
CONSOLIDATED FINANCIAL STATEMENTS AND AUDIT REPORT

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2020

	Note	2020 BD 000	2019 BD 000
ASSETS			
Cash and balances with banks and Central Bank of Bahrain	7	61,277	99,535
Due from banks	8	123,590	115,216
Financing contracts	9	1,005,228	913,907
Investments	10	6,861	6,156
Investment in sukuk	11	324,739	270,277
Investment in associate	12	6,889	8,461
Receivables and other assets	14	223,377	247,328
Premises and equipment		3,703	9,553
TOTAL ASSETS		1,755,664	1,670,433
LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNERS' EQUITY			
LIABILITIES			
Customers' current accounts		133,114	128,258
Due to banks	15	108,798	101,783
Due to non-banks		364,048	222,965
Other liabilities	17	16,298	15,399
TOTAL LIABILITIES		622,258	468,405
EQUITY OF INVESTMENT ACCOUNT HOLDERS			
Banks		182,948	159,699
Non-banks and individuals	18	783,229	848,670
TOTAL EQUITY OF INVESTMENT ACCOUNT HOLDERS		966,177	1,008,369
OWNERS' EQUITY			
Equity attributable to shareholders of the Parent			
Share capital	19	132,519	132,519
Statutory reserve		25,640	24,115
Fair value through equity reserve		1,018	324
Proposed dividend		-	22,517
Retained earnings		311	3,587
		159,488	183,062
Non-controlling shareholders		7,741	10,597
		167,229	193,659
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNERS' EQUITY		1,755,664	1,670,433
OFF-BALANCE SHEET			
EQUITY OF INVESTMENT ACCOUNT HOLDERS		136,710	135,145
CONTINGENT LIABILITIES AND COMMITMENTS	21	75,649	108,796

Hamad Abdul Mohsen Al-Marzouq
Chairman of the
Board of Directors

Abdulhakeem Yaqoub Alkhayyat
Managing Director and
Chief Executive Officer

The attached notes 1 to 40 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2020

	Note	2020 BD 000	2019 BD 000
Income from financing contracts	23	59,521	63,365
Income from investments	24	2,065	1,720
Income from sukuk		14,855	20,200
Share of loss from associate		(463)	(164)
OPERATING INCOME		75,978	85,121
Return on equity of investment account holders (wakala)		(18,045)	(22,017)
Return on equity of investment account holders (mudaraba) before Group's share as mudarib		(12,381)	(9,828)
Group's share as mudarib	18	10,346	7,945
Return on equity of investment account holders (mudaraba) after Group's share as mudarib		(2,035)	(1,883)
Profit on due to banks and non-banks	28	(15,038)	(12,490)
NET OPERATING INCOME		40,860	48,731
Staff costs		11,933	13,235
Depreciation		1,493	1,292
Provisions - net	26	1,633	(695)
Other expenses	27	10,564	9,889
TOTAL OPERATING EXPENSES		25,623	23,721
NET INCOME FOR THE YEAR		15,237	25,010
Attributable to:			
Shareholders of the Parent		15,246	25,019
Non-controlling shareholders		(9)	(9)
		15,237	25,010

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CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2020

	Note	2020 BD 000	2019 BD 000
OPERATING ACTIVITIES			
Net income for the year		15,237	25,010
Adjustments for:			
Share of loss from associate		463	164
Net (gain) on sale of investments	24	(359)	-
Net unrealised (gain) on investments	24	-	(198)
Net gain on sale of premises and equipment		-	(5)
Foreign exchange gain	24	(413)	(839)
Depreciation		1,493	1,292
Provisions - net	26	6,166	(631)
Operating income before changes in operating assets and liabilities		22,587	24,793
Changes in operating assets and liabilities:			
Mandatory reserve with Central Bank of Bahrain		2,966	(605)
Due from banks		454	4,041
Financing contracts		(137,084)	(38,796)
Receivables and other assets		18,502	(1,613)
Financial support from government		1,460	-
Customers' current accounts		4,856	510
Due to banks		7,015	(13,944)
Due to non-banks		141,083	61,000
Other liabilities		137	1,619
Net cash flows from operating activities		61,976	37,005
INVESTING ACTIVITIES			
Disposal of investments - net		3,452	-
Purchase of sukuk - net		(54,452)	(226,066)
Sale proceeds from disposal of sukuk		-	178,384
Purchase of premises and equipment - net		(463)	(885)
Proceeds from disposal of a subsidiary		4,760	-
Net cash flows used in investing activities		(46,703)	(48,567)
FINANCING ACTIVITY			
Net movement in equity of investment account holders		(42,192)	105,554
Net cash flows (used) from financing activity		(42,192)	105,554
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS			
Cash and cash equivalents at 1 January		182,693	88,701
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	29	155,774	182,693

The attached notes 1 to 40 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

For the year ended 31 December 2020

	Equity attributable to shareholders of the Parent							Non -controlling shareholders BD 000	Total owners' equity BD 000
	Share capital BD 000	Statutory reserve BD 000	Fair value through equity reserve BD 000	Retained earnings BD 000	Proposed dividend BD 000	Total BD 000			
Balance at 1 January 2020	132,519	24,115	324	3,587	22,517	183,062	10,597	193,659	
Net income for the year	-	-	-	15,246	-	15,246	(9)	15,237	
Other comprehensive income for the year (note 20)	-	-	694	-	-	694	-	694	
Total comprehensive income for the year	-	-	694	15,246	-	15,940	(9)	15,931	
Dividend payout	-	-	-	-	(22,517)	(22,517)	-	(22,517)	
Transfer to statutory reserve	-	1,525	-	(1,525)	-	-	-	-	
Recognition of modification loss net of government grant (note 39)	-	-	-	(16,997)	-	(16,997)	-	(16,997)	
Net movement in share of non-controlling shareholders	-	-	-	-	-	-	(2,847)	(2,847)	
Balance at 31 December 2020	132,519	25,640	1,018	311	-	159,488	7,741	167,229	
Balance at 1 January 2019	132,519	21,613	170	3,587	16,608	174,497	7,766	182,263	
Net income for the year	-	-	-	25,019	-	25,019	(9)	25,010	
Other comprehensive income for the year (note 20)	-	-	154	-	-	154	-	154	
Total comprehensive income for the year	-	-	154	25,019	-	25,173	(9)	25,164	
Dividend payout	-	-	-	-	(16,608)	(16,608)	-	(16,608)	
Transfer to statutory reserve	-	2,502	-	(2,502)	-	-	-	-	
Proposed dividend (note 19)	-	-	-	(22,517)	22,517	-	-	-	
Net movement in share of non-controlling shareholders	-	-	-	-	-	-	2,840	2,840	
Balance at 31 December 2019	132,519	24,115	324	3,587	22,517	183,062	10,597	193,659	

The attached notes 1 to 40 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN OFF-BALANCE SHEET EQUITY OF INVESTMENT ACCOUNT HOLDERS

For the year ended 31 December 2020

	Balance at 1 January 2020 BD 000	Additional investments BD 000	Gross income BD 000	Mudarib share BD 000	Withdrawals/ distributions BD 000	Balance at 31 December 2020 BD 000
Investment in Murabaha	135,145	98,470	9,963	(1,887)	(104,981)	136,710
	Balance at 1 January 2019 BD 000	Additional investments BD 000	Gross income BD 000	Mudarib share BD 000	Withdrawals / distributions BD 000	Balance at 31 December 2019 BD 000
Investment in Murabaha	135,110	104,525	9,654	(2,035)	(112,109)	135,145

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

1 CORPORATE INFORMATION AND ACTIVITIES

Kuwait Finance House (Bahrain) B.S.C. (c) (the "Bank") is a closed joint stock company incorporated in the Kingdom of Bahrain on 22 January 2002 under the Bahrain Commercial Companies Law No. 21/2001 and is registered with the Ministry of Industry and Commerce under commercial registration (CR) number 48128. The Bank is regulated and supervised by the Central Bank of Bahrain (the "CBB") and has an Islamic retail banking license. The Bank operates under Islamic principles and in accordance with all the relevant regulatory guidelines for Islamic banks issued by the CBB. The address of the Bank's registered office is World Trade Centre, road number 365, Building number 1B, Block 316, P.O. Box 2066, Manama, Kingdom of Bahrain.

The Bank offers a full range of Islamic banking services and products. The activities of the Bank include accepting Shari'a compliant money placements / deposits, managing Shari'a compliant profit sharing investment accounts, offering Shari'a compliant financing contracts, dealing in Shari'a compliant financial instruments as principal / agent, managing Shari'a compliant financial instruments and other activities permitted under the CBB's Regulated Islamic Banking Services as defined in the licensing framework.

The Bank is a wholly owned subsidiary of Kuwait Finance House K.S.C.P. (the "Ultimate Parent"), a public company incorporated in the State of Kuwait and listed at the Kuwait Stock Exchange. The Ultimate Parent is regulated and supervised by the Central Bank of Kuwait. The Bank's Shari'a Supervisory Board is entrusted to ensure the Group's adherence to Shari'a rules and principles in its transactions and activities.

During the year, the Bank disposed-off its investment in a subsidiary; Energy Central Utilities - Bahrain South Water Company B.S.C.. The income from disposal of the subsidiary is disclosed in note 24.

The Bank and its subsidiaries (together the "Group") operate in the Kingdom of Bahrain and Hashemite Kingdom of Jordan. The activities of the Bank's key subsidiaries are mentioned in note 5.

The Bank has nine branches (2019: nine), all operating in the Kingdom of Bahrain.

Impact of COVID-19

The outbreak of coronavirus ("COVID-19") pandemic across the globe has caused disruption to business and economic activities and uncertainties in the global economic environment. The fiscal and monetary authorities have announced several stimulus packages to the Bank's customers, which are in the process of implementation. The Bank has considered potential impacts of the current market volatility in the determination of the reported amounts of the Bank's financial and non-financial assets and are considered to represent management's best assessment based on current observable information. Markets, however, remain volatile and the recorded amounts remain sensitive to market fluctuations.

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors passed on 11 February 2021.

2 BASIS OF PREPARATION

2.1 Accounting convention

The consolidated financial statements have been prepared under the historical cost basis, except for managed funds and equity securities that have been measured at fair value. The consolidated financial statements are presented in Bahraini Dinars ("BD") which is the functional and presentation currency of the Bank. All the values are rounded to the nearest BD thousand, unless otherwise indicated.

2.2 Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with applicable rules and regulations issued by the Central Bank of Bahrain ("CBB") including the recently issued CBB circulars on regulatory concessionary measures in response to COVID-19. These rules and regulations, in particular CBB circular OG/226/2020 dated 21 June 2020 and related CBB communications, require the adoption of all Financial Accounting Standards ("FAS") issued by the Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI) with two exceptions which are set out below. In accordance with the AAOIFI framework, for matters not covered by FAS, the Group uses the requirements of the relevant International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB"). This framework is referred to as "FAS issued by AAOIFI".

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

2 BASIS OF PREPARATION (continued)

2.2 Statement of compliance (continued)

The two exceptions mentioned above are as follows:

- (a) recognition of modification losses on financial assets arising from payment holidays provided to customers impacted by COVID-19 without charging additional profit, in equity instead of profit or loss as required by FAS issued by AAOIFI. Any other modification gain or loss on financial assets are recognised in accordance with the requirements of FAS issued by AAOIFI.
- (b) recognition of financial assistance received from the government and / or regulators in response to its COVID-19 support measures that meets the government grant requirement, in equity instead of profit or loss. This will only be to the extent of any modification loss recorded in equity as a result of (a) above, and the balance amount to be recognised in profit or loss. Any other financial assistance is recognised in accordance with the relevant requirements of FAS issued by AAOIFI. Please refer note (39) for further details.

The above framework for basis of preparation of the consolidated financial statements is hereinafter referred to as 'FAS issued by AAOIFI as modified by CBB', which has been applied retrospectively and did not result in any change to the financial information reported for the comparative period.

2.3 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries as at 31 December each year. The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies.

All intra-group balances, transactions, income and expenses and unrealised gains and losses resulting from intra-group transactions are eliminated in full.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and continue to be consolidated until the date when such control ceases. Control is achieved where the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired or disposed of during the year, if any, are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate. A change in the Group's ownership of a subsidiary, without a loss of control, is accounted for as an equity transaction.

Share of non-controlling shareholders represents the portion of net income and net assets not held by the Group and are presented separately in the consolidated statement of income and within owners' equity in the consolidated statement of financial position, separately from the equity attributable to shareholders of the Parent. Transactions with the non-controlling interest are handled in the same way as transactions with external parties.

3 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of the Group's consolidated financial statements requires management to make judgments, estimates and assumptions that affect the amounts reported in the consolidated financial statements. The most significant uses of judgments and estimates are as follows:

3.1 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, the 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 a going concern basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

3 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES (continued)

3.2 Fair value of unquoted equity securities

Fair value is determined for each investment individually in accordance with the valuation policies set out in note 4.24 and note 32. Where the fair values of the Group's unquoted equity securities cannot be derived from an active market, they are derived using a variety of valuation techniques. Judgment by management is required to establish fair values through the use of appropriate valuation models, consideration of comparable assets, discount rates and the assumptions used to forecast cash flows.

3.3 Impairment provision against financing contracts

In determining impairment on receivables, judgment is required in the estimation of the amount and timing of future cash flows as well as an assessment of whether credit risk on the financial contract has increased significantly since initial recognition or the default has occurred and incorporation of forward-looking information in the measurement of expected credit losses ("ECL").

3.4 Impairment of investments at fair value through equity

The Group treats investments carried at fair value through equity as impaired when there is a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires judgment. The Group evaluates factors, such as the historical share price volatility for comparable quoted equities and future cash flows and the discount factors for comparable unquoted equities.

