

United Gulf Bank B.S.C. (c)
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2018

United Gulf Bank B.S.C. (c)
REPORT OF THE BOARD OF DIRECTORS

The Board of Directors is pleased to submit its report and the audited consolidated financial statements of United Gulf Bank B.S.C. (c) ("the Bank" or "UGB") for the year ended 31 December 2018.

Principal activities and review of business developments

The principal activities of the Bank and its subsidiaries (together the "Group") comprise of investment and commercial banking. Investment banking include asset portfolio management, corporate finance, advisory, investment in quoted and private equity / funds, real estate, capital markets, international banking and treasury functions. Commercial banking includes extending loans and other credit facilities, accepting deposits and current accounts from corporate and institutional customers.

Acquisition of Global Investment House

During September 2018, the Group (through its subsidiary KAMCO) acquired 71.18% effective equity interest of Global Investment House K.S.C. (Closed) ("GIH"), a Kuwaiti Shareholding Company, regulated by CMA as an investment company and CBK for financing activities. GIH is principally engaged in provision of asset management, investment banking and brokerage activities. The Group was able to control the investee and therefore, the entity became a subsidiary of the Group. Accordingly, GIH has been consolidated from 1 September 2018 being the date of exercise of control.

The Group carried out a Purchase Price Allocation exercise which resulted in a gain from business combination of US\$ 23.9 million, since the fair value of the assets acquired and liabilities assumed exceeded the purchase consideration paid and related transaction expenses.

Results for the year

For the year ended 31 December 2018, the Bank earned a net profit of US\$ 10.1 million (2017: net profit before reclassification adjustments of US\$ 8.4 million) and total operating income of US\$ 78.9 million (2017: US\$ 50.3 million). Reclassification adjustments for the year ended 31 December 2017 included foreign currency losses of US\$ 27.9 million and fair value losses of US\$ 59.8 million that were reclassified to the consolidated statement of income as part of the Group's restructuring.

As of 31 December 2018, total assets of the Group were US\$ 873.5 million (2017: US\$ 680.1 million) with total equity of shareholders at US\$ 187.0 million (2017: US\$ 203.0 million).

Appropriations for the year

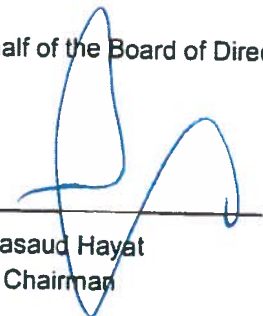
The Board of Directors' recommendation on the allocation of the net profit for the year is as follows:

- Transfer of US\$ 1,009 thousand equivalent to 10% of the Company's net profit for the period to the Company's Statutory Reserves;
- Transfer of US\$ 1,009 thousand equivalent to 10% of the Company's net profit for the period to the Company's General Reserves; and
- Retaining the remaining balance of net profit for the period as Retained Earnings for next year.

Auditors

Ernst & Young have expressed their willingness to continue in office and a resolution for their appointment as auditors of the Bank for the year ending 31 December 2019 has been put for approval by the Shareholders.

Signed on behalf of the Board of Directors



Masaud Hayat
Chairman



INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF UNITED GULF BANK B.S.C. (c)

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the accompanying consolidated financial statements of United Gulf Bank B.S.C. (c) ("the Bank") and its subsidiaries (together "the Group"), which comprise the consolidated statement of financial position as at 31 December 2018, and the consolidated statements of income and comprehensive income, cash flows and changes in equity for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2018 and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the 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.

Other information included in the Group's 2018 annual report

Other information consists of the information included in the Group's 2018 Annual Report, other than the consolidated financial statements and our auditor's report thereon. The Board of Directors is responsible for the other information. Prior to the date of this auditors' report, we obtained the Report of the Board of Directors which forms part of the annual report, and the remaining sections of the annual report are expected to be made available to us after that date.

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

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available 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 obtained prior to the date of the 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 UNITED GULF BANK B.S.C. (c) (continued)

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

Responsibilities of the Board of Directors for the consolidated financial statements

The Board of Directors is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs and for such internal control as the Board of Directors 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, the Board of Directors 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 the Board of Directors either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

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

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF UNITED GULF BANK B.S.C. (c) (continued)

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

Auditor's responsibilities for the audit of the consolidated financial statements (continued)

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.
- Conclude on the appropriateness of the Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the 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 the audit committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on Other Legal and Regulatory Requirements

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

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the Report of the Board of Directors is consistent with the consolidated financial statements;

**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF
UNITED GULF BANK B.S.C. (c) (continued)**

Report on Other Legal and Regulatory Requirements (continued)

- c) We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2018 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position; and
- d) satisfactory explanations and information have been provided to us by Management in response to all our requests.



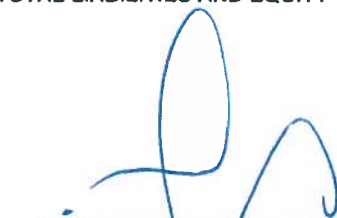
Partner's registration no. 115
27 February 2019
Manama, Kingdom of Bahrain

United Gulf Bank B.S.C. (c)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2018

	Note	2018 US\$ 000	2017 US\$ 000
ASSETS			
Demand and call deposits with banks		143,510	97,993
Placements with banks		108,529	68,577
Investments carried at fair value through statement of income	7	81,852	19,268
Non-trading investments	8	167,647	221,566
Held-to-maturity investments		494	-
Loans and receivables	9	25,191	4,216
Other assets	10	61,097	31,820
Investments in associates	11	71,513	77,512
Investment properties	12	107,629	105,093
Property and equipment	13	39,394	1,679
Goodwill and other intangible assets	14	66,634	52,390
TOTAL ASSETS		873,490	680,114
LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks and other financial institutions		220,879	250,211
Deposits from customers		32,608	31,018
Loans payable	16	67,033	98,658
Long term bonds	17	131,739	-
Other liabilities	18	106,375	37,358
TOTAL LIABILITIES		558,634	417,245
EQUITY			
Share capital	19	101,132	101,132
Share premium	19	5,687	5,687
Statutory reserve	19	50,890	49,881
General reserve	19	30,621	29,612
Fair value reserve	20	(10,121)	12,867
Foreign currency translation reserve	19	(4,534)	(3,871)
Retained earnings		13,318	7,659
CAPITAL AND RESERVES ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		186,993	202,967
Perpetual Tier 1 capital	21	33,000	33,000
Non-controlling interests in equity		94,863	26,902
TOTAL EQUITY		314,856	262,869
TOTAL LIABILITIES AND EQUITY		873,490	680,114


Masaud Hayat
Chairman


Faisal Al Ayyar
Vice Chairman


Hussain Lalani
Acting Chief Executive Officer

The attached notes 1 to 33 form part of these consolidated financial statements.

United Gulf Bank B.S.C. (c)

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2018

	Note	2018 US\$ 000	2017 US\$ 000
Continuing operations			
Interest income	22	6,363	4,431
Investment income - net	23	4,812	23,810
Gain on bargain purchase of a subsidiary	5	23,928	-
		<u>35,103</u>	<u>28,241</u>
Fees and commissions - net	24	42,965	25,391
Foreign currency gains (losses) - net		1,621	(409)
Share of results of associates - net	11,25	(764)	(2,922)
		<u>78,925</u>	<u>50,301</u>
Total income			
Interest expense	26	(14,732)	(15,232)
		<u>64,193</u>	<u>35,069</u>
Operating income before expenses and provisions			
Salaries and benefits		(30,310)	(15,862)
General and administrative expenses		(20,277)	(9,730)
		<u>13,606</u>	<u>9,477</u>
Operating income before provisions and tax			
Impairment loss on investments		-	(462)
Provision for losses against unfunded participation		(805)	-
Expected credit losses / provision	4	(2,306)	(2,895)
Taxation - net	15	95	(1,018)
		<u>10,590</u>	<u>5,102</u>
Net profit for the year from continuing operations			
Net profit from discontinued operations		524	3,268
		<u>11,114</u>	<u>8,370</u>
Net profit before reclassification adjustments			
Reclassification adjustments	19 (g)	-	(87,765)
		<u>11,114</u>	<u>(79,395)</u>
Profit (loss) for the year			
Net profit attributable to non-controlling interests		<u>1,021</u>	<u>455</u>
NET PROFIT (LOSS) ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT		<u><u>10,093</u></u>	<u><u>(79,850)</u></u>

Masaud Hayat
Chairman

Faisal Al Ayyar
Vice Chairman

Hussain Lalani
Acting Chief Executive Officer

The attached notes 1 to 33 form part of these consolidated financial statements.

United Gulf Bank B.S.C. (c)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2018

	2018 US\$ 000	2017 US\$ 000
Profit (loss) for the year	11,114	(79,395)
Other comprehensive income:		
Reclassification adjustments	-	87,765
	11,114	8,370
Other comprehensive (loss) income that may be reclassified to profit or loss in subsequent period		
Fair value reserve	(13,283)	4,950
Foreign currency translation reserve	(1,093)	6,029
Transfer to consolidated statement of income upon disposal	-	(1,880)
Cash flow hedges	180	256
	(14,196)	9,355
Other comprehensive loss that will not be reclassified to profit or loss in subsequent period		
Fair value reserve	(10,753)	-
Other comprehensive (loss) income for the year	(24,949)	97,120
TOTAL COMPREHENSIVE (LOSS) INCOME	(13,835)	17,725
Total comprehensive (loss) income attributable to:		
- shareholders of the parent	(11,405)	16,588
- non-controlling interests	(2,430)	1,137
	(13,835)	17,725

The attached notes 1 to 33 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2018

	Note	2018 US\$ 000	2017 US\$ 000
OPERATING ACTIVITIES			
Net profit (loss) for the year		11,114	(79,395)
Reclassification adjustments	19 (g)	-	87,765
Net profit from discontinued operations		(524)	(3,268)
Net profit for the year from continuing operations		10,590	5,102
Adjustments for non-cash items:			
Depreciation and amortisation		2,105	797
Share of results of associates - net	25	764	2,922
Expected credit losses / provision	9	2,306	2,895
Provision for losses against unfunded participation		805	-
Impairment loss on investments	8,11	-	462
(Gain) loss on investments carried at fair value through statement of income	23	852	(3,902)
Gain on fair valuation of investment properties	23	(124)	(2,732)
Gain on sale of an associate	23	523	(2,668)
Gain on sale of non-trading investments	23	-	(4,369)
Gain due to reclassification of investment	23	(31)	(2,971)
Gain on bargain purchase of a subsidiary	23	(23,928)	-
Interest income	22	(6,363)	(23,810)
Interest expense	26	14,732	15,232
Dividend income	23	(1,669)	(1,907)
Other non-cash items	14	298	(719)
Taxation		(95)	1,018
Operating profit (loss) before changes in operating assets and liabilities		765	(14,650)
Changes in operating assets and liabilities:			
Placements with banks with original maturities of more than ninety days		-	6,845
Investments carried at fair value through statement of income		142	29,812
Non-trading investments		51,804	187,165
Loans and receivables		(3,472)	1,178,460
Other assets		7,281	74,289
Due to banks and other financial institutions		(29,332)	(476,011)
Deposits from customers		1,590	(954,192)
Other liabilities		(4,642)	(13,924)
Net assets of disposal group classified as held for sale		524	3,268
Interest received		6,415	28,687
Interest paid		(14,010)	(26,279)
Dividends received	23	1,669	1,907
Donations		(200)	(200)
Directors' remuneration		-	(195)
Net cash from operating activities		18,534	24,982
INVESTING ACTIVITIES			
Investment in subsidiaries - net of cash acquired	5	(23,568)	-
Investments in associates - net		5,137	681,837
Investment properties - net		(241)	(1,035)
Property and equipment - net		(1,793)	29,641
Net cash (used in) from investing activities		(20,465)	710,443
FINANCING ACTIVITIES			
Share capital issued (Restructuring)		-	(277,775)
Repayment of loans		(31,625)	(553,467)
Interest payment on Tier 1 capital securities		(3,513)	(3,513)
Long term bonds		131,739	(50,000)
Net cash from (used in) financing activities		96,601	(884,755)
Foreign currency translation adjustments		663	33,605
Movement in non-controlling interests		(8,631)	(75,090)
NET CHANGE IN CASH AND CASH EQUIVALENTS		86,702	(190,815)
Cash and cash equivalents at 1 January		166,252	357,067
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	27	252,954	166,252

The attached notes 1 to 33 form part of these consolidated financial statements.

United Gulf Bank B.S.C. (c)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2018

	Attributable to shareholders of the parent												
	Share capital US\$ 000	Treasury shares US\$ 000	Share premium US\$ 000	Statutory reserve US\$ 000	General reserve US\$ 000	Treasury share reserve US\$ 000		Fair value reserve US\$ 000	Foreign currency translation reserve US\$ 000		Total before non-controlling interests US\$ 000		
						reserve US\$ 000	share US\$ 000		reserve US\$ 000	earnings US\$ 000	Perpetual Tier 1 capital US\$ 000	Non-controlling interests US\$ 000	
Balance at 1 January 2018	101,132	-	5,687	49,881	29,612	-	-	12,867	(3,871)	7,659	202,967	26,902	262,869
Transition adjustment on adoption of IFRS 9 at 1 January 2018 (note 4)	-	-	-	-	-	-	-	3,037	-	(4,093)	(1,056)	-	(591)
Profit for the year	101,132	-	5,687	49,881	29,612	-	-	15,904	(3,871)	3,566	201,911	33,000	27,367
Other comprehensive loss	-	-	-	-	-	-	-	-	-	10,093	10,093	-	1,021
	-	-	-	-	-	-	-	(20,835)	(663)	-	(21,498)	-	(3,451)
Total comprehensive (loss) income for the year	-	-	-	-	-	-	-	(20,835)	(663)	10,093	(11,405)	-	(2,430)
Transfer upon disposal of non-trading investments	-	-	-	-	-	-	-	(5,190)	-	5,190	-	-	-
Interest payment on Tier 1 capital	-	-	-	-	-	-	-	-	-	(3,513)	(3,513)	-	-
Transfers during the year	-	-	-	1,009	1,009	-	-	-	-	(2,018)	-	-	-
Acquisition of a subsidiary (note 5)	-	-	-	-	-	-	-	-	-	-	-	-	78,557
Other movements in non-controlling interests	-	-	-	-	-	-	-	-	-	-	-	-	(8,631)
Balance at 31 December 2018	101,132	-	5,687	50,890	30,621	-	-	(10,121)	(4,534)	13,318	186,993	33,000	94,863
Balance at 1 January 2017	208,651	(18,131)	11,459	100,514	80,999	14,248	-	(49,966)	(37,476)	83,711	394,009	33,000	102,447
Net profit before reclassification adjustments	-	-	-	-	-	-	-	-	-	7,915	7,915	-	455
Reclassification adjustments (note 19 (g))	-	-	-	-	-	-	-	59,826	27,939	(87,765)	-	-	-
Other comprehensive income	-	-	-	-	-	-	-	3,007	5,666	-	8,673	-	682
Total comprehensive income (loss) for the year	-	-	-	-	-	-	-	62,833	33,605	(79,850)	16,588	-	1,137
Capital reduction	(107,519)	18,131	(5,772)	(50,633)	(36,387)	(14,248)	-	-	-	(7,689)	(204,117)	-	-
Transfers during the year	-	-	-	-	(15,000)	-	-	-	-	15,000	-	-	-
Interest payment on Tier 1 capital	-	-	-	-	-	-	-	-	-	(3,513)	(3,513)	-	-
Other movements in non-controlling interests	-	-	-	-	-	-	-	-	-	-	-	-	(76,682)
Balance at 31 December 2017	101,132	-	5,687	49,881	29,612	-	-	12,867	(3,871)	7,659	202,967	33,000	26,902
													262,869

The attached explanatory notes 1 to 33 form part of these consolidated financial statements

1 INCORPORATION AND PRINCIPAL ACTIVITIES

Incorporation

United Gulf Bank B.S.C. (c) ("UGB" or "the Bank") is a closed joint stock company incorporated in the Kingdom of Bahrain in 1980, under Commercial Registration number 10550. The address of the Bank's registered office is UGB Tower, Diplomatic Area, P.O. Box 5964, Manama, Kingdom of Bahrain.

