



AHLI UNITED BANK K.S.C.P.
KUWAIT
FINANCIAL STATEMENTS
31 DECEMBER 2021

**Ahli United Bank K.S.C.P.
Kuwait**

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Ernst & Young
Al Alban, Al Osalmi & Partners
P.O. Box 74
18-20th Floor, Baitak Tower
Ahmed Al Jaber Street
Safal Square 13001, Kuwait

Tel: +965 2295 5000
Fax: +965 2245 6419
kuwait@kw.ey.com
ey.com/mena

Deloitte.

**Deloitte & Touche
Al-Wazzan & Co.**

Ahmed Al-Jaber Street, Sharq
Dar Al-Awadi Complex, Floors 7 & 9
P.O. Box 20174, Safat 13062
Kuwait

Tel : + 965 22408844, 22438060
Fax: + 965 22408855, 22452080
www.deloitte.com

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI UNITED BANK K.S.C.P.

Report on Audit of the Financial Statements

Opinion

We have audited the financial statements of Ahli United Bank K.S.C.P. (the "Bank"), which comprise the statement of financial position as at 31 December 2021 and the statement of profit or loss, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2021, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs), as adopted by the Central Bank of Kuwait for use by the State of Kuwait.

Basis for Opinion

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

Key Audit Matters

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

Credit losses on Islamic financing to customers

The recognition of credit losses on Islamic financing to customers ("credit facilities") is the higher of Expected Credit Loss determined under International Financial Reporting Standard 9: Financial Instruments ("IFRS 9"), according to Central Bank of Kuwait (the "CBK") guidelines ("ECL"), and the provision required by the CBK rules on classification of credit facilities and calculation of their provision (the "CBK instructions") as disclosed in the accounting policies in Note 2.5.1 and in Note 10 to the financial statements.

Recognition of ECL is a complex accounting policy, which requires considerable judgement in its implementation. ECL is dependent on management's judgement in assessing the level of credit risk on initial recognition and significant increase in credit risk subsequently on the reporting date relative to its initial recognition, and classification into three stages.

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

Report on Audit of the Financial Statements (continued)

Key Audit Matters (continued)

Credit losses on Islamic financing to customers (continued)

Furthermore, as disclosed by management, inherently judgmental modelling techniques are used to estimate ECLs which involves determining Probability of Default ("PD"), Loss Given Default ("LGD") and Exposure at Default ("EAD") which are modelled based on macroeconomic variables, and discounted to the reporting date. As disclosed in Note 30, the COVID-19 global pandemic significantly impacted management's determination of the ECL and required the application of heightened judgment. As a result, the ECL has a higher than usual degree of uncertainty and the inputs used are inherently subject to change, which may materially change the estimate in future periods.

On the other hand, recognition of specific provision on impaired credit facility under the CBK rules is based on the instructions prescribed by the CBK on the minimum provision to be recognised, together with any additional provision to be recognised based on management's estimate of expected cash flows related to that credit facility.

We determined that '*Credit losses on Islamic financing to customers*' is a key audit matter due to the significance of credit facilities and the related estimation uncertainty and judgement applied by management in the identification of significant increases in credit risk and consequent staging of customers; the significant judgment required by management when designing future macroeconomic scenarios and forecasting macroeconomic variables and probability-weighting scenarios. This is further heightened by the high degree of estimation uncertainty due to the economic impacts of COVID-19.

Our audit procedures included testing the design and implementation of controls over identification of significant increase in credit risk, consequent staging of customers; the effectiveness of controls over inputs and assumptions used by the Bank in developing the models, the forecasting of macro-economic variables, the probability weighting of the scenarios, governance, including the review controls performed by management over the determination of ECL.

The procedures also covered the impact of ECL caused by the economic disruption arising from the COVID 19 pandemic, including ones focused on rescheduled credit facilities.

With respect to the ECL, we selected samples of credit facilities outstanding, including rescheduled credit facilities, and assessed if the Bank's determination of significant increase in credit risk and the resultant basis for classification of the credit facilities into various stages was appropriate. We involved our specialists to review the ECL model in terms of key data, methods and assumptions used to ensure that they are in line with IFRS 9 requirements, determined in accordance with CBK guidelines. For a sample of credit facilities, we determined if the Bank's staging criteria, EAD, PD and LGD including the eligibility and value of collateral considered in the ECL models used by the Bank in order to determine the ECL taking into consideration CBK guidelines, was appropriate. We have also evaluated the consistency of various inputs and assumptions used by management to determine the ECL.

Further, for the CBK rule based provision requirements, we have assessed the criteria for determining whether there is a requirement to calculate any credit loss in accordance with the related regulations and, if required, we determined that it was computed accordingly. For the samples selected, which included rescheduled credit facilities, we verified whether all impairment events were identified by management. For the selected samples, which also included impaired credit facilities, we have assessed the valuation of collateral and reperfomed the resultant provision calculations.



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

Report on Audit of the Financial Statements (continued)

Other information included in the Annual Report of the Bank for the year ended 31 December 2021

Management is responsible for the other information. Other information consists of the information included in the Annual Report of the Bank for the year ended 31 December 2021, other than the financial statements and our auditors' report thereon. We obtained the report of the Bank's Board of Directors, prior to the date of our auditors' report, and we expect to obtain the remaining sections of the Annual Report after the date of our auditors' report.

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

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

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

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

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

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

Auditors' Responsibilities for the Audit of the Financial Statements

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



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

Report on Audit of the Financial Statements (continued)

Auditors' Responsibilities for the Audit of the Financial Statements (continued)

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

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

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

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


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

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

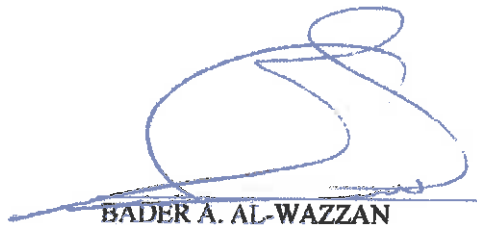
Report on Other Legal and Regulatory Requirements

Furthermore, in our opinion proper books of account have been kept by the Bank and the financial statements, together with the contents of the report of the Bank's Board of Directors relating to these financial statements, are in accordance therewith. We further report that, we obtained all the information and explanations that we required for the purpose of our audit and that the financial statements incorporate all information that is required by the Capital Adequacy Regulations and Financial Leverage Ratio Regulations issued by the CBK as stipulated in CBK Circular Nos. 2/RB, RBA/336/2014 dated 24 June 2014 and its amendments, and 2/I.B.S. 343/2014 dated 21 October 2014 and its amendments, respectively, the Companies Law No. 1 of 2016, as amended, and its executive regulations, as amended, and by the Bank's Memorandum of Incorporation and Articles of Association, as amended, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of the Capital Adequacy Regulations and Financial Leverage Ratio Regulations issued by the CBK as stipulated in CBK Circular Nos. 2/RB, RBA/336/2014 dated 24 June 2014 and its amendments and 2/I.B.S. 343/2014 dated 21 October 2014 and its amendments, respectively, the Companies Law No. 1 of 2016, as amended, and its executive regulations, as amended, or of the Bank's Memorandum of Incorporation and Articles of Association, as amended, have occurred during the year ended 31 December 2021 that might have had a material effect on the business of the Bank or on its financial position.

We further report that, during the course of our audit, we have not become aware of any violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the CBK and the organisation of banking business, and its related regulations during the year ended 31 December 2021 that might have had a material effect on the business of the Bank or on its financial position.



SHEIKHA AL FULALI
LICENCE NO. 289 A
EY
AL AIBAN, AL OSAIMI & PARTNERS



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

2 February 2022
Kuwait

Ahli United Bank K.S.C.P.

STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2021

	Notes	2021 KD 000	2020 KD 000
Financing income		119,197	138,395
Distribution to depositors	3	(41,552)	(63,098)
Net financing income		77,645	75,297
Net fees and commission income	4	6,997	5,847
Foreign exchange gains		3,623	3,618
Net gain from investment securities		1,612	5,651
Net gain on sale of investment properties		879	720
Share of results from an associate	12	306	(540)
Other income	5	369	119
Net operating income		91,431	90,712
Provision and impairment losses	6	(23,090)	(26,095)
Net operating income after provision and impairment losses		68,341	64,617
Staff costs		(19,737)	(18,633)
Depreciation expense		(4,311)	(4,068)
Other operating expenses		(11,691)	(10,495)
Total operating expenses		(35,739)	(33,196)
PROFIT BEFORE TAXATION AND DIRECTORS' REMUNERATION		32,602	31,421
Taxation	7	(1,117)	(1,437)
Directors' remuneration	22	(264)	(255)
PROFIT FOR THE YEAR		31,221	29,729
BASIC AND DILUTED EARNINGS PER SHARE (EPS)	8	11.5 fils	12.3 fils

The attached notes 1 to 30 form part of these financial statements.

Ahli United Bank K.S.C.P.