3.5 Liquidity

The Group manages its liquidity through consideration of the maturity profile of its assets, liabilities and equity of investment account holders which is set out in the maturity profile in note 33 and liquidity risk disclosures in note 34.3. This requires judgment when determining the maturity of assets and liabilities with no specific maturities.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of the consolidated financial statements are set out below:

4.1 Adoption of new and amended standards and interpretations

FAS 31 Investment Agency (Al-Wakala Bi Al-Istithmar)

This standard defines the accounting principles and reporting requirements for investment agency (Al-Wakala Bi Al-Istithmar) transactions and instruments, in the hands of both the principal and the agent. This standard shall be effective beginning on or after 1 January 2021, with early adoption permitted. The standard requires the principal to evaluate the nature of the investment as either a) a pass-through investment or b) wakala venture.

In case of a pass-through investment approach, the principal shall initially recognize the assets underlying the wakala arrangement in its books of account applying the initial recognition principles as applicable in line with respective FAS. The principal may opt to apply the wakala venture approach if, and only if, the investment agency contract meets any of the conditions described below:

- The instrument is transferable; or
- The investment is made in a single asset (or pool of assets) where such asset(s) are subject to frequent changes throughout the term of the contract i.e. there are routine changes or replacements over the term of arrangement (unless it constitutes a business) at the discretion of the agent; or
- The role of the agent is not limited whereby the agent performs day-to-day asset management function and, where applicable, is also responsible for replacement of assets or recoveries against them.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.1 Adoption of new and amended standards and interpretations (continued)

FAS 31 Investment Agency (Al-Wakala Bi Al-Istithmar) (continued)

In case of wakala venture approach, an investment shall be accounted for in the books of the investor applying the “equity method of accounting”; where the investment shall be recognized initially at cost and subsequently shall be measured at the end of the financial period at carrying amount and shall be adjusted to include the investor’s share in profit or loss of the wakala venture.

From the agent perspective, the standard requires that at inception of the transaction the agent shall recognize an agency arrangement under off-balance sheet approach since the agent does not control the related assets / business. However, there are exceptions to off-balance sheet approach where by virtue of additional considerations attached to the instrument based on investment agency may mandate the same to be accounted for as on-balance sheet. An agent may maintain multi-level investment arrangements. Under such arrangement, the Group is reinvesting Wakala funds into a secondary contract. Such secondary contracts shall be accounted for in line with the requirements of respective FAS in the books of the agent.

The Board of Directors decided to early adopt the standard with effect from the current year.

From the principal perspective, the Group opted to use Wakala venture approach instead of pass-through approach given the difficulties for the principal to identify in which assets the funds are invested in, and hence, the investment is accounted for applying the equity method of accounting.

The Group provides funds to other financial institutions under this Wakala venture arrangement where the Group is acting as principal. Those Wakala funds are mainly invested in money market placements. Below are the key terms of the Wakala agreements:

- The Muwakkil “Principal / Investor” appointed the Wakil «Agent» to invest its funds in the Wakil’s treasury pool.
- The Muwakkil as principal shall bear all the risks associated with the acts of the Wakil as an agent, except those risks resulting from the Wakil’s misconduct.
- The Muwakkil will not be entitled to withdraw its funds with the Wakil before the agreed maturity.
- The Wakil agreed to act as an agent of the Muwakkil on restricted limited agency, and the Wakil shall not have any authority to represent or bind the Muwakkil, or purport to do so.
- The Wakil shall be entitled to the agency fees specified in the Wakil Offer in respect of each Investment Transaction.
- The Wakil is a trustee to the Wakala investment and shall safeguard and protect the wakala investment.
- The Wakil shall not utilize the Wakala amount for any other purpose, except as permitted by the Muwakkil.
- Upon the completion of the term for each wakala transaction, the Wakil will return the respective amount to the Muwakkil along with the profit.

From agent perspective, a multi-level investment arrangement is maintained, whereby the Group invests funds under the investment agency into unrestricted investment arrangements, under a separate contract and accounted for accordingly based on the relevant accounting standard.

The adoption of the above accounting standard did not have a material impact on the Bank’s assets. However, the standard affects the classification of the Bank’s Wakala based contracts previously accounted for as part of liabilities. Balances previously classified under liabilities are now been classified under equity of investment account holders as the Bank has invested funds received under wakala in its capacity as a Wakil into unrestricted investment accounts.

As part of the transitional provisions of FAS 31, the Group may choose not to apply this standard on existing transactions executed before 1 January 2020 and have an original contractual maturity before 31 December 2020. However, the Bank has decided to apply the standard on all transactions outstanding as of the year end and the corresponding previous year end. Accordingly, following wakala balances outstanding as at 31 December 2019 have also been reclassified from liabilities to unrestricted investment accounts along with the related profits paid on the wakala balances during the year ended 31 December 2019.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.1 Adoption of new and amended standards and interpretations (continued)

FAS 31 Investment Agency (Al-Wakala Bi Al-Istithmar) (continued)

	Audited 31 December 2019 BD 000
Due to banks – wakala based contracts	63,688
Due to non-banks – wakala based contracts	179,410
Subordinated wakala liability	96,011
	339,109

Refer to note 13 for detailed disclosures with relation to Wakala Funds.

FAS 33 Investment in sukuk, shares and similar instruments

This standard aims at setting out principles for the classification, recognition, measurement, presentation, and disclosure of investment in Sukuk, shares and other similar instruments of investments made by Islamic financial institution. The standard defines the key types of instruments of Shari'a compliant investments and the primary accounting treatments commensurate to the characteristic and business model of institution under which the investments are made, managed and held. This standard supersedes FAS 25 "Investment in Sukuk" and is effective beginning or after 1 January 2021 with early adoption permitted. For the purpose of this standard, each investment is to be categorized as one of the below investment categories depending on its nature:

- Monetary Debt-type instrument;
- Non-monetary Debt-type instrument;
- Equity-type instrument; and
- Other investment instruments.

Classification

Unless the irrevocable initial recognition choices provided below are exercised, the Group shall classify investments subject to this standard as subsequently measured at either (i) amortised cost, (ii) fair value through equity or (iii) fair value through income statement, on the basis of both the Group's business model for managing investments and the expected cash flow characteristics of the investment in line with the nature of the underlying Islamic contracts.

Investment in a monetary debt-type instrument, as it reflects a debt at the back-end, shall be initially classified and measured at cost, till the time the transaction at the back-end is executed, and at amortised cost thereafter.

Investment in a non-monetary debt-type instrument or other investment instrument, may be classified under any of the three categories (i) amortised cost, (ii) fair value through equity or (iii) fair value through income statement) depending on the Group's business model.

Investment in equity-type instrument is carried as investment at fair value through income statement unless the Group make an irrevocable classification choice at initial recognition to classify this as investment at fair value through equity. An investment held for trading purposes shall always fall in fair value through income statement classification.

Recognition and Initial measurement

All investment shall be initially recognized at their value plus transaction costs except for investments at fair value through income statement. Transaction costs relating to investments at fair value through income statement are charged to the consolidated statement of income when incurred. A regular way purchase of investments shall be recognized upon the transfer of control to investor.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.1 Adoption of new and amended standards and interpretations (continued)

FAS 33 Investment in sukuk, shares and similar instruments (continued)

Subsequent measurement

a) Investments at amortised cost

Investments carried at amortised cost shall be re-measured as such using the effective profit rate method. All gains or losses arising from the amortization process and those arising from de-recognition or impairment of the investment, are recognized in the consolidated statement of income. Investment carried at amortised cost shall be tested for impairment at each reporting period in accordance with FAS 30 "Impairment, credit losses and onerous commitments".

b) Investments at fair value through income statement

Investment carried at fair value through income statement shall be re-measured at fair value at end of each reporting period. The resultant remeasurement gain or loss, if any being the difference between the carrying amount and the fair value shall be recognized in the consolidated statement of income.

c) Investments at fair value through equity

Investment carried at fair value through equity shall be re-measured at fair value at the end of each reporting period. The resultant re-measurement gain or loss, if any, being the difference between the carrying amount and the fair value shall be directly recognized in equity under "fair value through equity reserve". Investment carried at fair value through equity shall be tested for impairment at each reporting period in accordance with FAS 30 "Impairment, credit losses and onerous commitments".

Reclassification

When, and only when, the Group changes its business model for managing investments, it shall reclassify all affected financial assets prospectively from the reclassification date. In case of reclassification, the Group shall not restate any previously recognized gains, losses (including impairment gains or losses) or returns/ profits.

The Board of Directors decided to early adopt the standard with effect from the current year.

Except for investments in equity instruments and managed funds, all financial assets held by the Group are classified as investments in a monetary debt-type instruments and accordingly classified at amortised cost. With regard to the investments, the Group opted to make an irrevocable classification choice to classify them as investment at fair value through equity. Investment in managed funds is classified as investments at fair value through the statement of income

The adoption of the above accounting standard did not have a material impact on the consolidated financial statements.

FAS 34 Financial Reporting for Sukuk -holders

This standard prescribes the accounting principles and reporting requirements for underlying assets of a sukuk instrument. It requires the originator to prepare or cause to prepare financing reports as needed under this standard. This standard shall be effective from the financial periods beginning on or after 1 January 2021, with early adoption permitted.

The Board of Directors decided to early adopt the standard and concluded that the accounting standard does not have an impact on the Group's consolidated financial statements as the Group does not have any sukuk issued.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.2 Financial contracts and impairment

a) Financial contracts

Financial contracts consist of balances with banks and the Central Bank of Bahrain, Due from banks, Sukuk, Murabaha financing (net of deferred profits), Ijarah Muntahia Bittamleek, Musharaka, other assets, financing commitments and financial guarantee contracts. Balances relating to these contracts are stated net of allowance for credit losses.

b) Impairment assessment

Impairment of financial assets

The Group applies three-stage approach to measure ECL on financial assets carried at amortised cost. Assets migrate through the following three stages based on the change in credit quality since initial recognition.

Stage 1: Twelve months ECL

For exposures where there has not been a Significant Increase in Credit Risk («SICR»), since initial recognition, a portion of the lifetime ECL associated with the probability of default events occurring within next twelve months is recognised.

Twelve-month ECL (Stage 1) is the portion of ECL that results from probable default events on a financial contract within twelve months after the reporting date.

Stage 2: Lifetime ECL – not credit impaired

For credit exposures where there has been a SICR since initial recognition but that are not credit impaired, a lifetime ECL is recognised.

Lifetime ECL (Stage 2) is a probability-weighted estimate of credit losses and is determined based on the difference between the present value of all cash shortfalls. The cash shortfall is the difference between all contractual cash flows that are due to the Group and the present value of the recoverable amount, for financial assets that are not credit-impaired at the reporting date.

Stage 3: Lifetime ECL – credit impaired

Financial contracts 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.

For Stage 3 financial contracts, the provisions for credit-impairment are determined based on the difference between the net carrying amount and the recoverable amount of the financial contract.

Credit-impaired financial assets

At each reporting date, the Group assesses whether financial assets carried at amortised cost are credit-impaired. 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; and
- probability that the borrower will enter bankruptcy or other financial reorganization.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced through the use of a provision account and the amount of the loss is recognised in the consolidated statement of income.

Financing contracts together with the associated provisions are written off when there is no realistic prospect of future recovery and collateral has been realised or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced in the consolidated statement of income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.2 Financial contracts and impairment (continued)

b) Impairment assessment (continued)

Stage 3: Lifetime ECL – credit impaired (continued)

The present value of the estimated future cash flows is discounted at the financial asset's original effective profit rate. If a financial asset has a variable profit rate, the discount rate for measuring any impairment loss is the current effective profit rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs of obtaining and selling the collateral, whether or not foreclosure is probable.

Measurement of ECL

The key inputs into the measurement of ECL are the following variables:

- Probability of Default (PD);
- Loss Given Default (LGD); and
- Exposure At Default (EAD).

These parameters are generally derived from internally developed models and other historical data. These are adjusted to reflect forward-looking information as described below.

Probability of default

Credit risk grades are a primary input into the determination of the term structure of PD for exposures. The Group collects performance and default information about its credit risk exposures. The Group employs statistical models for analysing the data collected and generate estimates of PD of exposures and how these are expected to change as a result of the passage of time. This analysis includes the identification and calibration of relationships between changes in default rates and changes in key macro-economic factors, across various geographies in which the Bank has taken exposures. For most exposures, the key macro-economic indicators include gross domestic product (GDP) growth, real interest rates, oil prices and equity prices.

Incorporation of forward - looking information

The Group employs statistical models to incorporate macro-economic factors on historical default rates. In case none of the macro-economic parameters are statistically significant or the results of forecasted PDs are significantly deviated from the present forecast for the economic conditions, quantitative PD overlay shall be used by the management after analyzing the portfolio.

Incorporating forward-looking information increases the level of judgment as to how changes in these macroeconomic factors will affect the ECL applicable to the stage 1 and stage 2 exposures which are considered as performing (Stage 3 are the exposures under default category). The methodologies and assumptions involved, including any forecasts of future economic conditions, are reviewed periodically.

Loss Given Default

LGD is the magnitude of the likely loss if there is a default. The Group estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties and collaterals held, based on historical data using both internal and external factors including hair cuts.

Exposure At Default

EAD represents the expected exposure in the event of a default. The Group derives the EAD from the current exposure to the counterparty and potential changes to the current amounts allowed under the contract including amortisation. The EAD of a financial asset is its gross carrying amount. For financing commitments and financial guarantees, the EAD is converted to consolidated statement of financial position equivalents. The EAD is estimated using the outstanding exposure adjusted by CCF times undrawn portion of the facilities. In case of financial guarantee, EAD is estimated as CCF times the committed amount. The outstanding exposure is equivalent to the principal outstanding. The undrawn portion refers to the portion of the unutilized credit limit.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.2 Financial contracts and impairment (continued)

b) Impairment assessment (continued)

Significant Increase in Credit Risk

When determining whether the risk of default on a financial contracts has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Group's historical experience and expert credit assessment including forward-looking information.