The Bank operates in the Kingdom of Bahrain under a Wholesale Banking License issued by the Central Bank of Bahrain ("the CBB").

Activities

The principal activities of the Bank and its subsidiaries (together the "Group") comprise of investment and commercial banking. Investment banking include asset portfolio management, corporate finance, advisory, investment in quoted and private equity / funds, real estate, capital markets, international banking and treasury functions. Commercial banking includes extending loans and other credit facilities, accepting deposits and current accounts from corporate and institutional customers.

The Bank's parent company is United Gulf Holding Company B.S.C. ("UGHC") which owns 100% shares of the Bank and ultimate holding company is Kuwait Projects Company (Holding) K.S.C. ("KIPCO"). UGHC is incorporated in the Kingdom of Bahrain as a joint stock company and is listed on the Bahrain Bourse. KIPCO is incorporated in the State of Kuwait and is listed on the Kuwait Stock Exchange (Boursa Kuwait).

These consolidated financial statements were authorised for issue by the Board of Directors on 27 February 2019.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

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

Basis of preparation

The consolidated financial statements have been prepared under the historical cost convention as modified by the remeasurement at fair value of investments carried at fair value through statement of income, non-trading investments, investment properties and derivative financial instruments.

Certain of the prior year figures have been reclassified to conform to the presentation adopted in the current year. Such reclassification did not affect the previously reported net loss or the total equity of the Group.

Presentation and functional currency

The consolidated financial statements have been presented in United States Dollar (US\$) which is also the functional currency of the Group and are rounded to the nearest US\$ thousands except when otherwise indicated.

New and amended standards and interpretations

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in previous year, except for the adoption of the following new standards or amendments to existing standards applicable to the Group, and which are effective for annual periods beginning on or after 1 January 2018:

IFRS 9 Financial Instruments (IFRS 9)

IFRS 9 replaces *IAS 39 Financial instruments: recognition and measurement (IAS 39)* for annual periods on or after 1 January 2018 bringing together all three aspects of the accounting for financial instruments: classification and measurement; impairment; and hedge accounting.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

New and amended standards and interpretations (continued)

IFRS 9 Financial Instruments (IFRS 9) (continued)

The Group applied IFRS 9 prospectively, with an initial application date of 1 January 2018. The Group has not restated the comparative information, which continues to be reported under IAS 39. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings and other components of equity. The effect of adopting IFRS 9 as at 1 January 2018 is disclosed in note 4.

The nature of these adjustments are described below:

Classification and measurement of financial assets

Under IFRS 9, the classification and measurement category of all financial assets, except equity instruments and derivatives, is assessed based on a combination of the entity's business model for managing the financial assets and its contractual cash flow characteristics.

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

- Debt instruments at amortised cost;
- Debt instruments at fair value through other comprehensive income (FVOCI), with gains or losses recycled to profit or loss on derecognition;
- Equity instruments at FVOCI, with no recycling of gains or losses to profit or loss on derecognition; and
- Financial assets at fair value through profit or loss (FVTPL).

The above designation of equity investments at FVOCI (i.e. election to present subsequent changes in fair value of an equity investment that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies in other comprehensive income) and debt investment that meets the amortised cost or FVOCI criteria as FVTPL (only if doing so eliminates or significantly reduces an accounting mismatch), through an irrevocable election / designation at initial recognition of a financial asset.

The Group's classification of its financial assets is explained in detail in note 6. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in note 4.

Classification and measurement of financial liabilities

Classification of financial liabilities remained largely unchanged for the Group. Financial liabilities continue to be measured at amortised cost.

Impairment of financial assets

IFRS 9 impairment requirements are based on expected credit loss (ECL) model as compared to the incurred loss model approach under IAS 39. Key changes to the Group's accounting policy for impairment of financial assets are listed below:

Under IFRS 9, the Group applies a three-stage approach to measuring ECL on all loans and debt type financial assets (including loan commitments and financial guarantee contracts) accounted for at amortised cost and FVOCI. Assets migrate through the following three stages based on the change in the credit quality since initial recognition:

- i) Stage 1: 12 months ECL
For exposures where there has not been a significant increase in credit risk (SICR) since initial recognition and that are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.
- ii) Stage 2: Lifetime ECL - not credit impaired
For exposures where there has been a SICR since initial recognition but that are not credit impaired, a lifetime ECL is recognised.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

New and amended standards and interpretations (continued)

IFRS 9 Financial Instruments (IFRS 9) (continued)

iii) Stage 3: Lifetime ECL - credit impaired

Financial assets are assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred. As this uses the same criteria as under IAS 39, the Group's methodology for specific provisions remains unchanged. For financial assets that have become credit impaired, a lifetime ECL is recognised and interest income is suspended and recognised on cash receipt basis.

For more details on the accounting policies, refer section summary of changes in significant accounting policies. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in note 4.

IFRS 7(revised) Financial instruments: Disclosures (IFRS 7R)

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial instruments: Disclosures was updated and the Group has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in note 4.

Reconciliations from opening to closing ECL allowances are presented in note 4.

IFRS 7R also requires additional and more detailed disclosures for hedge accounting. However, the adoption of IFRS 9 for hedge accounting did not have a material impact on the hedging activities / accounting of the Group.

IFRS 15 Revenue from contracts with customers (IFRS 15)

The Group adopted IFRS 15 Revenue from contracts with customers (IFRS 15) resulting in a change in the revenue recognition policy of the Group in relation to its contracts with customers.

IFRS 15 was issued in May 2014 and is effective for annual periods commencing on or after 1 January 2018. IFRS 15 outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue guidance, which is found currently across several standards and interpretations within IFRS. It established a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The adoption of this standard will result into change in accounting policies as discussed below:

The Group has opted for the modified retrospective application permitted by IFRS 15 upon adoption of the new standard. Modified retrospective application also requires the recognition of the cumulative impact of adoption of IFRS 15 on all contracts as at 1 January 2018 in equity. There were no adjustments to opening retained earnings and other account balances on the adoption of IFRS 15.

Several other amendments to standards and interpretations applied for the first time in 2018, however, they did not impact the consolidated financial statements of the Group.

Principles of consolidation

The consolidated financial statements include the financial statements of the Bank and its subsidiaries as at 31 December 2018. The reporting dates of the subsidiaries and the Bank are identical and the subsidiaries' accounting policies conform to those used by the Bank for like transactions and events in similar circumstances.

Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Specifically, the Group controls an investee if and only if the Group has:

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

- 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 re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the statement of comprehensive income from the date the Group gains control until the date the Group ceases to control the subsidiary.

Profit or loss and each component of Other Comprehensive Income ("OCI") are attributed to the equity holders of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

- a) Derecognises the assets (including goodwill) and liabilities of the subsidiary;
- b) Derecognises the carrying amount of any non-controlling interest;
- c) Derecognises the cumulative transaction differences, recorded in equity;
- d) Recognises the fair value of consideration received;
- e) Recognises the fair value of any investment retained;
- f) Recognises any surplus or deficit in the consolidated statement of income; and
- g) Reclassifies the parent's share of a component previously recognised in OCI to consolidated statement of income or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities.

The principal subsidiaries of the Bank are as follows:

Name of the subsidiary	Country of incorporation	Ownership at 31 December		Year of incorporation
		2018	2017	
Held directly				
KAMCO Investment Company K.S.C.P. [KAMCO]	Kuwait	86%	86%	1998
United Gulf Financial Services Company-North Africa	Tunisia	83%	83%	2008
United Gulf Realty International, Ltd [UGRIL]	British Virgin Islands	100%	100%	2012
United Gulf Asset Company S.P.C.	Bahrain	100%	100%	2017

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

Name of the subsidiary	Country of incorporation	Ownership at		Year of incorporation
		31 December 2018	2017	
Held through KAMCO				
Al Dhiyafa United Real Estate Company W.L.L.	Kuwait	100%	100%	2007
Al Jazi Money Market Fund	Kuwait	51%	51%	2007
Al Tadamon United Holding Co	Kuwait	96%	96%	2017
Al Zad Real Estate W.L.L.	Kuwait	99%	99%	2007
Bukeye Power Project Advisory Co	U.S.A.	50%	50%	2017
Bukeye Power Project Manager Ltd	Jersey	100%	100%	2017
Carnation Advisory Company LLC	U.S.A.	75%	0%	2018
Carnation Manager limited	U.K.	100%	0%	2018
Flint Advisor Company Llc	Jersey	46%	46%	2017
Flint Manager Ltd	U.S.A.	100%	100%	2017
Global Investment House	Kuwait	71%	0%	1998
Kamco GCC Opportunistic Fund	Kuwait	100%	100%	2013
KAMCO Investment Company (DIFC) Limited	U.A.E.	100%	100%	2016
KAMCO Mena Plus Fixed Income Fund	Kuwait	38%	71%	2016
Kuwait Private Equity Opportunity Fund	Kuwait	73%	73%	2004
Nawasi United Holding Co	Kuwait	96%	96%	2017
North Africa Real Estate Co.	Kuwait	100%	100%	2014
S17P02V Holding Ltd	U.A.E.	100%	0%	2018

Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through the consolidated statement of income. It is then considered in the determination of goodwill.

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39 Financial Instruments: Recognition and Measurement, is measured at fair value with the changes in fair value recognised in the consolidated statement of income.

Goodwill and other Intangible assets**Goodwill**

Goodwill represents the excess of the cost of acquisition over the Group's share of the fair value of the net identifiable assets of the acquired subsidiary or associate at the date of the acquisition. Goodwill arising on the acquisition of an associate is included in the carrying amount of the respective associate and, therefore, is not separately tested for impairment. Goodwill arising on the acquisition of a subsidiary is recognised as a separate asset in the consolidated statement of financial position.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Goodwill and other Intangible assets (continued)

Goodwill (continued)

Goodwill acquired in a business combination is initially measured at cost, being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interests, and any previous interest held, over the Bank's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired.

If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the re-assessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognised in the consolidated statement of income.

After initial recognition, goodwill is stated at cost less any accumulated impairment losses. Goodwill of subsidiaries is allocated to cash-generating units and is tested annually for impairment. If the recoverable amount of the cash generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's fair value less costs to sell, and its value in use. Any impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a part of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Other Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses.

The useful lives of intangible assets are assessed as either finite or infinite.

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the consolidated statement of income in the expense category that is consistent with the function of the intangible assets.

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

As at 31 December 2018, the Group did not have any intangible assets which had an infinite useful life.

Investments in associates

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

The considerations made in determining significant influence are similar to those necessary to determine control over subsidiaries.

The Group's investments in its associates are accounted for using the equity method.

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

Under the equity method, the investment in an associate is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the associate since the acquisition date. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The consolidated statement of income reflects the Group's share of the results of operations of the associate. Any change in Other Comprehensive Income (OCI) of those investees is presented as part of the Group's consolidated OCI. In addition, when there has been a change recognised directly in the equity of the associate, the Group recognises its share of any changes, when applicable, in the consolidated statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

The financial statements of associates are prepared for the same reporting period as that of the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investments in its associates. At each reporting date, the Group determines whether there is objective evidence that an investment in an associate is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value, then recognises the loss as 'Share of results of associates' in the consolidated statement of income.

Upon loss of significant influence over an associate, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in the consolidated statement of income.

Financial instruments

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

Date of recognition

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

Initial measurement

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. At initial recognition, the Group measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at FVTPL, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees and commissions. Transaction costs of financial assets and financial liabilities carried at FVTPL are expensed in consolidated income. Immediately after initial recognition, an ECL is recognised for financial assets measured at amortised cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognised in the consolidated statement of income when an asset is newly originated.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**Financial instruments (continued)***Initial measurement (continued)*

When the fair value of financial assets and liabilities at initial recognition differs from the transaction price, the Group accounts for the Day 1 profit or loss as follows:

- (a) When the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e. a Level 1 input) or based on a valuation technique that uses data only from observable markets, the difference is recognised as a day 1 gain or loss.
- (b) In all other cases, the difference is deferred and the timing of recognition of deferred day 1 profit or loss is determined individually. It is either amortised over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or when the instrument is derecognised.

Measurement categories of financial assets and liabilities

From 1 January 2018, the Group classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost.
- Fair value through other comprehensive income (FVOCI); or
- Fair value through profit or loss (FVTPL);

The Group classifies and measures its derivative and trading portfolio at FVTPL. The Group may designate financial instruments at FVTPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

Before 1 January 2018, the Group classified its financial assets as loans and receivables (amortised cost), FVTPL, available-for-sale or held-to-maturity (amortised cost), as explained in the annual consolidated financial statements for the year ended 31 December 2017.

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVTPL when they are derivative instruments.

Financial assets*Classification and subsequent measurement*

The classification requirements for financial assets is as below:

Debt type Instrument: Classification and Subsequent measurement:

Classification and subsequent measurement of debt instruments depend on:

- (i) the Group's business model for managing the asset; and
- (ii) the cash flow characteristics of the asset i.e. solely payments of principal and interest (SPPI) test.

Based on these factors, the Group classifies its debt instruments into one of the following three measurement categories:

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent SPPI, and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any ECL allowance recognised and measured as described in note 4. Interest income from these financial assets is included in 'Interest income' using the EIR method.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial assets (continued)

- FVOCI: Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent SPPI, and that are not designated at FVTPL, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in consolidated statement of income. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to consolidated income and recognised in 'Investment income - net' as 'Gain on disposal of non-trading securities'. Interest income from these financial assets is included in 'Interest income' using the EIR method.
- FVTPL: Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at FVTPL and is not part of a hedging relationship is recognised in consolidated profit or loss and presented in the consolidated statement of income within 'Investment income - net' as 'Gain on trading securities' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Investment income - net' as 'Gain on disposal of non-trading securities'. Interest income from these financial assets is included in 'Interest income' using the EIR method.

Business model

The Group determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective. The business model reflects how the Group manages the assets in order to generate cash flows. That is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'held for trading' business model and measured at FVTPL. The business model assessment is not carried out on an instrument-by-instrument basis but at the aggregate portfolio level and is based on observable factors such as:

- The stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of the assets;
- How the asset's and business model performance is evaluated and reported to key management personnel and Asset and Liability Committee (ALCO);
- How risks are assessed and managed; and
- The frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

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

Financial assets that are held for trading and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial assets (continued)

SPPI test

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

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

Interest is the consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement.

In assessing whether the contractual cash flows are SPPI, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group considers:

- the currency in which the financial asset is denominated, and the period for which the interest rate is set;
- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms; and
- terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse asset arrangements).

Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at FVTPL.

The Group reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent.

Equity type instruments: classification and subsequent measurement

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets. Examples of equity instruments include basic ordinary shares.