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2021

	Note	2021 KD 000	2020 KD 000
PROFIT FOR THE YEAR		31,221	29,729
Other comprehensive income (loss):			
<i>Other comprehensive income (loss) that will not be reclassified to profit or loss in subsequent periods:</i>			
Net movement in cumulative changes in fair values of equity instruments designated at FVOCI		86	(167)
Revaluation of freehold land	14	107	370
Net other comprehensive income that will not be reclassified to profit or loss in subsequent periods		193	203
Other comprehensive income for the year		193	203
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		31,414	29,932

The attached notes 1 to 30 form part of these financial statements.

Ahli United Bank K.S.C.P.
STATEMENT OF FINANCIAL POSITION
As at 31 December 2021

	Notes	2021 KD 000	2020 KD 000
ASSETS			
Cash and balances with banks	9	183,320	184,276
Deposits with the Central Bank of Kuwait		184,270	274,476
Deposits with other banks		383,094	322,281
Financing receivables	10	3,342,148	3,113,685
Investment securities	11	380,840	392,492
Investment in an associate	12	8,070	7,778
Investment properties	13	19,919	18,360
Premises and equipment	14	39,310	40,109
Other assets	15	32,464	16,541
TOTAL ASSETS		4,573,435	4,369,998
LIABILITIES AND EQUITY			
LIABILITIES			
Deposits from banks and other financial institutions		736,274	772,097
Deposits from customers	16	3,109,922	3,008,222
Repurchase agreements with banks	17	-	7,585
Other liabilities	18	79,584	78,891
		3,925,780	3,866,795
EQUITY			
Share capital	19	238,245	216,587
Reserves	19	272,707	269,933
		510,952	486,520
Treasury shares	20	(43,957)	(43,957)
Attributable to Bank's equity shareholders		466,995	442,563
Perpetual Tier 1 Sukuk	21	180,660	60,640
TOTAL EQUITY		647,655	503,203
TOTAL LIABILITIES AND EQUITY		4,573,435	4,369,998


Dr. Anwar Ali Al-Mudhaf
Chairman


Jehad Al-Humaidhi
Chief Executive Officer



Ahli United Bank K.S.C.P.

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2021

Attributable to the Bank's equity shareholders

	Reserves										Total reserves KD 000	Treasury shares KD 000	Perpetual Tier 1 Sukuk KD 000	Total Equity KD 000
	Share capital KD 000	Share premium KD 000	Statutory reserve KD 000	General reserve KD 000	Retained earnings KD 000	Cumulative changes in fair values KD 000	Property revaluation reserve KD 000	Treasury shares reserve KD 000	Total reserves KD 000	Treasury shares KD 000				
Balance as at 1 January 2021	216,587	12,883	93,188	22,660	126,661	3,290	10,277	974	269,933	(43,957)	60,640	503,203		
Profit for the year	-	-	-	-	31,221	-	-	-	31,221	-	-	31,221		
Other comprehensive (loss) income for the year	-	-	-	-	-	86	107	-	193	-	-	193		
Total comprehensive income (loss) for the year	-	-	-	-	31,221	86	107	-	31,414	-	-	31,414		
Proceeds from issue of perpetual Tier 1 Sukuk-2021 (Note 21)	-	-	-	-	-	-	-	-	-	-	180,660	180,660		
Redemption of perpetual Tier 1 Sukuk 2016 (Note 21)	-	-	-	-	277	-	-	-	277	-	(60,640)	(60,363)		
Perpetual Tier 1 Sukuk issuance cost and others	-	-	-	-	(645)	-	-	-	(645)	-	-	(645)		
Issue of bonus shares - 2020 (Note 19)	21,658	-	-	-	(21,658)	-	-	-	(21,658)	-	-	-		
Transfer to reserves (Note 19)	-	-	3,262	-	(3,262)	-	-	-	-	-	-	-		
Profit payment on Tier 1 Sukuk (Note 21)	-	-	-	-	(6,614)	-	-	-	(6,614)	-	-	(6,614)		
Balance as at 31 December 2021	238,245	12,883	96,450	22,660	125,980	3,376	10,384	974	272,707	(43,957)	180,660	647,655		

The attached notes 1 to 30 form part of these financial statements

Ahli United Bank K.S.C.P.

STATEMENT OF CHANGES IN EQUITY (CONTINUED)

For the year ended 31 December 2021

	Attributable to the Bank's equity shareholders											
	Reserves											
	Share capital KD 000	Share premium KD 000	Statutory reserve KD 000	General reserve KD 000	Retained earnings KD 000	Cumulative changes in fair values KD 000	Property revaluation reserve KD 000	Treasury shares reserve KD 000	Total reserves KD 000	Treasury shares KD 000	Perpetual Tier 1 Sukuk KD 000	Total Equity KD 000
Balance as at 1 January 2020	206,273	12,883	90,046	22,660	153,272	3,460	9,907	974	293,202	(43,957)	60,640	516,158
Profit for the year	-	-	-	-	29,729	-	-	-	29,729	-	-	29,729
Other comprehensive (loss) income for the year	-	-	-	-	-	(167)	370	-	203	-	-	203
Total comprehensive income (loss) for the year	-	-	-	-	29,729	(167)	370	-	29,932	-	-	29,932
Cash dividends - 2019 (Note 19)	-	-	-	-	(27,858)	-	-	-	(27,858)	-	-	(27,858)
Issue of bonus shares - 2019 (Note 19)	10,314	-	-	-	(10,314)	-	-	-	(10,314)	-	-	-
Transfer to reserves (Note 19)	-	-	3,142	-	(3,142)	-	-	-	-	-	-	-
Profit payment on Tier 1 Sukuk (Note 21)	-	-	-	-	(3,397)	-	-	-	(3,397)	-	-	(3,397)
Transfer of fair value reserve of equity instruments designated at FVOCI on derecognition	-	-	-	-	3	(3)	-	-	-	-	-	-
Modification loss on payment deferral program	-	-	-	-	(11,515)	-	-	-	(11,515)	-	-	(11,515)
Other transactions	-	-	-	-	(117)	-	-	-	(117)	-	-	(117)
Balance as at 31 December 2020	216,587	12,883	93,188	22,660	126,661	3,290	10,277	974	269,933	(43,957)	60,640	503,203

The attached notes 1 to 30 form part of these financial statements.

Ahli United Bank K.S.C.P.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2021

	Notes	2021 KD 000	2020 KD 000
OPERATING ACTIVITIES			
Profit before taxation and directors' remuneration		32,602	31,421
<i>Adjustments to reconcile profit before taxation and directors' remuneration to net cash flows:</i>			
Net gain on sale of investment properties		(879)	(720)
Net gain from investment securities		(1,612)	(5,651)
Share of results from an associate	12	(306)	540
Dividend income	5	(337)	(114)
Net (income) loss from investment properties	5	(5)	25
Depreciation of premises and equipment		4,311	4,068
Amortisation		2,090	1,789
Provision and impairment losses	6	23,090	26,095
		58,954	57,453
<i>Changes in operating assets and liabilities:</i>			
Deposits with the Central Bank of Kuwait		30,202	55,357
Deposits with other banks		(60,651)	125,836
Financing receivables		(266,016)	(134,432)
Other assets		(5,315)	688
Deposits from banks and other financial institutions		(35,779)	(277,553)
Deposits from customers		101,700	311,238
Repurchase agreements with banks		(7,585)	7,585
Other liabilities		8,027	(17,830)
Taxes paid		(862)	(2,553)
Net cash flows (used in) from operating activities		(177,325)	125,789
INVESTING ACTIVITIES			
Purchase of investment securities		(223,961)	(179,116)
Sale and redemption of investment securities		224,177	104,940
Proceeds from sale of investment properties		4,864	11,113
Purchase of premises and equipment		(2,095)	(2,058)
Net income from investment properties		5	(25)
Dividend income received		337	114
Net cash flows from (used in) investing activities		3,327	(65,032)
FINANCING ACTIVITIES			
Dividend paid to shareholders		-	(27,858)
Proceeds from issue of perpetual Tier 1 Sukuk-2021		180,660	-
Perpetual Tier 1 Sukuk issuance cost		(645)	-
Redemption of perpetual Tier 1 Sukuk 2016		(60,363)	-
Profit payment on Tier 1 Sukuks		(6,614)	(3,397)
Net cash flows from (used in) financing activities		113,038	(31,255)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		(60,960)	29,502
Cash and cash equivalents at 1 January		259,281	229,779
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	9	198,321	259,281

Financing income received amounted to KD 121,497 thousand (2020: KD 135,500 thousand) and distribution to depositors paid amounted to KD 36,036 thousand (2020: KD 77,220 thousand).

The attached notes 1 to 30 form part of these financial statements.

Ahli United Bank K.S.C.P.

Notes to the Financial Statements As at 31 December 2021

1. CORPORATE INFORMATION

Ahli United Bank K.S.C.P. (the “Bank”) is a public shareholding company incorporated in Kuwait in 1971 and is listed on Boursa Kuwait. It is engaged in carrying out banking activities in accordance with Islamic Sharia’a and is regulated by the Central Bank of Kuwait (“the CBK”). Its registered office is at Darwazat Al-Abdul Razzak, P.O. Box 71, Safat 12168, Kuwait.

