

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



**CONSOLIDATED FINANCIAL STATEMENTS  
AND INDEPENDENT AUDITORS' REPORT  
FOR THE YEAR ENDED 31 DECEMBER 2016**

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

**CONSOLIDATED FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT**

For the year ended 31 December 2016



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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 2016, 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 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs), as adopted for use by the State of Kuwait.

#### **Basis for Opinion**

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

#### **Key Audit Matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current 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 identified the following as the key audit matter:

*a) Impairment of Islamic financing to customers*

The impairment of Islamic financing to customers is highly subjective and is determined by the management through the exercise of extensive judgment. Certain judgements applied by the management in accounting for impairment of Islamic financing to customers include the identification of impairment events, the valuation of collateral and assessment of customers that may default, and the future cash flows of Islamic financing granted to customers.

Due to the significance of Islamic financing to customers and the related estimation uncertainty, this is considered a key audit matter. The basis of the impairment provision policy is presented in the accounting policies and disclosures related to exposure to credit risk are presented in Note 12 to the consolidated financial statements.

Our audit procedures included understanding and assessing the controls over the granting, booking and monitoring processes of Islamic financing to customers and the impairment provisioning process, to confirm the operating effectiveness of the key controls in place which identify the impaired Islamic financing to customers and the required provisions against them. As part of the control testing procedures, we assessed whether the key controls in the above processes were designed, implemented and operating effectively for the purpose of our audit.

In addition to testing the key controls, we selected samples of Islamic financing to customers outstanding as at the reporting date and assessed the criteria for determining whether an impairment event had occurred and therefore whether there was a requirement to calculate an impairment provision. For the samples selected, we also verified whether impairment events as identified by us had also been identified by the Bank's management. Our selected samples also included non-performing Islamic financing to customers, where we assessed management's forecast of recoverable cash flows, valuation of collaterals, estimates of recovery on default and other sources of repayment. For the performing Islamic financing to customers, we assessed whether the borrowers exhibit any possible default risk that may affect the repayment abilities.

We have also assessed appropriateness of the Bank's financial statement disclosures on allowance for impairment of Islamic financing to customers as detailed in Note 12.

**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)**

*b) Impairment of investment in associates*

As at 31 December 2016, has recognised an impairment loss of KD 10,502 thousand on an associate as disclosed in note 16. The impairment test of investment in associates performed by the management is significant to our audit because the assessment of fair value less cost of disposal requires considerable judgment on the part of management. Estimates of fair values are based on management's views of market multiples derived from a set of comparable entities and considering qualitative and quantitative factors specific to the measurement. Therefore, we identified the impairment testing of the associate as a key audit matter.

We assessed the knowledge and expertise of the management of the Group to perform such valuations. Our audit procedures included, testing the key inputs forming the Group's fair value less cost of disposal estimate. We assessed the appropriateness of the valuation technique used and tested the key assumptions forming the Group's fair value less cost of disposal estimate. Additionally, we performed a sensitivity analysis for the effect on the valuation of changes to the inputs used.

The Bank's policy on assessing impairment on associates is disclosed in note 4 of the consolidated financial statements.

**Other information**

Management is responsible for the other information. Other information consists of the information included in Group's 2016 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 2016 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 in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information; we are required to report that fact. We have nothing to report in this regard.

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

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

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

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

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

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

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

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional 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.

**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)**

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

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

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

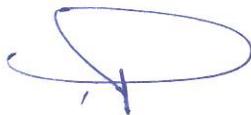
From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current year and are therefore the key audit matters. We describe these matters in our auditors' report unless law or 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.

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

**Report on Other Legal and Regulatory Requirements**

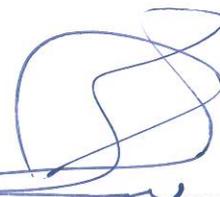
Furthermore, in our opinion proper books of account have been kept by the Bank and the consolidated financial statements, together with the contents of the report of the Bank's Board of Directors relating to these consolidated financial statements, are in accordance therewith. We further report that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

We further report that, during the course of our audit, we have not become aware of any violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the CBK and the organisation of banking business, and its related regulations during the year ended 31 December 2016 that might have had a material effect on the business of the Bank or on its financial position.



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



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BADER A. AL-WAZZAN  
LICENCE NO. 62 A  
DELOITTE & TOUCHE  
AL WAZZAN & CO.

5 January 2017  
Kuwait

## CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2016

|   | Notes | 2016<br>KD'000  | 2015<br>KD'000  |
|---|-------|-----------------|-----------------|
| <b>Income</b>   |       |                 |                 |
| Murabaha and other Islamic financing income   |       | 122,682         | 101,462         |
| Finance cost and distribution to depositors   | 5     | (34,151)        | (22,120)        |
| <b>Net financing income</b>   |       | <b>88,531</b>   | <b>79,342</b>   |
| Net investment income   | 6     | 4,442           | 2,200           |
| Net fees and commission income  | 7     | 9,820           | 7,839           |
| Share of results of associates  | 16    | (1,691)         | 313             |
| Net foreign exchange gain   |       | 2,201           | 1,659           |
| <b>Operating income</b>   |       | <b>103,303</b>  | <b>91,353</b>   |
| Staff costs   |       | (25,428)        | (22,933)        |
| General and administrative expenses   |       | (14,724)        | (13,624)        |
| Depreciation  |       | (3,250)         | (2,636)         |
| <b>Operating expenses</b>   |       | <b>(43,402)</b> | <b>(39,193)</b> |
| <b>Operating profit before provision for impairment</b>   |       | <b>59,901</b>   | <b>52,160</b>   |
| Provision for impairment  | 8     | (16,357)        | (15,058)        |
| <b>Operating profit before deductions</b>   |       | <b>43,544</b>   | <b>37,102</b>   |
| Contribution to Kuwait Foundation for the Advancement of Sciences ("KFAS")                        |       | (381)           | (327)           |
| National Labour Support Tax ("NLST")  |       | (1,074)         | (926)           |
| Zakat   |       | (428)           | (354)           |
| Board of directors' remuneration  |       | (360)           | (310)           |
| <b>Net profit for the year</b>  |       | <b>41,301</b>   | <b>35,185</b>   |
| <b>Attributable to:</b>   |       |                 |                 |
| Equity holders of the Bank  |       | 41,071          | 35,235          |
| Non-controlling interests   |       | 230             | (50)            |
| <b>Net profit for the year</b>  |       | <b>41,301</b>   | <b>35,185</b>   |
| <b>Basic and diluted earnings per share attributable to the equity holders of the Bank (fils)</b> | 9     | <b>17.79</b>    | <b>16.28</b>    |

The notes from 1 to 33 form an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME

For the year ended 31 December 2016

|   | <u>2016</u><br>KD'000 | <u>2015</u><br>KD'000 |
|---|-----------------------|-----------------------|
| <b>Net profit for the year</b>  | <b>41,301</b>         | 35,185                |
| <b>Other comprehensive income</b>   |                       |                       |
| <b>Items that are or may be reclassified to consolidated statement of profit or loss in subsequent periods:</b> |                       |                       |
| Change in fair value of available for sale investments  | (943)                 | (2,973)               |
| Net gains on sale of available for sale investments transferred to consolidated statement of profit and loss    | (85)                  | (198)                 |
| Impairment losses on available for sale investments transferred to consolidated statement of profit and loss    | 568                   | 2,248                 |
| Foreign currency translation adjustments  | 163                   | (2,794)               |
| <b>Other comprehensive loss for the year</b>  | <u>(297)</u>          | <u>(3,717)</u>        |
| <b>Total comprehensive income for the year</b>  | <u><b>41,004</b></u>  | <u>31,468</u>         |
| <b>Attributable to:</b>   |                       |                       |
| Equity holders of the Bank  | 40,774                | 31,518                |
| Non-controlling interests   | 230                   | (50)                  |
| <b>Total comprehensive income for the year</b>  | <u><b>41,004</b></u>  | <u>31,468</u>         |

The notes from 1 to 33 form an integral part of these consolidated financial statements.

**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**



As at 31 December 2016

|  | Notes | 2016<br>KD'000   | 2015<br>KD'000   |
|--|-------|------------------|------------------|
| <b>Assets</b>  |       |                  |                  |
| Cash and balances with banks                             | 10    | 36,911           | 35,009           |
| Deposits with Central Bank of Kuwait                     |       | 292,742          | 133,128          |
| Deposits with other banks                                | 11    | 328,952          | 515,198          |
| Islamic financing to customers                           | 12    | 2,516,760        | 2,171,794        |
| Financial assets at fair value through profit or loss    | 13    | 19,495           | 15,388           |
| Available for sale investments                           | 14    | 160,305          | 126,307          |
| Investments in associates                                | 16    | 62,204           | 79,713           |
| Investment properties                                    | 17    | 24,680           | 23,397           |
| Other assets   | 18    | 13,943           | 14,169           |
| Property and equipment                                   |       | 25,815           | 18,782           |
| <b>Total assets</b>                                      |       | <b>3,481,807</b> | <b>3,132,885</b> |
| <b>Liabilities and Equity</b>                            |       |                  |                  |
| <b>Liabilities</b>                                       |       |                  |                  |
| Due to banks   |       | 76,278           | 382,749          |
| Depositors' accounts                                     |       | 2,945,076        | 2,398,935        |
| Other liabilities  | 19    | 37,300           | 30,402           |
| <b>Total liabilities</b>                                 |       | <b>3,058,654</b> | <b>2,812,086</b> |
| <b>Equity</b>  |       |                  |                  |
| Share capital  | 20    | 216,641          | 206,325          |
| Share premium  | 21    | 62,896           | 62,896           |
| Proposed bonus shares                                    | 22    | 10,832           | 10,316           |
| Treasury shares  | 23    | (1,438)          | (568)            |
| Statutory reserve  | 24    | 14,329           | 9,998            |
| Voluntary reserve  | 25    | 13,713           | 9,570            |
| Share based payment reserve                              | 26    | 1,540            | 1,171            |
| Fair value reserve                                       |       | 3,699            | 4,159            |
| Foreign currency translation reserve                     |       | (9,099)          | (9,262)          |
| Retained earnings  |       | 18,884           | 13,320           |
| Proposed cash dividends                                  | 22    | 12,974           | 10,307           |
| <b>Equity attributable to equity holders of the Bank</b> |       | <b>344,971</b>   | <b>318,232</b>   |
| Perpetual Tier 1 Sukuk                                   | 33    | 75,388           | -                |
| Non-controlling interests                                |       | 2,794            | 2,567            |
| <b>Total equity</b>                                      |       | <b>423,153</b>   | <b>320,799</b>   |
| <b>Total liabilities and equity</b>                      |       | <b>3,481,807</b> | <b>3,132,885</b> |

  
 Mahmoud Yousef Al-Fulaij  
 Chairman

  
 Adef Abdul Wahab Al Majed  
 Vice Chairman & Chief Executive Officer

The notes from 1 to 33 form an integral part of these consolidated financial statements.