Equity instruments at FVOCI

Upon initial recognition, the Group may elect to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of Equity under IAS 32 *Financial Instruments: Presentation* and are not held for trading. Such classification is determined on an instrument-by-instrument basis. Fair value gains and losses are recognised in other comprehensive income and are not subsequently reclassified to consolidated income, including on disposal. Equity investments at FVOCI are not subject to impairment assessment. Equity investments at FVOCI are included in non-trading investments in the statement of financial position. All other equity investments which the Group has not irrevocably elected at initial recognition or transition, to classify at FVOCI, are recognised at FVTPL.

Financial asset at FVTPL

The Group classifies financial assets at fair value through profit and loss when they have been purchased or issued primarily for short-term profit making through trading activities or form part of a portfolio of financial instruments that are managed together, for which there is evidence of a recent pattern of short-term profit taking. Held-for-trading assets are recorded and measured in the statement of financial position at fair value. In addition, on initial recognition, the Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise. Changes in fair values gain and losses, financing income and dividends are recorded in consolidated statement of income according to the terms of the contract, or when the right to payment has been established.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**Financial assets (continued)***Financial asset at FVTPL (continued)*

Dividends are recognised in the consolidated statement of income as 'Investment income - net' when the Group's right to receive payments is established.

Impairment

The Group assesses on a forward-looking, basis the ECL associated with its debt instrument assets carried at amortised cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Group recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

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

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Group expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- undrawn loan commitments: estimates the expected portion of the loan commitment that are drawn down over the expected life of the loan commitment; and calculates the present value of cash shortfalls between the contractual cash flows that are due to the entity if the holder of the loan commitment draws down that expected portion of the loan and the cash flows that the entity expects to receive if that expected portion of the loan is drawn down; and
- financial guarantee contracts: estimates the ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the guarantor expects to receive from the holder, the debtor or any other party. If a loan is fully guaranteed, the ECL estimate for the financial guarantee contract would be the same as the estimated cash shortfall estimate for the loan subject to the guarantee.

For the purposes of calculation of ECL, the Group categorises its FVOCI debt securities, loans and receivable and loan commitments and financial guarantee contracts into Stage 1, Stage 2 and Stage 3, based on the applied impairment methodology, as described below:

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

For the purposes of categorisation into above stages, the Group has established a policy to perform an assessment at the end of each reporting period of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment (continued)

Measurement of ECL (continued)

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

No impairment is recorded on equity investments.

Stage 1

The Group measures loss allowances at an amount up to 12-month ECL for Stage 1 customers. All financial assets are classified as Stage 1 on initial recognition date. Subsequently on each reporting date the Group classifies following as Stage 1:

- debt type assets that are determined to have low credit risk at the reporting date; and
- on which credit risk has not increased significantly since their initial recognition.

Stage 2

IFRS 9 requires financial assets to be classified in Stage 2 when their credit risk has increased significantly since their initial recognition. For these assets, a loss allowance needs to be recognised based on their lifetime ECLs.

The Group considers whether there has been a significant increase in credit risk of an asset by comparing the rating migration upon initial recognition of the asset against the risk of a default occurring on the asset as at the end of each reporting period. In each case, this assessment is based on forward-looking assessment that takes into account a number of economic scenarios, in order to recognise the probability of higher losses associated with more negative economic outlooks.

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

Stage 3

Financial assets are included in Stage 3 when there is objective evidence that the loan is credit impaired. At each reporting date, the Group assesses whether financial assets carried at amortized cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Group on terms that the Group would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganization; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a loan that is overdue for 90 days or more is considered impaired.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment (continued)

Stage 3 (continued)

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Group considers the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

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

Forward looking information

The Group incorporates forward-looking information in the measurement of ECLs.

The Group considers forward-looking information such as macroeconomic factors (e.g., GDP growth, oil prices, country's equity indices and unemployment rates) and economic forecasts.

The Group uses internal information coming from internal economic experts, combined with published external information from government and private economic forecasting services. These forward looking assumptions undergo an internal governance process before they are applied for different scenarios.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the consolidated statement of financial position as follows:

- financial assets measured at amortized cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: as a provision under other liabilities; and
- debt instruments measured at FVOCI: no loss allowance is recognised in the consolidated statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the cumulative changes in fair value reserve.

Limitation of estimation techniques

The models applied by the Group may not always capture all characteristics of the market at a point in time as they cannot be recalibrated at the same pace as changes in market conditions. Interim adjustments are expected to be made until the base models are updated. Although the Group uses data that is as current as possible, models used to calculate ECLs are based on data that is up to date except for certain factors for which the data is updated once it is available and adjustments are made for significant events occurring prior to the reporting date.

Experienced credit adjustment

The Group's ECL allowance methodology requires the Group to use its experienced credit judgement to incorporate the estimated impact of factors not captured in the modelled ECL results, in all reporting periods.

For more details on the impairment calculations and policy refer to note 4 to these consolidated financial statements.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**Derivatives and hedging activities**

A derivative is a financial instrument or other contract with all three of the following characteristics:

- Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract (i.e., the 'underlying').
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts expected to have a similar response to changes in market factors.
- It is settled at a future date.

The Group enters into derivative transactions with various counterparties. These include interest rate swaps and forward foreign exchange contracts. Derivatives are initially recognised at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated and qualifies as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

- (a) Hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedges);
- (b) Hedges of highly probable future cash flows attributable to a recognised asset or liability (cash flow hedges); or
- (c) Hedges of a net investment in a foreign operation (net investment hedges).

The Group documents, at the inception of the hedge, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

(a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the consolidated statement of income, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to profit or loss over the period to maturity and recorded as net interest income.

(b) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the consolidated statement of income.

Amounts accumulated in equity are recycled to the consolidated statement of income in the periods when the hedged item affects income or loss. They are recorded in the income or expense lines in which the revenue or expense associated with the related hedged item is reported.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the periods when the hedged item affects income or loss. When a forecast transaction is no longer expected to occur (for example, the recognised hedged asset is disposed of), the cumulative gain or loss previously recognised in other comprehensive income is immediately reclassified to the consolidated statement of income.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivatives and hedging activities (continued)

(c) Net investment hedge

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised directly in other comprehensive income; the gain or loss relating to the ineffective portion is recognised immediately in the consolidated statement of income. Gains and losses accumulated in equity are included in the consolidated statement of income when the foreign operation is disposed of as part of the gain or loss on the disposal.

The Group did not have any impact on its retained earnings or profit or loss due to change in hedge accounting under IFRS 9.

Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and interest rate futures are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. Forward rate agreements are effectively tailor-made interest rate futures which fix a forward rate of interest on a notional loan, for an agreed period of time starting on a specified future date.

Swaps are contractual agreements between two parties to exchange interest or foreign currency amounts based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency. For cross-currency swaps, notional amounts are exchanged in different currencies. For cross-currency interest rate swaps, notional amounts and fixed and floating interest payments are exchanged in different currencies.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

Derivative related credit risk

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Group. The majority of the Group's derivative contracts are entered into with other financial institutions and there is no significant concentration of credit risk in respect of contracts with positive fair value with any individual counterparty at the date of the statement of financial position.

Derivatives held or issued for trading purposes

Most of the Group's derivative trading activities relate to entering into forward contracts with external counterparties on behalf of UGHC.

Derivatives held or issued for hedging purposes

The Group has adopted a comprehensive system for the measurement and management of risk. Part of the risk management process involves managing the Group's exposure to fluctuations in foreign exchange rates (currency risk) and interest rates through asset and liability management activities. It is the Group's policy to reduce its exposure to currency and interest rate risks to acceptable levels as determined by the Board of Directors. The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on an ongoing basis and hedging strategies used to ensure positions are maintained within established limits. The Board has established levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Interest rate gaps are reviewed on an ongoing basis and hedging strategies used to reduce the interest rate gaps to within the limits established by the Board of Directors.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**Derivatives held or issued for hedging purposes (continued)**

As part of its asset and liability management the Group uses derivatives for hedging purposes in order to reduce its exposure to currency and interest rate risks. This is achieved by hedging specific financial instruments, forecasted transactions as well as strategic hedging against overall statement of financial position exposures. For interest rate risk this is carried out by monitoring the duration of assets and liabilities using simulations to estimate the level of interest rate risk and entering into interest rate swaps and futures to hedge a proportion of the interest rate exposure, where appropriate. Since strategic hedging does not qualify for special hedge accounting related derivatives are accounted for as trading instruments.

The Group uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks. In addition, the Group uses interest rate swaps to hedge against the interest rate risk arising from specifically identified loans and securities bearing fixed interest rates. In all such cases the hedging relationship and objective, including details of the hedged item and hedging instrument, are formally documented and the transactions are accounted for as hedges.

The Group applies hedge accounting in three separate hedging strategies, as follows:

Interest rate risk on fixed rate debt type instruments (fair value hedge)

The Group holds a portfolio of long-term variable and fixed rate loans / securities and therefore is exposed to changes in fair value due to movements in market interest rates. The Group manages this risk exposure by entering into pay fixed / receive floating interest rate swaps.

Only the interest rate risk element is hedged and therefore other risks, such as credit risk, are managed but not hedged by the Group. The interest rate risk component is determined as the change in fair value of the long-term variable / fixed rate loans and securities arising solely from changes in LIBOR (the benchmark rate of interest). Such changes are usually the largest component of the overall change in fair value. This strategy is designated as a fair value hedge and its effectiveness is assessed by comparing changes in the fair value of the loans attributable to changes in the benchmark rate of interest with changes in the fair value of the interest rate swaps.

The Group establishes the hedging ratio by matching the notional of the derivatives with the principal of the portfolio being hedged. Possible sources of ineffectiveness are as follows:

- (i) differences between the expected and actual volume of prepayments, as the Group hedges to the expected repayment date taking into account expected prepayments based on past experience;
- (ii) hedging derivatives with a non-zero fair value at the date of initial designation as a hedging instrument; and
- (iii) counterparty credit risk which impacts the fair value of uncollateralised interest rate swaps but not the hedged items.

Net investment in foreign operation (net investment hedge)

The Group has investments in foreign operations which are consolidated in these financial statements. The foreign exchange rate exposure arising from this investment is hedged through the use of forward exchange contracts. These contracts are designated as net investment hedges to hedge the equity of the foreign operations. The Group establishes the hedging ratio by matching the contracts with the net assets of the foreign operations.

Hedge ineffectiveness

Hedge effectiveness is determined at the inception of the hedge relationship, and through periodic prospective effectiveness assessments to ensure that an economic relationship exists between the hedged item and hedging instrument. For hedges of exposures to fluctuations in foreign exchange rates, the Group enters into hedge relationships where the critical terms of the hedging instrument match exactly with the terms of the hedged item. The Group therefore performs a qualitative assessment of effectiveness.

In hedges of foreign currency exposures, ineffectiveness may arise if the timing of the cash flows changes from what was originally estimated, or if there are changes in the credit risk of the Bank or the derivative counterparty.

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

The Group enters into interest rate swaps that have similar critical terms as the hedged item, such as reference rate, reset dates, payment dates, maturities and notional amount. In cases, where the Group does not hedge 100% of its loans, the hedged item is identified as a proportion of the outstanding loans up to the notional amount of the swaps. As all critical terms matched during the year, the economic relationship was 100% effective.

Hedge ineffectiveness for interest rate swaps is assessed using the same principles as for hedges of foreign currency. It may occur due to the credit value/debit value adjustment on the interest rate swaps which is not matched by the loan, and differences in critical terms between the interest rate swaps and loans.

There was no ineffectiveness during 2018 or 2017 in relation to the interest rate swaps.

Interest income

Under both IFRS 9 and IAS 39, interest income is recorded using the effective interest rate (EIR) method for all financial instruments measured at amortised cost, financial instruments designated at FVTPL. Interest income on interest bearing financial assets measured at FVOCI under IFRS 9, similarly to interest bearing financial assets classified as available-for-sale or held to maturity under IAS 39 are also recorded by using the EIR method. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

Fair value measurement

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

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

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

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

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

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

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

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

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable; and

Level 3: valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair value measurement (continued)

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

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

The Group measures financial instruments, such as, derivatives, and non-financial assets such as investment properties, at fair value at each reporting date.

For financial instruments traded in an active market, fair value is determined by reference to quoted market bid prices for assets and quoted market offer prices for liabilities, without deduction for transaction costs. The fair value of investments in managed funds or similar investment vehicles, where available, are based on last published bid price.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indications that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For financial instruments where there is no active market, fair value is determined using appropriate valuation techniques. Such techniques may include the following:

- brokers' quotes
- recent arm's length market transactions
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics
- option pricing models
- other valuation methods (Note 32)

Financial instruments with no active market and where fair value can not be reliably determined are stated at cost less provision for any impairment.

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount payable on demand.

The fair value of forward foreign exchange contracts is determined using forward exchange rates at the statement of financial position date with the resulting value discounted back to present value.

The fair value of interest rate swaps is determined by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

Derecognition

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

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

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Derecognition (continued)

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to consolidated statement of income.

Investment properties

All properties held for rental or for capital appreciation purposes, or both, are classified as investment properties. Where a property is partially occupied by the Group and the portions could be sold separately, the Group accounts for the portions separately either as an investment property or property and equipment, as appropriate. If the portions cannot be sold separately, the property is classified as an investment property only if an insignificant portion is held for own use.

The Group applies the fair value model of accounting for investment properties. All investment properties are initially recorded at cost, including acquisition expenses associated with the property.

Subsequent to initial recognition, all investment properties are remeasured at fair value and changes in fair value are recognised in the consolidated statement of income. The Group engages independent valuation specialists to determine the fair value of investment properties. Fair values are determined based on an annual evaluation performed by an accredited external independent valuer applying a valuation model recommended by the International Valuation Standards Committee.

Investment properties are derecognised either when they have been disposed of or when they are permanently withdrawn from use and no future economic benefit is expected from their disposal. The difference between the net disposal proceeds and the carrying amount of the asset is recognised in profit or loss in the period of derecognition.

Transfers are made to (or from) investment property only when there is a change in use. For a transfer from investment property to owner-occupied property, the deemed cost for subsequent accounting is the fair value at the date of change in use. If owner-occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under property, plant and equipment up to the date of change in use.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and impairment losses. When assets are sold or retired, their cost and accumulated depreciation are eliminated from the consolidated statement of financial position and any gain or loss resulting from disposal is included in the consolidated statement of income.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount, being the higher of their fair value less costs to sell and their value in use.

Depreciation is provided on all property and equipment, except land and work in progress, at rates calculated to write off the cost of each asset on a straight line basis to their residual values over its expected useful life which is between 3 to 5 years for all property and equipment except for certain building fixtures and fittings which are depreciated over expected useful life of 10 years and building civil structure which is depreciated over its expected useful life of 20 years.

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

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial liabilities

Financial liabilities comprise of due to banks and other financial institutions, deposits from customers, loans, bonds and subordinated debt and other liabilities. These are stated at amortised cost. Transaction costs are amortised over the period of the debt using the effective yield method. Deposits from customers include deposits from both external customers and other group companies.

Classification and subsequent measurement

The accounting for financial liabilities remains largely the same as it was under IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVTPL. Such movements are presented in OCI with no subsequent reclassification to the consolidated statement of income.

Treasury shares and treasury share reserve

Treasury shares are own equity instruments of the Bank which are reacquired by the Bank or any of its subsidiaries. These are stated at cost and deducted from equity. Any gain or loss arising on reissuance of treasury shares is taken directly to treasury share reserve in the consolidated statement of changes in equity.

Cash and cash equivalents

Cash and cash equivalents include cash, demand and call deposits, highly liquid investments that are readily convertible into cash and placements (excluding escrow balances) with original maturities up to ninety days from the date of acquisition.

Fiduciary assets

Assets held in a fiduciary capacity are not treated as assets of the Group in the consolidated statement of financial position.