The criteria for determining whether credit risk has increased significantly vary on a portfolio level and include quantitative and qualitative factors, including days past due and risk rating.

Renegotiated financial assets

The contractual terms of a financing may be modified for a number of reasons including changing market conditions, and other factors not related to the current or potential credit deterioration of a customer.

The Group considers renegotiated financing to customers due to financial difficulties as one of the reasons for determining the significant increase in credit risk. This may involve extending the payment arrangements and documenting the agreement of new conditions for providing finance. Management continuously reviews renegotiated facilities to ensure that all criteria are met and that future payments are likely to occur.

Backward transition

FAS 30 staging model is of symmetrical nature as exposures may migrate from lifetime ECL measurement (Stage 2 and Stage 3) to 12 month ECL measurement (Stage 1). Once such indicators are no longer triggered, movement back to Stage 1 or Stage 2 are subject to certain criteria such as cooling off period, SICR indicators and payment history, where applicable.

Write-offs

Financing contracts are written-off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. 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.

Presentation of allowance for credit losses in the consolidated statement of financial position

Allowance for credit losses are presented in the consolidated statement of financial position as follows:

- financial assets measured at amortised cost, as a deduction from the gross carrying amount of the assets; and
- financing commitments and financial guarantee contracts: generally as a provision in other liabilities.

4.3 Foreign currency translation

The consolidated financial statements are presented in Bahraini Dinars, which is the Bank's functional and presentation currency. 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.

(i) Transactions and balances

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

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the date of the consolidated statement of financial position. All differences are taken to the consolidated statement of income with the exception of all monetary items that provide an effective protection for a net investment in a foreign operation. These are recognised in other comprehensive income until the disposal of the net investment, at which time they are recognised in the consolidated statement of income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.3 Foreign currency translation (continued)

(i) Transactions and balances (continued)

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial recognition. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined. Exchange gains and losses on non-monetary items classified as «fair value through statement of income» are taken to the consolidated statement of income and for items classified as «fair value through equity» such differences are taken to other comprehensive income. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations and translated at closing rate.

(ii) Group companies

As at the reporting date, the assets and liabilities of subsidiaries are translated into the Group's presentation currency (Bahraini Dinars) at the rate of exchange prevailing at the date of the consolidated statement of financial position, and their statements of income are translated at the average exchange rates for the year. Exchange differences arising on translation are recognised in other comprehensive income. On disposal of a foreign subsidiary, the cumulative amount recognised in other comprehensive income relating to that particular foreign subsidiary is recognised in the consolidated statement of income.

4.4 Financial instruments - initial recognition and subsequent measurement

Date of recognition

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. All financial assets and liabilities are initially recognised on the trade date, i.e. the date that the Group becomes a party to the contractual provisions of the instrument.

Initial and subsequent measurement of financial instruments

The classification of financial instruments at initial recognition depends on the purpose and the management's intention for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus transaction costs, except in the case of financial assets recorded at fair value through statement of income.

(i) Due from banks

Murabahas are international commodity murabaha transactions. The Bank arranges a murabaha transaction by buying a commodity (which represents the object of the murabaha) and then resells this commodity to the beneficiary murabeh (after computing a profit margin). The sale price (cost plus the profit margin) is paid either lump sum at maturity or in installments by the murabeh over the agreed period.

Murabaha with banks are stated net of deferred profits and provision for impairment, if any. Wakala with banks are stated at cost less provision for impairment, if any.

(ii) Financing contracts

(a) Murabaha

Murabaha represents the sale of goods at cost plus an agreed profit. Murabaha receivables are stated net of deferred profits, any amounts written off and provision for impairment, if any. Promise made in the murabaha to the purchase orderer is not obligatory upon the customer.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.4 Financial instruments - initial recognition and subsequent measurement

(ii) Financing contracts (continued)

(b) Ijarah Muntahia Bittamleek

Ijarah Muntahia Bittamleek mainly comprise of land and buildings and certain other assets. Ijarah Muntahia Bittamleek is a lease whereby the legal title of the leased asset passes to the lessee at the end of the ijarah (lease term), provided that all ijarah installments are settled.

Assets under Ijarah Muntahia Bittamleek are initially recognised at cost and subsequently depreciated at rates calculated to write off the cost of each asset over its useful life to its residual value.

(c) Musharaka

Musharaka represents a partnership between the Group and a customer whereby each party contributes to the capital in equal or varying proportions to establish a new project or share in an existing one, and whereby each of the parties becomes an owner of the capital on a permanent or declining basis and shall have a share of profits or losses. These are stated at the fair value of consideration given less any amounts written off and provision for impairment, if any.

(iii) Investments

The Bank accounts for the investments in accordance with the FAS 33 - Investment in sukuk, shares and similar instruments that has been adopted from 1 January 2020. Refer section 4.1 for details.

(iv) Equity of investment account holders

Equity of investment account holders is invested in cash, balances with banks and Central Bank of Bahrain, due from banks, sukuk and financing contracts. No priority is granted to any party for the purpose of distribution of profits. According to the terms of acceptance of the investment account holders funds, 100% of these funds are invested after deductions of mandatory reserve and sufficient operational cash requirements.

Equity of investment account holders is carried at fair value of consideration received less amounts settled. Expenses are allocated to investment accounts in proportion of average equity of investment account holders to average assets, however, investment related expenses and assets are excluded.

Income is allocated proportionately between equity of investment account holders and owners' equity on the basis of the average balances outstanding during the year and share of the funds invested.

4.5 Derecognition of financial assets and financial liabilities

(i) Financial assets

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

- the rights to receive cash flows from the asset have expired; or
- 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
- 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 assets, 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.5 Derecognition of financial assets and financial liabilities (continued)

(ii) Financial liabilities

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

4.6 Impairment of financial assets

(i) Financial assets carried at amortised cost

The Group applies three-stage approach to measure ECL on financial assets carried at amortised cost as required by FAS 30 with Expected Credit Loss model explained above.

(ii) Investments at fair value through equity

For investments at fair value through equity, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as «fair value through equity», objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss measured as the difference between the acquisition cost and the current fair value less any impairment loss on that investment previously recognised is removed from fair value through equity reserve and recognised in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income; increases in their fair value subsequent to impairment are recognised directly in equity.

4.7 Offsetting financial instruments

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 or religious 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.

4.8 Recognition of income and expense

(i) Income recognition

(a) Murabaha

Where the income is quantifiable and contractually determined at the commencement of the contract, income is recognised on a time-apportioned basis over the period of the contract based on the principal amounts outstanding. Accrual of income is suspended when the Group believes that the recovery of these amounts may be doubtful.

(b) Ijarah Muntahia Bittamleek

Ijarah income is recognised on a time-apportioned basis, net of depreciation, over the lease term. Accrual of income is suspended when the Group believes that the recovery of these amounts may be doubtful.

(c) Musharaka

Income on musharaka contracts is recognised when the right to receive payment is established or on distribution by the musharek.

(d) Dividends

Dividends from investments in equity securities are recognised when the right to receive the payment is established.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.8 Recognition of income and expense (continued)

(i) Income recognition (continued)

(e) Fees and commission income

Fees and commission income is recognised when earned.

(f) Revenue from sale of real estate

Revenue on sale of real estate is recognised when all of the following conditions are met:

- A sale is consummated and contracts are signed;
- The buyer's investment, as of the date of financial statements, is adequate (25% and above) to demonstrate a commitment to pay for the property; and
- The Group has transferred to the buyer the risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property.

Where property is under development and agreement has been reached to sell such property when construction is complete, the Group considers whether the contract comprises:

- contract to construct a property; or
- contract for the sale of a completed property.

Where a contract is determined to be a construction contract, revenue is recognised using the percentage of completion method as construction progresses. The percentage of work complete is measured based on the costs incurred up until the end of the reporting period as a proportion of total costs expected to be incurred.

Where the contract is judged to be for the sale of a completed property, revenue is recognised when the significant risks and rewards of ownership of the property are transferred to the buyer.

(g) Service income

Revenue from rendering of services is recognised when the services are rendered.

(h) Group's share as a mudarib

The Group's share as a mudarib for managing the equity of investment account holders is accrued based on the terms and conditions of the related mudaraba agreements whereas, for off balance sheet equity of investment account holders, mudarib share is recognised when distributed.

(ii) Expense recognition

(a) Profit on due to banks and non-banks

Profit on these is accrued on a time-apportioned basis over the period of the contract based on the principal amounts outstanding.

(b) Return on equity of investment account holders

Return on equity of investment account holders is based on the income generated from jointly financed assets after deducting mudarib share (in case of mudara contracts) and is accrued based on the terms and conditions of the underlying mudaraba or wakala agreement. Investors' share of income represents income generated from assets financed by investment account holders net of allocated operating expenses. The Group's share of profit is deducted from the investors' share of income before distribution to investors.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.9 Investment in associates

An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture.

Investment in associate is accounted for using the equity method of accounting. Under the equity method, the investment in the associate is carried in the consolidated statement of financial position at cost plus post acquisition changes in the Group's share of net assets of the associate. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised nor individually tested for impairment.

After application of the equity method, the Group determines whether it is necessary to recognise any impairment loss with respect to the Group's net investment in the associate. The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount in the consolidated statement of income.

The consolidated statement of income reflects the share of the results of operations of the associate. Where there has been an income or expense recognised in the other comprehensive income of the associate, the Group recognises its share of any such income or expense, when applicable, in other comprehensive income. Gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of stake in the associate.

The reporting dates of the associates and the Group are identical and their accounting policies conform to those used by the Group for like transactions and events in similar circumstances. In case of any difference in the associates' accounting policies, their results are adjusted to bring them in line with the Group accounting policies.

Upon loss of significant influence over the associate, the Group measures and recognises any retaining 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 retaining investment and proceeds from disposal is recognised in the consolidated statement of income.

4.10 Premises and equipment

Premises and equipment are stated at cost excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value, if any.

4.11 Depreciation

Depreciation is calculated using the straight-line method to write down the cost of premises and equipment to their residual values over their estimated useful lives. Land is not depreciated. The estimated useful lives are as follows:

	Years
Premises	20
Hardware, software and equipment	3 - 7
Motor vehicles and office furniture	5 - 7

An item of premises and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in the consolidated statement of income in the year the asset is derecognised.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.12 Impairment of non-financial assets

The Group assesses at each reporting date or more frequently whether there is an indication that a non-financial asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If any such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. Impairment losses relating to goodwill cannot be reversed for subsequent increase in its recoverable amount in future periods.

4.13 Financial guarantees

In the ordinary course of business, the Group provides financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recorded in the consolidated statement of financial position at fair value in 'other liabilities' being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the unamortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is recognised in the consolidated statement of income under 'provisions'. The premium received is recognised in the consolidated statement of income on a straight line basis over the life of the guarantee.

4.14 Treasury shares

Own equity instruments that are reacquired (treasury shares) are recognised at cost and deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments. Any difference between the carrying amount and the consideration, if reissued, is recognised in share premium.

4.15 Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) arising from a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of obligation.

4.16 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Chief Operating Decision Maker (CODM). CODM is a person or group that allocates resources to and assesses the performance of the operating segments of the entity. The Group has determined the Managing Director and Chief Executive Officer as its CODM.

4.17 Cash and cash equivalents

Cash and cash equivalents comprise of cash and balances with banks and the Central Bank of Bahrain (excluding mandatory reserve) and due from banks with original maturity of 90 days or less.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.18 Employees' end of service benefits

Provision is made for leaving indemnity payable under the Bahraini Labor Law applicable to non-Bahraini employees' accumulated periods of service at the consolidated statement of financial position date.

Bahraini employees of the Group are covered by contributions made to the Social Insurance Organisation ("SIO") as a percentage of the employees' salaries. The Group's obligations are limited to these contributions, which are expensed when due. For Bahrainis with basic salaries above a certain threshold, the Bank recognises leaving indemnity in line with the requirements of Bahrain Labour Law.

4.19 Off-balance sheet equity of investment account holders

Off-balance sheet equity of investment account holders represents funds received by the Bank on the basis of mudaraba to be invested in specified products as directed by the investment account holders. The assets funded by these funds are managed in a fiduciary capacity by the Bank for which the Bank earns mudarib share which is disclosed as part of 'income from financing contracts'. These assets are not included in the consolidated statement of financial position as the Group does not have the right to use or dispose of them except within the conditions laid down in the underlying mudaraba contract. Off-balance sheet equity of investment account holders is included in a separate statement in the consolidated financial statements of the Bank.

4.20 Earnings prohibited by Shari'a

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is transferred to charity.

4.21 Inventories

Inventories are carried at the lower of cost and net realisable value. For individually significant amounts this estimation is performed on an individual basis. Amounts which are not individually significant, but which are old or obsolete, are assessed collectively and an allowance applied according to the inventory type and the degree of ageing or obsolescence, based on historical selling prices.

4.22 Assets classified as held for sale

The Group classifies assets as held for sale if their carrying amounts will be recovered principally through a sale rather than through continuing use. Such assets classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

The criteria for held for sale classification is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Actions required to complete the sale should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. Management must be committed to the plan, expected within one year from the date of the classification.

Property, plant and equipment and intangible assets are not depreciated or amortised once classified as held for sale.

Assets and liabilities classified as held for sale are presented separately in the consolidated statement of financial position.

Results from discontinued operations are presented as a single amount in the consolidated statement of income.