**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

For the year ended 31 December 2016

|  | Share capital  | Share premium | Proposed bonus shares | Treasury shares | Statutory reserve | Voluntary reserve | Share based payment reserve | Fair value reserve | Foreign currency translation reserve | Retained earnings | Proposed cash dividends | Equity attributable to equity holders of the Bank | Perpetual Tier 1 Sukuk | Non-controlling interests | Total equity   |
|--|----------------|---------------|-----------------------|-----------------|-------------------|-------------------|-----------------------------|--------------------|--------------------------------------|-------------------|-------------------------|---|------------------------|---------------------------|----------------|
|  | KD'000         | KD'000        | KD'000                | KD'000          | KD'000            | KD'000            | KD'000                      | KD'000             | KD'000                               | KD'000            | KD'000                  | KD'000  | KD'000                 | KD'000                    | KD'000         |
| <b>Balance at 1 January 2016</b>                     | <b>206,325</b> | <b>62,896</b> | <b>10,316</b>         | <b>(568)</b>    | <b>9,998</b>      | <b>9,570</b>      | <b>1,171</b>                | <b>4,159</b>       | <b>(9,262)</b>                       | <b>13,320</b>     | <b>10,307</b>           | <b>318,232</b>                                    | -                      | <b>2,567</b>              | <b>320,799</b> |
| Profit for the year                                  | -              | -             | -                     | -               | -                 | -                 | -                           | -                  | -                                    | 41,071            | -                       | 41,071  | -                      | 230                       | 41,301         |
| Other comprehensive (loss)/ income                   | -              | -             | -                     | -               | -                 | -                 | -                           | (460)              | 163                                  | -                 | -                       | (297)   | -                      | -                         | (297)          |
| Total comprehensive (loss)/ income for the year      | -              | -             | -                     | -               | -                 | -                 | -                           | (460)              | 163                                  | 41,071            | -                       | 40,774  | -                      | 230                       | 41,004         |
| Capital redemption of non-controlling interests      | -              | -             | -                     | -               | -                 | -                 | -                           | -                  | -                                    | -                 | -                       | -   | -                      | (3)                       | (3)            |
| Transfer to reserves                                 | -              | -             | -                     | -               | 4,331             | 4,143             | -                           | -                  | -                                    | (8,474)           | -                       | -   | -                      | -                         | -              |
| Issue of bonus shares                                | <b>10,316</b>  | -             | <b>(10,316)</b>       | -               | -                 | -                 | -                           | -                  | -                                    | -                 | -                       | -   | -                      | -                         | -              |
| Cash dividend paid                                   | -              | -             | -                     | -               | -                 | -                 | -                           | -                  | -                                    | (4)               | (10,307)                | (10,311)  | -                      | -                         | (10,311)       |
| Issue of Perpetual Tier 1 Sukuk (Note 33)            | -              | -             | -                     | -               | -                 | -                 | -                           | -                  | -                                    | -                 | -                       | -   | 75,388                 | -                         | 75,388         |
| Transaction costs on issue of Perpetual Tier 1 Sukuk | -              | -             | -                     | -               | -                 | -                 | -                           | -                  | -                                    | (650)             | -                       | (650)   | -                      | -                         | (650)          |
| Profit paid on Perpetual Tier 1 Sukuk                | -              | -             | -                     | -               | -                 | -                 | -                           | -                  | -                                    | (2,573)           | -                       | (2,573)   | -                      | -                         | (2,573)        |
| Share based payment (note 26)                        | -              | -             | -                     | -               | -                 | -                 | 480                         | -                  | -                                    | -                 | -                       | 480   | -                      | -                         | 480            |
| Purchase of treasury shares                          | -              | -             | -                     | (1,032)         | -                 | -                 | -                           | -                  | -                                    | -                 | -                       | (1,032)   | -                      | -                         | (1,032)        |
| Sales of treasury shares                             | -              | -             | -                     | 162             | -                 | -                 | (111)                       | -                  | -                                    | -                 | -                       | 51  | -                      | -                         | 51             |
| Proposed bonus shares (note 22)                      | -              | -             | 10,832                | -               | -                 | -                 | -                           | -                  | -                                    | (10,832)          | -                       | -   | -                      | -                         | -              |
| Proposed cash dividends (note 22)                    | -              | -             | -                     | -               | -                 | -                 | -                           | -                  | -                                    | (12,974)          | 12,974                  | -   | -                      | -                         | -              |
| <b>Balance at 31 December 2016</b>                   | <b>216,641</b> | <b>62,896</b> | <b>10,832</b>         | <b>(1,438)</b>  | <b>14,329</b>     | <b>13,713</b>     | <b>1,540</b>                | <b>3,699</b>       | <b>(9,099)</b>                       | <b>18,884</b>     | <b>12,974</b>           | <b>344,971</b>                                    | <b>75,388</b>          | <b>2,794</b>              | <b>423,153</b> |

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

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

For the year ended 31 December 2016

|   | Share capital | Share premium | Proposed bonus shares | Treasury shares | Statutory reserve | Voluntary reserve | Share based payment reserve | Fair value reserve | Foreign currency translation reserve | Retained earnings | Proposed cash dividends | Equity attributable to equity holders of the Bank | Perpetual Tier 1 Sukuk | Non-controlling interests | Total equity |
|---|---------------|---------------|-----------------------|-----------------|-------------------|-------------------|-----------------------------|--------------------|--------------------------------------|-------------------|-------------------------|---|------------------------|---------------------------|--------------|
|   | KD'000        | KD'000        | KD'000                | KD'000          | KD'000            | KD'000            | KD'000                      | KD'000             | KD'000                               | KD'000            | KD'000                  | KD'000  | KD'000                 | KD'000                    | KD'000       |
| Balance at 1 January 2015                       | 196,500       | 62,896        | 9,825                 | (763)           | 6,283             | 6,015             | 864                         | 5,082              | (6,468)                              | 5,978             | 9,815                   | 296,027   | -                      | 5,075                     | 301,102      |
| Profit for the year                             | -             | -             | -                     | -               | -                 | -                 | -                           | -                  | -                                    | 35,235            | -                       | 35,235  | -                      | (50)                      | 35,185       |
| Other comprehensive loss for the year           | -             | -             | -                     | -               | -                 | -                 | -                           | (923)              | (2,794)                              | -                 | -                       | (3,717)   | -                      | -                         | (3,717)      |
| Total comprehensive (loss) /income for the year | -             | -             | -                     | -               | -                 | -                 | -                           | (923)              | (2,794)                              | 35,235            | -                       | 31,518  | -                      | (50)                      | 31,468       |
| Transfer to reserves                            | -             | -             | -                     | -               | 3,715             | 3,555             | -                           | -                  | -                                    | (7,270)           | -                       | -   | -                      | -                         | -            |
| Issue of bonus shares                           | 9,825         | -             | (9,825)               | -               | -                 | -                 | -                           | -                  | -                                    | -                 | -                       | -   | -                      | -                         | -            |
| Cash dividend paid                              | -             | -             | -                     | -               | -                 | -                 | -                           | -                  | -                                    | -                 | (9,815)                 | (9,815)   | -                      | -                         | (9,815)      |
| Capital redemption of non-controlling interests | -             | -             | -                     | -               | -                 | -                 | -                           | -                  | -                                    | -                 | -                       | -   | -                      | (2,458)                   | (2,458)      |
| Share based payment (note 26)                   | -             | -             | -                     | -               | -                 | -                 | 307                         | -                  | -                                    | 145               | -                       | 452   | -                      | -                         | 452          |
| Sales of treasury shares                        | -             | -             | -                     | 195             | -                 | -                 | -                           | -                  | -                                    | (145)             | -                       | 50  | -                      | -                         | 50           |
| Proposed bonus shares (note 22)                 | -             | -             | 10,316                | -               | -                 | -                 | -                           | -                  | -                                    | (10,316)          | -                       | -   | -                      | -                         | -            |
| Proposed cash dividends (note 22)               | -             | -             | -                     | -               | -                 | -                 | -                           | -                  | -                                    | (10,307)          | 10,307                  | -   | -                      | -                         | -            |
| Balance at 31 December 2015                     | 206,325       | 62,896        | 10,316                | (568)           | 9,998             | 9,570             | 1,171                       | 4,159              | (9,262)                              | 13,320            | 10,307                  | 318,232   | -                      | 2,567                     | 320,799      |

The notes from 1 to 33 form an integral part of these consolidated financial statements.

