | - | 237,088 |
| Islamic financing to customers | 3,032,967 | 228,474 | 69,331 | 3,330,772 |
| Investment in Sukuk | 309,339 | - | - | 309,339 |
| Other assets (excluding accrued income and prepayment) | 14,613 | - | - | 14,613 |
| | 3,888,958 | 228,474 | 69,331 | 4,186,763 |

**30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)**

**30.2 Credit risk (continued)**

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

Ageing analysis of past due or impaired financial assets:

| | Corporate banking | | Consumer banking | | Total | |
|---|---|---|---|---|---|---|
| | Past due and not impaired | Past due and impaired | Past due and not impaired | Past due and impaired | Past due and not impaired | Past due and impaired |
| | KD'000's | KD'000's | KD'000's | KD'000's | KD'000's | KD'000's |
| **2019** | | | | | | |
| **Up to 30 days** | **6,039** | **22,809** | **14,230** | **13** | **20,269** | **22,822** |
| **31 – 60 days** | **9,621** | **-** | **4,738** | **-** | **14,359** | **-** |
| **61 – 90 days** | **3,455** | **-** | **3,420** | **2** | **6,875** | **2** |
| **91 – 180 days** | **-** | **1** | **-** | **5,378** | **-** | **5,379** |
| **More than 180 days** | **-** | **868** | **-** | **3,815** | **-** | **4,683** |
| | **19,115** | **23,678** | **22,388** | **9,208** | **41,503** | **32,886** |
| 2018 | | | | | | |
| Up to 30 days | 8,089 | 5,090 | 16,499 | 33 | 24,588 | 5,123 |
| 31 – 60 days | 4,179 | 15 | 4,936 | 10 | 9,115 | 25 |
| 61 – 90 days | 4,090 | 86 | 3,230 | 15 | 7,320 | 101 |
| 91 – 180 days | - | 3,473 | - | 4,680 | - | 8,153 |
| More than 180 days | - | 4,516 | - | 10,390 | - | 14,906 |
| | 16,358 | 13,180 | 24,665 | 15,128 | 41,023 | 28,308 |

At 31 December 2019 management estimates the fair value of collaterals held against individually past due or impaired Islamic finance facilities to KD **32,417 thousand** (2018: KD 6,819 thousand).

**30.3 Market risk**

Market risk is the risk that the fair value of financial instruments will fluctuate due to changes in market prices. Market risks arise from open positions in currency and securities, all of which are exposed to general and specific market movements and changes in the level of volatility of prices and interest rates.

The Group is not exposed to material risk in terms of the re-pricing of its liabilities since, in accordance with Islamic Sharia'a, the Group does not provide a guaranteed contractual rate of return to its depositors.

The group takes major steps towards managing its market risk through diversification, pre-fact risk assessment, limits and controls at various points, and continuous monitoring and reporting.

**30.4 Foreign currency risk**

Foreign currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign currency exchange rates.

Foreign exchange risks are controlled through limits pre-established by the Board of Directors on currency position exposures. Assets are typically funded in the same currency as that of the business being transacted to eliminate exchange exposures. Appropriate segregation of duties exists between the treasury front and back office functions, while compliance with position limits is independently monitored on an ongoing basis by an independent middle office function.

## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.4 Foreign currency risk (continued)

The table below analyses the effect on profit and equity of an assumed 5% strengthening in value of the currency rate against the Kuwaiti Dinar from levels applicable at the year end, with all other variables held constant. A negative amount in the table reflects a potential net reduction in profit or equity, whereas a positive amount reflects a net potential increase.