The Bank commenced operations as an Islamic bank from 1 April 2010. Effective from that date, all activities are conducted in accordance with Islamic Sharia’a, as approved by the Bank’s Fatwa and Sharia’a Supervisory Board. The Bank is a subsidiary of Ahli United Bank B.S.C., a Bahraini bank (the “Parent”), listed on the Bahrain Stock Exchange and Boursa Kuwait.

The financial statements of the Bank for the year ended 31 December 2021 were authorised for issue in accordance with a resolution of the Board of Directors of the Bank on 09 January 2022 and are subject to the approval of the annual general assembly meeting (“AGM”) of the shareholders of the Bank. The AGM of the Shareholders has the power to amend these financial statements after issuance.

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 BASIS OF PREPARATION

The financial statements are prepared under the historical cost convention except for “investment securities” classified as financial assets at fair value through other comprehensive income and financial assets at fair value through profit or loss, “freehold land” and “derivative financial instruments”, that have been measured at fair values.

The financial statements are presented in Kuwaiti Dinars (“KD”), which is also the functional currency of the Bank, rounded to the nearest thousand except when otherwise indicated.

2.2 STATEMENT OF COMPLIANCE

The financial statements have been prepared in accordance with the regulations for financial services institutions as issued by the Central Bank of Kuwait (the CBK) in the State of Kuwait. These regulations, require banks and other financial institutions regulated by the CBK to adopt the International Financial Reporting Standards with the following amendments:

- (a) Expected credit loss (“ECL”) to be measured at the higher of ECL on credit facilities computed under IFRS 9 in accordance with the CBK guidelines or the provisions as required by the CBK instructions along with its consequent impact on related disclosures; and
- (b) Recognition of modification losses on financial assets arising from payment holidays to customers as a result of COVID during the financial year ended 31 December 2020, as required by CBK circular no. 2/BS/IBS/461/2020. Modification losses referred to in the circular, should be recognized in retained earnings instead of profit or loss as would be required by IFRS 9. However, modification loss on financial assets arising from any other payment holidays to customers shall be recognized in profit or loss in accordance with IFRS 9. All modification losses incurred after the year ended 31 December 2020 are recognized in the statement of profit or loss. The application of the policy will result in application of different accounting presentation for modification loss in 2020 compared to 2021.

The above framework is hereinafter referred to as “IFRS as adopted by the CBK for use by the State of Kuwait”.

Ahli United Bank K.S.C.P.

Notes to the Financial Statements As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.3 CHANGES IN ACCOUNTING POLICIES

New standards, interpretations, and amendments adopted by the Bank

The accounting policies adopted in the preparation of these financial statements are consistent with those used in the previous financial year, except for the adoption of new standards effective as of 1 January 2021. The following amendments to IFRSs are effective for annual period beginning on or after 1 January 2021. The Bank has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

Amendments to IFRS 3: *Definition of a Business*

The amendment to IFRS 3 clarifies that to be considered a business, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output. Furthermore, it clarified that a business can exist without including all of the inputs and processes needed to create outputs. These amendments had no impact on the financial statements of the Bank but may impact future periods should the Bank enter into any business combinations.

Profit Rate Benchmark Reform – Phase 2: Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16

Interbank offered rates (“IBORs”), such as the London Interbank Offered Rate (“LIBOR”), play a critical role in global financial markets, serving as reference rates for derivatives, financing and securities, and as parameters in the valuation of financial instruments. Uncertainty surrounding the integrity of IBOR rates has in recent years, led regulators, central banks and market participants to work towards a transition to alternative risk-free benchmark reference rates (“RFRs”) and market-led working rates. Banks in respective jurisdictions have recommended alternative risk-free reference rates, which are gradually being adopted.

Profit Rate Benchmark Reform - Phase 2 amendments have become effective from 1 January 2021 which address issues that might affect financial reporting as a result of the reform of an profit rate benchmark, including the effects of changes to contractual cash flows or hedging relationships arising from the replacement of a profit rate benchmark with an alternative benchmark rate. The amendments provide practical relief from certain requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 relating to changes in the basis for determining contractual cash flows of financial assets, financial liabilities and lease liabilities and hedge accounting. The Bank has adopted the requirements of ‘Profit Rate Benchmark Reform – Phase 2 Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16’ (IBOR reform Phase 2) which is effective for annual periods beginning on or after 1 January 2021 with earlier adoption permitted.

The amendments require an entity to account for a change in the basis for determining the contractual cash flows of a financial asset or financial liability that is required by profit rate benchmark reform by updating the effective interest rate of the financial asset or financial liability. In addition, it provides certain exceptions to hedge accounting requirements.

The majority of LIBOR and other Interbank Offer Rates are to be discontinued after 31 December 2021 and replaced with certain Alternative Benchmark Rates, with the exception of certain USD LIBOR rates where cessation is delayed until 30 June 2023.

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As at 31 December 2021**

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.3 CHANGES IN ACCOUNTING POLICIES (CONTINUED)

New standards, interpretations, and amendments adopted by the Bank (continued)

Profit Rate Benchmark Reform – Phase 2: Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 (continued)

Following the decision by global regulators to phase out IBORs and replace them with alternative reference rates and to manage our transition to ABRs, the Bank has implemented a comprehensive Bank-wide program and governance structure that addresses the key areas of impact including contract remediation, funding and liquidity planning, risk management, financial reporting and valuation, systems, processes and client education and communication.

The transition from IBORs to alternative benchmark profit rates will impact GBP and EUR denominated financial instruments referencing LIBOR rates for terms that extend beyond 31 December 2021. The corresponding date for majority of USD IBOR based contracts is 30 June 2023.

The announcement of changes in IBOR setting process has affected the Bank’s LIBOR linked products, including certain financing contracts and derivatives, and defined the dates of their transition to alternative benchmark rates. The fixed spreads to be used in the transition to the relevant alternative benchmark rate for each LIBOR setting were also defined by the respective regulatory bodies.

AUB management project team is managing the Bank’s transition activities and continues to engage with various stakeholders to support an orderly transition and to mitigate the risks resulting from the transition. The Bank will be using Secured Overnight Financing Rate (SOFR) and Sterling Overnight Index Average (SONIA) as alternative benchmark profit rates.

The table below summarizes the exposures to financial instruments referencing benchmark profit rates subject to the reform that are yet to transit to alternative benchmark profit rates. No significant impact is expected as a result of IBOR change on the transition date.

Currency	Assets	Derivatives
	KD 000	Notional amounts KD 000
Non-USD LIBOR*	16,194	-
USD LIBOR**	178,820	183,331
	195,014	183,331

*Includes EUR and GBP, only deals maturing beyond 31 December 2021

**Only deals maturing beyond 30 June 2023

The Bank’s exposure to IBOR linked financial liabilities is relatively insignificant.

The IBOR reform phase 2 amendments address issues arising during profit rate benchmark reform (IBOR reform), including specifying when the ‘phase 1’ amendments will cease to apply, when hedge designations and documentation should be updated, and when hedges of the alternative benchmark rate or alternative reference rate (ARR) as the hedged risk are permitted.

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Notes to the Financial Statements

As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.3 CHANGES IN ACCOUNTING POLICIES (CONTINUED)

New standards, interpretations, and amendments adopted by the Bank (continued)

Profit Rate Benchmark Reform – Phase 2: Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 (continued)

The 'phase 1' amendments provided temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR reform. The reliefs had the effect that IBOR reform should not generally cause hedge accounting to terminate prior to contracts being amended. However, any hedge ineffectiveness continued to be recorded in the statement of profit or loss. Furthermore, the amendments set out triggers for when the reliefs would end, which included the uncertainty arising from IBOR reform no longer being present.

The Bank evaluated the extent to which its fair value and cash flow hedging relationships are subject to uncertainty driven by IBOR reform as at the reporting date. The Bank's hedged items and hedging instruments continue to be indexed to IBOR benchmark rates, which is US Dollar LIBOR. These IBOR benchmark rates are quoted each day and IBOR cash flows are exchanged with its counterparties as usual.

Covid-19-Related Rent Concessions beyond 30 June 2021 Amendments to IFRS 16

On 28 May 2020, the IASB issued Covid-19-Related Rent Concessions - amendment to IFRS 16 Leases. The amendments provide relief to lessees from applying IFRS 16 guidance on lease modification accounting for rent concessions arising as a direct consequence of the Covid-19 pandemic. As a practical expedient, a lessee may elect not to assess whether a Covid-19 related rent concession from a lessor is a lease modification. A lessee that makes this election accounts for any change in lease payments resulting from the Covid-19 related rent concession the same way it would account for the change under IFRS 16, if the change were not a lease modification.

The amendment was intended to apply until 30 June 2021, but as the impact of the Covid-19 pandemic is continuing, on 31 March 2021, the IASB extended the period of application of the practical expedient to 30 June 2022. The amendment applies to annual reporting periods beginning on or after 1 April 2021.

This amendment had no material impact on the financial statements of the Bank.