**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**



For the year ended 31 December 2016

|   | 2016             | 2015            |
|---|------------------|-----------------|
| Notes   | KD'000           | KD'000          |
| <b>OPERATING ACTIVITIES</b>   |                  |                 |
| Net profit for the year   | 41,301           | 35,185          |
| <b>Adjustments for:</b>   |                  |                 |
| Provision for impairment  | 8 16,357         | 15,058          |
| Depreciation  | 3,250            | 2,636           |
| Foreign currency translation adjustments                                    | 5,472            | (2,791)         |
| Net gain from available for sale investments                                | (293)            | (198)           |
| Net (gain)/ loss from financial assets at fair value through profit or loss | (427)            | 630             |
| Share of results of associates  | 1,691            | (313)           |
| Dividend income   | (1,822)          | (1,824)         |
| Net unrealized loss from change in fair value of investment properties      | 628              | 998             |
| Net (gain)/loss on sale of investment properties                            | (52)             | 180             |
| Share based payment reserve   | 480              | 452             |
| <b>Operating profit before changes in operating assets and liabilities</b>  | <b>66,585</b>    | <b>50,013</b>   |
| <b>Changes in operating assets and liabilities:</b>                         |                  |                 |
| Deposits with Central Bank of Kuwait  | (164,635)        | (29,998)        |
| Deposits with other banks   | (188,514)        | 75,515          |
| Islamic financing to customers  | (351,030)        | (377,879)       |
| Other assets  | 226              | (3,649)         |
| Due to banks  | (306,471)        | 156,010         |
| Depositors' accounts  | 546,141          | 306,907         |
| Other liabilities   | 6,789            | 2,257           |
| <b>Net cash (used in)/ generated from operating activities</b>              | <b>(390,909)</b> | <b>179,176</b>  |
| <b>INVESTING ACTIVITIES</b>   |                  |                 |
| Purchase of financial assets at fair value through profit or loss           | (5,000)          | (3,690)         |
| Proceeds from sale of financial assets at fair value through profit or loss | 5,327            | 544             |
| Purchase of available for sale investments                                  | (98,108)         | (170,963)       |
| Proceeds from sale of available for sale investments                        | 60,032           | 158,991         |
| Dividends received from associates  | 397              | 559             |
| Purchase of investment properties   | (2,203)          | (58)            |
| Proceeds from sale of investment properties                                 | 176              | 2,194           |
| Purchase of property and equipment  | (10,283)         | (5,916)         |
| Dividend income received  | 1,822            | 1,824           |
| <b>Net cash used in investing activities</b>                                | <b>(47,840)</b>  | <b>(16,515)</b> |
| <b>FINANCING ACTIVITIES</b>   |                  |                 |
| Purchase of treasury shares   | (1,032)          | -               |
| Profit paid on perpetual Tier 1 Sukuk                                       | (2,573)          | -               |
| Perpetual Tier 1 Sukuk issuing cost   | (650)            | -               |
| Net proceeds from issue of Perpetual Tier 1 Sukuk                           | 75,388           | -               |
| Capital redemption of non-controlling interest                              | (3)              | (2,458)         |
| Proceeds from exercise of share options                                     | 51               | 50              |
| Dividends paid  | (10,311)         | (9,815)         |
| <b>Net cash generated from/(used in) financing activities</b>               | <b>60,870</b>    | <b>(12,223)</b> |
| Net increase in cash and cash equivalents                                   | (377,879)        | 150,438         |
| Cash and cash equivalents at the beginning of the year                      | 465,259          | 314,821         |
| <b>Cash and cash equivalents at the end of the year</b>                     | <b>10 87,380</b> | <b>465,259</b>  |

The notes from 1 to 33 form an integral part of these consolidated financial statements.

For the year ended 31 December 2016

## **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 and in accordance with the rules and regulations of the Central Bank of Kuwait (“CBK”) (Law No. 30 of 2003).

The Bank’s shares were listed on the Kuwait Stock Exchange on 15 May 2006.

The Bank was licensed by the CBK 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 new Companies Law No. 1 of 2016 was issued on 24 January 2016 and was published in the Official Gazette on 1 February 2016 which cancelled the Companies Law No 25 of 2012, and its amendments. According to article No. 5, the new Law will be effective retrospectively from 26 of November 2012. The new Executive Regulations of Law No. 1 of 2016 was issued on 12 July 2016 and was published in the Official Gazette on 17 July 2016 which cancelled the Executive Regulations of Law No. 25 of 2012.

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 **1278** employees as at 31 December 2016 (1201 employees as at 31 December 2015).

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 2017 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 International Financial Reporting Standards (“IFRSs”) promulgated by the International Accounting Standards Board (“IASB”) and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB, as adopted for use by the State of Kuwait for financial services institutions regulated by the Central Bank of Kuwait. These regulations require adoption of all IFRSs except for the IAS 39 requirements for collective impairment provision, which has been replaced by the Central Bank of Kuwait requirements for a minimum general provision as described in accounting policy 3.9.

### **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 available for sale investments, 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 the following new or amended IFRS applicable to the Group.

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

The following IFRS and Interpretations have been issued but are not yet effective and have not been early adopted by the Group. The Group intends to adopt them when they become effective.

#### **IFRS 9 “Financial Instruments”:**

The IASB issued IFRS 9 ‘Financial Instruments’ in its final form in July 2014 and is effective for annual periods beginning on or after 1 January 2018 with permission to early adopt. IFRS 9 sets out the requirements for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial assets, impairment of financial assets and hedge accounting. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement.

#### **a. Classification and measurement**

The adoption of this standard will have an effect on the classification and measurement of the Group’s financial assets but is not expected to have a significant impact on the classification and measurement of financial liabilities. The classification and measurement of financial assets will depend on how these are managed (the entity’s business model) and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income or fair value through statement of income.

**2. BASIS OF PREPARATION (CONTINUED)****2.5 New standards and interpretations not yet adopted (continued)****IFRS 9 “Financial Instruments”: (continued)****b. Hedge accounting**

IFRS 9 allows entities to continue with the hedge accounting under IAS 39 even when other elements of IFRS become mandatory on 1 January 2018.

**c. Impairment of financial assets**

The impairment requirements apply to financial assets measured at amortised cost, fair value through other comprehensive income, lease receivables and certain loan commitments and financial guarantee contracts. At initial recognition, allowance is required for expected credit losses (“ECL”) resulting from default events that are possible within the next 12 months (“12-month ECL”). In the event of a significant increase in credit risk, allowance is required for ECL resulting from all possible default events over the expected life of the financial instrument (“lifetime ECL”).

Financial assets where 12-month ECL is recognised are considered to be ‘stage 1’; financial assets which are considered to have experienced a significant increase in credit risk are in ‘stage 2’; and financial assets for which there is objective evidence of impairment or are considered to be in default or otherwise credit impaired and are in ‘stage 3’.

The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile.

The Group is in the process of quantifying the impact of this standard on the Group's consolidated financial statements, when adopted.

**IFRS 15 “Revenue from Contracts with Customers”:**

IFRS 15 was issued by IASB on 28 May 2014, effective for annual periods beginning on or after 1 January 2018. IFRS 15 supersedes IAS 11 “Construction Contracts” and IAS 18 “Revenue” along with related IFRIC 13, IFRIC 15, IFRIC 18 and SIC 31 from the effective date. This new standard removes inconsistencies and weaknesses in previous revenue recognition requirements, provides a more robust framework for addressing revenue issues and improves comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets.

The Group is in the process of evaluating the impact of IFRS 15 but does not expect any significant effect on adoption of this standard.

**IFRS 16 “Leases”**

In January 2016, the IASB issued IFRS 16 ‘Leases’ with an effective date of annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under IAS 17 ‘Leases’. Lessees will recognise a ‘right of use’ asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in IAS 17. The Group is in the process of evaluating the impact of IFRS 16 on the Group's consolidated financial statements and does not expect any significant effect on adoption of this standard.

### 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 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 2016 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.

##### 3.1.5 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.

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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

###### **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 financial assets at fair value through profit or loss and are recognized in other comprehensive income for available for sale investments. 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.

###### **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.

###### **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.

The Group classifies financial assets into the following categories: cash and cash equivalents, due from banks, Islamic financing to customers, financial assets at fair value through profit or loss, available for sale investments and other assets.

###### **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**

Due from banks and Islamic financing to customers are financial assets with fixed or determinable payments that are not quoted in an active market. These instruments comply with Code of Islamic Sharia.

###### **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.

For the year ended 31 December 2016

### **3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **3.4 Financial instruments (continued)**

##### **3.4.1 Financial assets (continued)**

###### **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 fair value through profit or loss**

A financial asset is classified as at fair value through profit or loss if it is classified as held for trading or is designated as such on initial recognition. Financial assets are designated as at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's strategy or such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise.

Attributable transaction costs are recognised in consolidated statement of profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value and changes therein, which takes into account any dividend income, are recognised in consolidated statement of profit or loss.

###### **Available for sale investment**

Available for sale investments are non-derivative financial assets that are not classified in any of the above categories of financial assets.

Available for sale investment are recognised initially at fair value plus any directly attributable transaction costs.

Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses (see note 3.9) and foreign currency differences on available for sale debt instruments, are recognised in other comprehensive income and presented in the fair value reserve in equity. When an investment is derecognised or is determined to be impaired, the gain or loss accumulated in equity is reclassified to consolidated statement of profit or loss.

##### **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.
- i) Investment deposit accounts include savings accounts, fixed term deposit accounts, and open term deposit accounts.

###### **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.

**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****3.4 Financial instruments (continued)****3.4.2 Financial liabilities (continued)****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.

**3.5 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. Forward foreign exchange contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. 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.

**3.7 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. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### 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 |
| • Building on leasehold land          | 20 years     |

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

#### 3.9. Impairment

##### 3.9.1 Financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. If such evidence exists, any impairment loss is recognised in the consolidated statement of profit or loss.

##### Financial assets measured at amortised cost

The amount of impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective yield. Losses are recognised in the consolidated statement of profit or loss and reflected in an allowance account against Islamic financing to customers. When an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through the consolidated statement of profit or loss.

In addition, in accordance with Central Bank of Kuwait's instructions, a minimum general provision of 1% for the cash facilities and 0.5% for the non-cash facilities, net of certain categories of collateral, to which CBK instructions are applicable and not subject to specific provisions is made. 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 from 1% 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.

##### Available for sale investment

Impairment losses on available for sale investment are recognised by reclassifying the losses accumulated in the other comprehensive income to consolidated statement of profit or loss. The cumulative loss that is reclassified from other comprehensive income to consolidated statement of profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss recognised previously in consolidated statement of profit or loss. If, in a subsequent period, the fair value of an impaired available for sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss is reversed, with the amount of the reversal recognised in consolidated statement of profit or loss. However, any subsequent recovery in the fair value of an impaired available for sale equity security is recognised in other comprehensive income.

**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****3.9. Impairment (continued)****3.9.2 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.

**3.10 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.

**3.11 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.

**3.12 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.

**3.13 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. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****3.14 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.

**3.15 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 and is computed as the amount payable to employees as a result of involuntary termination on the reporting date. This basis is considered to be a reliable approximation of the present value of the final obligation.

**3.16 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.

**3.17 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.

**3.18 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.

**3.19 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.

**3.20 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:

**Classification of investments**

Management decides on acquisition of an investment whether to classify it as held to maturity, available for sale or financial asset at fair value through profit or loss.

In designating financial assets at fair value through profit or loss, the Group determines if it meets one of the criteria for this designation set out in the significant accounting policies (see note 3.4.1).