Dividends on ordinary shares

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

Non-cash distributions are measured at the fair value of the assets to be distributed with fair value re-measurement recognised directly in equity.

Upon distribution of non-cash assets, any difference between the carrying amount of the liability and the carrying amount of the assets distributed is recognised in the consolidated statement of income.

Dividends for the year that are approved after the statement of financial position date are disclosed as an event after the statement of financial position date.

Taxes

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on overseas subsidiaries is calculated on the basis of the tax rates applicable and prescribed according to the prevailing laws, regulations and instructions of the countries where these subsidiaries operate. Income tax payable on taxable profit ("current tax") is recognised as an expense in the period in which the profits arise in accordance with the fiscal regulations of the respective countries in which the Group operates.

Deferred Tax

Deferred tax is provided using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

Deferred tax assets are recognised for all deductible temporary differences, the carry forward of unused tax credits and any unused tax losses. Deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised, except when the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Taxes (continued)

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are re-assessed at each reporting date and are recognised to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- (a) When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- (b) In respect of taxable temporary differences associated with investments in subsidiaries and associates, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are measured using tax rates and applicable legislation at the reporting date.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

Trade and settlement date accounting

All "regular way" purchases and sales of financial assets are recognised on the settlement date, i.e. the date the asset is delivered to the counterparty.

Employees benefits

The Group provides for end of service benefits to all its employees. Entitlement to these benefits is usually based upon the employees' length of service and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment. National employees of the Bank are also covered by the Social Insurance Organisation scheme and the Bank's obligations are limited to the amount contributed to the scheme.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and reliably measurable.

Foreign currencies

The consolidated financial statements have been presented in US Dollars being the functional and presentational currency of the Bank. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

Transactions in foreign currencies are initially recorded in the functional currency rate of exchange ruling at the date of transaction.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**Foreign currencies (continued)***Translation of foreign currency transactions and balances*

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Exchange differences arising on the retranslation of monetary items, are included in consolidated statement of income for the year. Non-monetary items measured at fair value in a foreign currency are retranslated using the exchange rates at the date when the fair value was determined. Exchange differences arising on the retranslation of non-monetary investments carried at fair value through the statement of income are included in the consolidated statement of income for the year. Exchange differences arising on the retranslation of available for sale equity investments, other than those which are carried at cost, are recognised directly in a fair value reserve in the consolidated statement of comprehensive income. Non-monetary items that are measured at historical cost in a foreign currency are translated using the spot exchange rates as at the date of recognition.

Translation of financial statements of foreign operations

Assets (including goodwill) and liabilities of foreign operations are translated at the exchange rates prevailing at the statement of financial position date. Income and expense items are translated at average exchange rates for the relevant period. All resulting exchange differences are taken directly to a foreign currency translation reserve in equity through consolidated OCI.

On disposal of a foreign operation, the component of consolidated OCI relating to that particular foreign operation is recognised in the consolidated statement of income.

Recognition of income and expenses

Interest income and related fees are recognised using the effective yield method, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Recognition of interest income is suspended when the related financial asset becomes impaired. Notional interest is recognised on impaired financial assets based on the rate used to discount future cash flows to their net present value.

Commission income and other fees are recognised when earned.

Performance-based fees

For revenue from performance-based fees for the provision of services over a period of time, the Group previously accrued revenue over that period. Under IFRS 15, performance-based fees will not be recognised until it is highly probable that a significant reversal in the amount of cumulative revenue will not occur. The recognition of performance-based fees will require significant judgement and are unlikely to be recognised in full until they have crystallised or are no longer subject to clawback.

Advisory income

For revenue from advisory fees for the provision of services over a period of time, the Group previously accrued revenue over that period. Under IFRS 15, the Group applied significant judgement to identify the performance obligations in an advisory service contract and whether each service is capable of being distinct in the context of contract. Revenue from these performance obligations are recognized either at a point in time or over time when the respective performance obligations in a contract are delivered to the customer.

Rental income on investment properties is recognised on a straight line basis.

Dividend income is recognised when the Group's right to receive the dividend is established.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Contingent liabilities and contingent assets

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

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

Financial guarantee contracts and commitments

Financial guarantee contracts issued by the Group are those contracts that require a payment to be made to reimburse the holder for a loss it incurs because the specified debtor fails to make a payment when due in accordance with the terms of a debt instrument. Financial guarantee contracts are recognised initially 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 recognised less cumulative amortisation.

The premium received is recognised in the consolidated statement of profit or loss in other operating income on a straight line basis over the life of the guarantee.

Undrawn loan commitments, under which, over the duration of the commitment, the Group is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, under IAS 39, a provision was made if they were an onerous contract but, from 1 January 2018, these contracts are in the scope of the ECL requirements.

The nominal contractual value of financial guarantees and undrawn loan commitments, where the loan agreed to be provided is on market terms, are not recorded in the consolidated statement of financial position.

Significant assumptions, accounting judgements and estimates

In the process of applying the Group's accounting policies, management has made the following assumptions, judgements and estimates in determining the amounts recognised in the consolidated financial statements:

Measurement of the expected credit loss allowance (ECL)

The measurement of the ECL for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions, credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses), estimation of the amount and timing of the future cash flows and collateral values. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Group's ECL calculation are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Internal credit rating model, which assigns PDs to the individual ratings;
- Determining criteria for SICR;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs;
- Selection and relative weightings of forward-looking scenarios to derive the economic inputs into the ECL models;
- Establishing groups of similar financial assets for the purposes of measuring ECL; and
- Determining relevant period of exposure with respect to the revolving facilities and facilities undergoing restructuring at the time of the reporting date.

Classification of financial assets

Classification of financial assets in the appropriate category depends upon the business model and SPPI test. Determining the appropriate business model and assessing whether the cash flows generated by the financial asset meet the SPPI test is complex and requires significant judgements by management.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**Significant assumptions, accounting judgements and estimates (continued)**

The Group applies judgement while carrying out SPPI test and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

Going concern

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

Impairment of goodwill

The Group determines whether goodwill is impaired at each reporting date. This requires an estimation of the value in use of the cash generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of consolidated financial position cannot be derived from active markets, they are determined using valuation techniques including discounted cash flow models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Policies before adoption of IFRS 9**Investments carried at fair value through statement of income**

Investments classified as carried at fair value through the statement of income comprise of two categories 'investments held for trading' and 'investments designated at fair value through statement of income'.

An investment is classified as 'held for trading' if it is acquired or incurred principally for the purpose of selling in the near term or if on initial recognition is part of a portfolio of identifiable financial investments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking. Derivatives which are not used as hedge are also categorised as held for trading.

Investments designated at fair value through statement of income are investments that are not classified as held for trading but are managed, and their performance is evaluated on a fair value basis in accordance with the Group's investment strategy.

These investments are initially recognised at fair value. Transaction costs are immediately expensed in the consolidated statement of income. Subsequent to initial recognition, investments designated at fair value through statement of income are remeasured at fair value and gains and losses arising from such remeasurement are included in the consolidated statement of income.

These are classified as follows:

- Held to maturity; and
- Available-for-sale

Investments which have fixed or determinable payments and fixed maturity and which are intended to be held to maturity are carried at amortised cost, less provision for impairment in value. Any gain or loss on such investments is recognised in the consolidated statement of income when the investment is derecognised or impaired.

Held to maturity

Investments with fixed or determinable payments and fixed maturities are classified as held to maturity when the Group has the positive intention and ability to hold these investments to maturity. These investments are initially recognised at fair value, including directly attributable transaction costs.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**Policies before adoption of IFRS 9 (continued)****Investments carried at fair value through statement of income (continued)**

After initial recognition investments held to maturity are carried at amortised cost using the effective interest rate method. Any gain or loss on such investments is recognised in the consolidated statement of income when the investment is derecognised or impaired. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in 'interest income' in the consolidated statement of income. The losses, if any, arising from impairment of such investments are recognised in the consolidated statement of income.

Investments available-for-sale

Investments classified as available for sale are remeasured at fair value. Fair value of investments quoted in active markets is determined by reference to quoted bid prices. Fair value of investments listed on inactive markets and unlisted investments are determined using other generally accepted methods such as recent arm's length transaction, current fair value of another instruments that is substantially the same, the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics, and other valuation techniques. The fair value changes of investments available for sale are reported separately in equity in the fair value reserve until such investments are sold, realised or deemed to be impaired, at which time the realised gain or loss is included in the consolidated statement of income.

Investments available-for-sale include equity investments and debt securities. Investments available-for-sale are those non-derivative financial assets that are designated as available-for-sale or are not classified as investment at fair value through statement of income, investments held to maturity or loans and receivables.

These investments are initially recognised at fair value, including directly attributable transaction costs.

After initial recognition, available-for-sale investments are measured at fair value with gains and losses being recognised in the consolidated OCI until the investment is derecognised or determined to be impaired at which time the cumulative gains or losses previously reported in the consolidated OCI are recognised in the consolidated statement of income. Investments whose fair value cannot be reliably measured are carried at cost less impairment losses, if any.

Dividends are included in 'dividend income'. Interest income on available-for-sale investments is recorded in 'interest income' in the consolidated statement of income, using the effective interest yield method.

Loans and receivables

Loans and receivables are non-derivative financial assets originated or acquired by the Group with fixed or determinable payments that are not quoted in an active market.

Loans and receivables are recognised when cash is advanced to borrowers. They are derecognised when either borrower repays their obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred.

Loans and receivables are initially measured at cost, being the fair value of the consideration given.

Following initial recognition, loans and receivables are stated at cost less any amount written off and specific and collective provisions for impairment.

When a loan is uncollectible and there is no realistic prospect of recovery, it is written off against the related provision. Subsequent recoveries and reductions in provision are credited to provision for doubtful loans in the consolidated statement of income.

3 NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

Standards issued but not yet effective up to the date of issuance of the Group's consolidated financial statements are listed below. This listing is of relevant standards and interpretations issued, which the Group reasonably expects to be applicable at a future date. The Group intends to adopt those standards (where applicable) when they become effective:

3 NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE (continued)

IFRS 16 Leases

The IASB issued the new standard for accounting for leases - IFRS 16 Leases in January 2016. The new standard does not significantly change the accounting for leases for lessors. However, it does require lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right-of-use assets. Lessees must apply a single model for all recognised leases, but will have the option not to recognise 'short-term' leases and leases of 'low-value' assets. Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in the statement of profit or loss.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date. Lessees must adopt IFRS 16 using either a full retrospective or a modified retrospective approach.

The Group does not anticipate early adopting IFRS 16 and does not expect any material impact on the consolidated financial statements of the Group.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 and does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments.

These amendments have no impact on the consolidated financial statements of the Group.

Amendments to IFRS 9: Prepayment Features with Negative Compensation

The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

The amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted. These amendments have no impact on the consolidated financial statements of the Group.

Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely. The Group will apply these amendments when they become effective.

Amendments to IAS 19: Plan Amendment, Curtailment or Settlement

The amendments to IAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments apply to plan amendments, curtailments, or settlements occurring on or after the beginning of the first annual reporting period that begins on or after 1 January 2019, with early application permitted. These amendments are not applicable to the Group.

Amendments to IAS 28: Long-term interests in associates and joint ventures

The amendments clarify that an entity applies IFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). This clarification is relevant because it implies that the expected credit loss model in IFRS 9 applies to such long-term interests.

3 NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE (continued)

Amendments to IAS 28: Long-term interests in associates and joint ventures (continued)

The amendments also clarified that, in applying IFRS 9, an entity does not take account of any losses of the associate or joint venture, or any impairment losses on the net investment, recognised as adjustments to the net investment in the associate or joint venture that arise from applying IAS 28 Investments in Associates and Joint Ventures.

The amendments should be applied retrospectively and are effective from 1 January 2019, with early application permitted. Since the Group does not have such long-term interests in its associate and joint venture, the amendments will not have an impact on its consolidated financial statements.

Annual Improvements 2015-2017 Cycle

IFRS 3 Business Combinations

The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation. (effective from 1 January 2019, with earlier application permitted).

IFRS 11 Joint Arrangements

A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in IFRS 3. The amendments clarify that the previously held interests in that joint operation are not remeasured (the amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted).

IAS 12 Income Taxes

The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognises the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised those past transactions or events (the amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted).

IAS 23 Borrowing Costs

The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete (the amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted).

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4 TRANSITION DISCLOSURES**(a) Remeasurement and reclassification**

The Group performed a detailed analysis of its business models for managing financial assets and analysis of their cash flow characteristics.

The following table reconciles the carrying amounts of financial assets and financial liabilities, from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018:

Financial assets	IAS 39			IFRS 9	
	carrying amount	Re classification	Re measurement	carrying amount	Classification under IFRS 9
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	
Demand and call deposits with banks	97,993	-	(1)	97,992	Amortised cost
Placements with banks	68,577	-	(204)	68,373	Amortised cost
Investments carried at fair value					
through statement of income	19,268	41,128	-	60,396	FVTPL
Non-trading investments	-	3,704	-	3,704	FVOCI
Non-trading investments	221,566	(72,828)	-	148,738	FVOCI
Loans and receivables	4,216	27,996	(1,005)	31,207	Amortised cost
Other assets	31,820	-	(157)	31,663	Amortised cost
Total assets	443,440	-	(1,367)	442,073	

The following explains how applying the new classification requirements of IFRS 9 led to changes in classification of certain financial assets held by the Group as shown in the table above:

(i) Debt instruments previously classified as available for sale

The Group holds a portfolio of debt instruments that were classified as available for sale under IAS 39. The Group has reassessed the debt instruments under IFRS 9. As a result, these instruments, which amounted to US\$ 27,996 thousand were classified as amortised cost from the date of initial application.

During the year, based on certain amendments to an initial credit facility agreement, the repayment of the debt instrument will be made in kind with the issuance of fixed number of ordinary shares of the counter party at a fixed price at the date of maturity. The Group has reassessed the classification of the debt instrument and as at 31 December 2018 the Group reclassified its investment as an equity instruments measured at FVOCI, as permitted under IFRS 9.

(ii) Designation of equity instruments at FVOCI

The Group has elected to irrevocably designate investments of US\$ 3,704 thousand that were previously classified as FVTPL, at FVOCI as permitted under IFRS 9. The changes in fair value of such securities will no longer be reclassified to profit or loss when they are disposed of.

(iii) Designation of equity instruments at FVTPL

The Group has elected to designate certain of its investments at a carrying value of US\$ 44,832 thousand as FVTPL as permitted under IFRS 9 from the initial date of application. These investments were previously classified as available-for-sale. Any changes in fair value of these securities will be recognised in the statement of income.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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4 TRANSITION DISCLOSURES (continued)**(b) Impact on retained earnings and other reserves**

	<i>Retained earnings</i>	<i>Other reserves</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Closing balance under IAS 39 (31 December 2017)	7,659	12,867
Reclassifications and remeasurement of investments under IFRS 9	(2,726)	3,037
Recognition of expected credit losses under IFRS 9	(1,367)	-
Opening balance under IFRS 9 (1 January 2018)	3,566	15,904

(c) Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The following table reconciles the prior period's closing loan loss provisions measured in accordance with IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 ECL model at 1 January 2018:

Measurement category	<i>Loan loss allowance under IAS 39</i>	<i>Remeasur- ement</i>	<i>ECL under IFRS 9</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Demand and call deposits with banks	-	1	1
Placements with banks	-	204	204
Loans and receivables	2,535	1,005	3,540
Other assets	-	157	157
Total	2,535	1,367	3,902

(d) Movement in ECL for the year

An analysis of movement in ECL allowances during the period is as follows:

	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
As at 1 January 2018	362	3,540	-	3,902
Net transfers between stage 1, 2 and 3	(298)	(1,276)	1,574	-
Amount written off	-	-	(1,574)	(1,574)
Acquisition of a subsidiary	176	-	10,650	10,826
Provided (reversed) during the year	3,206	(900)	-	2,306
Other movements	-	40	(116)	(76)
As at 31 December 2018	3,446	1,404	10,534	15,384

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At 31 December 2018

5 BUSINESS COMBINATION

During September 2018, the Group (through its subsidiary KAMCO) acquired 396,426,434 shares, representing 71.18% effective equity interest of Global Investment House K.S.C. (Closed) ("GIH"), a Kuwaiti Shareholding Company, regulated by CMA as an investment company and CBK for financing activities. GIH is principally engaged in provision of asset management, investment banking and brokerage activities. The Group was able to control the investee and therefore, the entity became a subsidiary of the Group. Accordingly, GIH has been consolidated from 1 September 2018 being the date of exercise of control. The acquisition has been accounted for in accordance with IFRS 3: Business combination ("IFRS 3").