Other amendments to IFRSs which are effective for annual accounting period starting from 1 January 2021 did not have any material impact on the accounting policies, financial position or performance of the Bank.

2.4 STANDARDS ISSUED BUT NOT YET EFFECTIVE

The Bank intends to adopt the new and amended standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements, when they become effective.

IFRS 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 Insurance Contracts (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 Insurance Contracts (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply.

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Notes to the Financial Statements

As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.4 STANDARDS ISSUED BUT NOT YET EFFECTIVE (continued)

IFRS 17 Insurance Contracts (continued)

IFRS 17 introduces new accounting requirements for banking products with insurance features that may affect the determination of which instruments or which components thereof will be in the scope of IFRS 9 or IFRS 17.

IFRS 17 is effective for reporting periods beginning on or after 1 January 2023, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17. The Bank is currently in the process of assessing the impact of adopting IFRS 17 on its financial statements.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.5.1 Financial instruments

a) Recognition

A financial asset or a financial liability is recognised when the Bank becomes a party to the contractual provisions of the instrument. All “regular way” purchases and sales of financial assets are recognised on the settlement date, i.e. the date that the Bank receives or delivers the asset. Changes in fair value between the trade date and settlement date are recognised in the statement of profit or loss or in the statement of comprehensive income in accordance with the policy applicable to the related instrument. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace.

b) Classification and measurement

The Bank offers Sharia’a compliant products and services such as Murabaha, Musawamah, Wakala and Ijara.

Murabaha is the sale of commodities, real estate and certain other assets at cost plus an agreed profit mark-up whereby the seller informs the purchaser of the cost of the product purchased and the amount of profit to be recognised.

Musawamah is an agreement under which negotiations between a buyer and a seller preclude the disclosure of sellers cost.

Wakala is an agreement whereby the Bank provides a sum of money to a customer under an agency arrangement, who invests it according to specific conditions in return for a fee. The agent is obliged to return the amount in case of default, negligence or violation of any terms and conditions of the Wakala.

Ijara is an agreement whereby the Bank (lessor) purchases or constructs an asset for lease according to the customer’s request (lessee), based on his promise to lease the asset for a specific period and against certain rent instalments. Ijara could end by transferring the ownership of the asset to the lessee.

The Bank classifies all of its financial assets except for equity instruments and derivatives, based on the business model for managing the assets and the asset’s contractual cashflow characteristics.

Financial liabilities, other than financing commitments and financial guarantees, are measured at amortised cost or at fair value through profit or loss (FVTPL) when they are held for trading and derivative instruments or the fair value designation is applied.

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**Notes to the Financial Statements
As at 31 December 2021**

**2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.1 Financial instruments (continued)

b) Classification and measurement (continued)

Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective. That is, whether the Bank's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- ▶ How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- ▶ The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- ▶ How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected)

The expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

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

The Contractual Cash flows assessment – Solely Payment of Principal and Profit (SPPP) test

The Bank assesses whether the financial instruments' cash flows represent Solely Payments of Principal and Profit (the 'SPPP test').

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

The most significant elements of profit within a financing arrangement are typically the consideration for the time value of money and credit risk. To make the SPPP assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the profit rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic financing arrangement do not give rise to contractual cash flows that are solely payments of principal and profit on the amount outstanding. In such cases, the financial asset is required to be measured at FVTPL.

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

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Notes to the Financial Statements As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.1 Financial instruments (continued)

b) Classification and measurement (continued)

The Contractual Cash flows assessment – Solely Payment of Principal and Profit (SPPP) test (continued)

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

- Debt instruments at amortised cost
- Debt instruments at Fair Value through Other Comprehensive Income (FVOCI)
- Equity instruments at FVOCI, with no recycling of gains or losses to statement of profit or loss on derecognition
- Financial assets at FVTPL

i) Debt instruments at amortised cost

A financial asset which is a debt instrument, is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and profit (SPPP) on the principal amount outstanding.

Deposits with the CBK, deposits with other banks, financing receivables, certain investments securities mainly representing Bank's investment in Sukuks and other assets are classified as debt instruments at amortised cost.

Debt instruments categorised at amortised cost are subsequently measured at amortised cost using the effective yield method adjusted for effective fair value hedges and impairment losses, if any. Profit income, foreign exchange gains and losses and impairment are recognised in the statement of profit or loss. Any gain or loss on derecognition is recognised in the statement of profit or loss.

ii) Debt instruments at FVOCI

A debt instrument is carried at FVOCI if it meets both of the following conditions:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets; and
- The contractual terms of the financial asset meet the SPPP test.

Debt instruments at FVOCI are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in other comprehensive income. Profit income and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost. Fair value changes which are not part of an effective hedging relationship are recognised in other comprehensive income and presented in the cumulative changes in fair values as part of equity until the asset is derecognised or reclassified. When the financial asset is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to the statement of profit or loss.

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**Notes to the Financial Statements
As at 31 December 2021**

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.1 Financial instruments (continued)

iii) Equity instruments at FVOCI

Upon initial recognition, the Bank may elect to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of Equity under IAS 32 *Financial Instruments: Presentation* and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

Equity instruments at FVOCI are subsequently measured at fair value. Changes in fair values including foreign exchange component are recognised in other comprehensive income and presented in the cumulative changes in fair values as part of equity.

Gains and losses on these equity instruments are never recycled to statement of profit or loss. Dividends are recognised in statement of profit or loss when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in the statement of comprehensive income.

Equity instruments at FVOCI are not subject to an impairment assessment. Upon disposal, cumulative gains or losses are reclassified from cumulative changes in fair value to retained earnings in the statement of changes in equity. Equity instruments at FVOCI are included in investment securities in the statement of financial position.

iv) Financial asset carried at FVTPL

The Bank classifies financial assets as carried at fair value through profit and loss when the business model of the class of financial assets is neither to solely collect the contractual cash flows from the assets nor to collect both the contractual cash flows and cash flows arising from the sale of assets. Financial assets that do not satisfy the SPPP test are mandatory classified under this category.

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL, if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise. Included in this classification are certain debt securities, equities and derivatives that are not designated as hedging instruments in a hedge relationship, that have been acquired principally for the purpose of selling or repurchasing in the near term.

FVTPL assets are subsequently measured at fair value.

Changes in fair values, financing income and dividends are recorded in the statement of profit or loss according to the terms of the contract, or when the right to payment has been established.

Day 1 profit or loss

When the transaction price of the instrument differs from the fair value at origination and the fair value is based on a valuation technique using only inputs observable in market transactions, the Bank recognises the difference between the transaction price and fair value in the investment income. In those cases where fair value is based on models for which some of the inputs are not observable, the difference between the transaction price and the fair value is deferred and is only recognised in profit or loss when the inputs become observable, or when the instrument is derecognised.

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Notes to the Financial Statements As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.1 Financial instruments (continued)

Day 1 profit or loss (continued)

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets.

c) Impairment of financial assets

The Bank recognises ECL on financing receivables, non-cash credit facilities in the form of bank guarantees, letters of guarantee, documentary letters of credit, bank acceptances, undrawn cash and non-cash credit facilities (revocable and irrevocable) and investment in debt securities measured at amortised cost or FVOCI.

Balances with the CBK and Sukuks issued by the CBK and the Government of Kuwait, are low risk and fully recoverable and hence no ECL is measured. Equity investments are not subject to ECL.

Impairment of financing receivables shall be recognised at the higher of ECL computed based on the CBK guidelines for measurement of ECL under IFRS 9, and the provision required by the CBK instructions.

Expected credit losses

The Bank has established a policy to perform an assessment at the end of each reporting period, whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument. To calculate ECL, the Bank will estimate the risk of a default occurring on the financial instrument during its expected life. ECLs are estimated based on the present value of all cash shortfalls over the remaining expected life of the financial asset, i.e., the difference between: the contractual cash flows that are due to the Bank under the contract, and the cash flows that the Bank expects to receive, discounted at the effective profit rate of the financing.

The Bank applies three-stage approach to measure ECL. Assets migrate through the following three stages based on the change in credit quality since initial recognition.

Stage 1: 12 months ECL

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

Stage 2: Lifetime ECL – not credit impaired

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

Stage 3: Lifetime ECL – credit impaired

The Bank measures loss allowances at an amount equal to 100% of net exposure i.e. after deduction from the amount of exposure the value of collaterals determined in accordance with the CBK guidelines.

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**Notes to the Financial Statements
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2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.1 Financial instruments (continued)

Expected credit losses (continued)

Stage 3: Lifetime ECL – credit impaired (continued)

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

For financial assets for which the Bank has no reasonable expectations of recovering either the entire outstanding amount, or a portion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) derecognition of the asset.

When estimating lifetime ECL for undrawn financing commitments, the Bank estimates the expected portion of the financing commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the financing facility is drawn down. The expected cash shortfalls are discounted at an approximation to the expected effective profit rate on the financing.

The Bank’s liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in statement of profit or loss, and the ECL provision. For this purpose, the Bank estimates ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs. The shortfalls are discounted by the risk-adjusted profit rate relevant to the exposure.