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

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

###### Impairment of investments

The Group treats available for sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgement. In addition, the Group evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

###### Fair value hierarchy

As disclosed in note 30.6, 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, the expected future cash flows and selection of appropriate inputs for valuation.

##### 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.

###### 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. 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. FINANCE COST AND DISTRIBUTION TO DEPOSITORS

The Bank determines and distributes the depositors' share of profit based on the Bank's results at the end of each month.

#### 6. NET INVESTMENT INCOME

|   | 2016         | 2015         |
|---|--------------|--------------|
|   | KD'000       | KD'000       |
| Sukuk coupon income   | 2,414        | 1,986        |
| Dividend income   | 1,822        | 1,824        |
| Net rental income from investment properties                                | 62           | -            |
| Net gain /(loss) from financial assets at fair value through profit or loss | 427          | (630)        |
| Net gain from sale of available for sale investments                        | 293          | 198          |
| Net gain/(loss) on sale of investment properties                            | 52           | (180)        |
| Unrealized loss from changes in fair value of investment properties         | (628)        | (998)        |
|   | <u>4,442</u> | <u>2,200</u> |

**7. NET FEES AND COMMISSION INCOME**

|                                  | <u>2016</u>         | <u>2015</u>  |
|----------------------------------|---------------------|--------------|
|                                  | KD'000              | KD'000       |
| Gross fees and commission income | <b>14,102</b>       | 10,812       |
| Fees and commission expenses     | <b>(4,282)</b>      | (2,973)      |
|                                  | <b><u>9,820</u></b> | <u>7,839</u> |

**8. PROVISION FOR IMPAIRMENT**

|   | <u>2016</u>          | <u>2015</u>   |
|---|----------------------|---------------|
|   | KD'000               | KD'000        |
| Provision for impairment of finance facilities          | <b>5,287</b>         | 9,951         |
| Impairment of investments                               | <b>568</b>           | 2,672         |
| Impairment losses of investments in associate (note 16) | <b>10,502</b>        | 2,435         |
|   | <b><u>16,357</u></b> | <u>15,058</u> |

The analysis of provision for impairment of finance facilities based on specific and general provision is as follows:

|                                      | <u>Specific</u>      | <u>General</u>       | <u>Total</u>         |
|--------------------------------------|----------------------|----------------------|----------------------|
|                                      | KD'000               | KD'000               | KD'000               |
| Balance at 1 January 2015            | 5,380                | 36,204               | 41,584               |
| Provided during the year             | 4,139                | 5,812                | 9,951                |
| Recovery of written off balances     | 1,463                | -                    | 1,463                |
| Written off balances during the year | (2,262)              | -                    | (2,262)              |
| Balance at 31 December 2015          | <u>8,720</u>         | <u>42,016</u>        | <u>50,736</u>        |
| Provided during the year             | <b>2,258</b>         | <b>3,029</b>         | <b>5,287</b>         |
| Recovery of written off balances     | <b>1,578</b>         | -                    | <b>1,578</b>         |
| Written off balances during the year | <b>(312)</b>         | -                    | <b>(312)</b>         |
| Balance at 31 December 2016          | <b><u>12,244</u></b> | <b><u>45,045</u></b> | <b><u>57,289</u></b> |

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

|                                      | <u>Islamic finance</u> | <u>Non-cash</u>     | <u>Total</u>         |
|--------------------------------------|------------------------|---------------------|----------------------|
|                                      | to customers           | facilities          | KD'000               |
|                                      | KD'000                 | KD'000              | KD'000               |
| Balance at 1 January 2015            | 40,089                 | 1,495               | 41,584               |
| Provided during the year             | 9,860                  | 91                  | 9,951                |
| Recovery of written off balances     | 1,463                  | -                   | 1,463                |
| Written off balances during the year | (2,262)                | -                   | (2,262)              |
| Balance at 31 December 2015          | <u>49,150</u>          | <u>1,586</u>        | <u>50,736</u>        |
| Provided during the year             | <b>5,178</b>           | <b>109</b>          | <b>5,287</b>         |
| Recovery of written off balances     | <b>1,578</b>           | -                   | <b>1,578</b>         |
| Written off balances during the year | <b>(312)</b>           | -                   | <b>(312)</b>         |
| Balance at 31 December 2016          | <b><u>55,594</u></b>   | <b><u>1,695</u></b> | <b><u>57,289</u></b> |

At 31 December 2016, non-performing finance facilities amounted to **KD 8,856 thousand**, net of provision of **KD 12,244 thousand** (31 December 2015: KD 10,803 thousand, net of provision of KD 8,720 thousand). The analysis of specific and general provision stated above is based on Central Bank of Kuwait's instructions.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

**9. 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.

|  | <u>2016</u>      | <u>2015</u>      |
|--|------------------|------------------|
| Net profit for the year attributable to the equity holders of the Bank (KD'000)            | 41,071           | 35,235           |
| Less: profit payment on Perpetual Tier 1 Sukuk   | (2,573)          | -                |
|  | <u>38,498</u>    | <u>35,235</u>    |
| Weighted average number of shares outstanding during the year (thousands of shares)        | <u>2,164,135</u> | <u>2,164,583</u> |
| Basic and diluted earnings per share attributable to the equity holders of the Bank (fils) | <u>17.79</u>     | <u>16.28</u>     |

Earnings per share for the year ended 31 December 2015 was 17.09 fils per share before retroactive adjustment to the number of shares following the bonus issue (see note 22).

**10. CASH AND CASH EQUIVALENTS**

|   | <u>2016</u>   | <u>2015</u>    |
|---|---------------|----------------|
|   | <u>KD'000</u> | <u>KD'000</u>  |
| Cash and balances with banks                    | 36,911        | 35,009         |
| Placement with banks maturing within seven days | 50,469        | 430,250        |
|   | <u>87,380</u> | <u>465,259</u> |

**11. DEPOSITS WITH OTHER BANKS**

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

|                      | <u>2016</u>    | <u>2015</u>    |
|----------------------|----------------|----------------|
|                      | <u>KD'000</u>  | <u>KD'000</u>  |
| Kuwait & Middle East | 313,419        | 489,398        |
| Europe               | 15,533         | 25,800         |
|                      | <u>328,952</u> | <u>515,198</u> |

**12. ISLAMIC FINANCING TO CUSTOMERS**

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

|                                | <u>Kuwait &amp; Middle East</u> | <u>Europe</u> | <u>Asia</u>   | <u>Total</u>     |
|--------------------------------|---------------------------------|---------------|---------------|------------------|
|                                | <u>KD'000</u>                   | <u>KD'000</u> | <u>KD'000</u> | <u>KD'000</u>    |
| <b>2016</b>                    |                                 |               |               |                  |
| Corporate banking              | 1,393,476                       | 2,645         | 3,325         | 1,399,446        |
| Consumer banking               | 1,172,908                       | -             | -             | 1,172,908        |
|                                | <u>2,566,384</u>                | <u>2,645</u>  | <u>3,325</u>  | <u>2,572,354</u> |
| Less: provision for impairment | (52,763)                        | (26)          | (2,805)       | (55,594)         |
|                                | <u>2,513,621</u>                | <u>2,619</u>  | <u>520</u>    | <u>2,516,760</u> |
| <b>2015</b>                    |                                 |               |               |                  |
| Corporate banking              | 1,215,001                       | 3,385         | 3,534         | 1,221,920        |
| Consumer banking               | 999,024                         | -             | -             | 999,024          |
|                                | <u>2,214,025</u>                | <u>3,385</u>  | <u>3,534</u>  | <u>2,220,944</u> |
| Less: provision for impairment | (46,804)                        | (34)          | (2,312)       | (49,150)         |
|                                | <u>2,167,221</u>                | <u>3,351</u>  | <u>1,222</u>  | <u>2,171,794</u> |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

**12. ISLAMIC FINANCING TO CUSTOMERS (CONTINUED)**

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

|                                      | Specific      |              | General       |               | Total         |               |
|--------------------------------------|---------------|--------------|---------------|---------------|---------------|---------------|
|                                      | 2016          | 2015         | 2016          | 2015          | 2016          | 2015          |
|                                      | KD'000        | KD'000       | KD'000        | KD'000        | KD'000        | KD'000        |
| Balance at beginning of the year     | 8,720         | 5,380        | 40,430        | 34,709        | 49,150        | 40,089        |
| Provided during the year             | 2,258         | 4,139        | 2,920         | 5,721         | 5,178         | 9,860         |
| Recovery of written off balances     | 1,578         | 1,463        | -             | -             | 1,578         | 1,463         |
| Written off balances during the year | (312)         | (2,262)      | -             | -             | (312)         | (2,262)       |
| <b>Balance at end of the year</b>    | <b>12,244</b> | <b>8,720</b> | <b>43,350</b> | <b>40,430</b> | <b>55,594</b> | <b>49,150</b> |

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

|                                      | Corporate banking |              | Consumer banking |              | Total         |              |
|--------------------------------------|-------------------|--------------|------------------|--------------|---------------|--------------|
|                                      | 2016              | 2015         | 2016             | 2015         | 2016          | 2015         |
|                                      | KD'000            | KD'000       | KD'000           | KD'000       | KD'000        | KD'000       |
| Balance at beginning of the year     | 7,123             | 3,756        | 1,597            | 1,624        | 8,720         | 5,380        |
| Provided during the year             | 658               | 3,093        | 1,597            | 1,046        | 2,258         | 4,139        |
| Recovery of written off balances     | 971               | 1,066        | 610              | 397          | 1,578         | 1,463        |
| Written off balances during the year | (300)             | (792)        | (12)             | (1,470)      | (312)         | (2,262)      |
| <b>Balance at end of the year</b>    | <b>8,452</b>      | <b>7,123</b> | <b>3,792</b>     | <b>1,597</b> | <b>12,244</b> | <b>8,720</b> |

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:

|                                   | 2016         | 2015          |
|-----------------------------------|--------------|---------------|
|                                   | KD'000       | KD'000        |
| Islamic financing to customers    | 21,100       | 19,523        |
| Specific provision for impairment | (12,244)     | (8,720)       |
|                                   | <b>8,856</b> | <b>10,803</b> |

At 31 December 2016 management estimates the fair value of collaterals held against individually impaired Islamic finance facilities to be **KD 5,109 thousand** (31 December 2015: KD 7,171 thousand).**13. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS**

|  | 2016          | 2015          |
|--|---------------|---------------|
|  | KD'000        | KD'000        |
| Investment in unquoted equity securities | 2,987         | 2,560         |
| Investment in unquoted equity funds      | 16,508        | 12,828        |
|  | <b>19,495</b> | <b>15,388</b> |