The consideration paid and the values of assets acquired and liabilities assumed, as well as the non-controlling interest at the proportionate share of the acquiree's identifiable net assets, are summarized as follows:

	US\$ 000
Assets	
Demand and call deposits with banks	108,739
Investments carried at fair value through statement of income	63,578
Non-trading investments	22,814
Amortised cost investments	494
Loans and receivables	19,809
Other assets	36,430
Investments in associates	425
Investment properties	2,171
Property and equipment	37,614
Intangible assets	14,955
	307,029
Liabilities	
Other liabilities	46,735
Total identifiable net assets at fair value	260,294
Non-controlling interests	4,982
	255,312
Group's share of net assets acquired	181,737
Gain on bargain purchase	(23,928)
Total purchase consideration	157,809
Analysis of cash flows on business combination	
Cash consideration	(132,307)
Demand and call deposits with banks in subsidiary acquired	108,739
Net cash out flow on business combination	(23,568)
Deferred consideration payable	(25,502)

In accordance with requirements of IFRS 3, the Group has carried out a Purchase Price Allocation exercise which resulted in a gain from business combination, since the fair value of the assets acquired and liabilities assumed exceeded the purchase consideration paid and related transaction expenses. Non-controlling interest has been recognised at the proportionate share of GIH's identifiable net assets.

Intangible assets of GIH represent Customer relationship and commercial license which has been assigned a provisional value. The Group is in the process of identification of other intangible assets and these are subject to change on the completion of Purchase Price Allocation ("PPA") exercise. Fair valuation for GIH is based on an exercise performed by a valuation expert.

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5 BUSINESS COMBINATION (continued)

Had the business combinations taken place at the beginning of the year, revenue of the Group and profit attributable to equity holders of the Group, would have been higher by US\$ 35,391 thousand and US\$ 11,193 thousand, respectively. From the date of acquisition, GIH contributed US\$ 11,774 thousand of revenue and US\$ 96 thousand net loss to the net profit from continuing operations of the Group.

At the time of acquisition, the Group was required to pay deferred consideration of US\$ 8,264 thousand after 180 days of the acquisition and remaining amount of US\$ 17,238 thousand was payable on completion of certain conditions, as per the arrangement terms agreed between the parties. As of 31 December 2018, only US\$ 8,264 is remaining as payable with respect to the deferred consideration to the previous shareholders of GIH.

6 FINANCIAL ASSETS AND LIABILITIES

The table below summarises the accounting classification of the Group's financial assets and financial liabilities:

	<i>Held for trading</i>	<i>Designated at FVTPL</i>	<i>Designated at FVOCI</i>	<i>Amortised cost</i>	<i>Total</i>
<i>31 December 2018</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
Demand and call deposits with banks	-	-	-	143,510	143,510
Placements with banks	-	-	-	108,529	108,529
Investments carried at fair value through statement of income	-	81,852	-	-	81,852
Non-trading investments	-	-	167,647	-	167,647
Held-to-maturity investments	-	-	-	494	494
Loans and receivables	-	-	-	25,191	25,191
Other assets	-	-	1,280	58,931	60,211
Total financial assets	-	81,852	168,927	336,655	587,434
Due to banks and other financial institutions	-	-	-	220,879	220,879
Deposits from customers	-	-	-	32,608	32,608
Loans payable	-	-	-	67,033	67,033
Long term bonds	-	-	-	131,739	131,739
Other liabilities	168	-	208	105,999	106,375
Total financial liabilities	168	-	208	558,258	558,634

	<i>Held for trading</i>	<i>Designated at FVTPL</i>	<i>Available-for-sale</i>	<i>Amortised cost / Loans and receivables</i>	<i>Total</i>
<i>31 December 2017</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
Demand and call deposits with banks	-	-	-	97,993	97,993
Placements with banks	-	-	-	68,577	68,577
Investments carried at fair value through statement of income	17,983	1,285	-	-	19,268
Non-trading investments	-	-	221,566	-	221,566
Loans and receivables	-	-	-	4,216	4,216
Other assets	-	1,100	-	29,740	30,840
Total financial assets	17,983	2,385	221,566	200,526	442,460
Due to banks and other financial institutions	-	-	-	250,211	250,211
Deposits from customers	-	-	-	31,018	31,018
Loans payable	-	-	-	98,658	98,658
Other liabilities	115	-	-	37,243	37,358
Total financial liabilities	115	-	-	417,130	417,245

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7 INVESTMENTS CARRIED AT FAIR VALUE THROUGH STATEMENT OF INCOME

	2018 US\$ 000	2017 US\$ 000
Quoted equities	12,278	6,305
Quoted debt securities	6,941	11,678
Unquoted equity	3,210	-
Managed funds	59,423	1,285
	81,852	19,268

Managed funds primarily represent funds invested through unlisted companies and limited partnership interests. The fund managers have created these legal structures for tax efficiency and to meet other investors' requirements. The underlying investments in these funds are primarily in quoted debt and equity instruments in Kuwait and other international markets.

8 NON-TRADING INVESTMENTS

Below is an analysis of the Group's non-trading investments measured at FVOCI (2017: Available for sale):

	2018 US\$ 000	2017 US\$ 000
Quoted		
Managed funds	33	-
Equities	45,219	42,081
Total quoted	45,252	42,081
Unquoted		
Equities	120,298	143,117
Other managed funds	1,950	36,074
Real estate managed funds	147	294
Total unquoted	122,395	179,485
Total non-trading investments	167,647	221,566

9 LOANS AND RECEIVABLES

	2018				2017
	Stage 1 US\$ 000	Stage 2 US\$ 000	Stage 3 US\$ 000	Total US\$ 000	US\$ 000
Loans to customers	21,839	-	10,534	32,373	4,077
Staff loans	4,028	-	-	4,028	2,674
	25,867	-	10,534	36,401	6,751
Less: Expected credit losses	(676)	-	(10,534)	(11,210)	(2,535)
	25,191	-	-	25,191	4,216

The movement in the expected credit losses is as follows:

	Stage 1 US\$ 000	Stage 2 US\$ 000	Stage 3 US\$ 000	Total US\$ 000
As at 31 December 2017	-	2,535	-	2,535
Impact of adoption of IFRS 9	-	1,005	-	1,005
As at 1 January 2018	-	3,540	-	3,540
Acquisition of a subsidiary	176	-	10,650	10,826
Other movements	500	(3,540)	(116)	(3,156)
As at 31 December 2018	676	-	10,534	11,210

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

9 LOANS AND RECEIVABLES (continued)

An analysis of the allowance for impairment losses under IAS 39, for the year ended 31 December 2017 are as follows:

	2017	
	<i>Specific</i>	<i>Collective</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>
		<i>Total</i>
		<i>US\$ 000</i>
At 1 January	28,913	43,536
Provided (written-back) during the year - net	-	2,129
Written-off during the year	-	(2,107)
Other adjustments	(28,913)	(41,023)
Balance at 31 December	-	2,535

The table below shows the credit quality of loans and receivables:

	<i>Neither past due nor impaired</i>	<i>Past due and impaired</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
31 December 2018			
Loans to customers	21,839	10,534	32,373
Staff loans	4,028	-	4,028
Total	25,867	10,534	36,401
	<i>Neither past due nor impaired</i>	<i>Past due and impaired</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
31 December 2017			
Loans to customers	4,077	-	4,077
Staff loans	2,674	-	2,674
Total	6,751	-	6,751

No ECL is recognised against the Group's exposures to staff loans as these are fully collateralized.

10 OTHER ASSETS

	2018	2017
	US\$ 000	US\$ 000
Due from customers	47,928	16,379
Accounts receivable	10,897	13,203
Prepayments	886	980
Interest receivable	106	158
Derivative assets (Note 30)	1,280	1,100
	61,097	31,820

Due from customers and accounts receivable are stated net of ECL of US\$ 2,941 thousand (2017: provision of US\$ 77 thousand). During the year, ECL of US\$ 2,864 thousand was made against doubtful receivables (2017: provision reversed US\$ 766 thousand).

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11 INVESTMENTS IN ASSOCIATES

			<i>Carrying value 2018 US\$ 000</i>	<i>Ownership 2018 %</i>	<i>Carrying value 2017 US\$ 000</i>	<i>Ownership 2017 %</i>
	<i>Activity</i>					
a)	Adhari Park Development	Real estate	188	20	-	-
b)	Arab Leadership Academy	Training institute	-	-	414	15
c)	FINA Corporation	Financial services	221	49	-	-
d)	Kamco Investment Fund	Fund	24,357	23	22,750	23
e)	KAMCO Real Estate Yield Fund	Fund	14,549	30	-	-
f)	Kuwait Education	Fund	136	34	14,139	34
g)	Manafae Investment Company	Islamic investment	11,202	33	12,870	31
h)	N.S. 88	Real estate	11,570	20	12,280	20
i)	United Capital Transport Co K.S.C.C.	Transport	9,269	40	15,038	40
j)	United Real Estate Company - Syria	Real estate	21	20	21	20
			71,513		77,512	

The Group has no share of any contingent liabilities or capital commitments, as at 31 December 2018 and 2017 on behalf of its associates.

- a) During the year, the Group had acquired GIH which holds 20% equity interest in Adhari Park Development Company B.S.C (c) situated in the Kingdom of Bahrain (2017: Nil).
- b) Arab Leadership Academy is a training institute incorporated in the State of Kuwait in 2007. During the year, KAMCO has reclassified its ownership in Arab Leadership Academy from an associate to financial assets designated at FVOCI included under non-trading investments.
- c) During the year, the Group had acquired GIH which holds 49% equity interest in FINA Corporation situated in Tunisia (2017: Nil).
- d) The Group holds a 23% (2017: 23%) equity interest in KAMCO Investment Fund ("KIF") through its subsidiary KAMCO.
- e) During the year, the Group has reclassified its investment in KAMCO Real Estate Yield Fund from financial asset designated at FVTPL to investment in associates, since the ownership increased to 30%.
- f) Kuwait Education Fund is a fund incorporated in the State of Kuwait in 2007. As of 31 December 2018, the Group owns 34% through its subsidiary KAMCO (2017: 34%).
- g) The Group owns 33% of Manafae Investment Company through its subsidiary KAMCO (2017: 31%).
- h) The Group owns 20% of N.S. 88 (formerly known as Savannah SPV) through its subsidiary KAMCO (2017: 20%).
- i) United Capital Transport Company K.S.C.C. (UniCap) was incorporated in State of Kuwait in 2011. The Group owns a 40% equity interest through its subsidiary KAMCO (2017: 40%). UniCap is a dedicated leasing solutions provider to governments, international oil companies and varied construction, mining and industrial services businesses.
- j) United Real Estate Company - Syria is a closed company incorporated in the Syrian Arab Republic. At 31 December 2018, the Bank directly owns 20% (2017: 20%) of its equity interest.

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11 INVESTMENTS IN ASSOCIATES (continued)

In accordance with IAS 36 Impairment of Assets, the Group's recoverable amount of these associates (i.e. value in use) was in excess of their carrying values and accordingly no impairment was recognised against these investments during the year ended 31 December 2018 (2017: same).

Investments in associates that are not individually significant

As at 31 December 2018 and 2017, all of the Group's investments in associates were not individually significant. The aggregate summarised financial information of the Group's associates that are not individually significant are provided below:

	2018 US\$ 000	2017 US\$ 000
Summarised statement of financial position as of 31 December:		
Total assets	274,625	243,037
Total liabilities	(5,328)	(2,786)
Equity	<u>269,297</u>	<u>240,251</u>
Carrying amount of investments	<u>71,513</u>	<u>77,512</u>
Summarised statement of income for the year ended 31 December:		
Revenue	<u>1,824</u>	14,666
Loss for the year	<u>(1,414)</u>	(2,879)
Other comprehensive income for the year	<u>-</u>	<u>-</u>
Total comprehensive loss for the year	<u>(1,414)</u>	(2,879)
Group's share of loss for the year (note 25)	<u>(764)</u>	(2,922)

12 INVESTMENT PROPERTIES

	2018 US\$ 000	2017 US\$ 000
At 1 January	105,093	101,326
Acquired on acquisition of subsidiary (note 5)	2,171	-
Revaluation (note 23)	124	2,732
Foreign currency translation and other adjustments	241	1,035
At 31 December	<u>107,629</u>	<u>105,093</u>

Investment properties comprise of land and buildings owned by the Group. These are stated at fair values, determined based on independent valuations performed by external professional valuers at the year end.

Valuations of investment properties were conducted by independent appraisers with a recognised and relevant professional qualification and recent experience of the location and category of investment property being valued. The discounted future cash flow method or property market value method have been used as deemed appropriate considering the nature and usage of the properties. The Group's investment properties are categorised in level 3 of the fair value hierarchy as at 31 December 2018 and 2017.

Significant increases (decreases) in estimated rental value and rent growth per annum in isolation would result in a significantly higher (lower) fair value of the properties. Significant increases (decreases) in the long-term vacancy rate and discount rate (and exit yield) in isolation would result in a significantly lower (higher) fair value.