| | | **2019** | | 2018 | |
|---|---|---|---|---|---|
| | | **Effect on profit** | **Effect on equity** | Effect on profit | Effect on equity |
| | | **KD'000's** | **KD'000's** | KD'000's | KD'000's |
| US Dollar | +5 | **2,499** | **-** | 2,347 | - |
| Sterling Pound | +5 | **(150)** | **-** | (68) | - |
| Euro | +5 | **20** | **-** | - | - |
| Indonesian Rupiah | +5 | **-** | **265** | - | 755 |
| Sudanese Pound | +5 | **16** | **91** | 10 | 38 |
| Japanese Yen | +5 | **3** | **-** | 2 | - |
| Others | +5 | **(2)** | **-** | 19 | - |

A five percent decrease of the above currencies against the Kuwaiti Dinar would have had equal, but opposite, effect of the amounts shown above, on the basis that all other variables remain constant.

**Equity price risk**

Equity price risk arises from the change in fair values of equity investments. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

For such investments classified as FVOCI, a five percent increase in stock prices as at 31 December 2019 would have increased equity by **KD 1,039 thousand** (2018: an increase of KD 1,537 thousand). An equal change in the opposite direction would have had equal, but opposite effect to the amounts shown above, on the basis that all other variables remain constant.

### 30.5 Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its financial liabilities when they fall due. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind and monitors liquidity on a daily basis.

The Group has established an Asset and Liabilities Management Committee to manage the assets and liabilities of the Group comprehensively and strategically. The committee meets regularly to determine and review policies for managing liquidity risk, as well as to set risk limits.

## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.5 Liquidity risk (continued)

The table below summarises the maturity profile of Group's assets, liabilities and equity based on contractual cash flows, maturity dates or on management's estimate of liquidation. This does not necessarily take account of the effective maturities.

| | **Up to three months** | **3 to 6 months** | **6 to one year** | **Over 1 year** | **Total** |
|---|---|---|---|---|---|
| | **KD'000's** | **KD'000's** | **KD'000's** | **KD'000's** | **KD'000's** |
| **2019** | | | | | |
| **Assets** | | | | | |
| Cash and balances with banks | **232,393** | **-** | **-** | **-** | **232,393** |
| Deposits with Central Bank of Kuwait | **226,726** | **63,293** | **16,137** | **-** | **306,156** |
| Deposits with Banks | **322,267** | **48,510** | **56,570** | **-** | **427,347** |
| Islamic financing to customers | **1,003,559** | **826,597** | **241,104** | **1,657,512** | **3,728,772** |
| Investment in sukuk | **250,630** | **-** | **-** | **55,685** | **306,315** |
| Other investment securities | **-** | **-** | **-** | **101,215** | **101,215** |
| Investments in associates | **-** | **-** | **-** | **33,144** | **33,144** |
| Investment properties | **-** | **-** | **-** | **46,555** | **46,555** |
| Other assets | **26,131** | **-** | **6,291** | **-** | **32,422** |
| Property and equipment | **-** | **-** | **-** | **86,229** | **86,229** |
| **Total assets** | **2,061,706** | **938,400** | **320,102** | **1,980,340** | **5,300,548** |
| **Liabilities and Equity** | | | | | |
| Due to banks | **219,372** | **7,078** | **10,030** | **-** | **236,480** |
| Depositors' accounts | **3,135,604** | **542,904** | **518,387** | **150,331** | **4,347,226** |
| Other liabilities | **29,281** | **-** | **13,679** | **20,701** | **63,661** |
| Equity | **-** | **-** | **-** | **653,181** | **653,181** |
| **Total liabilities and equity** | **3,384,257** | **549,982** | **542,096** | **824,213** | **5,300,548** |