**14. AVAILABLE FOR SALE INVESTMENTS**

|  | 2016           | 2015           |
|--|----------------|----------------|
|  | KD'000         | KD'000         |
| Investment in Sukuk                      | 121,304        | 96,805         |
| Investment in unquoted equity funds      | 27,953         | 18,015         |
| Investment in unquoted equity securities | 10,097         | 10,153         |
| Investment in quoted equity securities   | 951            | 1,334          |
|  | <b>160,305</b> | <b>126,307</b> |

**15. SUBSIDIARIES**

Principal operating subsidiaries are as follows:

| Name of subsidiary                                 | Country of incorporation | Principal activity  | 2016                  | 2015  |
|--|--------------------------|---------------------|-----------------------|-------|
|  |                          |                     | % Effective ownership |       |
| Boubyan Takaful Insurance Company K.S.C. (Closed)  | Kuwait                   | Takaful insurance   | <b>67.68</b>          | 67.63 |
| Boubyan Capital Investment Company K.S.C. (Closed) | Kuwait                   | Islamic investments | <b>99.67</b>          | 99.67 |

**16. INVESTMENTS IN ASSOCIATES**

| Name of associate                            | Country of incorporation | Principal activity | 2016                  | 2015  |
|--|--------------------------|--------------------|-----------------------|-------|
|  |                          |                    | % Effective ownership |       |
| Bank Syariah Muamalat Indonesia Tbk (“BSMI”) | Indonesia                | Islamic Banking    | <b>22.00</b>          | 22.00 |
| Bank of London and the Middle East (“BLME”)  | United Kingdom           | Islamic Banking    | <b>26.40</b>          | 25.62 |
| United Capital Bank                          | Republic of Sudan        | Islamic Banking    | <b>21.67</b>          | 21.67 |
| Saudi Projects Holding Group                 | Kuwait                   | Real Estate        | <b>25.00</b>          | 25.00 |
| Ijarah Indonesia Finance Company             | Indonesia                | Islamic financing  | <b>33.33</b>          | 33.33 |

During the year, the Group provided for an impairment in respect of one of its associates. The impairment is calculated as the difference between fair value less cost of disposal and the carrying value. Fair value less cost of disposal is determined using market multiples.

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**16. INVESTMENTS IN ASSOCIATES (CONTINUED)**

Summarized financial information in respect of BSMI is set out below:

|   | <u>2016</u><br>KD'000 | <u>2015</u><br>KD'000 |
|---|-----------------------|-----------------------|
| Total assets                            | <b>1,161,139</b>      | 1,206,572             |
| Total liabilities                       | <b>(1,090,461)</b>    | (1,122,595)           |
| Net assets                              | <b>70,678</b>         | 83,977                |
| Group's share of net assets             | <b>15,549</b>         | 18,475                |
| Group's share of contingent liabilities | <b>3,295</b>          | 4,032                 |
|   | <u>2016</u><br>KD'000 | <u>2015</u><br>KD'000 |
| Total revenue                           | <b>43,227</b>         | 46,640                |
| Net profit                              | <b>1,727</b>          | 2,397                 |
| Group's share of results                | <b>380</b>            | 410                   |

Summarized financial information in respect of BLME is set out below:

|                             | <u>2016</u><br>KD'000 | <u>2015</u><br>KD'000 |
|-----------------------------|-----------------------|-----------------------|
| Total assets                | <b>508,697</b>        | 634,139               |
| Total liabilities           | <b>(416,841)</b>      | (518,104)             |
| Net assets                  | <b>91,856</b>         | 116,035               |
| Group's share of net assets | <b>24,564</b>         | 29,728                |
|                             | <u>2016</u><br>KD'000 | <u>2015</u><br>KD'000 |
| Total revenue               | <b>12,374</b>         | 19,528                |
| Net profit                  | <b>(6,846)</b>        | 322                   |
| Group's share of results    | <b>(2,317)</b>        | (440)                 |

Summarized financial information in respect of the Group's other associates that are individually immaterial, are set out below:

|   | <u>2016</u><br>KD'000 | <u>2015</u><br>KD'000 |
|---|-----------------------|-----------------------|
| Total assets                            | <b>127,822</b>        | 140,669               |
| Total liabilities                       | <b>(95,605)</b>       | (104,166)             |
| Net assets                              | <b>32,217</b>         | 36,503                |
| Group's share of net assets             | <b>7,482</b>          | 8,582                 |
| Group's share of contingent liabilities | <b>2,214</b>          | 2,434                 |
|   | <u>2016</u><br>KD'000 | <u>2015</u><br>KD'000 |
| Total revenue                           | <b>6,767</b>          | 10,355                |
| Net profit                              | <b>1,271</b>          | 1,412                 |
| Group's share of results                | <b>246</b>            | 343                   |

**17. INVESTMENT PROPERTIES**

The movement in the investment properties is as follows:

|  | <u>2016</u>   | <u>2015</u>   |
|--|---------------|---------------|
|  | KD'000        | KD'000        |
| Balance at the beginning of the year                                   | 23,397        | 25,637        |
| Additions during the year  | 2,203         | 1,394         |
| Disposals during the year  | (172)         | (2,447)       |
| Net unrealized loss from change in fair value of investment properties | (628)         | (998)         |
| Foreign currency translation adjustments                               | (120)         | (189)         |
| Balance at the ending of the year                                      | <u>24,680</u> | <u>23,397</u> |

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 2016.

**18. OTHER ASSETS**

|                | <u>2016</u>   | <u>2015</u>   |
|----------------|---------------|---------------|
|                | KD'000        | KD'000        |
| Accrued income | 1,246         | 1,017         |
| Prepayments    | 5,342         | 5,406         |
| Others         | 7,355         | 7,746         |
|                | <u>13,943</u> | <u>14,169</u> |

**19. OTHER LIABILITIES**

|  | <u>2016</u>   | <u>2015</u>   |
|--|---------------|---------------|
|  | KD'000        | KD'000        |
| Creditors and accruals                   | 17,372        | 13,740        |
| Accrued staff benefits                   | 10,578        | 8,902         |
| Clearing accounts                        | -             | 2,731         |
| General provision on non-cash facilities | 1,695         | 1,586         |
| Others                                   | 7,655         | 3,443         |
|  | <u>37,300</u> | <u>30,402</u> |

**20. SHARE CAPITAL**

|   | <u>2016</u>          |                | <u>2015</u>          |                |
|---|----------------------|----------------|----------------------|----------------|
|   | Shares               | KD'000         | Shares               | KD'000         |
| Shares authorised, issued and paid up of 100 fils each comprised of <b>2,063,251,570</b> shares (2015: 1,965,001,500 shares) fully paid in cash and <b>103,162,578</b> shares (2015: 98,250,070 shares) issued as bonus shares during the year. | <u>2,166,414,153</u> | <u>216,641</u> | <u>2,063,251,570</u> | <u>206,325</u> |

**21. SHARE PREMIUM**

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

**22. PROPOSED DIVIDEND**

The board of directors recommended distribution of cash dividends of **6 fils** per share (2015: 5 fils) and bonus shares of **5%** (2015: 5%) (The increase in capital during the year was recorded in the commercial register on 23 March 2016) on outstanding shares as at 31 December 2016. The cash dividend, if approved by the shareholders' general assembly, shall be payable to the shareholders registered in the records of the Bank as of the date of the annual general assembly meeting and the bonus shares, if approved by the shareholders' general assembly, shall be payable to the shareholders registered in the records of the Bank as of the date of the regulatory approval for distribution of bonus shares.

**23. TREASURY SHARES**

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

|  | 2016      | 2015      |
|--|-----------|-----------|
| Number of treasury shares                                  | 4,024,946 | 1,790,413 |
| Treasury shares as a percentage of total issued shares - % | 0.1858%   | 0.0868%   |
| Cost of treasury shares – KD thousand                      | 1,438     | 568       |
| Market value of treasury shares – KD thousand              | 1,590     | 790       |
| Weighted average of market value per share (fils)          | 0.382     | 0.427     |

An amount equivalent to the cost of purchase of the treasury shares have been earmarked as non-distributable from retained earnings and 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, 10% of 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. 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. VOLUNTARY RESERVE**

As required by the Bank's Articles of Association, 10% of 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).

**26. SHARE BASED PAYMENT RESERVE**

The Bank operates an equity settled share based compensation plan and granted share options to its senior executives. These options will vest if the employees remain in service for a period of three years from the grant date and the employees can exercise the options within one year from the vesting date. If the exercise price is not paid within one year from date of vesting, the options vested will be cancelled. The exercise price of the granted options is equal to 100 fils per share.

The fair value of options granted during the year as determined using the Black-Scholes valuation model was **347 fils** (2015: 316 fils). The significant inputs into the model were a share price of **440 fils** (2015: 410 fils) at the grant date, an exercise price of 100 fils as shown above, a standard deviation of expected share price returns of **23%** (2015: 21%), option life disclosed above and annual risk free rate of **2.25%** (2015: 2%). The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices over the last three years. The weighted average remaining life of the share options was **461 days** (2015: 501 days) and the weighted average fair value of share options granted was **376 fils** (2015: 402 fils).

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

|                            | 2016                    | 2015                    |
|----------------------------|-------------------------|-------------------------|
|                            | Number of share options | Number of share options |
| Outstanding at 1 January   | 3,399,565               | 2,410,645               |
| Granted during the year    | 2,115,938               | 1,821,007               |
| Cancelled during the year  | (329,814)               | (340,107)               |
| Exercised during the year  | (558,749)               | (491,980)               |
| Outstanding at 31 December | 4,626,940               | 3,399,565               |

The expense accrued on account of share based compensation plans for the year amounts to **KD 491 thousand** (31 December 2015: KD 461 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 **559 thousand shares** (2015: 492 thousands shares) and these shares have been issued from treasury shares held by the Bank.