Assets which ceases to be classified as held for sale are consolidated on a line by line basis. Prior period balances are re-presented.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.23 Repossessed assets

Repossessed assets are real estate assets acquired in settlement of financing contracts with customers. These assets are carried at the lower of carrying amount and fair value less costs to sell and reported within "receivables and other assets" in the consolidated statement of financial position.

4.24 Fair value of financial instruments

The Group measures financial instruments and non-financial assets such as investment in real estate, at fair value at the date of statement of financial position. Fair values of financial instruments are disclosed in note 32.

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 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.

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. Observable data used along with the Group's approach to determining fair values of financial instruments and quantitative disclosure are disclosed in note 32.

4.25 Taxation

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on overseas operations is provided for in accordance with the fiscal regulations of the respective countries in which the Group operates and is included in the accompanying consolidated statement of income under "other operating expenses".

4.26 Zakah

In accordance with the instructions of the Shari'a Supervisory Board of the Bank, payment of Zakah is the responsibility of the shareholders of the Bank. Accordingly, no Zakah has been charged to these consolidated financial statements.

4.27 Cross currency swap

Cross currency swap ("Islamic derivative financial instruments") are used to mitigate foreign currency risk. They are initially recognised and subsequently measured in the consolidated statement of financial position at fair value. The fair value of this instrument includes unrealized gain or loss from marking to market the instrument using prevailing market rates or internal pricing models. The instrument with positive market value (unrealised gain) is included in other assets and the instrument with negative market value (unrealised loss) is included in other liabilities in the consolidated statement of financial position. Any gain or loss arising from changes in the fair value of this instrument is taken directly to the consolidated statement of income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.28 Provision for onerous contract or commitment to acquire an asset

The Group will recognize provision when the Group is obligated to acquire an asset under a future commitment or contracts permissible to be entered in the future, and it is expected that the obligation under the contract or commitment is higher than the economic benefits expected to flow through acquisition of such asset. In such situation, the Group will create a provision on this account reflecting the expected losses arising on such transaction.

4.29 New standards, amendments and interpretations issued but not yet effective

FAS 35 Risk Reserves

This standard defines the accounting and financial reporting principles for risk reserves to be in line with global best practices for accounting and risk management. This standard complements FAS 30 "Impairment, Credit Losses and Onerous Commitments". Both standards FAS 35 & FAS 30 together supersede the earlier FAS 11 "Provisions and Reserves". This standard shall be effective beginning or after 1 January 2021, with early adoption is permitted, only if the financial institution decided to early adopt FAS 30.

The Board of Directors expects that the adoption of this standard will have no material impact on the financial statements of the Bank in the year of initial application as the Bank does not maintain risk reserves.

FAS 32 Ijarah

This standard supersedes FAS 8 "Ijarah and Ijarah Muntahia Bittamleek". The standard aims at setting out principles for the classification, recognition, measurement, presentation and disclosure of Ijarah type transactions including their different forms entered into by an institution, in both the capacities of lessor and lessee. This standard shall be effective beginning or after 1 January 2021, with early adoption permitted.

The Board of Directors is currently assessing the impact of this standard on the consolidated financial statements upon the initial application.

5 LIST OF KEY SUBSIDIARIES

Key subsidiaries, all of which have 31 December as their year end, are listed below.

Subsidiary	Year of incorporation	Country of incorporation	Ownership %	
			2020	2019
Kuwait Finance House - Jordan The company and its subsidiaries are engaged in investment advisory and investments in private equities and real estate development.	2007	Hashemite Kingdom of Jordan	100.00	100.00
Ishbiliya Village W.L.L. The principal activity of the company is to invest in and develop real estate projects and consequently buying, selling and marketing of such properties.	2005	Kingdom of Bahrain	100.00	100.00

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

6 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

The Group's financial instruments have been classified in accordance with their measurement basis as follows:

At 31 December 2020	Financial assets at fair value through statement of income BD 000	Financial assets at fair value through equity BD 000	Financial assets at amortised cost BD 000	Financial liabilities at amortised cost BD 000	Total BD 000
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	-	-	61,277	-	61,277
Due from banks	-	-	123,590	-	123,590
Financing contracts	-	-	1,005,228	-	1,005,228
Investments	-	6,861	-	-	6,861
Investment in sukuk	-	-	324,739	-	324,739
Receivables and other assets	-	-	160,481	-	160,481
	-	6,861	1,675,315	-	1,682,176
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS					
Customers' current accounts	-	-	-	133,114	133,114
Due to banks	-	-	-	108,798	108,798
Due to non-banks	-	-	-	364,048	364,048
Other liabilities	-	-	-	14,573	14,573
Equity of investment account holders	-	-	-	966,177	966,177
	-	-	-	1,586,710	1,586,710
At 31 December 2019					
	Financial assets at fair value through statement of income BD 000	Financial assets at fair value through equity BD 000	Financial assets at amortised cost BD 000	Financial liabilities at amortised cost BD 000	Total BD 000
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	-	-	99,535	-	99,535
Due from banks	-	-	115,216	-	115,216
Financing contracts	-	-	913,907	-	913,907
Investments	1,760	4,396	-	-	6,156
Investment in sukuk	-	-	270,277	-	270,277
Receivables and other assets	-	-	198,684	-	198,684
	1,760	4,396	1,597,619	-	1,603,775
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS					
Customers' current accounts	-	-	-	128,258	128,258
Due to banks	-	-	-	101,783	101,783
Due to non-banks	-	-	-	222,965	222,965
Other liabilities	-	-	-	13,721	13,721
Equity of investment account holders	-	-	-	1,008,369	1,008,369
	-	-	-	1,475,096	1,475,096

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

7 CASH AND BALANCES WITH BANKS AND CENTRAL BANK OF BAHRAIN

	Note	2020 BD 000	2019 BD 000
Cash		11,357	10,816
Balances with banks		7,939	17,925
Balance with CBB		12,888	38,736
CBB mandatory reserve	71	29,094	32,060
Less: allowance for credit losses		(1)	(2)
	72	61,277	99,535

71 This mandatory reserve is not available for use in the Group's day to day operations.

72 This balance includes BD 43,599 thousand (2019: BD 19,915 thousand) financed by investment account holders' funds.

8 DUE FROM BANKS

	2020 BD 000	2019 BD 000
Murabaha	42,779	72,765
Wakala	81,041	43,135
	123,820	115,900
Less: allowance for credit losses	(230)	(684)
	123,590	115,216

8.1 Under the above wakala arrangement, the agent pays the Bank a profit, when realised, equivalent to the expected profit rate stated in the respective wakala offer and anything beyond this rate goes to the agent as an incentive.

8.2 Due from Banks includes BD 100,801 thousand (2019: BD 21,933 thousand) financed by investment account holders' funds. Due from banks carry profit rates ranging from 0.10% to 1.20% per annum (2019: 0.76% to 2.70% per annum).

9 FINANCING CONTRACTS

The table below shows the financing contracts by stage and type of facility:

	31 December 2020		
	Murabaha BD 000	Ijarah Muntahia Bittamleek BD 000	Total BD 000
Self financed			
Stage 1: 12-month ECL	166,402	202,149	368,551
Stage 2: Lifetime ECL not credit-impaired	11,011	36,782	47,793
Stage 3: Lifetime ECL credit-impaired	4,684	1,670	6,354
Total allowance for credit losses	(4,034)	(3,766)	(7,800)
	178,063	236,835	414,898
31 December 2019	135,827	207,245	343,072

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

9 FINANCING CONTRACTS (continued)

	31 December 2020		
	Murabaha BD 000	Ijarah Muntahia Bittamleek BD 000	Total BD 000
Financed through investment account holders' funds			
Stage 1: 12-month ECL	236,741	287,642	524,383
Stage 2: Lifetime ECL not credit-impaired	15,668	52,337	68,005
Stage 3: Lifetime ECL credit-impaired	6,666	2,376	9,042
Total allowance for credit losses	(5,741)	(5,359)	(11,100)
	253,334	336,996	590,330
31 December 2019	225,910	344,925	570,835

The murabaha balances included above are presented net of deferred profits amounting to BD 38,913 thousand (2019: BD 36,196 thousand).

The table below shows the days past due for the financing contracts. The amounts presented are gross of impairment allowances.

	31 December 2020			Total BD 000	31 December 2019 Total BD 000
	Stage 1: 12-month ECL BD 000	Stage 2: Lifetime ECL not credit- impaired BD 000	Stage 3: Lifetime ECL credit- impaired BD 000		
Not past due	877,770	112,356	553	990,679	850,414
1 to 89 days past due	15,164	3,442	-	18,606	43,804
90 days or more past due	-	-	14,843	14,843	38,302
Total allowance for credit losses	(6,799)	(9,957)	(2,144)	(18,900)	(18,613)
	886,135	105,841	13,252	1,005,228	913,907

Movements in allowance for credit losses on financing contracts

	Stage 1: 12-month ECL BD 000	Stage 2: Lifetime ECL not credit- impaired BD 000	Stage 3: Lifetime ECL credit- impaired BD 000	Total BD 000
Balance at 1 January 2020	1,655	9,736	7,222	18,613
- transferred to Stage 1: 12-month ECL	141	(73)	(68)	-
- transferred to Stage 2: Lifetime ECL not credit-impaired	(14)	1,071	(1,057)	-
- transferred to Stage 3: Lifetime ECL credit-impaired	(1)	(8)	9	-
Net remeasurement of loss allowance	5,018	(769)	698	4,947
Allowance for credit losses	5,144	221	(418)	4,947
Amounts written off during the year	-	-	(4,660)	(4,660)
Balance at 31 December 2020	6,799	9,957	2,144	18,900

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

9 FINANCING CONTRACTS (continued)

Movements in allowance for credit losses on financing contracts (continued)

	Stage 1: 12-month ECL BD 000	Stage 2: Lifetime ECL not credit- impaired BD 000	Stage 3: Lifetime ECL credit- impaired BD 000	Total BD 000
Balance at 1 January 2019	2,638	13,337	5,661	21,636
- transferred to Stage 1: 12-month ECL	70	(9)	(61)	-
- transferred to Stage 2: Lifetime ECL not credit-impaired	(27)	529	(502)	-
- transferred to Stage 3: Lifetime ECL credit-impaired	(1)	(1,437)	1,438	-
Net remeasurement of loss allowance	(1,025)	(670)	797	(898)
Allowance for credit losses	(983)	(1,587)	1,672	(898)
Amounts written off during the year	-	(2,014)	(111)	(2,125)
Balance at 31 December 2019	1,655	9,736	7,222	18,613

Movements in deferred profit from murabaha contracts

	2020 BD 000	2019 BD 000
Deferred profit at the beginning of the year	36,196	25,892
Murabaha Sales revenue during the year	744,855	577,130
Murabaha Cost of Sales	721,696	541,332
	23,159	35,798
Deferred profit collected during the year	(15,779)	(21,213)
Deferred profit settled during the year	(4,663)	(4,281)
Deferred profit at the end of the year	38,913	36,196

9.1 Ijarah Muntahia Bittamleek mainly comprise of land and building and are presented net of accumulated depreciation amounting to BD 81,307 thousand (2019: BD 99,123 thousand).

9.2 During the year, the Bank took possession of properties with a carrying value of BD 18,874 thousand (2019: BD 11,659 thousand) as part of financing settlement and were classified as repossessed assets in the receivables and other assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

10 INVESTMENTS

The Group's investments are classified as follows:

	Note	2020 BD 000	2019 BD 000
Investment at fair value through statement of income	10.1	-	1,760
Investments at fair value through equity	10.2	6,861	4,396
		6,861	6,156

10.1 Carried at fair value through statement of income

	2020 BD 000	2019 BD 000
Designated at fair value through statement of income upon initial recognition - Managed Fund	-	1,760

10.2 Carried at fair value through equity

	2020 BD 000	2019 BD 000
Quoted equity securities - cost	1,572	1,572
Unquoted equity securities - cost	4,271	2,500
	5,843	4,072
Fair value changes	1,018	324
	6,861	4,396

10.2.1 The movement of investments carried at fair value through equity during the year is as follows:

	2020 BD 000	2019 BD 000
At 1 January	4,396	4,742
Additions	3,104	-
Disposals / redemptions during the year	(1,333)	-
Impairment provisions	-	(500)
Fair value changes	694	154
At 31 December	6,861	4,396

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

10 INVESTMENTS (continued)

10.3 Composition of investment portfolio:

The industry and geographic composition of the Group's investment portfolio is as follows. All of these investments are in Middle East.

	2020 BD 000	2019 BD 000
Banking and financial services	3,746	6,156
Others	3,115	-
	6,861	6,156

11 INVESTMENT IN SUKUK

	Note	2020 BD 000	2019 BD 000
Quoted sukuk			
Government		199,904	181,498
Unquoted sukuk			
Government		103,801	67,755
Others		21,039	21,039
		324,744	270,292
Less: allowance for credit losses		(5)	(15)
	11.1	324,739	270,277

11.1 Investment in sukuk includes an amount of BD 231,447 thousand (2019: BD 49,461 thousand) financed by investment account holders' funds. Fair value of investment in sukuk as at 31 December 2020 amounted to BD 332,210 thousand (2019: BD 279,901 thousand).

11.2 All sukuk investments are classified as debt-type instruments.

12 INVESTMENT IN ASSOCIATE

The Group has the following associate as at 31 December 2020:

Name of the associate	Nature of business	Country of incorporation	Holding
Deera Investment and Real Estate Development Company	Real estate project development and property management.	Hashemite Kingdom of Jordan	28.00%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

12 INVESTMENT IN ASSOCIATE (continued)

The movement of the Group's investment in an associate is as follows:

	Note	2020 BD 000	2019 BD 000
At 1 January		8,461	12,885
Share of loss from associate		(463)	(164)
Provision for impairment	26	(1,109)	-
Transfer to subsidiaries		-	(4,260)
At 31 December		6,889	8,461

12.1 The quoted value of the investment in associate for which quoted prices are available is BD 4,944 thousand (2019: BD 4,527 thousand). However, the quoted price does not represent the fair value as the shares are not actively traded. The fair value based on internal models approximates their carrying value.