It is Bank’s policy to maintain consistent internal risk ratings across the credit portfolio. The credit quality of the portfolio of financing receivables that were neither past due nor impaired can be assessed by reference to the Bank’s internal credit rating system. This facilitates focused portfolio management of the inherent level of risk across all lines of business. The credit quality ratings disclosed below can be equated to the following risk rating grades, which are either internally applied or externally ratings mapped to internal ratings.

Credit Quality	Risk Rating	Definition
High standard	Risk rating 1 to 4	Undoubted through to good credit risk
Standard	Risk rating 5 to 7	Satisfactory through to adequate credit risk
Credit Impaired	Risk rating 8 to 10	Substandard through to loss

The risk rating system is supported by various financial analytics and qualitative market information for the measurement of counterparty risk.

Determining the stage of impairment

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12-month ECL or Lifetime ECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition and back stop indicators and analysis based on the Bank’s historical experience and expert credit risk assessment, including forward-looking information. The Bank considers an exposure to have significantly increased in credit risk when there is significant deterioration in customer rating compared to rating at origination, restructured due to financial difficulties of the customers and other conditions mentioned below.

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Notes to the Financial Statements As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.1 Financial instruments (continued)

c) Impairment of financial assets (continued)

Expected credit losses (continued)

Determining the stage of impairment (continued)

The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for financial assets, such as moving a customer/facility to the watch list, or the account becoming forborne. In certain cases, the Bank may also consider that events explained below (and not restricted to) are indicators of significant increase in credit risk as opposed to a default.

- ▶ Internal rating of the customer indicating default or near-default;
- ▶ The customer requesting emergency funding from the Bank;
- ▶ The customer having past due liabilities to public creditors or employees;
- ▶ The customer is deceased;
- ▶ A material decrease in the underlying collateral value where the recovery of the financing is expected from the sale of the collateral;
- ▶ A material decrease in the customer's turnover, loss of major customers or deterioration of customer financial position;
- ▶ A covenant breach not waived by the Bank;
- ▶ The obligor (or any legal entity within the obligor's group) filing for bankruptcy application / protection or liquidation;
- ▶ Obligor's listed debt or equity suspended at the primary exchange because of rumours or facts about financial difficulties;
- ▶ Legal measures and action against customer by other creditors;
- ▶ Clear evidence that the customer is unable to repayment financing receivable on maturity dates;
- ▶ Financial assets are classified under Stage 2 when there has been a downgrade in the facility's credit rating by 2 grades for the facilities with Investment Grade and by 1 grade for those with Non-Investment Grade;
- ▶ All rescheduled financial assets are classified under the Stage 2 unless it qualifies for Stage 3 classification.

The quantitative criteria used to determine a significant increase in credit risk is a series of relative and absolute thresholds. All financial assets that are more than 30 days past due are deemed to have significant increase in credit risk since initial recognition and migrated to stage 2 even if other criteria do not indicate a significant increase in credit risk.

Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition and are taken to Stage 3.

Objective evidence that debt instrument is impaired includes whether any payment of principal or profit is overdue by more than 90 days or there are any known difficulties in the cash flows including the sustainability of the counterparty's business plan, credit rating downgrades, breach of original terms of the contract, its ability to improve performance once a financial difficulty has arisen, deterioration in the value of collateral, etc. The Bank assess whether objective evidence of impairment exists on an individual basis for each individually significant asset and collectively for others not deemed individually significant.

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Notes to the Financial Statements As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.1 Financial instruments (continued)

c) Impairment of financial assets (continued)

Expected credit losses (continued)

Measurement of ECLs (continued)

Except for consumer and instalment financing, transfer of credit facility from Stage 2 to Stage 1 is made after a period of 12 months from the satisfaction of all conditions that triggered classification of the credit facility to Stage 2. Transfer of credit facility from Stage 3 to Stage 2 or Stage 1 is subject to approval of the CBK.

Measurement of ECLs

ECLs are probability weighted estimates of credit losses and are measured as the present value of all cash shortfalls discounted at the effective profit rate of the financial instrument. Cash shortfall represent the difference between cashflows due to the Bank in accordance with the contract and the cashflows that the Bank expects to receive. The key elements in the measurement of ECL include probability of default, loss given default and exposure at default.

The Probability of Default (“PD”) is an estimate of the likelihood of default over a given time horizon.

- ▶ A default may only happen at a certain time over the assessed period, if the financial asset has not been previously derecognised and is still in the portfolio. The Bank uses Point In Time PD (PIT PD) for each rating to calculate the ECL. The minimum PD is 0.75% for Investment Grade credit facilities and 1% for Non-Investment Grade credit facilities except for credit facilities granted to Government and Banks rated as Investment Grade by an external rating agency and financing transactions related to consumer and instalment financing (except for credit cards).
- ▶ The Exposure at Default (“EAD”) is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and profit, whether scheduled by contract or otherwise, expected drawdowns on committed facilities. As per the CBK requirements, the Bank applies 100% Credit Conversion Factor (CCF) on utilised cash and non-cash facilities. For unutilised facilities, CCF is applied based on the CBK requirements for leverage ratio issued on 21 October 2014.
- ▶ The Loss Given Default (“LGD”) is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD. The CBK has prescribed list of eligible collaterals and minimum hair-cuts that are applied in determination of LGD. Further, for unsecured senior and subordinate credit facilities minimum LGD threshold applied is 50% and 75% respectively.

The maximum period for which the credit losses are determined is the contractual life of a financial asset, including credit cards and other revolving facilities unless the Bank has the legal right to call it earlier. However, for financial assets in Stage 2, the Bank considers a minimum maturity of 7 years for all credit facilities (excluding consumer financing, credit cards and housing financing) unless credit facilities have non-extendable contractual maturity and final payment is less than 50% of the total facility extended. For consumer financings and credit cards and housing financings in Stage 2, the Bank considers minimum maturity of 5 years and 15 years respectively.

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Notes to the Financial Statements As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.1 Financial instruments (continued)

c) Impairment of financial assets (continued)

Expected credit losses (continued)

Incorporation of forward-looking information

The Bank incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. The Bank has performed historical analysis and identified the key economic variables impacting credit risk and expected credit losses for each portfolio. Relevant macro-economic adjustments are applied to capture variations from economic scenarios. These reflect reasonable and supportable forecasts of future macro-economic conditions that are not captured within the base ECL calculations.

Macro-economic factors

In its models, the Bank's macro-economic factors taken into consideration include, but are not limited to, gross domestic product, consumer price index and government expenditure, and require an evaluation of both the current and forecast direction of the macro-economic cycle. Incorporating forward-looking information increases the degree of judgement required as to how changes in these macro-economic factors will affect ECLs. The methodologies and assumptions including any forecasts of future economic conditions are reviewed regularly.

Multiple forward-looking scenarios

The Bank determines its allowance for credit losses using three probability-weighted forward-looking scenarios. The Bank considers both internal and external sources of information and data in order to achieve an unbiased projections and forecasts. The Bank prepares the scenarios using forecasts. The forecasts are created using internal and external models which are modified by Bank as necessary to formulate a 'Baseline' view of the most probable future direction of relevant economic variables as well as a representative range of other possible forecast scenarios. The process involves the development of two additional economic scenarios (Upturn, and Downturn) and consideration of the relative probabilities of each outcome.

The 'baseline' represents the most likely outcome and is aligned with information used by the Bank for other purposes such as strategic planning and budgeting. The other scenarios represent more optimistic and more pessimistic outcomes. The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macroeconomic variables, credit risk, and credit losses

Renegotiated financing receivables

In the event of a default, the Bank seeks to restructure financing to customers rather than take possession of collateral. This may involve extending the payment arrangements and the agreement of new financing conditions. When the financing to customers has been renegotiated or modified but not derecognised, any impairment is measured using the original effective yield method as calculated before the modification of terms. Management continually reviews renegotiated financing to ensure that all criteria are met and that future payments are likely to occur. Management also assesses whether there has been significant increase in credit risk, or the facility should be classified in Stage 3.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented as a deduction from the gross carrying amount of the financial assets for financial assets carried at amortised cost. In the case of debt instruments measured at FVOCI, the Bank recognises the ECL charge in the statement of profit or loss and a corresponding amount is recognised in other comprehensive income with no reduction in the carrying amount of the financial asset in the statement of financial position.

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2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.1 Financial instruments (continued)

c) Impairment of financial assets (continued)

Write-offs

Financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense.

Provisions for credit losses in accordance with the CBK instructions

The Bank is required to calculate provisions for credit losses on financing receivables in accordance with the instructions of the CBK on the classification of financing receivables and calculation of provisions. Financing receivables are classified as past due when a payment has not been received on its contractual payment date or if the facility is in excess of pre-approved limits. A financing receivable is classified as past due and impaired when the profit or a principal instalment is past due for more than 90 days and if the carrying amount of the facility is greater than its estimated recoverable value.

Past due and past due and impaired financing receivables are managed and monitored as irregular facilities and are classified into the following four categories which are then used to determine the provisions.