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At 31 December 2018

13 PROPERTY AND EQUIPMENT

2018	<i>Land US\$ 000</i>	<i>Buildings US\$ 000</i>	<i>Furniture and fixtures US\$ 000</i>	<i>Computers and vehicles US\$ 000</i>	<i>Total US\$ 000</i>
Cost					
Balance as at 1 January 2018	-	-	4,329	6,167	10,496
Acquired on acquisition of a subsidiary	15,852	55,627	14,265	10,645	96,389
Additions during the year	-	-	199	2,090	2,289
At 31 December 2018	15,852	55,627	18,793	18,902	109,174
Depreciation					
Balance as at 1 January 2018	-	-	(3,508)	(5,309)	(8,817)
Acquired on acquisition of a subsidiary	-	(35,040)	(14,002)	(9,733)	(58,775)
Charge for the year	-	(495)	(576)	(1,117)	(2,188)
At 31 December 2018	-	(35,535)	(18,086)	(16,159)	(69,780)
Net book value:					
At 31 December 2018	15,852	20,092	707	2,743	39,394
At 31 December 2017	-	-	821	858	1,679

14 GOODWILL AND OTHER INTANGIBLE ASSETS

2018	<i>Goodwill US\$ 000</i>	<i>Customer relationships US\$ 000</i>	<i>Licenses with definite useful lives US\$ 000</i>	<i>Total US\$ 000</i>
Cost				
Balance as at 1 January 2018	52,390	-	-	52,390
Acquired on acquisition of a subsidiary	-	11,328	3,627	14,955
Foreign currency translation adjustments	(298)	-	-	(298)
At 31 December 2018	52,092	11,328	3,627	67,047
Amortisation and impairment				
Balance as at 1 January 2018	-	-	-	-
Acquired on acquisition of a subsidiary	-	-	-	-
Amortisation	-	(413)	-	(413)
At 31 December 2018	-	(413)	-	(413)

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At 31 December 2018

14 GOODWILL AND OTHER INTANGIBLE ASSETS (continued)

	<i>Goodwill</i>	<i>Customer</i>	<i>Licenses</i>	
	<i>US\$ 000</i>	<i>relationships</i>	<i>with definite</i>	
		<i>US\$ 000</i>	<i>useful lives</i>	<i>Total</i>
			<i>US\$ 000</i>	<i>US\$ 000</i>
2017				
Cost				
Balance as at 1 January 2017	51,868	-	-	51,868
Transferred as part of restructuring	(197)	-	-	(197)
Foreign currency translation adjustments	719	-	-	719
At 31 December 2017	52,390	-	-	52,390
Amortisation and impairment				
Balance as at 1 January 2017 and				
At 31 December 2017	-	-	-	-
Net book value:				
At 31 December 2018	52,092	10,915	3,627	66,634
At 31 December 2017	52,390	-	-	52,390

Goodwill

The goodwill remaining as of 31 December relates to KAMCO (a subsidiary) and is allocated to the asset management and investment banking operating segment, a cash generating unit (a CGU). The recoverable amount of the CGU is determined based on a value in use calculation using cash flow projections from financial budgets approved by the Group's senior management covering a five year period. The key assumptions used in the value in use calculation include a perpetuity growth rate of 3% (2017: 3%) and discount factor of 9.6% (2017: 9.5%). There was no goodwill impairment identified in 2018 or 2017 as the recoverable amount of the CGU was higher than its net book value.

The calculation of value in use for the CGU is sensitive primarily to market risk premium, growth risk rate, risk free rate and country risk premium.

The sensitivity of the value in use calculation to changes in key assumptions used in the impairment assessment of goodwill is disclosed below:

	<i>Impact of change</i>	
	<i>+10%</i>	<i>-10%</i>
Key assumptions		
Growth rate	14,544	(13,284)
Discount factor	(36,551)	48,977

These changes do not result in impairment of goodwill.

Other intangible assets

Intangible assets of US\$ 14,955 thousand were recognised as a result of a Purchase Price Allocation exercise done by KAMCO following its acquisition of GIH (note 5).

Customer relationships and licenses with finite useful lives have a useful economic life of 10 years each and are amortised on a straight line basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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15 TAXATION

The Group's subsidiaries in the United States of America (2017: Malta, the United Kingdom, India, Chile and the United States of America) were subject to income tax in their respective jurisdictions. During 2017, all such subsidiaries, with the exception of UGRIL, were transferred to UGHC as part of the Group's restructuring.

a) Deferred tax liabilities

Deferred tax liabilities relate to the following:

	2018 US\$ 000	2017 US\$ 000
Excess of capital allowances over depreciation	-	390
Changes in fair value of financial instruments	2,666	2,859
	<u>2,666</u>	<u>3,249</u>

Reconciliation of deferred tax liabilities is as follows:

	Opening balance US\$ 000	<i>Recognised in consolidated statement of income US\$ 000</i>	Closing balance US\$ 000
2018			
Excess of capital allowances over depreciation	390	(390)	-
Changes in fair value of financial instruments	2,859	(193)	2,666
	<u>3,249</u>	<u>(583)</u>	<u>2,666</u>
2017			
Excess of capital allowances over depreciation	403	(13)	390
Changes in fair value of financial instruments	1,799	1,060	2,859
	<u>2,202</u>	<u>1,047</u>	<u>3,249</u>

b) Income tax credit

The major components of income tax credit for the year ended 31 December are as follows:

	2018 US\$ 000	2017 US\$ 000
Consolidated statement of income		
Current income tax credit (charge)	678	(2,065)
Movement in deferred tax liabilities recognised in statement of income	(583)	1,047
Income tax credit (charge) reported in the consolidated statement of income - net	<u>95</u>	<u>(1,018)</u>

The Group offsets tax assets and liabilities if and only if it has a legally enforceable right to set off current tax assets and current tax liabilities and the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same tax authority.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

16 LOANS PAYABLE

	Currency*	Subsidiaries US\$ 000	Total US\$ 000
31 December 2018			
Maturing within one year			
1 month or less	KWD	6,994	6,994
3 months or less but over 1 month	KWD	16,326	16,326
1 year or less but over 3 months	KWD	16,467	16,467
		39,787	39,787
Maturing after one year			
More than 1 year & less than 2 years	KWD	16,467	16,467
More than 2 years	US\$	10,779	10,779
		27,246	27,246
		67,033	67,033
31 December 2017			
Maturing within one year			
1 month or less	KWD	662	662
3 months or less but over 1 month	KWD	16,501	16,501
	GBP	2,419	2,419
1 year or less but over 3 months	US\$	2,749	2,749
	GBP	3,534	3,534
	KWD	28,652	28,652
		54,517	54,517
Maturing after one year			
More than 1 year & less than 2 years	KWD	16,562	16,562
More than 2 years	KWD	16,562	16,562
	US\$	11,017	11,017
		44,141	44,141
		98,658	98,658

* KWD represents Kuwaiti Dinar and GBP represents Pound Sterling.

17 LONG TERM BONDS

	2018 US\$ 000	2017 US\$ 000
Fixed interest rate of 6.00% per annum and maturing on 26 July 2023, (KWD 14.9 million)	49,073	-
Floating interest at CBK discount rate + 2.75% per annum (capped at 7% per annum) and maturing on 26 July 2023, (KWD 25.1 million)	82,666	-
	131,739	-

18 OTHER LIABILITIES

	2018 US\$ 000	2017 US\$ 000
Staff related payables	35,812	20,019
Accrued expenses	13,767	3,002
Interest payable	1,045	322
Dividends payable	2,505	2,511
Deferred tax (Note 15)	2,666	3,249
Derivative financial liabilities (Note 30)	376	115
Provisions for legal liabilities under IFRS 3	9,899	-
Deferred consideration payable (note 5)	8,264	-
Deferred income	13,898	-
Other payables	18,143	8,140
	106,375	37,358

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

19 EQUITY**a) Share capital**

The Bank's authorised share capital as of 31 December 2018 comprised 500 million shares of US\$ 0.50 each (2017: 1 billion shares of US\$ 0.25 each).

The issued and fully paid up share capital as of 31 December 2018 comprised 202,263,041 shares of US\$ 0.50 each (2017: 404,526,082 shares of US\$ 0.25 each).

b) Share premium

Share premium represents a non-distributable reserve arising from the exercise of the Bank's Employee Share Option Plan. The reserve is credited with the difference between the proceeds from the exercise of share options and the par value of the shares issued under the plan.

c) Statutory reserve

In accordance with the Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the profit for the year is transferred to a statutory reserve until such time as the reserve reaches 50% of the Bank's paid-up share capital. The reserve is not available for distribution, except in circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

d) General reserve

The Directors have approved a transfer of 10% (2017: nil) of the profit of the Group for the year to general reserve in accordance with the Bank's Articles of Association. During the previous year, the Group transferred US\$ 15,000 thousand from general reserves to retained earnings.

e) Dividend paid

No dividend was announced or paid during the years ended 31 December 2018 or 2017.

f) Foreign currency translation reserve

The foreign currency translation reserve represents the net foreign exchange gain or loss arising from translating the financial statements of the Bank's foreign subsidiaries and associated companies from their functional currencies into United States Dollars.

g) Reclassification adjustment

As part of the Group's restructuring in 2017, foreign currency losses of US\$ 27,939 thousand and fair value losses of US\$ 59,826 thousand were transferred to the consolidated statement of income.

20 FAIR VALUE RESERVE

	Note	2018 US\$ 000	2017 US\$ 000
Non-trading investments			
Balance at 1 January		11,767	(50,811)
Transition adjustment on adoption of IFRS 9	4 (b)	3,037	-
Transferred to consolidated statement of income:			
- as part of restructuring	19 (g)	-	59,826
- sale of non-trading investments		(5,190)	(1,880)
Net movement in unrealised fair values during the year		(21,015)	4,632
Balance at 31 December		(11,401)	11,767
Cash flow hedges			
Balance at 1 January		1,100	844
Net movement in the fair values during the year		180	256
Balance at 31 December		1,280	1,100
		(10,121)	12,867

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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21 PERPETUAL TIER 1 CAPITAL

On 28 March 2016, the Bank issued Perpetual Additional Tier 1 Capital (the "AT1 Capital") amounting to US\$ 33,000 thousand.

The AT1 Capital constitutes subordinated obligations of the Bank and is classified as equity in accordance with IAS 32: *Financial Instruments – Classification*. The AT1 Capital does not have a maturity date and bears interest on its nominal amount from the date of issue at a fixed annual rate.

The AT1 Capital is redeemable by the Bank at its sole discretion on or after 28 March 2021 or on any interest payment date thereafter subject to the prior consent of the Central Bank of Bahrain.

The Bank at its sole discretion may elect not to distribute interest and this is not considered an event of default. If the Bank does not pay interest on the AT1 Capital (for whatever reason), then the Bank must not make any other distribution on or with respect to its other shares that rank equally with or junior to the AT1 Capital.

22 INTEREST INCOME

	2018 US\$ 000	2017 US\$ 000
Loans and receivables	1,084	2,044
Investments carried at fair value through statement of income	595	743
Placements with banks	3,532	1,243
Demand and call deposits with banks	1,152	401
	6,363	4,431

23 INVESTMENT INCOME - NET

	2018 US\$ 000	2017 US\$ 000
Dividend income	1,669	1,907
(Loss) gain on sale of associates	(523)	2,668
Rental income from investment properties	3,945	4,757
Gain on sale of non-trading investments	-	4,369
(Loss) gain on investments carried at fair value through statement of income	(794)	3,902
Unrealized gain on investment properties	124	2,732
Gain on sale due to reclassification of investment	31	2,971
Others	360	504
	4,812	23,810

24 FEES AND COMMISSIONS - NET

	2018 US\$ 000	2017 US\$ 000
Credit related fees, commissions and other income - net	21,381	2,266
Management fees from fiduciary activities	14,965	15,971
Advisory fees	6,619	7,154
	42,965	25,391

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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25 SHARE OF RESULTS OF ASSOCIATES - NET

	2018 US\$ 000	2017 US\$ 000
Al Sharq Financial Brokerage Co.	-	129
Kamco Investment Fund	1,737	(1,787)
KAMCO Real Estate Yield Fund	21	-
Kuwait Education Fund	237	1,055
Manafae Investment Company	(423)	(172)
N.S. 88	(392)	(2)
United Capital Transport Company	(1,944)	(2,145)
	<u>(764)</u>	<u>(2,922)</u>

26 INTEREST EXPENSE

	2018 US\$ 000	2017 US\$ 000
Loans payable	3,975	6,129
Long term bonds	3,353	-
Due to banks and other financial institutions	6,617	7,548
Deposits from customers	787	1,555
	<u>14,732</u>	<u>15,232</u>

27 CASH AND CASH EQUIVALENTS

	2018 US\$ 000	2017 US\$ 000
Demand and call deposits with banks excluding mandatory reserves	143,192	97,675
Placements with original maturities of ninety days or less	109,762	68,577
Cash and cash equivalents gross of expected credit losses	<u>252,954</u>	<u>166,252</u>
Expected credit losses as per IFRS 9	(1,233)	-
Cash and cash equivalents net of expected credit losses	<u>251,721</u>	<u>166,252</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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28 RELATED PARTY TRANSACTIONS

Related parties represent the parent, associates and joint ventures, directors and key management personnel and entities which are controlled, jointly controlled or significantly influenced by any of the above mentioned parties.

The income and expenses in respect of related parties transactions during the year and included in the consolidated financial statements are as follows:

	2018			
	Parent	Associates	Other related parties	Total
	US\$ 000	US\$ 000	US\$ 000	US\$ 000
Gain on investments carried at fair value through statement of income	-	-	15	15
Fees and commissions - net*	6,800	3,290	9,499	19,589
Dividend income	-	-	836	836
Rental income	-	-	2,711	2,711
Interest income	-	-	2,272	2,272
Interest expense	(547)	-	(4,562)	(5,109)
Others	(12)	-	(1,243)	(1,255)
2017				
	Parent	Associates	Other related parties	Total
	US\$ 000	US\$ 000	US\$ 000	US\$ 000
Gain on investments carried at fair value through statement of income	-	-	48	48
Gain on sale of non-trading investments	-	-	(11)	(11)
Fees and commissions - net	1,476	2,224	7,044	10,744
Dividend income	-	-	503	503
Rental income	-	-	2,457	2,457
Interest income	-	-	2,746	2,746
Interest expense	-	-	(19,319)	(19,319)
Others	-	-	(1,023)	(1,023)

*The Bank and UGHC have entered into an arrangement for service sharing between the two group entities. In line with the arrangement the Bank will provide certain services and incur certain expenses on behalf of UGHC.

All related party transactions are on terms that are mutually agreed between the counterparties.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

28 RELATED PARTY TRANSACTIONS (continued)

The year-end balances in respect of related parties included in the consolidated financial statements are as follows:

	2018			
	<i>Parent</i> <i>US\$ 000</i>	<i>Associates</i> <i>US\$ 000</i>	<i>Other related parties</i> <i>US\$ 000</i>	<i>Total</i> <i>US\$ 000</i>
Demand and call deposits with banks	-	-	21,120	21,120
Placements with banks	-	-	21,546	21,546
Non-trading investments	-	-	98,652	98,652
Loans and receivables	-	-	4,101	4,101
Other assets	102	1,716	9,083	10,901
Due to banks and other financial institutions	-	-	(135,908)	(135,908)
Deposits from customers	(14,365)	-	(7,074)	(21,439)
Other liabilities	-	-	(4,335)	(4,335)
Perpetual Tier 1 Capital	-	-	(10,000)	(10,000)
<i>Off statement of financial position items:</i>				
Letters of guarantee	-	-	150	150
Investment related commitments	-	-	3,194	3,194
	2017			
	<i>Parent</i> <i>US\$ 000</i>	<i>Associates</i> <i>US\$ 000</i>	<i>Other related parties</i> <i>US\$ 000</i>	<i>Total</i> <i>US\$ 000</i>
Demand and call deposits with banks	-	-	2,170	2,170
Placements with banks	-	-	22,777	22,777
Investments carried at fair value through statement of income	-	-	2,209	2,209
Non-trading investments	-	-	66,274	66,274
Loans and receivables	-	-	33,648	33,648
Other assets	2,357	-	7,212	9,569
Due to banks and other financial institutions	-	-	(134,689)	(134,689)
Deposits from customers	-	-	(18,902)	(18,902)
Loans payable	-	-	(14,078)	(14,078)
Other liabilities	-	-	(4,778)	(4,778)
Perpetual Tier 1 Capital	-	-	(10,000)	(10,000)
<i>Off statement of financial position items:</i>				
Letters of guarantee	-	-	150	150
Investment related commitments	-	-	4,000	4,000

All related party transactions are on terms that are mutually agreed between the counterparties. All related party exposures are performing.

The Parent has committed to acquire certain FVOCI investment of the Group at its carrying value of US\$ 28 million.

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28 RELATED PARTY TRANSACTIONS (continued)

Compensation of key management personnel was as follows:

	2018	2017
	US\$ 000	US\$ 000
Short term employee benefits	5,991	3,943

29 COMMITMENTS AND CONTINGENCIES***Credit-related commitments***

Credit-related commitments include commitments to extend credit, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Group's customers.