13 FUNDS UNDER WAKALA ARRANGEMENT

The Group has the below Wakala funds which are received from different fund providers and are reinvested by the Group in its capacity as Wakeel under multi-level investment arrangements into unrestricted investment accounts with the Group. Under those Wakala agreements, the Group agrees a target rate with the fund providers and any rate beyond that is considered as incentive fee for the Group. Currently, all the below Wakala arrangements are reinvested and maintained under Unrestricted Investment Account. All expenses incurred with relation to Wakala funds are beard by the fund providers. The Group does not charge mudarib fee on these funds.

	2020 BD 000	2019 BD 000
Banks	87,773	63,688
Non-banks	-	179,410
Parent - subordinated wakala	95,175	96,011
Individuals	473,213	391,953
	656,161	731,062

Movement of Wakala funds during the year is as follow:

	2020 BD 000	2019 BD 000
At 1 January	731,062	601,863
Additions during the year	309,612	442,516
Income during the year	40,509	36,465
Less: expenses charged during the year	(10,805)	(12,222)
Less: incentive fee	(11,659)	(2,226)
Distributions to wakala holders	(18,045)	(22,017)
Withdrawals	(366,468)	(291,300)
At 31 December	656,161	731,062

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

14 RECEIVABLES AND OTHER ASSETS

	Note	2020 BD 000	2019 BD 000
Land and development cost	14.1	25,007	25,047
Fees receivable		517	1,528
Project expenses receivable		83	308
Inventories		-	1,570
Profit receivable		282	257
Repossessed assets		34,974	18,932
Trade receivables of subsidiaries		893	1,524
Prepaid expenses		1,410	1,828
Receivables relating to disposal of investments	14.3	152,579	187,297
Receivables from corporate customers		3,269	6,838
Other assets		4,767	2,808
Gross receivables and other assets		223,781	247,917
Impairment provisions	14.2	(404)	(589)
At 31 December		223,377	247,328

14.1 Land and development cost

	2020 BD 000	2019 BD 000
Land	23,671	23,690
Development cost	1,336	1,357
	25,007	25,047

This development cost represents construction, consultancy and profit paid on financing, capitalised relating to various real estate projects being undertaken by the Group.

14.2 Movement in impairment provisions relating to receivables and other assets.

	Note	2020 BD 000	2019 BD 000
At 1 January		589	1,551
Charge / (reversals) for the year	26	540	(372)
Settlements / write-offs		(725)	(590)
At 31 December		404	589

14.3 This includes a receivable of BD 152,579 thousand (2019: BD 187,297 thousand) due from a related party. This receivable is expected to be settled through the realisation of underlying assets and dividend payouts from the Bank. The Ultimate Parent has also provided a letter of guarantee for settlement of the receivable.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

15 DUE TO BANKS

	2020 BD 000	2019 BD 000
Murabaha payables	108,410	100,869
Current accounts	388	914
	108,798	101,783

16 ASSETS UNDER MANAGEMENT

At 31 December 2020, assets managed in a fiduciary capacity amounted to BD 685,247 thousand (2019: BD 592,074 thousand).

17 OTHER LIABILITIES

	2020 BD 000	2019 BD 000
Pay orders issued but not presented	2,967	2,903
Payable on account of financing contracts	1,038	771
Staff related accruals	3,354	3,486
Trade payables of subsidiaries	184	803
Fixed assets related payables	1,724	1,789
Unearned fees	1,725	1,678
Accrued expenses and other liabilities	5,306	3,969
	16,298	15,399

18 EQUITY OF INVESTMENT ACCOUNT HOLDERS - NON-BANKS AND INDIVIDUALS

The mudarib share on investment accounts ranges from 30% to 85% (2019: 30% to 85%) depending on the investment period and in the case of saving accounts, where there is no restriction on cash withdrawal, the mudarib share ranges from 85% to 95% (2019: 85% to 95%). No mudarib share is charged on the URIA collected as per the wakala arrangement with customers in accordance with the multi-level arrangement. The following table includes the funds received from the Non-Banks and individuals under the wakala arrangement and does not include URIA balances received from Banks under this arrangement. The rate of return to investment account holders, as at 31 December 2020 and 2019, for various types of investment accounts, denominated in BD and USD, is as follows:

	2020 Rate of return %	2019 Rate of return %
Investment accounts (mudaraba and wakala) - denominated in BD		
Saving accounts	0.20	0.19
VIP saving accounts	0.61	0.56
Saving call accounts	2.50	3.00
One month investment accounts	1.20 - 1.64	1.50 - 2.00
Three months investment accounts	1.90 - 2.04	1.88 - 2.20
Six months investment accounts	2.10 - 2.45	2.25 - 2.50
Nine months investment accounts	2.20 - 2.50	2.60 - 2.70
One year investment accounts	2.50 - 2.86	2.63 - 3.10
Two year investment accounts	2.90 - 3.10	3.60 - 3.80
Three year investment accounts	3.10 - 3.20	3.80 - 4.00
Five year investment accounts	3.20 - 3.30	4.30 - 4.50

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

18 EQUITY OF INVESTMENT ACCOUNT HOLDERS - NON-BANKS AND INDIVIDUALS (continued)

	2020 Rate of return %	2019 Rate of return %
Investment accounts (mudaraba and wakala) - denominated in USD		
Saving accounts	0.20	0.19
VIP saving accounts	0.41	0.38
Saving call accounts	1.50	3.00
One month investment accounts	0.70 - 1.23	0.95 - 1.13
Three months investment accounts	1.00 - 1.64	1.25 - 1.50
Six months investment accounts	1.20 - 2.04	1.55 - 1.88
Nine months investment accounts	1.30	1.70
One year investment accounts	1.50 - 2.45	1.85 - 2.25

18.1 Investment accounts by type

	2020 Rate of return	2019 Rate of return
Investment accounts (mudaraba and wakala) - denominated in BD		
Saving accounts	380,876	247,152
VIP saving accounts	16,637	20,090
One month investment accounts	42,731	118,175
Three months investment accounts	52,024	93,742
Six months investment accounts	50,644	51,559
Nine months investment accounts	1,378	1,104
One year investment accounts	201,262	285,908
Two year investment accounts	21,357	20,392
Three year investment accounts	11,443	8,242
Five year investment accounts	4,877	2,306
	783,229	848,670

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

19 SHARE CAPITAL AND RESERVES

	2020 BD 000	2019 BD 000
Authorised:		
3,500,000 thousand (2019 : 3,500,000 thousand) ordinary shares of BD 0.1 each	350,000	350,000
Issued and fully paid up:		
As at the beginning and end of the year 1,325,187 thousand (2019 : 1,325,187 thousand) ordinary shares of BD 0.1 each	132,519	132,519

The Board of Directors of the Bank have proposed a capital reduction of BD 13,721 thousand with a corresponding reduction in the receivable from a related party. This proposal is subject to the approval of the Extra Ordinary General Meeting of the Bank, Ministry of Industry and Commerce, Central Bank of Bahrain and the completion of legal formalities.

Nature and purpose of reserves

Statutory reserve

As required by Bahrain Commercial Companies Law («BCCL») and the Bank's articles of association, 10% of the net income for the year has been transferred to the statutory reserve. However, as allowed under BCCL the Bank may resolve to discontinue such annual transfers when the reserve totals 50% of paid up share capital. The reserve is not distributable except in such circumstances as stipulated in the BCCL and following the approval of the CBB.

Fair value through equity reserve

Unrealised gains and losses resulting from investments carried at fair value through equity, if not determined to be impaired is recorded in the fair value through equity reserve and is not available for distribution. Upon disposal of related assets, the related cumulative gains or losses are transferred to retained earnings and become available for distribution.

Retained earnings

Retained earnings is the cumulative amount of annual earnings not paid out as dividends. Included in retained earnings is a non-distributable reserve amounting to BD 500 thousand (2019: BD 613 thousand) relating to subsidiaries of the Bank. An amount of BD 16,997 thousand representing modification loss net of government grant is adjusted against the retained earnings. For more details refer to note 39.

Proposed dividend

Proposed dividend is shown separately within equity till it is approved by the Annual General Meeting. The Board of Directors of the Bank have proposed nil dividend for the year ended 31 December 2020 (2019: BD 22,517 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

20 TOTAL COMPREHENSIVE INCOME

	2020 BD 000	2019 BD 000
Net income for the year:	15,237	25,010
Other comprehensive income		
Fair value adjustments against fair value through equity investments	694	154
Total comprehensive income for the year	15,931	25,164
Adjustment attributable to non-controlling shareholders	9	9
	15,940	25,173

21 CONTINGENT LIABILITIES AND COMMITMENTS

	Note	2020 BD 000	2019 BD 000
Contingent liabilities			
Letters of credit		5,096	8,899
Guarantees		7,754	6,975
		12,850	15,874
Irrevocable commitments to extend credit (original term to maturity of one year or less)		62,799	92,474
Development cost commitment	21.1	-	448
		75,649	108,796

21.1 As of 31 December 2019, this represent payments to contractors and consultants for a development project.

21.2 Operating lease commitments

At 31 December 2020, the Group had commitments in respect of non-cancellable operating leases amounting to BD 2,157 thousand (2019: BD 3,088 thousand) relating to leasehold premises. Of the commitments in respect of operating leases, BD 971 thousand (2019: BD 1,107 thousand) are due within one year, BD 917 thousand (2019: BD 1,901 thousand) are due in one to five years and the remaining over five years.

21.3 The Bank is carrying expected credit loss of BD 77 thousand (2019: BD 42 thousand) against the contingent liabilities and commitments which is classified in other liabilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

22 CROSS CURRENCY SWAP

During 2019, the Bank entered into cross currency swap with the Parent (“Islamic derivative financial instruments”) to mitigate foreign currency risk. Cross currency swap is based on Wa’ad (promise) structure between two parties to buy a specified Shari’a compliant commodity at an agreed price on the relevant date in future. It is a conditional promise to purchase a commodity through unilateral purchase undertaking. For cross currency swaps, fixed or floating payments as well as notional amounts are exchanged in different currencies.

The table below shows the positive and negative fair value of these instruments, which are equivalent to the market value, together with the notional amounts. The notional amount is the amount of currency swap instruments’ underlying asset, reference rate or index and is the basis upon which changes in the value of this instrument is measured. The notional amounts indicate the volume of transactions outstanding at the period end and are not indicative of the credit risk.

	Currency Swap		
	Positive fair value BD 000	Negative fair value BD 000	Notional amount BD 000
31 December 2020	-	162	195,537
31 December 2019	-	69	82,940

In respect of cross currency swaps, the notional amount represents the gross cash flows. However, the amounts may be settled net. The following table shows the net cash flows:

	31 December 2020			
	Notional amount BD 000	Within 3 months BD 000	3 to 12 months BD 000	More than 12 months BD 000
Cash inflows	195,537	-	195,537	-
Cash outflows	(195,537)	-	(195,537)	-
	-	-	-	-

	31 December 2020			
	Notional amount BD 000	Within 3 months BD 000	3 to 12 months BD 000	More than 12 months BD 000
Cash inflows	82,940	-	82,940	-
Cash outflows	(82,940)	-	(82,940)	-
	-	-	-	-

23 INCOME FROM FINANCING CONTRACTS

	Note	2020 BD 000	2019 BD 000
Murabaha		23,585	22,053
Ijarah Muntahia Bittamleek	23.1	32,092	36,185
Due from banks		1,476	2,373
	23.2	57,153	60,611
Mudarib share from off balance sheet equity of investment account holders		1,887	2,055
Fees and commission income		481	719
Income from financing contracts		59,521	63,365

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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23 INCOME FROM FINANCING CONTRACTS (continued)

23.1 This rent revenue is presented net of depreciation on Ijarah Muntahia Bittamleek assets amounting to BD 21,069 thousand (2019: BD 21,761 thousand).

23.2 This is excluding net income of BD 113 thousand (2019: BD 777 thousand) suspended during the year on account of regulatory requirements.

24 INCOME FROM INVESTMENTS

	Note	2020 BD 000	2019 BD 000
Net unrealised gain on investments	24.1	-	198
Net gain on sale of investments	24.2	359	-
Fee income		1,238	974
Foreign exchange		413	839
Loss on sale of development properties		-	(361)
Other income		55	70
		2,065	1,720

24.1 This represents fair value changes recognized during the year based on the latest net asset values (NAV's) of the managed funds.