| | Up to three months | 3 to 6 months | 6 to one year | Over 1 year | Total |
|---|---|---|---|---|---|
| | KD'000's | KD'000's | KD'000's | KD'000's | KD'000's |
| 2018 | | | | | |
| Assets | | | | | |
| Cash and balances with banks | 83,805 | - | - | - | 83,805 |
| Deposits with Central Bank of Kuwait | 106,871 | 95,501 | 42,313 | - | 244,685 |
| Deposits with Banks | 237,088 | - | - | - | 237,088 |
| Islamic financing to customers | 1,217,734 | 291,434 | 217,168 | 1,535,949 | 3,262,285 |
| Investment in sukuk | 264,962 | - | - | 44,377 | 309,339 |
| Other investment securities | - | - | - | 73,500 | 73,500 |
| Investments in associates | - | - | - | 28,916 | 28,916 |
| Investment properties | - | - | - | 24,036 | 24,036 |
| Other assets | 14,613 | - | 9,475 | - | 24,088 |
| Property and equipment | - | - | - | 57,036 | 57,036 |
| Total assets | 1,925,073 | 386,935 | 268,956 | 1,763,814 | 4,344,778 |
| Liabilities and Equity | | | | | |
| Due to banks | 97,216 | - | - | - | 97,216 |
| Depositors' accounts | 2,211,054 | 418,497 | 811,616 | 279,768 | 3,720,935 |
| Other liabilities | 10,342 | - | 11,568 | 18,757 | 40,667 |
| Equity | - | - | - | 485,960 | 485,960 |
| Total liabilities and equity | 2,318,612 | 418,497 | 823,184 | 784,485 | 4,344,778 |

## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.5 Liquidity risk (continued)

The liquidity profile of financial liabilities of the Group summarised below reflects the projected cash flows including future profit payments over the life of these financial liabilities based on contractual repayment arrangements.

| | **Up to three months** | **3 to 6 months** | **6 to one year** | **Over 1 year** | **Total** |
|---|---|---|---|---|---|
| | **KD'000's** | **KD'000's** | **KD'000's** | **KD'000's** | **KD'000's** |
| **2019** | | | | | |
| **Financial liabilities** | | | | | |
| Due to banks | **219,572** | **7,124** | **10,225** | **-** | **236,921** |
| Depositors' accounts | **3,141,215** | **549,621** | **531,221** | **168,612** | **4,390,669** |
| | **3,360,787** | **556,745** | **541,446** | **168,612** | **4,627,590** |
| **Contingent liabilities and capital commitments** | | | | | |
| Contingent liabilities | **130,862** | **47,481** | **88,304** | **95,376** | **362,023** |
| Capital commitments | **-** | **-** | **2,032** | **-** | **2,032** |
| | **130,862** | **47,481** | **90,336** | **95,376** | **364,055** |

| | Up to three months | 3 to 6 months | 6 to one year | Over 1 year | Total |
|---|---|---|---|---|---|
| | KD'000's | KD'000's | KD'000's | KD'000's | KD'000's |
| 2018 | | | | | |
| Financial liabilities | | | | | |
| Due to banks | 100,899 | - | - | - | 100,899 |
| Depositors' accounts | 2,225,699 | 426,442 | 818,616 | 302,318 | 3,773,075 |
| | 2,326,598 | 426,442 | 818,616 | 302,318 | 3,873,974 |
| Contingent liabilities and capital commitments | | | | | |
| Contingent liabilities | 127,538 | 46,517 | 83,335 | 99,182 | 356,572 |
| Capital commitments | - | - | 9,278 | - | 9,278 |
| | 127,538 | 46,517 | 92,613 | 99,182 | 365,850 |

### 30.6 Profit Rate Risk

Profit Rate Risk is the risk of losses arising as a result of adverse changes in profit rates. It refers to the current or prospective risk to the bank's capital and earnings arising from adverse movements in profit rates that affect the bank's banking book positions.

Accepting this risk is a part of normal banking activities. However, excessive profit rate risk can pose a significant threat to Bank's earnings and capital base.

The goal of profit rate risk management at the Bank is to ensure stability in profitability by adopting pro-active balance sheet management techniques.

### 30.7 Operational risk

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

The Group has established policies and procedures, which are applied to identify, assess, monitor, control and mitigate operational risk in addition to other types of risks relating to the banking and financial activities of the Group as part of overall risk management activities.