For the year ended 31 December 2016

**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 |      | 2016    | 2015    |
|---|--|------|---------------------------|------|---------|---------|
|   | 2016   | 2015 | 2016                      | 2015 | KD'000  | KD'000  |
| Islamic financing to customers              | 8  | 8    | 3                         | 3    | 2,965   | 3,918   |
| Depositors' accounts                        | 17   | 16   | 9                         | 8    | 22,563  | 53,059  |
| Letters of guarantee and letters of credit  | 1  | 1    | 1                         | -    | 25      | 43      |
| Murabaha and other Islamic financing income |  |      |                           |      | 83      | 96      |
| Finance cost and distribution to depositors |  |      |                           |      | (500)   | (537)   |
| <b>Parent Company</b>                       |  |      |                           |      |         |         |
| Due from banks                              |  |      |                           |      | 124,188 | 72,021  |
| Due to banks                                |  |      |                           |      | 38,528  | 124,310 |
| Murabaha and other Islamic financing income |  |      |                           |      | 595     | 234     |
| Finance cost and distribution to depositors |  |      |                           |      | (278)   | (246)   |

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 4,670 thousand** as at 31 December 2016 (31 December 2015: KD 5,713 thousand).

**Compensation of key management personnel:**

Details of compensation for key management comprise the following:

|                          | 2016         | 2015         |
|--------------------------|--------------|--------------|
|                          | KD'000       | KD'000       |
| Short-term benefits      | 1,787        | 1,790        |
| Post-employment benefits | 336          | 373          |
| Share based compensation | 470          | 398          |
|                          | <b>2,593</b> | <b>2,561</b> |

Senior executive officers also participate in the Group's share based payment programme (see note 26).

**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:

|                                   | 2016           | 2015           |
|-----------------------------------|----------------|----------------|
|                                   | KD'000         | KD'000         |
| Guarantees                        | 200,246        | 184,644        |
| Acceptances and letters of credit | 58,604         | 49,756         |
| Other commitments                 | 27,969         | 3,812          |
|                                   | <b>286,819</b> | <b>238,212</b> |

**Operating lease commitments:**

Future minimum lease payments:

|  | 2016         | 2015         |
|--|--------------|--------------|
|  | KD'000       | KD'000       |
| Within one year  | 2,515        | 2,400        |
| After one year but not more than five years                            | 3,636        | 5,259        |
| Total operating lease expenditure contracted for at the reporting date | <b>6,151</b> | <b>7,659</b> |

**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.

|                                 | <b>Consumer banking</b> | <b>Corporate banking</b> | <b>Investment banking</b> | <b>Treasury</b> | <b>Group centre</b> | <b>Total</b>  |
|---------------------------------|-------------------------|--------------------------|---------------------------|-----------------|---------------------|---------------|
|                                 | <b>KD'000</b>           | <b>KD'000</b>            | <b>KD'000</b>             | <b>KD'000</b>   | <b>KD'000</b>       | <b>KD'000</b> |
| <b>2016</b>                     |                         |                          |                           |                 |                     |               |
| Net financing income/(loss)     | 52,101                  | 28,970                   | (2,025)                   | 4,254           | 5,231               | 88,531        |
| Share of results of associates  | -                       | -                        | (1,691)                   | -               | -                   | (1,691)       |
| Operating income/(loss)         | 55,287                  | 36,239                   | 3,884                     | 6,457           | 1,436               | 103,303       |
| Depreciation                    | (2,121)                 | (65)                     | (65)                      | (16)            | (983)               | (3,250)       |
| Net profit/ (loss) for the year | 30,076                  | 31,376                   | (10,044)                  | 6,057           | (16,164)            | 41,301        |
| Total assets                    | 1,173,513               | 1,565,260                | 172,836                   | 592,655         | (22,457)            | 3,481,807     |
| Total liabilities               | 1,192,754               | 276,269                  | 24,474                    | 1,560,582       | 4,575               | 3,058,654     |
|                                 | <b>Consumer banking</b> | <b>Corporate banking</b> | <b>Investment banking</b> | <b>Treasury</b> | <b>Group centre</b> | <b>Total</b>  |
|                                 | <b>KD'000</b>           | <b>KD'000</b>            | <b>KD'000</b>             | <b>KD'000</b>   | <b>KD'000</b>       | <b>KD'000</b> |
| <b>2015</b>                     |                         |                          |                           |                 |                     |               |
| Net financing income/(loss)     | 47,293                  | 27,758                   | (1,837)                   | 4,625           | 1,503               | 79,342        |
| Share of results of associates  | -                       | -                        | 313                       | -               | -                   | 313           |
| Operating income/(loss)         | 49,339                  | 34,490                   | 2,392                     | 6,277           | (1,145)             | 91,353        |
| Depreciation                    | (1,571)                 | (50)                     | (79)                      | (10)            | (926)               | (2,636)       |
| Net profit/(loss) for the year  | 27,232                  | 27,357                   | (5,803)                   | 5,876           | (19,477)            | 35,185        |
| Total assets                    | 1,004,871               | 1,381,277                | 175,623                   | 597,377         | (26,263)            | 3,132,885     |
| Total liabilities               | 1,034,387               | 258,201                  | 20,009                    | 1,497,611       | 1,878               | 2,812,086     |

**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.

|   | <b>Middle East &amp; North Africa</b> | <b>North America</b> | <b>Europe</b> | <b>Asia</b>   | <b>Total</b>  |
|---|---------------------------------------|----------------------|---------------|---------------|---------------|
|   | <b>KD'000</b>                         | <b>KD'000</b>        | <b>KD'000</b> | <b>KD'000</b> | <b>KD'000</b> |
| <b>2016</b>   |                                       |                      |               |               |               |
| Assets  | 3,309,100                             | 5,020                | 77,414        | 90,273        | 3,481,807     |
| Non-current assets<br>(excluding financial instruments) | 68,047                                | -                    | 33,748        | 24,847        | 126,642       |
| Liabilities and equity                                  | 3,478,500                             | -                    | 3,307         | -             | 3,481,807     |
| Segment income/(expenses)                               | 103,144                               | -                    | (768)         | 927           | 103,303       |
|   | <b>Middle East &amp; North Africa</b> | <b>North America</b> | <b>Europe</b> | <b>Asia</b>   | <b>Total</b>  |
|   | <b>KD'000</b>                         | <b>KD'000</b>        | <b>KD'000</b> | <b>KD'000</b> | <b>KD'000</b> |
| <b>2015</b>   |                                       |                      |               |               |               |
| Assets  | 2,897,131                             | 3,102                | 142,559       | 90,093        | 3,132,885     |
| Non-current assets<br>(excluding financial instruments) | 60,815                                | -                    | 40,670        | 34,576        | 136,061       |
| Liabilities and equity                                  | 3,131,880                             | -                    | 1,005         | -             | 3,132,885     |
| Segment income/(expenses)                               | 91,678                                | 40                   | (1,032)       | 667           | 91,353        |

**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 changes in foreign exchange and equity risks. 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**

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 creditworthiness. 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.

**30.2.1 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:

|  | 2016                     |                        | 2015                     |                        |
|--|--------------------------|------------------------|--------------------------|------------------------|
|  | Gross exposure<br>KD'000 | Net exposure<br>KD'000 | Gross exposure<br>KD'000 | Net exposure<br>KD'000 |
| Islamic financing to customers                 | 2,516,760                | 1,620,289              | 2,171,794                | 1,375,208              |
| Contingent liabilities and capital commitments | 286,819                  | 250,358                | 238,212                  | 204,459                |

**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)****30.2.2 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 2016 are **23.98%** (2015: 19.6%).

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:

|   | <b>Middle East<br/>&amp; North<br/>Africa</b> | <b>North<br/>America</b> | <b>Europe</b> | <b>Asia</b>   | <b>Total</b>     |
|---|---|--------------------------|---------------|---------------|------------------|
|   | <b>KD'000</b>                                 | <b>KD'000</b>            | <b>KD'000</b> | <b>KD'000</b> | <b>KD'000</b>    |
| <b>2016</b>   |   |                          |               |               |                  |
| Balances with banks                                     | 3,356   | 5,020                    | 1,174         | 148           | 9,698            |
| Deposits with Central Bank of Kuwait                    | 292,742                                       | -                        | -             | -             | 292,742          |
| Deposits with other banks                               | 313,419                                       | -                        | 15,533        | -             | 328,952          |
| Islamic financing to customers                          | 2,513,621                                     | -                        | 2,619         | 520           | 2,516,760        |
| Available for sale investments (Sukuk)                  | 52,196  | -                        | 4,350         | 64,758        | 121,304          |
| Other assets (excluding accrued income and prepayments) | 7,355   | -                        | -             | -             | 7,355            |
|   | <b>3,182,689</b>                              | <b>5,020</b>             | <b>23,676</b> | <b>65,426</b> | <b>3,276,811</b> |
| Contingent liabilities                                  | 248,756                                       | -                        | 2,069         | 8,025         | 258,850          |
| Commitments   | 27,969  | -                        | -             | -             | 27,969           |
| Total credit risk exposure                              | <b>3,459,414</b>                              | <b>5,020</b>             | <b>25,745</b> | <b>73,451</b> | <b>3,563,630</b> |
|   |   |                          |               |               |                  |
|   | <b>Middle East &amp;<br/>North Africa</b>     | <b>North<br/>America</b> | <b>Europe</b> | <b>Asia</b>   | <b>Total</b>     |
|   | <b>KD'000</b>                                 | <b>KD'000</b>            | <b>KD'000</b> | <b>KD'000</b> | <b>KD'000</b>    |
| <b>2015</b>   |   |                          |               |               |                  |
| Balances with banks                                     | 3,654   | 2,543                    | 3,031         | 183           | 9,411            |
| Deposits with Central Bank of Kuwait                    | 133,128                                       | -                        | -             | -             | 133,128          |
| Deposits with other banks                               | 444,935                                       | -                        | 70,263        | -             | 515,198          |
| Islamic financing to customers                          | 2,167,458                                     | -                        | 3,351         | 985           | 2,171,794        |
| Available for sale investments (Sukuk)                  | 42,897  | -                        | 8,089         | 45,819        | 96,805           |
| Other assets (excluding accrued income and prepayments) | 7,746   | -                        | -             | -             | 7,746            |
|   | <b>2,799,818</b>                              | <b>2,543</b>             | <b>84,734</b> | <b>46,987</b> | <b>2,934,082</b> |
| Contingent liabilities                                  | 226,094                                       | -                        | 281           | 8,025         | 234,400          |
| Commitments   | 3,812   | -                        | -             | -             | 3,812            |
| Total credit risk exposure                              | <b>3,029,724</b>                              | <b>2,543</b>             | <b>85,015</b> | <b>55,012</b> | <b>3,172,294</b> |