<i>Category</i>	<i>Criteria</i>	<i>Specific provision</i>
Watch list	Irregular for a period up to 90 days	-
Substandard	Irregular for a period of 91- 180 days	20%
Doubtful	Irregular for a period of 181- 365 days	50%
Bad	Irregular for a period exceeding 365 days	100%

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

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

d) Derecognition

A financial asset (in whole or in part) is derecognised either when: (i) the contractual rights to receive the cash flows from the asset have expired or (ii) the Bank has retained its right to receive cash flows from the assets but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement; or (iii) the Bank has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Bank has transferred its right 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 Bank's continuing involvement in the asset, in which case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

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As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.1 Financial instruments (continued)

d) Derecognition (continued)

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

If continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the continuing involvement is measured at the value the Bank would be required to pay upon repurchase. In the case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

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

e) Offsetting

Financial assets and financial liabilities are offset, and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and the Bank intends to settle on a net basis.

2.5.2 Fair values measurement

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

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

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

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

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

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

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Notes to the Financial Statements As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.2 Fair values measurement (continued)

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

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

For financial instruments quoted in an active market, fair value is determined by reference to quoted market prices. Bid prices are used for assets and offer prices are used for liabilities. The fair value of investments in mutual funds, unit trusts or similar investment vehicles are based on the last published net assets value.

For unquoted financial instruments fair value is determined by reference to the market value of a similar investment, discounted cash flows, other appropriate valuation models or brokers' quotes.

For financial instruments carried at amortised cost, the fair value is estimated by discounting future cash flows at the current market rate of return for similar financial instruments.

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

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

2.5.3 Derivative financial instruments and Hedging

The Bank deals in Islamic derivative instruments to manage exposures to profit rate, foreign currency and credit risks.

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

Islamic forward agreements

In the ordinary course of business, the Bank enters into various types of transactions that involve financial instruments represented in forward foreign exchange agreements (Waad) to mitigate foreign currency risk. A Waad is a financial transaction between two parties where payments are dependent upon movements in price of one or more underlying financial instruments, reference rate or index in accordance with Islamic Sharia'a.

The notional amount, disclosed gross, is the amount of a Waad's underlying asset/liability and is the basis upon which changes in the value are measured.

The notional amounts indicate the volume of transactions outstanding at the year-end and are neither indicative of the market risk nor credit risk.

Ahli United Bank K.S.C.P.

Notes to the Financial Statements As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.3 Derivative financial instruments and Hedging (continued)

Islamic forward agreements (continued)

For derivative contracts that do not qualify for hedge accounting, any gains or losses arising from changes in fair value of the derivative contract are taken directly to the statement of profit or loss.

Profit rate swaps

Profit rate swaps are contractual agreements between two parties and may involve exchange of profit or exchange of both principal and profit for a fixed period of time based on contractual terms.

The notional amounts indicate the volume of transactions outstanding at the period-end and are neither indicative of the market risk nor credit risk. Most of the Bank's profit rate swaps are held for hedging.

Hedge accounting

The Bank uses profit rate swaps to hedge against the profit rate risk arising from specifically identified, or a portfolio of, fixed profit rate investments. At the inception of a hedge relationship, the Bank formally designates and documents the hedge relationship to which the Bank wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the effectiveness of changes in the hedging instrument's fair value in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

For the purposes of hedge accounting, hedges are classified into two categories: (a) fair value hedges when hedging the exposure to changes in the fair value of a recognised asset or liability or an unrecognised firm commitment; and (b) cash flow hedges, when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction or a foreign currency risk in an unrecognised firm commitment.

The changes in fair value of the hedging instrument that qualify and is designated as fair value hedge is recorded in the statement of profit or loss, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge accounting is discontinued, the fair value adjustment to the hedged item is amortised to the statement of profit or loss over the period to maturity of the previously designated hedge relationship using the effective profit rate. If the hedged item is derecognised, the unamortised fair value is recognised immediately in the statement of profit or loss.

When an unrecognised firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognised as an asset or liability with a corresponding gain or loss recognised in statement of profit or loss.

For those contracts classified as cash flow hedges, the effective portion of the gain or loss on the hedging instrument is recognised directly as other comprehensive income in the cash flow hedge reserve, while any ineffective portion is recognised immediately in the statement of profit or loss.

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Notes to the Financial Statements

As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.3 Derivative financial instruments and Hedging (continued)

Amounts recognised as other comprehensive income are transferred to the statement of profit or loss when the hedged transaction affects profit or loss, such as when the hedged financial income or financial expense is recognised or when a forecast sale occurs. Where the hedged item is the cost of a non-financial asset or non-financial liability, the amounts recognised as other comprehensive income are transferred to the initial carrying amount of the non-financial asset or liability.

If the forecast transaction or firm commitment is no longer expected to occur, the cumulative gain or loss previously recognised in fair value reserve are transferred to the statement of profit or loss. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, any cumulative gain or loss previously recognised in other comprehensive income remains in other comprehensive income until the forecast transaction or firm commitment affects profit or loss.

The Bank discontinues hedge accounting when the following criteria are met:

- a) it is determined that the hedging instrument is not, or has ceased to be, highly effective as a hedge;
- b) the hedging instrument expires, or is sold, terminated, or exercised;
- c) the hedged item matures or is sold or repaid; or
- d) a forecast transaction is no longer deemed highly probable.

2.5.4 Financial guarantees

In the ordinary course of business, the Bank provides financial guarantees, consisting of letter of credit, guarantees and acceptances. Financial guarantees are initially recognised in the financial statements at fair value, being the premium received, in other liabilities. The premium received is amortised in the statement of profit or loss on a straight-line basis over the life of the guarantee. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium received and the best estimate of net cash flow required to settle any financial obligation arising as a result of the guarantee. A provision for credit losses based on the higher of ECL under IFRS 9 according to the CBK guidelines and the provisions required by the CBK instructions is also accounted.

2.5.5 Investment in an associate

The Bank's investment in its associate is accounted for using the equity method. An associate is an entity in which the Bank has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

Under the equity method, the investment in associate is carried in the statement of financial position at cost plus post acquisition changes in the Bank's share of net assets of the associate.

Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The statement of profit or loss reflects the share of the results of operations of the associate. Where there has been a change recognised directly in the other comprehensive income of the associate, the Bank recognises its share of any changes and discloses this, when applicable, in the statement of comprehensive income. Unrealised gains and losses resulting from transactions between the Bank and the associate are eliminated to the extent of the interest in the associate.

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Notes to the Financial Statements As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.5 Investment in an associate (continued)

The Bank's share of profit attributable to equity holders of an associate is shown on the face of the statement of profit or loss.

The financial statements of the associate are prepared for the same reporting period as the Bank. Where necessary, adjustments are made to bring the accounting policies in line with those of the Bank.

After application of the equity method, the Bank determines whether it is necessary to recognise an additional impairment loss on the Bank's investment in its associate. The Bank 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 Bank 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 statement of profit or loss.

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

2.5.6 Investment properties

Land and buildings held for the purpose of capital appreciation or for long term rental yields and not occupied by the Bank are classified as investment properties.

Investment properties are measured at cost less accumulated depreciation (based on an estimated useful life of forty years using the straight-line method) and accumulated impairment.

Any gains or losses on the retirement or disposal of an investment property are recognised in the statement of profit or loss in the period of retirement or when sale is completed.

Fair values of investment properties are determined by appraisers having an appropriate recognised professional qualification and recent experience in the location and category of the property being valued. The fair value measurement takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

2.5.7 Premises and equipment

Freehold land is initially recognised at cost and not depreciated. After initial recognition freehold land is carried at the revalued amount, which is the fair value at the date of revaluation. The revaluation is carried out periodically by professional property evaluators. The resultant revaluation surplus or deficit is recognised in the statement of comprehensive income to the extent the deficit does not exceed the previously recognised surplus. The portion of the revaluation deficit that exceeds a previously recognised revaluation surplus is recognised in the statement of profit or loss. To the extent that a revaluation surplus reverses a revaluation decrease previously recognised in the statement of profit or loss, the increase is recognised in the statement of profit or loss. Upon disposal, the revaluation reserve relating to the freehold land sold is transferred to retained earnings.

Buildings, other premises and equipment are stated at cost, less accumulated depreciation and impairment losses if any. Depreciation of buildings and other premises and equipment is provided on a straight-line basis over their estimated useful lives.

Ahli United Bank K.S.C.P.

**Notes to the Financial Statements
As at 31 December 2021**

**2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.7 Premises and equipment (continued)

The estimated useful lives of the assets for the calculation of depreciation are as follows:

› Buildings	40 to 45 years
• Other premises and equipment	2 to 7 years

When assets are sold or retired, their cost and accumulated depreciation are eliminated from the accounts and any gain or loss resulting from their disposal is recognised in the statement of profit or loss.

Expenditure incurred to replace a component of an item of premises and equipment that is accounted for separately is capitalised and the carrying amount of the component that is replaced is written off. Other subsequent expenditure is capitalised only when it increases future economic benefits of the related item of premises and equipment. All other expenditure is recognised in the statement of profit or loss as the expense is incurred.