The operational risk of the Group is managed in line with the Central Bank of Kuwait's instructions concerning the general guidelines for internal controls and best practice for managing and supervising operational risks in banks.

## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.8 Fair value of financial instruments

Fair values are obtained from quoted market prices, discounted cash flow models and other models as appropriate. The carrying values of financial instruments are approximate to their fair values as at 31 December 2019 due to relatively short-term maturity of the instruments.

**Fair value of the Group's financial assets that are measured at fair value on a recurring basis.**
Some of the Group's financial assets are measured at fair value at the end of each reporting period. The following tables give information about how the fair values of these financial assets are determined (in particular, the valuation techniques(s) and inputs used).

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

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

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **2019** | **KD'000's** | **KD'000's** | **KD'000's** | **KD'000's** |
| Financial assets at fair value through profit or loss | **-** | **38,578** | **41,862** | **80,440** |
| Investment in Sukuk – FVOCI | **306,315** | **-** | **-** | **306,315** |
| Financial assets at fair value through other comprehensive income | **151** | **-** | **20,624** | **20,775** |
| | **306,466** | **38,578** | **62,486** | **407,530** |
| 2018 | | | | |
| Financial assets at fair value through profit or loss | - | 42,760 | - | 42,760 |
| Investment in Sukuk – FVOCI | 309,339 | - | - | 309,339 |
| Financial assets at fair value through other comprehensive income | 166 | - | 30,574 | 30,740 |
| | 309,505 | 42,760 | 30,574 | 382,839 |

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

| | At 1 January 2019 | Change in fair value | Additions/ transfers | Sale/ redemption | Exchange rate movements | At 31 December 2019 |
|---|---|---|---|---|---|---|
| | **KD'000's** | **KD'000's** | **KD'000's** | **KD'000's** | **KD'000's** | **KD'000's** |
| **31 December 2019:** | | | | | | |
| ***Assets measured at fair value*** | | | | | | |
| Financial assets at fair value through profit or loss | **-** | **171** | **77,110** | **(35,152)** | **(267)** | **41,862** |
| Financial assets at fair value through other comprehensive income | **30,574** | **(10,320)** | **-** | **(124)** | **494** | **20,624** |
| | **30,574** | **(10,149)** | **77,110** | **(35,276)** | **227** | **62,486** |

| | At 1 January 2018 | Change in fair value | Additions/ transfers | Sale/ redemption | Exchange rate movements | At 31 December 2018 |
|---|---|---|---|---|---|---|
| | KD'000's | KD'000's | KD'000's | KD'000's | KD'000's | KD'000's |
| 31 December 2018: | | | | | | |
| *Assets measured at fair value* | | | | | | |
| Financial assets at fair value through profit or loss | 3,477 | - | (3,477) | - | - | - |
| Available for sale investments | 9,788 | - | (9,788) | - | - | - |
| Financial assets at fair value through other comprehensive income | - | (612) | 30,882 | (141) | 445 | 30,574 |
| | 13,265 | (612) | 17,617 | (141) | 445 | 30,574 |

## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.8 Fair value of financial instruments (continued)

**Fair value hierarchy (continued)**

The significant unobservable inputs used in the fair value measurement categorised within Level 3 of the fair value hierarchy together with a quantitative sensitivity analysis as at 31 December 2019 are not material.

Fair values of remaining financial assets and liabilities carried at amortised cost are estimated using valuation techniques incorporating a range of input assumptions that are appropriate in the circumstances. Carrying value of financial assets and liabilities that are carried at amortised cost are not materially different from their fair values as most of these assets and liabilities are of short term maturities or are repriced immediately based on market movement in profit rates and is only used for disclosure purpose.

### 30.9 Capital management

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

The Group actively manages its capital base in order to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision (BIS rules/ratios) and adopted by the Central Bank of Kuwait in supervising the Group.