24.2 This amount includes a gain on disposal of a subsidiary during 2020.

25 INCOME AND EXPENSE RELATING TO FINANCING CONTRACTS AND SUKUK

	Note	2020 BD 000	2019 BD 000
Income from financing contracts	23	57,153	60,611
Income from sukuk	25.1	14,855	20,200
		72,008	80,811
Less: Profit on due to banks and non-banks	28	15,038	12,490
Less: Return on equity of investment account holders (wakala)		18,045	22,017
Less: Return on equity of investment account holders (mudaraba)		2,035	1,883
		35,118	36,390
		36,890	44,421

25.1 This includes an amount of nil (2019: BD 6,316 thousand) on account of gain on sale of sukuk recorded during the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

26 PROVISIONS - NET

	Note	2020 BD 000	2019 BD 000
Balances with banks and Central Bank of Bahrain		(1)	1
Due from banks		(454)	149
Financing contracts	9	4,947	(898)
Investments	10.2.1	-	500
Investment in sukuk		(10)	6
Investment in associates	12	1,109	-
Receivables and other assets	14.2	540	(372)
Financing commitments and financial guarantees		35	(17)
Recoveries from written-off accounts		(4,533)	(64)
		1,633	(695)

27 OTHER EXPENSES

	2020 BD 000	2019 BD 000
Business development	1,932	1,911
Technology and communication	3,715	3,410
Legal, consulting and outsourcing	795	514
Premises - rentals and maintenance	2,021	1,888
Administration, selling and others	2,101	2,166
	10,564	9,889

28 PROFIT ON DUE TO BANKS AND NON-BANKS

	2020 BD 000	2019 BD 000
Due to banks	4,981	1,292
Due to non-banks	10,057	11,198
	15,038	12,490

29 CASH AND CASH EQUIVALENTS

Cash and cash equivalents for the purpose of the consolidated statement of cash flows comprise of the following amounts:

	2020 BD 000	2019 BD 000
Cash	11,357	10,816
Balances with banks	7,939	17,925
Balances with CBB excluding mandatory reserve	12,888	38,736
Due from banks with original maturity of less than ninety days	123,590	115,216
	155,774	182,693

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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30 RELATED PARTY TRANSACTIONS AND BALANCES

Related parties represent associated companies, the parent and its major shareholders, directors and key management personnel of the Bank, the Bank's Shari'a Supervisory Board and entities controlled, jointly controlled or significantly influenced by such parties. Transactions with related parties arise from the ordinary course of business. Pricing policies and terms of these transactions are approved by the Group's management. Outstanding balances at the year end, excluding financing contracts, are unsecured.

The balances with related parties included in the consolidated financial statements are as follows:

	Note	Parent BD 000	Directors and key management personnel BD 000	Other related parties BD 000	Total 2020 BD 000	Total 2019 BD 000
Balances with Banks		24	-	20	44	998
Due from banks		66,003	-	-	66,003	3,771
Financing contracts *		-	2,651	20,814	23,465	46,662
Investment in sukuk		-	-	21,039	21,039	21,039
Fees receivable		-	-	517	517	1,528
Receivables and other assets	14.3	-	-	152,579	152,579	187,296
Due to non-banks		-	-	754	754	4,156
Customers' current accounts		249	714	7,176	8,139	2,469
Equity of investment account holders		136,720	2,875	23,582	163,177	340,212
Letters of credit		-	-	2,227	2,227	1,528
Commitments to extend credit		-	-	442	442	442
Off balance sheet equity of investment account holders						
- Funds extended to related parties		-	-	136,710	136,710	135,145
- Funds received from related parties		-	675	3,200	3,875	4,460
Assets under management		-	-	583,615	583,615	592,074

*Includes nil (2019: BD 16,473 thousand) which is past due and impaired

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

	Parent BD 000	Directors and key management personnel BD 000	Other related parties BD 000	Total 2020 BD 000	Total 2019 BD 000
Income from due from banks	30	-	-	30	28
Income from financing contracts	-	64	1,605	1,669	2,281
Income from investment in sukuk	-	-	1,271	1,271	1,271
Fee income	-	-	713	713	729
Allowance for credit losses	-	11	30	41	849
Profit on due to non-banks	-	-	48	48	216
Profit on equity investment account holders	3,775	52	1,622	5,449	10,469
Staff costs	-	4,738	-	4,738	5,353
Other expenses	-	-	1,331	1,331	1,344
Mudarib share of off-balance sheet equity of investment account holders	-	-	1,887	1,887	2,035

Compensation of key management personnel, included in the consolidated statement of income, is as follows:

	2020 BD 000	2019 BD 000
Short term employee benefits	4,517	5,030
Long term employee benefits	221	323

Directors' remuneration and attendance fee for the year ended 31 December 2020 amounted to BD 189 thousand and BD 115 thousand respectively (2019: BD 198 thousand and BD 127 thousand respectively).

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31 SEGMENT INFORMATION

Corporate banking	Principally engaged in Shari'a compliant profit sharing investment arrangements, providing Shari'a compliant financing contracts and other facilities to corporate customers.
Retail and private banking	Principally engaged in Shari'a compliant profit sharing investment arrangements, providing Shari'a compliant financing contracts and other facilities to retail and private banking customers.
Investments	Principally engaged in investment banking activities including private equity, managed funds and other investment management activities.
Treasury	Principally engaged in liquidity management, Shari'a compliant financing contracts to treasury customers, investment in Sukuk, investment accounts from non-bank customers and other international banking relationships.

Management monitors the operating results of its segments separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on segment profit (as reported in internal management reports) which is measured using the same measurement principles as are used in the preparation of these interim condensed consolidated financial statements.

The following table presents segment wise operating income, net income, total assets and total liabilities and equity of investment account holders of the Group for the year ended and as at 31 December 2020:

	Corporate banking BD 000	Retail & Private Banking BD 000	Investment BD 000	Treasury BD 000	Total BD 000
Operating income	28,239	23,482	3,215	21,042	75,978
Net income for the year	7,164	1,445	2,141	4,487	15,237
Segment assets	443,043	473,656	235,496	603,469	1,755,664
Segment liabilities and equity of investment account holders	26,129	1,067,705	359	494,242	1,588,435

The following table shows the distribution of the Group's operating income and total assets by geographical segments, based on the location in which the transactions and assets are recorded, for the year ended and as at 31 December 2020:

	Kingdom of Bahrain BD 000	Other countries BD 000	Total BD 000
Operating income	73,920	2,058	75,978
Segment assets	1,457,100	298,564	1,755,664

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At 31 December 2020

31 SEGMENT INFORMATION (continued)

The following table presents segment wise operating income, net income, total assets and total liabilities and equity of investment account holders of the Group for the year ended and as at 31 December 2019:

	Corporate banking BD 000	Retail & Private Banking BD 000	Investment BD 000	Treasury BD 000	Total BD 000
Operating income	28,573	24,591	3,608	28,349	85,121
Net income for the year	8,496	9,284	255	6,975	25,010
Segment assets	423,790	417,320	274,282	555,041	1,670,433
Segment liabilities and equity of investment account holders	44,562	941,627	978	489,607	1,476,774

The following table shows the distribution of the Group's operating income and total assets by geographical segments, based on the location in which the transactions and assets are recorded, for the year ended and as at 31 December 2019:

	Kingdom of Bahrain	Other countries	Total
Operating income	82,602	2,519	85,121
Segment assets	1,373,395	297,038	1,670,433

32 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the value representing the estimate of the amount of cash or cash equivalents that would be received for an asset sold or the amount of cash or cash equivalents paid for a liability extinguished or transferred in an orderly transaction between a willing buyer and a willing seller at the measurement date.

At 31 December 2020 and 2019, the fair value of financial instruments carried at amortised cost approximate their carrying values except for the investment in sukuk.

Financial instruments recorded at fair value

The Group uses the following hierarchy for determining and disclosing the fair value of instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

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At 31 December 2020

32 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

	Level 1 2020 BD 000	Level 2 2020 BD 000	Level 3 2020 BD 000	Total 2020 BD 000
Investments at fair value through equity				
Quoted equity securities	1,390	-	-	1,390
Unquoted equity securities	-	-	5,471	5,471
	1,390	-	5,471	6,861
	Level 1 2019 BD 000	Level 2 2019 BD 000	Level 3 2019 BD 000	Total 2019 BD 000
Investments at fair value through statement of income				
Managed funds	-	1,760	-	1,760
Investments at fair value through equity				
Quoted equity securities	706	-	-	706
Unquoted equity securities	-	-	3,690	3,690
	706	1,760	3,690	6,156

During the year ended 31 December 2020, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

The following table shows a reconciliation of the opening and closing amount of Level 3 financial assets which are recorded at fair value.

	Unquoted equity securities 2020 BD 000	Unquoted equity securities 2019 BD 000
Balance at 1 January	3,690	4,190
Impairment	-	(500)
Additions	3,104	-
Disposals / redemptions during the year	(1,333)	-
Fair value changes	10	-
Balance at 31 December	5,471	3,690

Impact on fair value of Level 3 financial instruments measured at fair value of changes to key assumptions

	Carrying amount 2020 BD 000	Effect of reasonably possible alternative assumption 2020 BD 000	Carrying amount 2019 BD 000	Effect of reasonably possible alternative assumption 2019 BD 000
Investments at fair value through equity				
Unquoted equity securities	5,471	547	3,690	369
	5,471	547	3,690	369

In order to determine reasonably possible alternative assumptions the Group adjusted key unobservable models inputs as follows:

For equities, the Group adjusted the price earning ratio by increasing and decreasing the price earning ratio by ten percent, which is considered by the Group to be within a range of reasonably possible alternatives based on the price earning ratios of companies with similar industry and risk profiles.

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33 MATURITY ANALYSIS OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS

The table below shows an analysis of assets, liabilities and equity of investment account holders analysed according to when they are expected to be recovered or settled. Group's contractual undiscounted repayment obligations are disclosed in note 34.3 'Risk Management - Liquidity Risk and Funding Management'.

	Up to one year			Over one year			Subtotal Over 1 year 2020 BD 000	Total 2020 BD 000
	Up to 3 months 2020 BD 000	3 to 12 months 2020 BD 000	Subtotal upto 12 months 2020 BD 000	1 to 5 years 2020 BD 000	5 to 10 years 2020 BD 000	Over 10 years 2020 BD 000		
Assets								
Cash and balances with banks and Central Bank of Bahrain	17,064	765	17,829	12,112	7,622	23,714	43,448	61,277
Due from banks	123,590	-	123,590	-	-	-	-	123,590
Financing contracts	204,907	141,964	346,871	324,449	166,584	167,324	658,357	1,005,228
Investments	-	-	-	6,861	-	-	6,861	6,861
Investment in sukuk	28,322	61,260	89,582	205,536	29,621	-	235,157	324,739
Investment in associate	-	-	-	6,889	-	-	6,889	6,889
Receivables and other assets	38,631	695	39,326	184,051	-	-	184,051	223,377
Premises and equipment	-	-	-	-	3,703	-	3,703	3,703
Total	412,514	204,684	617,198	739,898	207,530	191,038	1,138,466	1,755,664
Liabilities and equity of investment account holders								
Customers' current accounts	7,162	-	7,162	41,984	41,984	41,984	125,952	133,114
Due to banks	108,798	-	108,798	-	-	-	-	108,798
Due to non-banks	8,785	754	9,539	251,515	51,498	51,496	354,509	364,048
Other liabilities	9,374	4,080	13,454	2,844	-	-	2,844	16,298
Equity of investment account holders	64,026	150,357	214,383	250,600	250,597	250,597	751,794	966,177
Total	198,145	155,191	353,336	546,943	344,079	344,077	1,235,099	1,588,435
Net	214,369	49,493	263,862	192,955	(136,549)	(153,039)	(96,633)	167,229

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

33 MATURITY ANALYSIS OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS (continued)

	Up to one year			Over one year				Total
	Up to 3 months	3 to 12 months	Subtotal upto 12 months	1 to 5 years	5 to 10 years	Over 10 years	Subtotal Over 1 year	
	2019 BD 000	2019 BD 000	2019 BD 000	2019 BD 000	2019 BD 000	2019 BD 000	2019 BD 000	
Assets								
Cash and balances with banks and Central Bank of Bahrain	34,852	6,706	41,558	8,153	8,043	41,781	57,977	99,535
Due from banks	115,216	-	115,216	-	-	-	-	115,216
Financing contracts	176,064	158,753	334,817	308,775	155,380	114,935	579,090	913,907
Investments	1,760	-	1,760	4,396	-	-	4,396	6,156
Investment in sukuk	16,525	22,609	39,134	112,388	118,755	-	231,143	270,277
Investment in associate	-	-	-	8,461	-	-	8,461	8,461
Receivables and other assets	48,255	68	48,323	199,005	-	-	199,005	247,328
Premises and equipment	-	-	-	-	9,553	-	9,553	9,553
Total	392,672	188,136	580,808	641,178	291,731	156,716	1,089,625	1,670,433
Liabilities and equity of investment account holders								
Customers' current accounts	6,899	-	6,899	40,453	40,453	40,453	121,359	128,258
Due to banks	914	-	914	100,869	-	-	100,869	101,783
Due to non-banks	9,466	42,881	52,347	59,643	55,488	55,487	170,618	222,965
Other liabilities	7,789	4,388	12,177	3,222	-	-	3,222	15,399
Equity of investment account holders	46,383	193,070	239,453	341,438	213,739	213,739	768,916	1,008,369
Total	71,451	240,339	311,790	545,625	309,680	309,679	1,164,984	1,476,774
Net	321,221	(52,203)	269,018	95,553	(17,949)	(152,963)	(75,359)	193,659

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

34 RISK MANAGEMENT

34.1 Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring of material risks. The Group manages its exposure to risks within the approved risk limits. The process of risk management is critical to the Group's continuing profitability and each business unit within the Group is accountable for the risk exposures relating to its responsibilities. The Group is mainly exposed to credit risk, liquidity risk, profit rate risk and market risk, the latter being subdivided into trading and non-trading risks. The Group is also subject to prepayment risk and operating risk.

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

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies, policies and risk appetite of the Bank.

Audit & Compliance Committee (ACC)

The ACC is a Board appointed committee which is comprised of two independent directors and an executive director. The Chairman of the Committee is also an independent director. For audit related matters, the committee assists the Board of Directors in carrying out its responsibilities with respect to assessing the quality and integrity of financial reporting, the audit thereof and the soundness of the internal controls of the Bank. For compliance related matters, the committee assists the Board of Directors in the assessment of compliance with law, regulations and other requirements imposed on the Bank from time to time. The committee also oversees and manages the compliance and anti financial crime requirements of the Bank and legal related matters.