2.5.8 Leases – Bank as a lessee

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

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

a) Right-of-use assets

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

b) Lease liabilities

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

Ahli United Bank K.S.C.P.

Notes to the Financial Statements

As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.8 Leases – Bank as a lessee (continued)

b) Lease liabilities (continued)

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

2.5.9 Perpetual Tier 1 Sukuk

Perpetual Tier 1 Sukuk are recognised under equity in the statement of financial position and corresponding distributable profits on those Sukuk are accounted as a debit to the retained earnings.

2.5.10 Impairment of non-financial assets

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets and then its recoverable amount is assessed as part of the cash-generating unit to which it belongs. Where the carrying amount of an asset (or cash-generating unit) exceeds its recoverable amount, the asset (or cash-generating unit) is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset (or cash-generating unit). In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by available fair value indicators.

2.5.11 End of service indemnity

Provision is made for employees' end of service indemnity in accordance with the local laws based on employees' salaries and accumulated periods of service or on the basis of employment contracts, where such contracts provide extra benefits. The provision, which is unfunded, is determined as the liability that would arise as a result of involuntary termination of staff at the reporting date. This basis is considered to be a reliable approximation of the present value of the final obligation. End of service indemnity is presented under other liabilities in the statement of financial position.

2.5.12 Treasury shares

Treasury shares consist of the Bank's own issued shares that have been reacquired by the Bank and not yet reissued or cancelled. The treasury shares are accounted for using the cost method. Under this method, the weighted average cost of the shares reacquired is charged to a contra account in equity. When the treasury shares are reissued, gains are credited to a separate account in equity, (the "treasury shares reserve"), which is not distributable. Any realised losses are charged to the same account to the extent of the credit balance on that account. Any excess losses are charged to retained earnings then to the general reserve and statutory reserve. Gains realised subsequently on the sale of treasury shares are first used to offset any previously recorded losses in the order of reserves, treasury shares reserve account and retained earnings. No cash dividends are paid on these shares. The issue of stock dividend shares increases the number of treasury shares proportionately and reduces the average cost per share without affecting the total cost of treasury shares.

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Notes to the Financial Statements

As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.15 Revenue recognition (continued)

2.5.13 Repurchase agreements

Securities sold under agreements to repurchase (“repos”) at a specified future date are not derecognised from the statement of financial position as the Bank retains substantially all of the risks and rewards of ownership. The corresponding cash received is recognised in the statement of financial position as an asset with a corresponding obligation to return it, including accrued profit as a liability within repurchase agreements with banks, reflecting the transaction’s economic substance Repurchase agreements with banks. The difference between the sale and repurchase prices is treated as profit expense and is accrued over the life of agreement using the Effective Profit Rate.

2.5.14 Cash and cash equivalents

Cash and cash equivalents for the purpose of statement of cash flows include cash and balances with the Central Bank of Kuwait, deposits with banks with original maturity not exceeding seven days.

2.5.15 Revenue recognition

(i) *Financing income*

For all financial instruments measured at amortised cost, financing income is recorded using the effective profit rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective profit rate, but not future credit losses.

Once a financial instrument categorised as “financing receivables” is written down to its estimated recoverable amount, related income is thereafter recognised on the unimpaired portion based on the original effective profit rate that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

(ii) *Fee and commission income*

The Bank earns fee and commission income from a diverse range of services it provides to its customers.

Fee income can be divided into the following two categories:

- Fee income earned from services that are provided over a certain period of time are accrued over that period
- Fee income arising from negotiating or participating in the negotiation of a transaction for a third party, are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

2.5.16 Taxation

National Labour Support Tax (NLST)

The Bank calculates NLST in accordance with Law No. 19 of 2000 and the Ministry of Finance Resolutions No. 24 of 2006 at 2.5% of taxable profit for the year. As per law, cash dividends from listed companies which are subjected to NLST have been deducted from the profit for the year.

Kuwait Foundation for the Advancement of Sciences (KFAS)

The Bank calculates the contribution to KFAS at 1% of profit for the year, in accordance with the modified calculation based on the Foundation’s Board of Directors resolution, which states that the Board of Directors’ remuneration and transfer to statutory reserve should be excluded from profit for the year when determining the contribution.

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Notes to the Financial Statements As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.16 Taxation (continued)

Zakat

Contribution to Zakat is calculated at 1% of the profit of the Bank in accordance with Law No. 46 of 2006 and the Ministry of Finance resolution No. 58/2007 effective from 10 December 2007.

2.5.17 Provisions

Provisions are recognised when, as a result of past events, it is probable that an outflow of economic resources will be required to settle a present, legal or constructive obligation and the amount can be reliably estimated.

2.5.18 Foreign currency

Foreign currency transactions are recorded at the rate of exchange prevailing at the date of transactions. Monetary assets and liabilities denominated in foreign currencies outstanding at the year-end are translated into Kuwaiti Dinars at the rates of exchange prevailing at reporting date. Any resultant gains or losses are taken to the statement of profit or loss.

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 transactions. Non-monetary assets and liabilities in foreign currencies that are stated at fair value are translated to Kuwaiti Dinars using exchange rates ruling at the dates when the fair value was determined. In case of non-monetary assets, whose changes in fair values are recognised directly in other comprehensive income, related foreign exchange differences are also recognised directly in other comprehensive income unless it is part of an effective hedging strategy. For other non-monetary assets foreign exchange differences are recognised directly in the statement of profit or loss.

Translation differences arising on net investments in foreign operations are taken to the statement of comprehensive income.

2.5.19 Government grants

Government grants are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognised as income on a systematic basis over the periods that the related costs, for which it is intended to compensate, are expensed. When the grant relates to an asset, it is recognised as income in equal amounts over the expected useful life of the related asset.

When the Bank receives grants of non-monetary assets, the asset and the grant are recorded at nominal amounts and released to statement of profit or loss over the expected useful life of the asset, based on the pattern of consumption of the benefits of the underlying asset by equal annual instalments.

To mitigate the impact of the COVID-19 pandemic, the Government of Kuwait has introduced measures to aid private entities in response to the pandemic. These measures include government assistance made towards the workforce in the private sector for a period of up to six months effective from April 2021.

The government assistance is accounted for in accordance with IAS 20 '*Accounting for Government Grants and Disclosures of Government Assistance*' and recognised in the statement of profit or loss as a deduction to 'staff costs'.

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Notes to the Financial Statements

As at 31 December 2021

2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5.20 Segment information

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker.

2.5.21 Contingencies

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

Contingent liabilities are not recognised in the financial statements, but are disclosed unless the possibility of an outflow of resources embodying economic benefit is remote. Provisions for contingent liabilities are recognised when the outflow of resources is probable.

2.6 SIGNIFICANT ACCOUNTING JUDGEMENT, ESTIMATES AND ASSUMPTIONS

The preparation of financial statements requires management to make judgements and estimates that affect the reported amounts of financial assets and liabilities and disclosure of contingent liabilities. These judgements and estimates also affect the revenues and expenses and the resultant provisions as well as the fair value changes reported in other comprehensive income.

2.6.1 Significant judgements

Classification of financial assets

The Bank determines the classification of financial assets based on the assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and profit on the principal amount outstanding.

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

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

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

Fair value of financial instruments

The fair value of financial instruments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e., an exit price) regardless of whether that price is directly observable or estimated using another valuation technique. When the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of valuation models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, estimation is required in establishing fair values. Judgements and estimates include considerations of liquidity and model inputs related to items such as credit risk (both own and counterparty), funding value adjustments, correlation and volatility. For further details about determination of fair value please see Note 25.

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Notes to the Financial Statements

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2. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.6 SIGNIFICANT ACCOUNTING JUDGEMENT, ESTIMATES AND ASSUMPTIONS (CONTINUED)

2.6.1 Significant judgements (continued)

Hedge accounting

The Bank's hedge accounting policies include an element of judgement and estimation. Estimates of future profit rates and the general economic environment will influence the availability and timing of suitable hedged items, with an impact on the effectiveness of the hedge relationships.

2.6.2 Estimation uncertainty and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment of financial instruments

The measurement of impairment losses across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their dependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- ▶ The Bank's internal credit rating model, which assigns PDs to the individual grades.
- ▶ The Bank's criteria for assessing if there has been a significant increase in credit risk so allowances for financial assets should be measured on a lifetime ECL basis and qualitative assessment.
- ▶ The segmentation of financial assets when their ECL is assessed on a collective basis.
- ▶ Development of ECL models, including various formulas and choice of inputs.
- ▶ Determination of associations between macroeconomic scenarios and, economic inputs, and the effect on PDs, EADs and LGDs.
- ▶ Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

The Bank has the policy to regularly review its models in the context of actual loss experience and adjust when necessary.

Impairment of investment in an associate

The Bank calculates the amount of impairment as the difference between the recoverable amount and its carrying value if there is any objective evidence that the investment in an associate is impaired. The estimation of recoverable amount requires the Bank to make an estimate of the expected future cashflows and selection of appropriate inputs for valuation.