The Group's regulatory capital and capital adequacy ratios for the years ended 31 December 2019 and 31 December 2018 are calculated in accordance with Central Bank of Kuwait circular number 2/RB, RBA/336/2014 dated 24 June 2014 related to Basel III regulations which are shown below:

| | **2019** | 2018 |
|---|---|---|
| | **KD'000's** | KD'000's |
| Risk weighted assets | **3,246,032** | 2,704,257 |
| Capital required | **421,984** | 365,075 |
| Capital available | | |
| Common Equity Tier 1 Capital | **546,790** | 385,348 |
| Additional Tier 1 Capital | **75,616** | 75,658 |
| Tier 1 Capital | **622,406** | 461,006 |
| Tier 2 Capital | **37,288** | 30,871 |
| Total Capital | **659,694** | 491,877 |
| Common Equity Tier 1 Capital Adequacy Ratio | **16.84%** | 14.25% |
| Tier 1 Capital Adequacy Ratio | **19.17%** | 17.05% |
| Total Capital Adequacy Ratio | **20.32%** | 18.19% |

The Group's financial leverage ratio for the year ended 31 December 2019 is calculated in accordance with Central Bank of Kuwait circular number 2/RBA/ 343/2014 dated 21 October 2014 and is shown below:

| | **2019** | 2018 |
|---|---|---|
| | **KD'000's** | KD'000's |
| Tier 1 Capital | **622,406** | 461,006 |
| Total Exposures | **5,575,567** | 4,606,606 |
| Financial Leverage Ratio | **11.16%** | 10.01% |

The disclosures relating to the capital adequacy regulations issued by Central Bank of Kuwait as stipulated in Central Bank of Kuwait's circular number 2/RB, RBA/336/2014 dated 24 June 2014 and disclosures related to financial leverage ratio as stipulated in Central Bank of Kuwait's circular number 2/RBA/ 343/2014 dated 21 October 2014 for the year ended 31 December 2019 are included under the 'Risk Management' section of the annual report.

## 31. DERIVATIVES

In the ordinary course of business, the Bank enters into various types of transactions that involve Sharia'a approved derivative financial instruments such as currency swaps, profit rate swaps and forward foreign exchange contracts to mitigate foreign currency and profit rate risk. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price of one or more underlying financial instruments, reference rate or index.

**Currency swaps**
Currency swaps is a contractual agreement between two parties to buy a Sharia'a compliant asset at an agreed price on the relevant future date in different currencies. The fixed or floating payments as well as notional amounts are exchanged in different currencies.

**Profit rate swaps**
Profit rate swaps are contractual agreements between two counter-parties to exchange fixed and floating payments based on a notional value in a single currency.

**Forward foreign exchange contracts**
Forward foreign exchange contracts are agreements to buy or sell currencies at a specified rate and at a future date.

The notional amount, disclosed gross, is the amount of a derivative's underlying asset and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year-end and are neither indicative of the market risk nor credit risk.

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

| | **2019** | | | 2018 | | |
|---|---|---|---|---|---|---|
| | **Positive fair value** | **Negative fair value** | **Notional** | Positive fair value | Negative fair value | Notional |
| | **KD '000s** | **KD '000s** | **KD '000s** | KD '000s | KD '000s | KD '000s |
| Profit rate swaps (held as fair value hedges) | **324** | **(12,284)** | **290,235** | 3,288 | (219) | 203,116 |
| Cross currency swaps | **6,220** | **(166)** | **269,399** | - | - | 60,800 |
| | **6,544** | **(12,450)** | **559,634** | 3,288 | (219) | 263,916 |

## 32. FIDUCIARY ASSETS

The aggregate value of assets held in a trust or fiduciary capacity by the Group amounted to **KD 348,614 thousand** (2018: KD 237,480 thousand) and the related income from these assets amounted to **KD 2,416 thousand** (2018: KD 1,445 thousand).