Letters of credit, guarantees (including standby letters of credit) and acceptances committed by the Group to make payments on behalf of customers if certain conditions are met under the terms of the contract.

The Group has the following credit and investment related commitments:

	2018	2017
	US\$ 000	US\$ 000
Credit related		
Letters of guarantee	2,162	812
	2,162	812
Investment related commitments*	5,157	4,017
	7,319	4,829

* Investment related commitments represent commitments for capital calls of fund structures. These commitments can be called during the investment period of the fund which is normally 1 to 5 years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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30 DERIVATIVES

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments.

The table below shows the positive and negative fair values of derivative financial instruments. The notional amount is that of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at year end and are not indicative of either market or credit risk.

	<i>Notional amounts by term to maturity</i>					
	<i>Positive fair value</i>	<i>Negative fair value</i>	<i>Notional amount Total</i>	<i>Within 3 months</i>	<i>3 - 12 months</i>	<i>1 - 5 years</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
31 December 2018						
<i>Derivatives held for trading *</i>						
Forward foreign exchange contracts	1,171	(1,339)	767,694	420,762	327,311	19,621
<i>Derivatives used as hedge of net investments in foreign operations</i>						
Forward foreign exchange contracts	377	(585)	186,165	153,641	32,524	-
<i>Derivatives used as cash flow hedges</i>						
Interest rate swaps	1,280	-	75,000	-	-	75,000
31 December 2017						
<i>Derivatives held for trading *</i>						
Forward foreign exchange contracts	774	(889)	427,968	274,505	153,463	-
<i>Derivatives used as hedge of net investments in foreign operations</i>						
Forward foreign exchange contracts	-	-	245,114	245,114	-	-
<i>Derivatives used as cash flow hedges</i>						
Interest rate swap	1,100	-	145,000	-	70,000	75,000

* The Group uses foreign currency denominated borrowings and forward currency contracts to manage some of its transaction exposures. These currency forward contracts are not designated as cash flow, fair value or net investment in foreign operations hedges and are entered into for periods consistent with currency transaction exposures.

Forward foreign exchange contracts are contractual agreements to either buy or sell a specified currency, at a specific price and date in the future, and are customised contracts transacted in the over-the-counter market.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency.

Hedge of net investments in foreign operations

The Bank has designated certain forward foreign exchange contracts to hedge against changes in the value of its investments in foreign operations for an amount of US\$ 186 million (KWD 37.3 million and EUR 54.7 million) [2017: US\$ 245 million (KWD 74 million)]. Gains or losses on the retranslation of these forward foreign exchange contracts are transferred to equity through other comprehensive income to offset any gains or losses on the translation of the net investments in foreign operations.

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At 31 December 2018

30 DERIVATIVES (continued)**Cash flow hedges**

The Group is exposed to variability in interest cash flows on liabilities which bear interest at a variable rate. The Group uses interest rate swaps as cash flow hedges of these interest rate risks. A schedule indicating as at 31 December, the periods when the net cash flows are expected to occur and when they are expected to affect the consolidated statement of income is as follows:

	2018		2017	
	<i>Within 1 year US\$ 000</i>	<i>1-5 years US\$ 000</i>	<i>Within 1 year US\$ 000</i>	<i>1-5 years US\$ 000</i>
Net cash outflows (liabilities)	1,141	391	1,363	1,985
Other comprehensive income	1,280	-	1,100	-

31 RISK MANAGEMENT**a) Introduction**

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is considered critical to the Group's continuing profitability.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Group's strategic planning process.

The major risks to which the Group is exposed while conducting its business and operations, and the means and organisational structure it employs to manage them strategically for building shareholder value, are outlined below.

Risk management structure

Each subsidiary within the Group is responsible for managing its own risks and has its own Board Committees, including Audit and Executive Committees in addition to other management committees such as Credit/Investment Committee and Asset and Liability Committees (ALCO), or equivalent, with responsibilities generally the same as the Bank's committees.

The Board's role is to approve investment strategies of the Bank. However, it has delegated authority for the day-to-day decision making to the Executive Committee so that risk can be effectively managed within the Bank.

The Board of Directors has delegated the executive management of the Bank to the Acting Chief Executive Officer (who is not a Director) and has appointed several Board Committees to work with them and to form and define policies and approve procedures for all of the Bank's activities.

The Executive Management of the Bank is headed by the Acting Chief Executive Officer who is broadly responsible for the day to day conduct of the Bank's business in line with the Board's approved policies and procedures and complements and facilitates the Board in meeting its responsibility towards all stakeholders. He is assisted by the six members of the Bank's management team, each of whom is responsible for his or her respective department. Several management committees have been formed which are chaired by the Acting Chief Executive Officer.

Executive Committee

The Executive Committee comprises of four directors including the Chairman, Vice Chairman and two other directors. Board meetings are held through circulation to approve all proposals not within the Investment Committee's risk authority, as well as to act on all matters within the Board's remit.

At 31 December 2018

31 RISK MANAGEMENT (continued)

a) Introduction (continued)

Risk management structure (continued)

Investment Committee

The Investment Committee is mainly responsible for approving or recommending approval to the Executive Committee limits for individual exposures, investments and concentrations towards banks, countries, industries, risk rating classes, or other special risk asset categories. In addition, the Committee also monitors the overall risk profile of the Bank and recommends provision levels to the Executive Committee. The Investment Committee is constituted by a majority motion passed in the Executive Committee. Currently the Committee consists of four members.

Audit Committee

The Audit Committee is appointed by the Board and consists of four members who are Directors, including three independent Directors. The Audit Committee assists the Board in carrying out its responsibilities with respect to assessing (a) the quality and integrity of financial reporting, (b) the audit thereof, (c) the soundness of the internal controls of the Bank, (d) the risk assessment of the Bank's activities, and (e) the methods for monitoring compliance with laws, regulations and supervisory and internal policies.

Risk and Compliance

The Risk and Compliance Committee is responsible for the monitoring and assessment of risks facing the Bank, the review of compliance with internal and external guidelines, the review and recommendation of provisioning requirements, the assessment of the impact on the Bank from new regulatory requirements, and review of Investment Committee decisions. The Committee comprises of six senior executives of the Bank including the Acting Chief Executive Officer. Additionally, the Head of Internal Audit and Quality Assurance participates in the Committee meetings in the capacity of an observer.

Asset and Liability Committee

The Asset and Liability Committee establishes policies and objectives for the asset and liability management of the Bank's statement of financial position in terms of structure, distribution, risk and return and its impact on profitability. It also monitors the cash flow, tenor and cost/yield profiles of assets and liabilities and evaluates the Bank's financial position both from interest rate sensitivity and liquidity points of view, making corrective adjustments based upon perceived trends and market conditions, monitoring liquidity, monitoring foreign exchange exposures and positions. The Committee comprises of six senior executives of the Bank including the Acting Chief Executive Officer.

Management Committee

The Management Committee acts as the steering committee of the Bank as well as a management forum to discuss any relevant issues. It meets on a weekly basis and consists of the Acting Chief Executive Officer and all Department Heads as well as Internal Audit. It also serves to follow up on a weekly basis on the daily conduct of the Bank's business activities. The Committee is headed by the Acting Chief Executive Officer.

Key Persons Committee

The Key Persons Committee comprises three members of senior management. The Committee is mainly responsible for the supervision of adequacy of compliance with the Central Bank of Bahrain and Bahrain Bourse guidelines on key persons trading (insider trading).

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected geographies and industry sectors. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

31 RISK MANAGEMENT (continued)

a) Introduction (continued)

Nominating and Remunerations Committee

The Nominating and Remuneration Committee (NRC) assists the Board in assessing the skills set of Board members and is responsible to oversee the preparation of appropriate nomination documents and notifications proposing candidates for directorships. It reviews the independence of directors on an annual basis, supervises the preparation of induction materials and orientation sessions, makes recommendations to the Board regarding the management structure and ensures that there is a succession plan in place. The NRC comprises of three members, all of whom are independent.

The NRC also recommends/ reviews the remuneration policies for the Board of Directors and senior management and submits recommendations for shareholders' approval.

Risk mitigation

As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates and foreign currency transactions.

The risk profile is assessed before entering into hedge transactions, which are authorised by the appropriate level of seniority within the Group.

Where warranted, the Group enters into legally enforceable netting arrangements covering its money market and foreign exchange trading activities whereby the only net amounts may be settled at maturity. With regard to the credit risk in the off statement of financial statement exposures, third party guarantees are obtained wherever possible as a risk mitigation measure.

Concentration risk

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

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on country and counterparty limits and maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. Robust limit structures put in place by the Board ensures effective monitoring and control of concentration risk and any limit breaches are immediately rectified and reported to the Board.

b) Credit risk

Credit risk arises from the extension of credit facilities in the Group's banking and trading activities as well as in investment activities where there is a possibility that a counterparty may fail to honour its commitment whenever an investment may fail.

Credit risk is mitigated through:

- (i) Establishing an appropriate credit risk environment;
- (ii) Operating under a sound credit and investment approval process;
- (iii) Maintaining appropriate credit administration, measurement and monitoring processes; and
- (iv) Ensuring adequate controls over the credit risk management process.

The Group has well defined policies approved at the individual board level. These provide carefully documented guidelines for credit risk management. There is a two tier committee structure to approve and review credit and investment risk. The Investment Committee comprises of the Acting Chief Executive Officer, Head of Treasury and the Chief Financial Officer. The Head of Credit and Risk Management acts as a non-voting member to the Committee. Exposures beyond Investment Committee limits are approved by the Board's Executive Committee or by the Board of Directors.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

31 RISK MANAGEMENT (continued)

b) Credit risk (continued)

Maximum exposure to credit risk without taking account of any collateral or other credit enhancements

The table below shows the Group's maximum exposure to credit risk for the components of on and off statement of financial position exposure. The maximum exposure shown is gross before the effect of mitigation through the use of collateral arrangements, but after any expected credit losses.

	2018 US\$ 000	2017 US\$ 000
Demand and call deposits with banks	143,510	97,993
Placements with banks	108,529	68,577
Investments at FVTPL	6,941	11,678
Held-to-maturity investments	494	-
Loans and receivables	25,191	4,216
Other assets	58,931	29,740
Letters of guarantee	2,162	812
Derivative financial assets	1,280	1,100
	347,038	214,116

Risk concentrations of the maximum exposure to credit risk

Concentration of risk is managed by client/counterparty, by geographical region and by industry sector. The maximum credit exposure to any single client or counterparty as of 31 December 2018 was US\$ 31.3 million (2017 US\$ 72.1 million) before taking account of collateral or other credit enhancements.

An analysis of the Group's financial assets by geographical region, before taking into account collateral held or other credit enhancements, is as follows:

	<i>G.C.C.</i>	<i>Middle East and North Africa</i>	<i>Europe</i>	<i>Americas</i>	<i>Others</i>	<i>Total</i>
	US\$ 000	US\$ 000	US\$ 000	US\$ 000	US\$ 000	US\$ 000
Demand and call deposits with banks	119,762	192	474	23,082	-	143,510
Placements with banks	85,267	23,262	-	-	-	108,529
Investments at FVTPL	6,941	-	-	-	-	6,941
Held-to-maturity investments	-	494	-	-	-	494
Loans and receivables	17,816	7,375	-	-	-	25,191
Other assets	51,061	6,735	2	1,133	-	58,931
Letters of guarantee	15	343	1,647	157	-	2,162
Derivative financial assets	1,280	-	-	-	-	1,280
31 December 2018	282,142	38,401	2,123	24,372	-	347,038
Demand and call deposits with banks	22,064	111	1,963	73,844	11	97,993
Placements with banks	45,800	22,777	-	-	-	68,577
Investments at FVTPL	11,678	-	-	-	-	11,678
Loans and receivables	3,834	382	-	-	-	4,216
Other assets	27,715	1,257	4	764	-	29,740
Letters of guarantee	662	150	-	-	-	812
Derivative financial assets	1,100	-	-	-	-	1,100
31 December 2017	112,853	24,677	1,967	74,608	11	214,116

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

31 RISK MANAGEMENT (continued)**b) Credit risk (continued)****Risk concentrations of the maximum exposure to credit risk (continued)**

An industry sector analysis of the Group's financial assets, before taking into account collateral held or other credit enhancements, is as follows:

	<i>Trading & Manufacturing</i>	<i>Banks and other financial institutions</i>	<i>Construction and real estate</i>	<i>Individuals</i>	<i>Others</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
At 31 December 2018						
Demand and call deposits with banks	-	143,510	-	-	-	143,510
Placements with banks	-	108,529	-	-	-	108,529
Investments at FVTPL	-	6,941	-	-	-	6,941
Held-to-maturity investments	-	494	-	-	-	494
Loans and receivables	-	1,516	-	23,283	392	25,191
Other assets	-	53,485	-	10	5,436	58,931
Letters of guarantee	-	2,162	-	-	-	2,162
Derivative financial assets	-	1,280	-	-	-	1,280
	-	317,917	-	23,293	5,828	347,038
At 31 December 2017						
Demand and call deposits with banks	-	97,993	-	-	-	97,993
Placements with banks	-	68,577	-	-	-	68,577
Investments at FVTPL	-	11,678	-	-	-	11,678
Loans and receivables	-	-	1,873	1,670	673	4,216
Other assets	15,283	5,366	2,298	752	6,041	29,740
Letters of guarantee	662	150	-	-	-	812
Derivative financial assets	-	1,100	-	-	-	1,100
	15,945	184,864	4,171	2,422	6,714	214,116

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained for commercial lending include charges over real estate properties, inventory, trade receivables, trading securities and bank guarantees.

The Group also obtains guarantees from parent companies for loans to their subsidiaries.

Management monitors the market value of collateral and requests additional collateral in accordance with the underlying agreement, during its review of the adequacy of the allowance for impairment losses.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

31 RISK MANAGEMENT (continued)

b) Credit risk (continued)

Credit risk exposure for each credit rating

	<i>Investment grade</i>	<i>Non- investment grade</i>	<i>Unrated*</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
At 31 December 2018				
Demand and call deposits with banks	143,071	318	121	143,510
Placements with banks	85,267	-	23,262	108,529
Investments at FVTPL	6,941	-	-	6,941
Held-to-maturity investments	-	-	494	494
Loans and receivables	-	-	25,191	25,191
Other assets	2,330	-	56,601	58,931
Letters of guarantee	-	-	2,162	2,162
Derivative financial assets	1,280	-	-	1,280
	238,889	318	107,831	347,038

* Includes exposures to counterparties not rated by credit rating agencies

At 31 December 2017

Demand and call deposits with banks	97,498	318	177	97,993
Placements with banks	45,800	-	22,777	68,577
Investments at FVTPL	11,678	-	-	11,678
Loans and receivables	-	-	4,216	4,216
Other assets	1,406	34	28,300	29,740
Letters of guarantee	662	-	150	812
Derivative financial assets	1,100	-	-	1,100
	158,144	352	55,620	214,116

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risk and the comparison of credit exposures across all business lines, geographic regions and products. All externally rated credit risk exposures are rated by the relevant External Credit Assessment Institutions ("ECAIs").

Additionally, the internal risk ratings of the Group's externally unrated credit risk exposures which are largely subjective, are tailored to the various categories and are derived in accordance with the internal rating policy and practices. The attributable internal risk ratings are assessed and updated on a regular basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

31 RISK MANAGEMENT (continued)**b) Credit risk (continued)****Credit risk exposure for each credit rating (continued)**

The table above reflects the risk ratings of the credit risk exposures rated by the relevant ECAs. All of the externally unrated credit risk exposures have been classified under "Unrated" category.