**30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)****30.2 Credit risk (continued)****30.2.2 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:

|  | <u>2016</u>      | <u>2015</u>      |
|--|------------------|------------------|
|  | KD'000           | KD'000           |
| Trading                                  | 129,368          | 160,991          |
| Manufacturing                            | 100,194          | 83,672           |
| Banking and other financial institutions | 548,352          | 669,345          |
| Construction                             | 46,013           | 37,306           |
| Real Estate                              | 697,203          | 648,343          |
| Retail                                   | 1,116,265        | 967,672          |
| Government                               | 328,465          | 165,776          |
| Others                                   | 310,951          | 200,977          |
|  | <u>3,276,811</u> | <u>2,934,082</u> |

**30.2.3 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<br>impaired |                | Past due or<br>impaired | Total            |
|--|----------------------------------|----------------|-------------------------|------------------|
|  | High                             | Standard       |                         |                  |
|  | KD'000                           | KD'000         | KD'000                  | KD'000           |
| <b>2016</b>  |                                  |                |                         |                  |
| Balances with banks                                    | 9,698                            | -              | -                       | 9,698            |
| Deposits with Central Bank of Kuwait                   | 292,742                          | -              | -                       | 292,742          |
| Deposits with other banks                              | 328,952                          | -              | -                       | 328,952          |
| Islamic financing to customers                         | 2,379,997                        | 127,321        | 65,036                  | 2,572,354        |
| Available for sale investments (Sukuk)                 | 121,304                          | -              | -                       | 121,304          |
| Other assets (excluding accrued income and prepayment) | 7,355                            | -              | -                       | 7,355            |
|  | <u>3,140,048</u>                 | <u>127,321</u> | <u>65,036</u>           | <u>3,332,405</u> |
|  |                                  |                |                         |                  |
|  | Neither past due nor<br>impaired |                | Past due or<br>impaired | Total            |
|  | High                             | Standard       |                         |                  |
|  | KD'000                           | KD'000         | KD'000                  | KD'000           |
| <b>2015</b>  |                                  |                |                         |                  |
| Balances with banks                                    | 9,411                            | -              | -                       | 9,411            |
| Deposits with Central Bank of Kuwait                   | 133,128                          | -              | -                       | 133,128          |
| Deposits with other banks                              | 515,198                          | -              | -                       | 515,198          |
| Islamic financing to customers                         | 2,004,175                        | 123,651        | 93,118                  | 2,220,944        |
| Available for sale investments (Sukuk)                 | 96,805                           | -              | -                       | 96,805           |
| Other assets (excluding accrued income and prepayment) | 7,746                            | -              | -                       | 7,746            |
|  | <u>2,766,463</u>                 | <u>123,651</u> | <u>93,118</u>           | <u>2,983,232</u> |

**30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)****30.2 Credit risk (continued)****30.2.3 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                    | KD'000                | KD'000                    | KD'000                | KD'000                    | KD'000                |
| <b>2016</b>        |                           |                       |                           |                       |                           |                       |
| Up to 30 days      | 8,180                     | 2,793                 | 11,391                    | -                     | 19,571                    | 2,793                 |
| 31 – 60 days       | 4,916                     | -                     | 4,066                     | -                     | 8,982                     | -                     |
| 61 – 90 days       | 13,371                    | -                     | 2,012                     | -                     | 15,383                    | -                     |
| 91 – 180 days      | -                         | 424                   | -                         | 2,698                 | -                         | 3,122                 |
| More than 180 days | -                         | 11,005                | -                         | 4,180                 | -                         | 15,185                |
|                    | <b>26,467</b>             | <b>14,222</b>         | <b>17,469</b>             | <b>6,878</b>          | <b>43,936</b>             | <b>21,100</b>         |
|                    |                           |                       |                           |                       |                           |                       |
|                    | 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                    | KD'000                | KD'000                    | KD'000                | KD'000                    | KD'000                |
| <b>2015</b>        |                           |                       |                           |                       |                           |                       |
| Up to 30 days      | 40,254                    | 2,688                 | 10,936                    | -                     | 51,190                    | 2,688                 |
| 31 – 60 days       | 6,072                     | -                     | 3,953                     | -                     | 10,025                    | -                     |
| 61 – 90 days       | 10,597                    | -                     | 1,783                     | -                     | 12,380                    | -                     |
| 91 – 180 days      | -                         | 498                   | -                         | 3,111                 | -                         | 3,609                 |
| More than 180 days | -                         | 11,628                | -                         | 1,598                 | -                         | 13,226                |
|                    | <b>56,923</b>             | <b>14,814</b>         | <b>16,672</b>             | <b>4,709</b>          | <b>73,595</b>             | <b>19,523</b>         |

At 31 December 2016 management estimates the fair value of collaterals held against individually past due or impaired Islamic finance facilities to **KD 5,109 thousand** (31 December 2015: KD 7,171 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 equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of prices such as foreign exchange rates and equity prices.

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.

**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)****30.3 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.

|                   |    | 2016             |                  | 2015             |                  |
|-------------------|----|------------------|------------------|------------------|------------------|
|                   |    | Effect on profit | Effect on equity | Effect on profit | Effect on equity |
|                   |    | KD'000           | KD'000           | KD'000           | KD'000           |
| US Dollar         | +5 | 81               | -                | 131              | -                |
| Sterling Pound    | +5 | 3                | -                | 4                | -                |
| Euro              | +5 | 4                | -                | 5                | -                |
| Indonesian Rupiah | +5 | -                | 1,242            | -                | 1,729            |
| Sudanese Pound    | +5 | 54               | 229              | 58               | 258              |
| Japanese Yen      | +5 | 1                | -                | 8                | -                |
| Others            | +5 | (7)              | -                | 7                | -                |

A 5 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 available for sale, a five percent increase in stock prices as at 31 December 2016 would have increased equity by **KD 48 thousand** (31 December 2015: an increase of KD 67 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.

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**30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)****30.4 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.

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<br>months | 3 to 6<br>months | 6 to 12<br>Months | Over<br>1 year   | Total            |
|---|-----------------------|------------------|-------------------|------------------|------------------|
|   | KD'000                | KD'000           | KD'000            | KD'000           | KD'000           |
| <b>2016</b>   |                       |                  |                   |                  |                  |
| <b>Assets</b>   |                       |                  |                   |                  |                  |
| Cash and balances with banks                          | 36,911                | -                | -                 | -                | 36,911           |
| Deposits with Central Bank of Kuwait                  | 55,318                | 119,153          | 70,803            | 47,468           | 292,742          |
| Deposits with Banks                                   | 328,952               | -                | -                 | -                | 328,952          |
| Islamic financing to customers                        | 994,119               | 140,788          | 123,602           | 1,258,251        | 2,516,760        |
| Financial assets at fair value through profit or loss | -                     | -                | -                 | 19,495           | 19,495           |
| Available for sale investments                        | 116,425               | -                | -                 | 43,880           | 160,305          |
| Investments in associates                             | -                     | -                | -                 | 62,204           | 62,204           |
| Investment properties                                 | -                     | -                | -                 | 24,680           | 24,680           |
| Other assets  | 7,355                 | -                | 6,588             | -                | 13,943           |
| Property and equipment                                | -                     | -                | -                 | 25,815           | 25,815           |
| <b>Total assets</b>                                   | <b>1,539,080</b>      | <b>259,941</b>   | <b>200,993</b>    | <b>1,481,793</b> | <b>3,481,807</b> |
| <b>Liabilities and Equity</b>                         |                       |                  |                   |                  |                  |
| Due to banks  | 61,076                | 15,202           | -                 | -                | 76,278           |
| Depositors' accounts                                  | 1,769,894             | 281,477          | 638,353           | 255,352          | 2,945,076        |
| Other liabilities                                     | 7,655                 | -                | 17,372            | 12,273           | 37,300           |
| Equity  | -                     | -                | -                 | 423,153          | 423,153          |
| <b>Total liabilities and equity</b>                   | <b>1,838,625</b>      | <b>296,679</b>   | <b>655,725</b>    | <b>690,778</b>   | <b>3,481,807</b> |
| <b>2015</b>   |                       |                  |                   |                  |                  |
| <b>Assets</b>   |                       |                  |                   |                  |                  |
| Cash and balances with banks                          | 35,009                | -                | -                 | -                | 35,009           |
| Deposits with Central Bank of Kuwait                  | 35,253                | 40,236           | 57,639            | -                | 133,128          |
| Deposits with Banks                                   | 475,733               | 28,842           | 10,623            | -                | 515,198          |
| Islamic financing to customers                        | 703,406               | 222,738          | 164,901           | 1,080,749        | 2,171,794        |
| Financial assets at fair value through profit or loss | -                     | -                | -                 | 15,388           | 15,388           |
| Available for sale investments                        | 91,336                | -                | -                 | 34,971           | 126,307          |
| Investments in associates                             | -                     | -                | -                 | 79,713           | 79,713           |
| Investment properties                                 | -                     | -                | -                 | 23,397           | 23,397           |
| Other assets  | 7,746                 | -                | 6,423             | -                | 14,169           |
| Property and equipment                                | -                     | -                | -                 | 18,782           | 18,782           |
| <b>Total assets</b>                                   | <b>1,348,483</b>      | <b>291,816</b>   | <b>239,586</b>    | <b>1,253,000</b> | <b>3,132,885</b> |
| <b>Liabilities and Equity</b>                         |                       |                  |                   |                  |                  |
| Due to banks  | 382,749               | -                | -                 | -                | 382,749          |
| Depositors' accounts                                  | 1,371,830             | 504,917          | 506,468           | 15,720           | 2,398,935        |
| Other liabilities                                     | 6,179                 | -                | 13,741            | 10,482           | 30,402           |
| Equity  | -                     | -                | -                 | 320,799          | 320,799          |
| <b>Total liabilities and equity</b>                   | <b>1,760,758</b>      | <b>504,917</b>   | <b>520,209</b>    | <b>347,001</b>   | <b>3,132,885</b> |