Board Risk Committee (BRC)

The Board Risk Committee is a Board appointed committee which is comprised of two independent directors and one executive director. The Chairman of the Committee is also an independent director. The committee is a reviewing and recommending body appointed by the Board of Directors to assist the Board in discharging its oversight duties relating to:

- Recommendation of the risk charter of the Bank to the Board, highlighting the key risks from identified business strategies, the risk appetite, the risk governance models including strategies, policies, processes, roles and responsibilities relating to various departments and various levels of risk management within the Bank; and
- Establishing appropriate policies and procedures to mitigate the applicable risks on the overall operations of the Bank.

Corporate Governance Committee

The Corporate Governance Committee is a Board appointed committee which is comprised of three independent directors including the Chairman. The committee is a reviewing and recommending body appointed by the Board of Directors to assist the Board in discharging its oversight duties relating to:

- Establishing appropriate Corporate Governance structures, delegation of authority and reporting protocols; and
- Ensure potential measure and improvements in corporate governance are implemented.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

34 RISK MANAGEMENT (continued)

34.1 Introduction (continued)

Internal Control Systems

The Board is responsible for approving and reviewing the effectiveness of the Bank's system of internal control, for the purpose of ensuring effective and efficient operations, quality of internal and external reporting, internal control, and compliance with laws and regulations. Senior Management is responsible for establishing and maintaining the system of internal control designed to manage the risk of failure to achieve the Bank's objectives. The system of internal control can only provide reasonable but not absolute assurance against the risk of material loss.

The effectiveness of the internal control system is reviewed by the Board and the Audit & Compliance Committee, which also receives review reports undertaken by the Bank's Internal Audit, Compliance and Anti Financial Crime departments. The Audit & Compliance Committee reviews the management letters issued by the external auditors and holds periodic meetings with them to discuss various matters including existing and potential internal control issues.

The regulatory non-compliances, if any, resulting in financial penalties are disclosed in the Annual Public Disclosures of the Bank. The Bank always enhances its internal control environment to avoid recurrence of similar penalties.

Asset and Liability Committee (ALCO) / Risk Management Committee (RMC)

ALCO / RMC is a senior management committee responsible for maintaining oversight of the Bank's risk profile and governance aspects. It helps the Board Risk Committee in establishing the risk policies and strategies and monitors the risk appetite in terms of risk limits and reports. It also controls the risks by appropriate actions. ALCO / RMC establishes policy and objectives for the asset and liability management of the Bank in terms of structure, distribution, risk and return and its impact on profitability. It also monitors the cash flow, cost and yield profiles and tenor of assets and liabilities and evaluates both from profit rate sensitivity and liquidity points of view, makes corrective adjustments based upon perceived trends and market conditions and monitors liquidity, foreign exchange exposures and positions.

Shari'a Supervisory Board

The Bank's Shari'a Supervisory Board is entrusted with the responsibility of ensuring the Bank's adherence to Shari'a rules and principles in its transactions and activities.

Provisioning Committee (PC)

The PC is a senior management committee responsible for ensuring adequate provisions and profit suspensions against all the past due and impaired exposures of the Bank. It reviews past due details and approve the resulting provisioning and profit suspension amounts submitted by the respective departments in line with the approved Provisions & Impairment Policy of the Bank. The PC also reviews credit classification and reclassification requests submitted by Business Units and recommends the provisions and profit suspensions to the Audit & Compliance Committee and Board of Directors for final approval.

Risk management department

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure an independent control process. It also helps the ALCO / RMC in establishing risk strategies, policies and limits, across the Bank. The department is also responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This department also ensures the complete capture of the risks in risk measurement and reporting systems and performs stress tests on the various portfolios of the Bank.

Treasury department

The treasury department is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

34 RISK MANAGEMENT (continued)

34.1 Introduction (continued)

Internal audit

Independent, objective activity that reviews the effectiveness of risk management, internal control environment and governance processes. Internal Audit discusses the results of all assessments with the management, and reports its findings and recommendations to the Audit & Compliance Committee.

Compliance department

The compliance department is responsible for managing all the compliance related issues with the external parties and regulators.

Risk measurement and reporting systems

The Group identifies, measures, controls and monitors its material risks on a periodic basis. The Bank has established relevant risk limit structures to quantify its risk appetite. The Bank conducts stress testing under various scenarios for its material portfolios using statistical methods to assess the impact of such scenarios on its portfolio and regulatory capital.

Established risk limits reflect the business strategy and market environment in which the Bank operates as well as the level of risk that the Bank is willing to accept. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposures across its material risk types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify risks at an early stage. This information is presented and explained to the Board of Directors, the Board Risk Committee and senior management. The report includes aggregate credit exposures, concentration limits, investment limits, foreign exchange exposures, profit rate limits, liquidity gaps and ratios and changes in Group's risk profile. On a periodic basis, detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the general allowance for credit losses on a quarterly basis. The Board of Directors receives the risk management report once in a quarter or when needed which is designed to provide all the necessary information to assess and conclude on the risks of the Group.

As part of the Risk Management's reporting framework, tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information. Periodic briefing is given to the Managing Director and Chief Executive Officer and all other relevant members of the Bank on the utilisation of market limits, proprietary investments and liquidity and any other risk developments.

34.2 Credit risk

Credit risk is the risk that the Group will incur a loss because its customers, clients or counterparties fail to discharge their contractual obligations. The Bank manages and controls its credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established with the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings for corporate customers are subject to revision at the time of renewal of the corporate facility. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

34 RISK MANAGEMENT (continued)

34.2 Credit risk (continued)

The Bank has adopted FAS 30 starting January 2018 where impairment is based on a forward-looking Expected Credit Loss (ECL) model. ECL would be measured taking into account the projected cash flows, Probability of Default (PD), Loss Given Default (LGD) and Exposure At Default (EAD). The amount of ECLs recognised as a loss allowance or provision depends on the extent of credit deterioration since initial recognition.

Credit-related commitments risk

The Bank makes available to its customers guarantees which may require that the Bank makes payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to risks similar to financing contracts and these are mitigated by the same control processes and policies.

Risk concentrations of the maximum exposure to credit risk without taking collateral

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 Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

The maximum credit exposure to any client or counterparty as of 31 December 2020 was BD 290,045 thousand (2019: BD 276,740 thousand).

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

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

	Gross maximum exposure 2020 BD 000	Gross maximum exposure 2019 BD 000
Balances with banks and Central Bank of Bahrain	49,920	88,719
Due from banks	123,590	115,216
Financing contracts	1,005,228	913,907
Investment in sukuk	324,739	270,277
Receivables and other assets	160,481	199,554
Total	1,663,958	1,587,673
Contingent liabilities and commitments	75,649	108,796
Total credit risk exposure	1,739,607	1,696,469

Where financial instruments are recorded at fair value the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

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At 31 December 2020

34 RISK MANAGEMENT (continued)

34.2 Credit risk (continued)

Risk concentrations of the maximum exposure to credit risk

The Group financial assets having credit risk, before taking into account any collateral held can be analysed by the following geographical regions:

	Bahrain 2020	Other GCC 2020	North America 2020	Other 2020	Total 2020
	BD 000	BD 000	BD 000	BD 000	BD 000
Balances with banks and Central Bank of Bahrain	41,993	1,469	5,236	1,222	49,920
Due from banks	22,813	98,506	2,271	-	123,590
Financing contracts	980,871	24,357	-	-	1,005,228
Investment in sukuk	324,739	-	-	-	324,739
Receivables and other assets	6,369	154,112	-	-	160,481
Contingent liabilities and commitments	75,649	-	-	-	75,649
Total	1,452,434	278,444	7,507	1,222	1,739,607

	Bahrain 2019	Other GCC 2019	North America 2019	Other 2019	Total 2019
	BD 000	BD 000	BD 000	BD 000	BD 000
Balances with banks and Central Bank of Bahrain	70,806	1,829	14,361	1,723	88,719
Due from banks	64,036	46,987	4,193	-	115,216
Financing contracts	884,253	29,654	-	-	913,907
Investment in sukuk	270,277	-	-	-	270,277
Receivables and other assets	9,710	189,844	-	-	199,554
Contingent liabilities and commitments	108,796	-	-	-	108,796
Total	1,407,878	268,314	18,554	1,723	1,696,469

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

34 RISK MANAGEMENT (continued)

34.2 Credit risk (continued)

Risk concentrations of the maximum exposure to credit risk (continued)

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

	Trading and manufacturing 2020	Banking and financial institutions 2020	Construction and real estate 2020	Other 2020	Total 2020
	BD 000	BD 000	BD 000	BD 000	BD 000
Balances with banks and Central Bank of Bahrain	-	49,920	-	-	49,920
Due from banks	-	123,590	-	-	123,590
Financing contracts	117,428	1,119	465,689	420,992	1,005,228
Investment in sukuk	-	303,705	21,034	-	324,739
Receivables and other assets	-	156,024	4,457	-	160,481
Contingent liabilities and commitments	5,022	2,227	10,951	57,449	75,649
Total	122,450	636,585	502,131	478,441	1,739,607

	Trading and manufacturing 2019	Banking and financial institutions 2019	Construction and real estate 2019	Other 2019	Total 2019
	BD 000	BD 000	BD 000	BD 000	BD 000
Balances with banks and Central Bank of Bahrain	-	88,719	-	-	88,719
Due from banks	-	115,216	-	-	115,216
Financing contracts	101,765	6,976	489,663	315,503	913,907
Investment in sukuk	-	249,240	21,037	-	270,277
Receivables and other assets	-	188,623	5,301	5,630	199,554
Contingent liabilities and commitments	40,036	4,053	36,603	28,104	108,796
Total	141,801	652,827	552,604	349,237	1,696,469

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At 31 December 2020

34 RISK MANAGEMENT (continued)

34.2 Credit risk (continued)

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 by the Bank are as follows:

- For commercial financing, lien over investment accounts, charges over real estate properties, inventory, trade receivables and unlisted equities; and
- For retail and consumer financing, lien over investment accounts, and mortgages over the related assets.

The Bank also obtains personal guarantees from company owners for commercial financing obtained. Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained periodically during its review of the Expected credit losses.

The Bank closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Bank will take possession of the collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

	Gross Exposures 2020	Expected Credit Loss 2020	Carrying Amount 2020	Fair Value of Collateral Held 2020
Murabaha	11,350	1,355	9,995	52,965
Ijarah Muntahia Bittamleek	4,046	789	3,257	9,059
Total	15,396	2,144	13,252	62,024

	Gross Exposures 2019	Impairment Allowance 2019	Carrying Amount 2019	Fair Value of Collateral Held 2019
	BD 000	BD 000	BD 000	BD 000
Murabaha	33,002	4,896	28,106	162,649
Ijarah Muntahia Bittamleek	30,680	2,326	28,354	117,360
Total	63,682	7,222	56,460	280,009

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

34 RISK MANAGEMENT (continued)

34.2 Credit risk (continued)

Individually assessed provisions

The Group performs assessment of Expected Credit Loss (ECL) and Significant Increase in Credit Risk (SICR) using qualitative and quantitative information appropriate for each individually significant financing contract on an individual basis. Individual assessment is important for large material exposures, as these are managed individually and incorporate obligor and facility specific information. Items considered when determining provision amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support, the realisable value of collateral, and the timing of the expected cash flows. The ECL is evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed provisions

ECLs are assessed collectively for financing contracts in case of small, very immaterial portfolios. Provisions are evaluated on each reporting date with each portfolio subjected to a separate review. Collective assessment would enable application of standardized rules to specific portfolios for assessing SICR.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment provision, and expected receipts and recoveries once impaired. Management is responsible for deciding the length of this period which can extend for as long as one year. The impairment provision is then reviewed as a part of the credit management framework to ensure alignment with the Group's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for financing contracts.

34.3 Liquidity risk and funding management

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management arranges diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Group maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Group also has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains a mandatory reserve with the Central Bank of Bahrain equal to 3% of customer deposits denominated in Bahrain Dinars, excluding deposits from resident subsidiaries. The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank. The most important of these is to maintain limits on the ratio of high quality liquid assets ("HQLA") to customer deposits. HQLA comprise of cash, balances with Central Bank of Bahrain, investment in quoted securities and liquid sukuk in line with the Liquidity Risk Module of the CBB. Customer deposits comprise of customers' current accounts, unrestricted investment accounts and murabaha due to non-banks. The ratios during the year were as follows:

HQLA to Customer Deposits Ratio	2020 %	2019 %
31 December	28.48%	28.02%
During the year:		
Average	31.41%	26.87%
Highest	34.16%	31.27%
Lowest	28.48%	25.27%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

34 RISK MANAGEMENT (continued)

34.3 Liquidity risk and funding management (continued)

Analysis of financial liabilities and equity of investment account holders by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities and equity of investment account holders at 31 December 2020 and 2019 based on contractual undiscounted repayment obligations. Maturity analysis of assets, liabilities and equity of investment account holders by expected maturities is disclosed in Note 33. 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.