Restructured loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. The Group has not restructured any loans as of 31 December 2018 (31 December 2017: Same).

Offsetting financial assets and financial liabilities

The disclosures set out in the table below include financial assets and financial liabilities that are offset in the Group's statement of financial position:

	<i>Loans and receivables US\$ 000</i>	<i>Customer deposits US\$ 000</i>
31 December 2018		
Gross amounts of recognised financial asset / liability	285,000	285,000
Gross amounts offset in the consolidated statement of financial position	(285,000)	(285,000)
Net amount of financial liability presented in the consolidated statement of financial position	-	-
31 December 2017		
Gross amounts of recognised financial asset / liability	305,700	305,700
Gross amounts offset in the consolidated statement of financial position	(305,700)	(305,700)
Net amount of financial liability presented in the consolidated statement of financial position	-	-

c) Market risk

Market risk is defined as the risk of losses in the value of on-or-off statement of financial position financial instruments caused by a change in market prices or rates, (including changes in interest rates and foreign exchange rates). The Group's policy guidelines for market risk have been vetted by the Board of Directors in compliance with the rules and guidelines provided by the Central Bank of Bahrain. The Central Bank of Bahrain guidelines introduced a risk measurement framework whereby all locally incorporated banks in Bahrain are required to measure and apply capital charges in respect of their market risk in addition to capital requirements for credit risk and operational risk.

The market risk subject to capital charge normally arises from changes in value due to market forces in the following exposures:

- Interest rate instruments and securities in the trading book; and
- Foreign exchange throughout the banking book.

The Group has entered into interest rate swaps and forward foreign exchange contracts for hedging purposes and does not actively trade in derivatives.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

31 RISK MANAGEMENT (continued)

c) Market risk (continued)

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's consolidated statement of income based on the consolidated statement of financial position as of 31 December:

Currency	Sensitivity of		Sensitivity of	
	Increase in basis points 2018	net interest income 2018 US\$ 000	Increase in basis points 2017	net interest income 2017 US\$ 000
Kuwaiti Dinar	+ 25	(260)	+ 25	(356)
United States Dollar	+ 25	(104)	+ 25	(147)
Euro	+ 25	(4)	+ 25	13
Pound Sterling	+ 25	-	+ 25	-
Others	+ 25	286	+ 25	32

The decrease in the basis points will have an opposite impact on the net interest income.

The sensitivity of the consolidated statement of income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate financial assets and financial liabilities held at 31 December 2018, including the effect of hedging instruments.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group considers the United States Dollar as its functional currency. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

The table below indicates the effect on profit before tax for the positions as at statement of financial position date as a result of change in the currency rate with all other variables held constant.

Currency	Effect on		Effect on		Effect on	
	Change in currency rate in % 2018	profit before tax 2018 US\$ 000	Effect on equity 2018 US\$ 000	Change in currency rate in % 2017	profit before tax 2017 US\$ 000	Effect on equity 2017 US\$ 000
Kuwaiti Dinar	+2	(16,280)	19,615	+2	(6,174)	2,143
	-2	16,280	(19,615)	-2	6,174	(2,143)
Euro	+2	(1,425)	24,037	+2	(59)	3
	-2	1,425	(24,037)	-2	59	(3)
Pound Sterling	+2	17	-	+2	(121)	-
	-2	(17)	-	-2	121	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

31 RISK MANAGEMENT (continued)**c) Market risk (continued)****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.

The geographical distribution of the Group's equity investments is as follows:

Geographical distribution

At 31 December 2018	<i>Middle East/ North Africa</i> US\$ 000	<i>Europe</i> US\$ 000	<i>North America</i> US\$ 000	<i>Others</i> US\$ 000	<i>Total</i> US\$ 000
Investments carried at fair value through statement of income					
Quoted equities	10,584	879	783	32	12,278
Unquoted equities	280	-	2,930	-	3,210
Managed funds	42,706	9,916	6,801	-	59,423
	53,570	10,795	10,514	32	74,911
Non-trading investments					
Quoted equities	45,219	-	-	-	45,219
Unquoted equities	76,565	40,109	3,182	442	120,298
Managed funds	1,124	-	973	33	2,130
	122,908	40,109	4,155	475	167,647
Total	176,478	50,904	14,669	507	242,558
At 31 December 2017	<i>Middle East/ North Africa</i> US\$ 000	<i>Europe</i> US\$ 000	<i>North America</i> US\$ 000	<i>Others</i> US\$ 000	<i>Total</i> US\$ 000
Investments carried at fair value through statement of income					
Quoted equities	6,303	-	1	1	6,305
Managed funds	956	263	66	-	1,285
	7,259	263	67	1	7,590
Non-trading investments					
Quoted equities	31,514	-	10,567	-	42,081
Unquoted equities	111,629	25,609	5,879	-	143,117
Managed funds	34,129	-	2,239	-	36,368
	177,272	25,609	18,685	-	221,566
Total	184,531	25,872	18,752	1	229,156

At the reporting date, the exposure to listed equity securities at fair value was US\$ 57,497 thousand (2017: US\$ 48,386 thousand). A decrease of 10% on the market indices of MENA stock exchanges could have an impact of approximately US\$ 5,750 thousand (2017: US\$ 4,839 thousand) on the income or equity attributable to the Group, depending on whether the decline is significant or prolonged. The majority of the equities in the MENA region are quoted on the Boursa Kuwait.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

31 RISK MANAGEMENT (continued)**d) Liquidity risk****Analysis of financial liabilities by remaining contractual maturities**

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2018 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

At 31 December 2018**Financial liabilities**

Due to banks and other financial institutions
Deposits from customers
Loans payable
Long term bonds
Other liabilities

	On demand US\$ 000	1 - 6 months US\$ 000	6 - 12 months US\$ 000	1 - 5 years US\$ 000	Over 5 years US\$ 000	Total US\$ 000
	120,879	-	100,000	-	-	220,879
	31,145	1,463	-	-	-	32,608
	-	23,320	16,467	27,246	-	67,033
	-	-	-	131,739	-	131,739
	-	63,601	-	42,774	-	106,375
Total non-derivative undiscounted financial liabilities	152,024	88,384	116,467	201,759	-	558,634

Derivatives

Net cash outflows on interest rate swaps
Gross settled foreign currency derivatives

	-	571	571	390	-	1,532
	-	846,491	87,747	19,621	-	953,859

Off-statement of financial position items

Letters of guarantee
Investment related commitments

	-	-	2,162	-	-	2,162
	-	-	-	5,157	-	5,157

The Group expects that not all of contingent items or commitments will be drawn before expiry of the commitments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

31 RISK MANAGEMENT (continued)
d) Liquidity risk (continued)

At 31 December 2017

Financial liabilities

Due to banks and other financial institutions
Deposits from customers
Loans payable
Other liabilities

On demand US\$ 000	1 - 6 months US\$ 000	6 - 12 months US\$ 000	1 - 5 years US\$ 000	Over 5 years US\$ 000	Total US\$ 000
133,661	16,757	101,423	-	-	251,841
62,395	6,323	-	-	-	68,718
663	40,270	14,746	49,224	-	104,903
37,358	-	-	-	-	37,358
234,077	63,350	116,169	49,224	-	462,820

Total non-derivative undiscounted financial liabilities

Derivatives

Net cash outflows on interest rate swaps
Gross settled foreign currency derivatives

-	780	583	1,985	-	3,348
-	673,082	-	-	-	673,082

Off statement of financial position items

Letters of guarantee
Investment related commitments

-	-	812	-	-	812
-	-	-	4,017	-	4,017

The Group expects that not all of contingent items or commitments will be drawn before expiry of the commitments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

31 RISK MANAGEMENT (continued)**d) Liquidity risk (continued)**

In order to ensure that the Group can meet its financial obligations as they fall due, there is a close monitoring of its assets / liabilities position. Besides other functions, the Asset-Liability Committee evaluates the statement of financial position both from a liquidity and an interest rate sensitivity point of view. The whole process is aimed at ensuring sufficient liquidity to fund its ongoing business activities and to meet its obligations as they fall due. A diversified funding base has evolved in deposits raised from the interbank market, deposits received from customers and medium term funds raised through syndicated and commodity based murabaha transactions. These, together with the strength of its equity and the asset quality, ensure that funds are made available on competitive rates.

The maturity analysis of assets and liabilities analysed according to when they are expected to be recovered or settled are as follows:

At 31 December 2018

	<i>Less than 12 months US\$ 000</i>	<i>Over 12 months US\$ 000</i>	<i>Total US\$ 000</i>
Demand and call deposits with banks	143,192	318	143,510
Placements with banks	108,529	-	108,529
Investments carried at fair value through statement of income	81,852	-	81,852
Non-trading investments	45,252	122,395	167,647
Non-trading investments	-	494	494
Loans and receivables	21,169	4,022	25,191
Other assets	61,097	-	61,097
Investments in associates	-	71,513	71,513
Investment properties	-	107,629	107,629
Property and equipment	-	39,394	39,394
Goodwill and other intangible assets	-	66,634	66,634
Total assets	461,091	412,399	873,490
Due to banks and other financial institutions	220,879	-	220,879
Deposits from customers	32,608	-	32,608
Loans payable	39,787	27,246	67,033
Long term bonds	-	131,739	131,739
Other liabilities	63,601	42,774	106,375
Total liabilities	356,875	201,759	558,634
Net	104,216	210,640	314,856

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

31 RISK MANAGEMENT (Continued)**d) Liquidity risk (continued)**

At 31 December 2017

	<i>Less than 12 months US\$ 000</i>	<i>Over 12 months US\$ 000</i>	<i>Total US\$ 000</i>
Demand and call deposits with banks	97,675	318	97,993
Placements with banks	68,577	-	68,577
Investments carried at fair value through statement of income	19,268	-	19,268
Non-trading investments	42,081	179,485	221,566
Loans and receivables	1,564	2,652	4,216
Other assets	31,820	-	31,820
Investments in associates and joint venture	-	77,512	77,512
Investment properties	-	105,093	105,093
Property and equipment	-	1,679	1,679
Goodwill	-	52,390	52,390
Total assets	260,985	419,129	680,114
Due to banks and other financial institutions	250,211	-	250,211
Deposits from customers	31,018	-	31,018
Loans payable	54,517	44,141	98,658
Other liabilities	37,358	-	37,358
Total liabilities	373,104	44,141	417,245
Net	(112,119)	374,988	262,869

e) Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. When controls fail to perform operational risk can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group has established a board approved framework for operational risk management which comprehensively outlines operational risk appetite for the Bank and provides operational risk management procedures. The Framework is supported by a dedicated operational risk system covering Loss Data Collection, Risk and Control Self Assessment and Key Indicator modules which have been rolled out in the Bank. While, the Group cannot expect to eliminate all operational risks, but through dedicated operational risk framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

32 FAIR VALUE MEASUREMENT

The Group uses the hierarchy for determining and disclosing the fair value of financial instruments as disclosed in Note 2.

Management has assessed that financial assets comprising of demand and call deposits with banks, placements with banks, and loans and receivables maturing within one year, and financial liabilities comprising of on-demand customer deposits, amounts due to banks and loans payable falling due within one year approximate their carrying values largely due to the short term maturities of these instruments.

The following table provides the fair value measurement hierarchy of the Group's assets and liabilities.

Quantitative disclosures fair value measurement hierarchy for assets as at 31 December 2018:

	<i>Fair value measurement using</i>			
	<i>Level 1</i> <i>US\$ 000</i>	<i>Level 2</i> <i>US\$ 000</i>	<i>Level 3</i> <i>US\$ 000</i>	<i>Total</i> <i>US\$ 000</i>
Assets measured at fair value				
Investments carried at fair value through statement of income				
Quoted equities	12,278	-	-	12,278
Quoted debt securities	6,941	-	-	6,941
Unquoted equities	-	-	3,210	3,210
Managed funds	-	43,516	15,907	59,423
Non-trading investments				
Equities - quoted	45,219	-	-	45,219
Equities - unquoted	-	69,025	51,273	120,298
Other managed funds	-	-	2,130	2,130
Derivatives				
Interest rate swaps	-	1,280	-	1,280
Investment properties	-	-	107,629	107,629
	64,438	113,821	180,149	358,408
Liabilities measured at fair value				
Derivatives				
Forward foreign exchange contracts	-	(376)	-	(376)
	-	(376)	-	(376)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2018

32 FAIR VALUE MEASUREMENT (continued)

Quantitative disclosures fair value measurement hierarchy for assets as at 31 December 2017:

	Fair value measurement using			
	Level 1	Level 2	Level 3	Total
	US\$ 000	US\$ 000	US\$ 000	US\$ 000
Assets measured at fair value				
Investments carried at fair value through statement of income				
Quoted equities	6,305	-	-	6,305
Quoted debt securities	11,678	-	-	11,678
Managed funds	-	1,285	-	1,285
Non-trading investments				
Equities - quoted	42,081	-	-	42,081
Equities - unquoted	-	82,410	463	82,873
Other managed funds	-	25,011	10,342	35,353
Derivatives				
Interest rate swaps	-	1,100	-	1,100
Investment properties	-	-	105,093	105,093
	60,064	109,806	115,898	285,768
Liabilities measured at fair value				
Derivatives				
Forward foreign exchange contracts	-	(115)	-	(115)
	-	(115)	-	(115)

Transfers between Level 1, Level 2 and Level 3

During the year ended 31 December 2018 there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into or out of Level 3 fair value measurement.

Reconciliation of fair value measurement of investments in level 3 of the fair value hierarchy:

	<i>Equities US\$ 000</i>	<i>Other managed funds US\$ 000</i>	<i>Investment properties US\$ 000</i>	<i>Total US\$ 000</i>
As at 1 January 2017	474	15,581	101,326	117,381
Recognised in statement of income	-	-	3,767	3,767
Net purchases, sales and transfers and settlements	(11)	(5,024)	-	(5,035)
Remeasurement recognised in OCI	-	(215)	-	(215)
As at 1 January 2018	463	10,342	105,093	115,898
Recognised in statement of income	-	(652)	124	(528)
Net purchases, sales and transfers and settlements	64,052	8,347	2,171	74,570
Remeasurement recognised in OCI	(10,032)	-	-	(10,032)
Other adjustments	-	-	241	241
As at 31 December 2018	54,483	18,037	107,629	180,149

33 CAPITAL ADEQUACY

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") as adopted by the Central Bank of Bahrain.

Capital management

The primary objectives of the Group's capital management are to ensure that the Group complies with capital requirements of the Central Bank of Bahrain and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, or issue equity securities. No changes were made in the capital management objectives, policies and processes from previous years.

The risk asset ratio calculated in accordance with the capital adequacy guidelines issued by the Central Bank of Bahrain, for the Group is as follows:

	2018	2017
	US\$ 000	US\$ 000
Capital base:		
Tier 1	147,347	188,657
Tier 2	6,219	3,428
Total capital base (a)	153,566	192,085
Credit risk weighted exposure	944,533	750,074
Market risk weighted exposure	10,375	87,463
Operational risk weighted exposure	38,413	54,400
Total risk weighted exposure (b)	993,321	891,937
Capital adequacy (a/b * 100)	15.46%	21.54%
Minimum requirement	12.5%	12.5%

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, statutory reserve, general reserve, treasury share reserve, foreign currency reserve, retained earnings and non-controlling interests less goodwill. The other component of regulatory capital is Tier 2 capital, which includes subordinated long term debt and fair value reserves.