**30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)****30.4 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<br>months | 3 to 6<br>months | 6 to 12<br>months | Over 1<br>year | Total            |
|---|-----------------------|------------------|-------------------|----------------|------------------|
|   | KD'000                | KD'000           | KD'000            | KD'000         | KD'000           |
| <b>2016</b>   |                       |                  |                   |                |                  |
| <b>Financial liabilities</b>                          |                       |                  |                   |                |                  |
| Due to banks  | 61,116                | 15,285           | -                 | -              | 76,401           |
| Depositors' accounts                                  | 1,778,675             | 281,646          | 647,375           | 268,654        | 2,976,350        |
|   | <u>1,839,791</u>      | <u>296,931</u>   | <u>647,375</u>    | <u>268,654</u> | <u>3,052,751</u> |
| <b>Contingent liabilities and capital commitments</b> |                       |                  |                   |                |                  |
| Contingent liabilities                                | 77,011                | 32,620           | 71,413            | 77,806         | 258,850          |
| Capital commitments                                   | -                     | -                | 27,969            | -              | 27,969           |
|   | <u>77,011</u>         | <u>32,620</u>    | <u>99,382</u>     | <u>77,806</u>  | <u>286,819</u>   |
| <b>2015</b>   |                       |                  |                   |                |                  |
| <b>Financial liabilities</b>                          |                       |                  |                   |                |                  |
| Due to banks  | 383,356               | -                | -                 | -              | 383,356          |
| Depositors' accounts                                  | 1,375,582             | 506,007          | 510,276           | 15,770         | 2,407,635        |
|   | <u>1,758,938</u>      | <u>506,007</u>   | <u>510,276</u>    | <u>15,770</u>  | <u>2,790,991</u> |
| <b>Contingent liabilities and capital commitments</b> |                       |                  |                   |                |                  |
| Contingent liabilities                                | 68,138                | 36,352           | 51,051            | 78,859         | 234,400          |
| Capital commitments                                   | -                     | -                | 3,812             | -              | 3,812            |
|   | <u>68,138</u>         | <u>36,352</u>    | <u>54,863</u>     | <u>78,859</u>  | <u>238,212</u>   |

**30.5 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.

**30.6 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 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).

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

## 30.6 Fair value of financial instruments (continued)

| Financial assets   | Fair value as at |        | Fair value Hierarchy 2016 | Sector                 |
|--|------------------|--------|---------------------------|------------------------|
|  | 2016             | 2015   |                           |                        |
| Financial assets at fair value through profit or loss - <i>Unquoted securities</i> | <b>2,987</b>     | 2,560  | Level 3                   | Real Estate            |
| Financial assets at fair value through profit or loss - <i>Unquoted funds</i>      | <b>16,508</b>    | 12,828 | Level 2                   | Financial Institutions |
| Available for sale investments – <i>Sukuk</i>                                      | <b>35,723</b>    | 32,183 | Level 1                   | Government             |
|  | <b>85,581</b>    | 64,622 | Level 1                   | Financial Institutions |
| Available for sale investments - <i>Unquoted funds</i>                             | <b>5,365</b>     | 7,609  | Level 2                   | Financial Institutions |
|  | <b>8,133</b>     | 6,244  | Level 2                   | Real Estate            |
|  | <b>14,455</b>    | 4,162  | Level 2                   | Services               |
| Available for sale investments - <i>Unquoted securities</i>                        | <b>1,743</b>     | 1,712  | Level 3                   | Financial Institutions |
|  | <b>1,738</b>     | 1,836  | Level 3                   | Real Estate            |
|  | <b>6,616</b>     | 6,605  | Level 3                   | Services               |
| Available for sale investments - <i>Quoted securities</i>                          | <b>657</b>       | 886    | Level 1                   | Real Estate            |
|  | <b>294</b>       | 448    | Level 1                   | Financial Institutions |

**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).

| 2016  | Level 1        | Level 2       | Level 3       | Total          |
|---|----------------|---------------|---------------|----------------|
|   | KD'000         | KD'000        | KD'000        | KD'000         |
| Financial assets at fair value through profit or loss | -              | <b>16,508</b> | <b>2,987</b>  | <b>19,495</b>  |
| Available for sale investments                        | <b>122,255</b> | <b>27,953</b> | <b>10,097</b> | <b>160,305</b> |
|   | <b>122,255</b> | <b>44,461</b> | <b>13,084</b> | <b>179,800</b> |
|   | Level 1        | Level 2       | Level 3       | Total          |
| 2015  | KD'000         | KD'000        | KD'000        | KD'000         |
| Financial assets at fair value through profit or loss | -              | 12,828        | 2,560         | 15,388         |
| Available for sale investments                        | 98,139         | 18,015        | 10,153        | 126,307        |
|   | 98,139         | 30,843        | 12,713        | 141,695        |

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

## 30.6 Fair value of financial instruments (continued)

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

|   | At 1<br>January<br>2016 | Change in<br>fair value | Impairment     | Additions    | Sale/<br>redemption | Exchange<br>rate<br>movements | At 31<br>December<br>2016 |
|---|-------------------------|-------------------------|----------------|--------------|---------------------|-------------------------------|---------------------------|
|   | KD 000's                | KD 000's                | KD 000's       | KD 000's     | KD 000's            | KD 000's                      | KD 000's                  |
| Financial assets at fair value through profit or loss |                         |                         |                |              |                     |                               |                           |
| Unquoted securities                                   | 2,560                   | 427                     | -              | -            | -                   | -                             | 2,987                     |
| Available for sale investments                        |                         |                         |                |              |                     |                               |                           |
| Unquoted securities                                   | 10,153                  | 421                     | -              | 1,595        | (2,090)             | 18                            | 10,097                    |
|   | <b>12,713</b>           | <b>848</b>              | <b>-</b>       | <b>1,595</b> | <b>(2,090)</b>      | <b>18</b>                     | <b>13,084</b>             |
|   |                         |                         |                |              |                     |                               |                           |
|   | At 1 January<br>2015    | Change in<br>fair value | Impairment     | Additions    | Sale/<br>redemption | Exchange<br>rate<br>movements | At 31<br>December<br>2015 |
|   | KD 000's                | KD 000's                | KD 000's       | KD 000's     | KD 000's            | KD 000's                      | KD 000's                  |
| Financial assets at fair value through profit or loss |                         |                         |                |              |                     |                               |                           |
| Unquoted securities                                   | 2,995                   | (435)                   | -              | -            | -                   | -                             | 2,560                     |
| Available for sale investments                        |                         |                         |                |              |                     |                               |                           |
| Unquoted securities                                   | 11,906                  | 397                     | (1,098)        | 336          | (1,495)             | 107                           | 10,153                    |
|   | <b>14,901</b>           | <b>(38)</b>             | <b>(1,098)</b> | <b>336</b>   | <b>(1,495)</b>      | <b>107</b>                    | <b>12,713</b>             |

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 2016 are as shown below:

|   | Valuation<br>technique | Significant<br>unobservable<br>inputs | Range<br>(weighted<br>average) | Sensitivity of the input to fair value   |
|---|------------------------|---------------------------------------|--------------------------------|--|
| Financial assets at fair value through profit or loss – unquoted securities | Market approach        | Discount for lack of liquidity        | 5%-10%                         | An increase (decrease) in the Discount rate by 1% would result in an increase (decrease) in fair value by <b>KD 30 thousand</b> .  |
| Available for sale investments – unquoted securities                        | Market approach        | Discount for lack of liquidity        | 5%-10%                         | An increase (decrease) in the Discount rate by 1% would result in an increase (decrease) in fair value by <b>KD 101 thousand</b> . |

The discount for lack of marketability represents the amounts that the Group has determined that market participants would take into account when pricing the investments.

In the case of available for sale investments, the impairment charge in the profit or loss would depend on whether the decline is significant or prolonged. In case of equity securities classified as available for sale, an increase in the fair value would only impact equity (through other comprehensive income) and, would not have an effect on profit or loss.

**30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)****30.6 Fair value of financial instruments (continued)**

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.

Sensitivity analysis on fair value estimations, by varying input assumptions by a reasonable margin, did not indicate any material impacts on consolidated statement of financial position or consolidated statement of profit or loss.

**30.7 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 2016 and 31 December 2015 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:

|   | <u>2016</u>      | <u>2015</u>      |
|---|------------------|------------------|
|   | <u>KD'000</u>    | <u>KD'000</u>    |
| Risk weighted assets                        | <u>1,875,775</u> | <u>1,631,425</u> |
| Capital required                            | <u>253,230</u>   | <u>203,928</u>   |
| Capital available                           |                  |                  |
| Common Equity Tier 1 Capital                | <u>304,023</u>   | 259,364          |
| Additional Tier 1 Capital                   | <u>75,725</u>    | 230              |
| Tier 1 Capital                              | <u>379,748</u>   | 259,594          |
| Tier 2 capital                              | <u>20,750</u>    | 18,332           |
| Total capital                               | <u>400,498</u>   | <u>277,926</u>   |
| Common Equity Tier 1 capital adequacy ratio | <u>16.21%</u>    | 15.90%           |
| Tier 1 capital adequacy ratio               | <u>20.24%</u>    | 15.91%           |
| Total capital adequacy ratio                | <u>21.35%</u>    | 17.04%           |

The Group's financial leverage ratio for the year ended 31 December 2016 is calculated in accordance with Central Bank of Kuwait circular number 2/RBA/ 343/2014 dated 21 October 2014 and is shown below:

|                          | <u>2016</u>      | <u>2015</u>      |
|--------------------------|------------------|------------------|
|                          | <u>KD'000</u>    | <u>KD'000</u>    |
| Tier 1 capital           | <u>379,748</u>   | 259,594          |
| Total exposures          | <u>3,675,971</u> | <u>3,286,647</u> |
| Financial leverage ratio | <u>10.33%</u>    | 7.90%            |

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 2016 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 to mitigate foreign currency 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.

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 positive fair value of forward foreign exchange contracts outstanding as of 31 December 2016 is **KD 6 thousand** (2015: KD 1 thousand) and their notional amounts outstanding as of 31 December 2016 are **KD 243 thousand** (2015: KD 1,345 thousand)

The Group's derivative trading activities mainly related to deals with customers, which are normally matched by entering into reciprocal spot deals with counterparties.

**32. FIDUCIARY ASSETS**

The aggregate value of assets held in a trust or fiduciary capacity by the Group amounted to **KD 127,203 thousand** (31 December 2015: KD 95,496 thousand) and the related income from these assets amounted to **KD 420 thousand** (31 December 2015: KD 355 thousand).

**33. PERPETUAL TIER 1 SUKUK**

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