	On demand BD 000	Less than 3 months BD 000	3 to 12 months BD 000	1 to 5 years BD 000	Total BD 000
At 31 December 2020					
Due to banks	388	108,829	-	-	109,217
Due to non-banks	-	75,401	198,827	96,456	370,684
Customers' current accounts	133,114	-	-	-	133,114
Other liabilities	-	9,369	4,081	2,848	16,298
Equity of investment account holders	397,512	353,571	190,587	31,327	972,997
Total undiscounted financial liabilities 2020	531,014	547,170	393,495	130,631	1,602,310
	On demand BD 000	Less than 3 months BD 000	3 to 12 months BD 000	1 to 5 years BD 000	Total BD 000
At 31 December 2019					
Due to banks	914	-	-	106,217	107,131
Due to non-banks	-	148,945	76,966	1,260	227,171
Customers' current accounts	128,258	-	-	-	128,258
Other liabilities	-	7,788	4,389	3,222	15,399
Equity of investment account holders	266,082	325,772	269,995	166,595	1,028,444
Total undiscounted financial liabilities 2019	395,254	482,505	351,350	277,294	1,506,403

Contingent liabilities and commitments

These include commitments to enter into contracts which are designed to meet the requirements of the Group's customers. Commitments represent contractual commitments under murabaha, musharaka and ijarah muntahia bittamleek contracts. Commitments generally have fixed expiration dates, or other termination clauses. Since commitments may expire without being exercised, the total contract amounts do not necessarily represent future cash flow requirements.

Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

34 RISK MANAGEMENT (continued)

34.3 Liquidity risk and funding management (continued)

Contingent liabilities and commitments (continued)

The table below shows the contractual expiry by maturity of the Group's credit commitments and contingent items.

	On demand BD 000	Less than 3 months BD 000	3 to 12 months BD 000	1 to 5 years BD 000	Total BD 000
At 31 December 2020					
Letters of credit	7,872	271	4,746	(7,793)	5,096
Guarantees	7,754	114	1,885	(1,999)	7,754
Irrevocable commitments to extend credit	-	1,421	33,315	28,063	62,799
Development commitment	-	-	-	-	-
Total	15,626	1,806	39,946	18,271	75,649
	On demand BD 000	Less than 3 months BD 000	3 to 12 months BD 000	1 to 5 years BD 000	Total BD 000
At 31 December 2019					
Letters of credit	6,630	164	1,528	577	8,899
Guarantees	6,975	-	-	-	6,975
Irrevocable commitments to extend credit	-	4,651	87,823	-	92,474
Development commitment	-	-	448	-	448
Total	13,605	4,815	89,799	577	108,796

34.4 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as profit rates, foreign exchange rates, and equity prices. The Group manages and monitors the positions using sensitivity analysis.

Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Bank measures the profit rate risk by measuring and managing the repricing gaps. It also performs sensitivity analysis.

The following table demonstrates the sensitivity to reasonably possible change in profit rates, with all other variables held constant of the Group's consolidated statement of income. The sensitivity of the consolidated statement of income is the effect of the assumed changes in profit rates on the consolidated net income for the year, based on the non-trading financial assets and financial liabilities held as at the date of statement of financial position.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

34 RISK MANAGEMENT (continued)

34.4 Market risk (continued)

Profit rate risk (continued)

The effect of decrease in basis points is expected to be equal and opposite to the effect of the increase shown.

	2020 BD 000	Change in basis points BD 000	Effect on net income for the year BD 000
ASSETS			
Due from banks	123,590	+25	309
Financing contracts	836,291	+25	2,091
Investment in sukuk	324,739	+25	812
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS			
Due to banks	108,798	+25	(272)
Due to non-banks	364,048	+25	(910)
Equity of investment account holders	966,177	+25	(2,415)
Total			(385)

	2019 BD 000	Change in basis points BD 000	Effect on net income for the year BD 000
ASSETS			
Due from banks	115,216	+25	288
Financing contracts	770,671	+25	1,927
Investment in sukuk	270,277	+25	676
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS			
Due to banks	101,783	+25	(255)
Due to non-banks	222,965	+25	(557)
Equity of investment account holders	1,008,369	+25	(2,521)
Total			(442)

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank has established Value at Risk limit for foreign currency exposures. This limit is monitored on a regular basis by the risk management department and reported to the ALCO / RMC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

34 RISK MANAGEMENT (continued)

34.4 Market risk (continued)

Currency risk (continued)

The Group had the following significant net exposures denominated in foreign currencies as of 31 December:

	Equivalent long (short) 2020 BD 000	Equivalent long (short) 2019 BD 000
Currency		
GBP	(1,012)	12
KWD	2,533	122
EUR	(997)	(711)

The table below indicates the currencies to which the Group had significant exposure at 31 December on all its monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Bahraini Dinar, with all other variables held constant, on the consolidated statement of income.

The effect of decreases in currency rate is expected to be equal and opposite to the effect of the increases shown.

	Change in currency rate %	Effect on profit 2020 BD 000	Change in currency rate %	Effect on profit 2019 BD 000
GBP	+20	(202)	+20	2
KWD	+20	507	+20	24
EUR	+20	(199)	+20	(142)
Total		106		(116)

Equity price risk

Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio.

The effect on income and equity (as a result of a change in the fair value of equity instruments) due to a reasonably possible change (i.e. +10%) in the value of individual investments, with all other variables held constant, is nil and BD 686 thousand (2019: nil and BD 440 thousand) respectively, except in cases where impairment loss occurred which will result in decrease being taken to the consolidated statement of income.

The effect of decrease in the value of individual investments is expected to be equal and opposite to the effect of the increase shown.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

34 RISK MANAGEMENT (continued)

34.5 Prepayment risk

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier than expected. The Group is not exposed to any significant prepayment risk.

34.6 Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks. The Bank has implemented Risks Controls and Self Assessment process (RCSA) whereby each of the units identifies risks in processes, key risk indicators and implemented controls. The key risk indicators values and actual incidents to the operational risk unit are reported to senior management for action. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

35 CAPITAL MANAGEMENT

The Group maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") and adopted by the Central Bank of Bahrain in supervising the Group. The Bank has also implemented the Internal Capital Adequacy and Assessment Plan (ICAAP) as per the CBB guidelines based on Pillar II recommendations of the Basel Committee. The Bank had identified the capital requirement for future three years based on the Bank's projected financials and the risk charges required for its significant risks including credit risk, market risk, profit rate risk, liquidity risk, investments risks and operational risks. The Board of Directors, on an annual basis, review and approve the ICAAP plan for both normal and stress conditions.

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

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

35 CAPITAL MANAGEMENT (continued)

Regulatory capital and risk-weighted assets

The regulatory capital and risk-weighted assets have been calculated in accordance with Basel III as adopted by the CBB.

	Note	2020 BD 000	2019 BD 000
Common equity Tier 1 capital	35.1	175,631	182,079
Tier 2 capital	35.2	38,567	59,015
Total capital		214,198	241,094
Credit risk-weighted assets		823,366	951,189
Market risk-weighted assets		23,580	25,320
Operational risk-weighted assets		136,539	171,366
Total risk weighted assets		983,485	1,147,875
Capital adequacy ratio		21.8%	21.0%
Minimum requirement		12.5%	12.5%

35.1 Common equity Tier 1 capital comprises of share capital, share premium, general reserve, statutory reserve and retained earnings, less unrealised loss arising from fair valuing equities.

35.2 Tier 2 capital comprises of subordinated wakala payable under unrestricted investment account holder, provisions against stage 1 and stage 2 exposures and asset revaluation reserves. Certain adjustments are made to AAOIFI-based results and reserves, as prescribed by the Central Bank of Bahrain.

36 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

The Group did not receive any significant income or incur significant expenses which were prohibited by the Shari'a.

37 SOCIAL RESPONSIBILITY

The Bank discharges its social responsibilities through donations to charitable causes and organisations approved by Shari'a Supervisory Board.

38 COMPARATIVE FIGURES

Certain of the prior year figures have been reclassified to conform to the presentation adopted in the current year. Such reclassification does not affect previously reported net income or owners' equity.

39 MODIFICATION LOSS, GOVERNMENT ASSISTANCE & OTHER MEASURES BY THE CBB TO HELP BANKS COMBAT THE EFFECTS OF COVID-19 PANDEMIC

During the year, based on a regulatory directive issued by the CBB (refer note 2) as concessionary measures to mitigate the impact of COVID-19, the one-off modification losses amounting to BD 18,457 thousand arising from the 6-month payment holidays provided to financing customers without charging additional profits has been recognized directly in equity. The modification loss has been calculated as the difference between the net present value of the modified cash flows calculated using the original effective profit rate and the current carrying value of the financial assets on the date of modification. The Bank provided payment holidays on financing exposures amounting to BD 699,288 thousand as part of its support to impacted customers.

Further, as per the regulatory directive, financial assistance amounting to BD 1,460 thousand (representing specified reimbursement of a portion of staff costs and waiver of fees, levies and utility charges) received from the government and/or regulators, in response to its COVID-19 support measures, have been recognized directly in equity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

39 MODIFICATION LOSS, GOVERNMENT ASSISTANCE & OTHER MEASURES BY THE CBB TO HELP BANKS COMBAT THE EFFECTS OF COVID-19 PANDEMIC (continued)

The CBB has issued various other measures to help banks combat the effect of COVID-19 and ease liquidity conditions as well as to assist in complying with the regulatory requirements which are as follows:

- Concessionary repo to eligible banks at zero percent profit rate;
- Reduction in cash reserve ratio requirement with CBB from 5% to 3%.
- Reduction in liquidity coverage ratio ("LCR") and net stable funding ratio ("NSFR") from 100% to 80%;
- Aggregate of modification loss and incremental ECL for stage 1 and stage 2 (recorded post March 2020) to be added back to the Tier 1 Capital for the two years ending 31 December 2020 and 31 December 2021. Subsequently from the year ending 31 December 2022, these to be deducted from Tier 1 capital on a straight line basis over the three year period ending 31 December 2024.
- Bank's to be more prudent in determining additional provisions for the period from 1st April to 31 December 2020 considering the economic and financial impact of COVID-19 on its customers.

The aforementioned measures have resulted in the following effects to the Group:

- Since the Group is maintaining adequate liquidity (LCR of 604.90% and NSFR of 112.38%), it was not eligible for the concessionary repo from the CBB and therefore the Group has not applied for this facility.
- The reduction in cash reserve requirement with the CBB has resulted in an average positive impact of BD 18,440 thousand on the Bank's liquidity position.
- The Bank is maintaining adequate liquidity ratios i.e. LCR of 604.90% and NSFR of 112.38% as at 31 December 2020. Although the relaxation is provided by the CBB, the Bank on a prudent basis continues to target 100% as the internal limit for the LCR and the NSFR ratios.
- Based on the above relaxation regarding the adding back of aggregate of modification loss and incremental ECL for Stage 1 and Stage 2 to the Tier 1 Capital, the capital adequacy ratio of the Bank stands at 21.78% as at 31 December 2020.
- Bank has performed a detailed assessment of its financing portfolio and concluded that the current provision levels are sufficient. The Bank on a regular basis assesses its financing portfolio for any credit deterioration due to COVID -19 and its resulting impact on the additional ECL requirements.

	Net Impact on the Group's consolidated income statement BD 000	Net Impact on the Group's consolidated net assets BD 000	Net Impact on the Group's consolidated total equity BD 000
Modification loss	-	(18,457)	(18,457)
Amortisation related to the modification loss	18,457	18,457	18,457
Government assistance	-	1,460	1,460
Total	18,457	1,460	1,460

In addition to the above, reduction in CBB cash reserve ratio has also improved the Group's liquidity by BD 19.8 million. However, there will not be a net increase in the Group's consolidated net assets as the reduction in CBB cash reserve is offset by increase in the other yielding financing assets of the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2020

40 NSFR REQUIREMENTS AND CALCULATION METHODOLOGY

The Net Stable Funding Ratio ('NSFR') is calculated in accordance with the Liquidity Risk Management Module guidelines, issued by the CBB and is effective from 2019. The minimum NSFR ratio as per CBB is 100%. However, based on the regulatory directive issued by the CBB in response to its COVID-19 measures, the minimum NSFR reduced to 80%. The Group's consolidated NSFR ratio as of 31 December 2020 is 112.38%.

The NSFR (as a percentage) is calculated as follows:

Item	Unweighted Values (i.e. before applying relevant factors)				Reviewed 31 December 2020 BD 000s Total weighted value	Audited 31 December 2019 BD 000s Total weighted value
	No specified maturity	Less than 9 months	More than 9 months and less than one year	Over one year		
Available Stable Funding (ASF):						
Capital:						
Regulatory Capital	176,485	-	-	37,904	214,390	242,192
Other Capital Instruments	-	-	-	65,975	65,975	47,125
Retail deposits and deposits from small business customers:						
Stable deposits						
Less stable deposits	-	562,058	69,788	37,208	605,870	520,031
Wholesale funding:						
Other wholesale funding	-	556,049	160,886	81,282	280,927	385,177
Other liabilities:						
All other liabilities not included in the above categories	-	26,836	-	7,741	7,741	10,597
Total ASF	176,485	1,144,944	230,674	230,111	1,174,902	1,205,122
Required Stable Funding (RSF):						
Total NSFR high-quality liquid assets (HQLA)	351,762	12,888	-	-	15,566	12,733
Performing financing and sukuk/securities:						
Performing financing to financial institutions secured by non-level 1 HQLA and unsecured performing financing to financial institutions	-	131,760	-	-	19,764	19,950
Performing financing to non-financial corporate clients, financing to retail and small business customers, and financing to sovereigns, central banks and PSEs, of which:	-	-	46,229	536,339	519,165	635,867
With a risk weight of less than or equal to 35% as per the CBB Capital Adequacy Ratio guidelines	-	-	-	161,636	105,064	-
Performing residential mortgages, of which:						
With a risk weight of less than or equal to 35% under the CBB Capital Adequacy Ratio Guidelines	-	-	-	184,613	119,998	97,222
Securities/sukuk that are not in default and do not qualify as HQLA, including exchange-traded equities	-	-	-	20,886	17,753	17,753
Other assets:						
All other assets not included in the above categories	246,463	-	-	-	246,463	332,290
OBS items	33,590	-	-	-	1,680	2,148
Total RSF	631,815	144,648	46,229	903,474	1,045,451	1,117,963
NSFR (%)					112.38%	107.80%