Valuation of unquoted financial assets

Fair value of unquoted financial assets is determined using valuation techniques including the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments. The determination of the cash flows and discount factors requires significant estimation.

The impact of COVID -19 on estimates has been disclosed in Note 30.

Ahli United Bank K.S.C.P.

Notes to the Financial Statements

As at 31 December 2021

3. DISTRIBUTION TO DEPOSITORS

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

4. NET FEES AND COMMISSION INCOME

	2021 KD 000	2020 KD 000
Fees and commission income	12,889	7,683
Fees and commission expense	(5,892)	(1,836)
Net fees and commission income	6,997	5,847

5. OTHER INCOME

	2021 KD 000	2020 KD 000
Dividend income	337	114
Net income (loss) from investment properties	5	(25)
Others	27	30
	369	119

6. PROVISION AND IMPAIRMENT LOSSES

	2021 KD 000	2020 KD 000
Impairment of financing receivables (Note 10)	29,052	32,622
Recoveries from written-off financing receivables	(7,170)	(4,405)
Reversal of provision for non-cash credit facilities (Note 10)	(743)	(1,057)
Impairment of investment properties (Note 13)	-	458
Other provisions	2,084	(2,392)
Charge for expected credit losses for investment in sukuks (Note 11)	29	610
(Reversal) charge for expected credit losses for other financial assets	(162)	259
	23,090	26,095

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7. TAXATION

	2021 KD 000	2020 KD 000
Contribution to Kuwait Foundation for the Advancement of Sciences (KFAS)	293	283
National Labour Support Tax (NLST)	504	803
Zakat	320	351
	1,117	1,437

8. BASIC AND DILUTED EARNINGS PER SHARE (EPS)

	2021	2020
Net profit for the year attributable to the Bank's equity shareholders (KD 000)	31,221	29,729
Less: Profit payments on Tier 1 Sukuks (KD 000)	(6,614)	(3,397)
Net profit for the year attributable to equity holders of the Bank after profit payment on Tier 1 Sukuks (KD 000)	24,607	26,332
Weighted average number of shares outstanding during the year	2,145,034,556	2,145,034,556
BASIC AND DILUTED EPS ATTRIBUTABLE TO THE BANK'S EQUITY SHAREHOLDERS (FILS)	11.5	12.3

The weighted average number of shares outstanding during the year is calculated after adjusting for treasury shares as follows:

	2021	2020
Weighted average number of Bank's issued and paid up shares	2,382,454,533	2,382,454,533
Less: Weighted average number of treasury shares	(237,419,977)	(237,419,977)
	2,145,034,556	2,145,034,556

Earnings per share for the year ended 31 December 2020 was 13.5 fils, before retroactive adjustment to the number of shares following the bonus issue (Note 19).

As there are no dilutive instruments outstanding, basic and diluted earnings per share are identical.

9. CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the statement of cash flows consists of the following:

	2021 KD 000	2020 KD 000
Cash and balances with banks	183,320	184,276
Deposits with Central Bank of Kuwait and other banks with an original maturity of seven days or less	15,001	75,005
	198,321	259,281

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10. FINANCING RECEIVABLES

	<i>31 December 2021</i>		<i>31 December 2020</i>	
	Retail financing KD 000	Commercial financing KD 000	Total KD 000	Total KD 000
Financing receivables	466,482	2,990,004	3,456,486	3,249,221
Less: Provision for impairment	(12,182)	(102,156)	(114,338)	(135,536)
	454,300	2,887,848	3,342,148	3,113,685

The movement in provision for impairment of financing receivables by class of financial assets is as follows:

	Retail financing KD 000	Commercial financing KD 000	Total KD 000
At 1 January 2021	12,213	123,323	135,536
Charge for the year (Note 6)	3,378	25,674	29,052
Amounts written-off	(3,409)	(46,841)	(50,250)
At 31 December 2021	12,182	102,156	114,338
	Retail financing KD 000	Commercial financing KD 000	Total KD 000
At 1 January 2020	10,146	93,886	104,032
Charge for the year (Note 6)	2,955	29,667	32,622
Amounts written-off	(888)	(230)	(1,118)
At 31 December 2020	12,213	123,323	135,536

As at 31 December 2021, non-performing financing receivables on which income has been suspended from recognition amounted to KD 64,516 thousand (2020: KD 63,109 thousand).

The available specific provision on cash facilities is KD 28,065 thousand (2020: KD 27,948 thousand).

The provision reversal for the year on non-cash facilities is KD 743 thousand (2020: KD 1,057 thousand). The available provision on non-cash facilities of KD 7,287 thousand (2020: KD 8,030 thousand) is included in other liabilities (Note 18).

The policy of the Bank for calculation of the impairment provision for financing receivables complies in all material respects with the provision requirements of the CBK.

According to the CBK instructions, a minimum general provision of 1% for cash facilities and 0.5% for non-cash facilities has been made on all applicable credit facilities (net of certain categories of collateral), that are not provided for specifically.

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10. FINANCING RECEIVABLES (CONTINUED)

The Bank's provision committee also evaluated the customers who have not exceeded the days past due, but yet having potential distress due to their business and economic environment, and where required, the Bank recorded additional provisions in line with the rules of the Central Bank of Kuwait.

An analysis of the carrying amounts of financing receivables, and the corresponding Expected Credit Losses based on the staging criteria under IFRS 9 in accordance with CBK regulations.

	<i>As at 31 December 2021</i>			
	<i>Stage 1</i> <i>KD 000's</i>	<i>Stage 2</i> <i>KD 000's</i>	<i>Stage 3</i> <i>KD 000's</i>	<i>Total</i> <i>KD 000's</i>
Financing receivables				
High	2,310,874	39,895	-	2,350,769
Standard	921,352	104,032	-	1,025,384
Past due or impaired	9,528	3,766	67,039	80,333
	<u>3,241,754</u>	<u>147,693</u>	<u>67,039</u>	<u>3,456,486</u>
	<i>As at 31 December 2020</i>			
	<i>Stage 1</i> <i>KD 000's</i>	<i>Stage 2</i> <i>KD 000's</i>	<i>Stage 3</i> <i>KD 000's</i>	<i>Total</i> <i>KD 000's</i>
Financing receivables				
High	2,199,008	46,247	-	2,245,255
Standard	799,946	121,614	-	921,560
Past due or impaired	12,056	5,332	65,018	82,406
	<u>3,011,010</u>	<u>173,193</u>	<u>65,018</u>	<u>3,249,221</u>

An analysis of the changes in the Expected Credit Losses in relation to financing receivables computed under IFRS 9 in accordance to the CBK guidelines:

	<i>31 December 2021</i>			
	<i>Stage 1</i> <i>KD 000's</i>	<i>Stage 2</i> <i>KD 000's</i>	<i>Stage 3</i> <i>KD 000's</i>	<i>Total</i> <i>KD 000's</i>
As at 1 January 2021	11,699	19,625	42,891	74,215
Impact due to transfer between stages	686	(1,370)	684	-
Additional (reversal) ECL for the period	8,012	(9,517)	45,238	43,733
Amounts written off	(16)	(201)	(50,031)	(50,248)
At 31 December 2021	<u>20,381</u>	<u>8,537</u>	<u>38,782</u>	<u>67,700</u>

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As at 31 December 2021**

10. FINANCING RECEIVABLES (CONTINUED)

	31 December 2020			
	Stage 1 KD 000's	Stage 2 KD 000's	Stage 3 KD 000's	Total KD 000's
As at 1 January 2020	9,793	17,314	17,737	44,844
Impact due to transfer between stages	250	(3,209)	2,959	-
Additional ECL for the period	1,656	5,520	23,313	30,489
Amounts written off	-	-	(1,118)	(1,118)
At 31 December 2020	<u>11,699</u>	<u>19,625</u>	<u>42,891</u>	<u>74,215</u>

11. INVESTMENT SECURITIES

	2021 KD 000	2020 KD 000
<i>Measured at amortised cost:</i>		
Sukuks	<u>375,734</u>	<u>386,905</u>
<i>Measured at FVTPL:</i>		
Quoted equity securities	-	11
Unquoted funds	-	657
	<u>-</u>	<u>668</u>
<i>Measured at FVOCI:</i>		
Unquoted equity securities	<u>5,106</u>	<u>4,919</u>
	<u>5,106</u>	<u>4,919</u>
	<u>380,840</u>	<u>392,492</u>

An analysis of changes in the gross carrying amount and the corresponding expected credit losses in relation to investment in sukuks are as follows:

	2021 KD 000	2020 KD 000
Gross carrying amount as at 1 January	<u>387,789</u>	<u>297,722</u>
New assets purchased net of redemptions/sales during the year	<u>1,852</u>	<u>80,143</u>
Other movements including exchange rate impact	<u>(12,994)</u>	<u>9,924</u>
At 31 December	<u>376,647</u>	<u>387,789</u>
	<u>2021 KD 000</u>	<u>2020 KD 000</u>
ECL allowance as at 1 January	<u>884</u>	<u>274</u>
Net charge during the year	<u>29</u>	<u>610</u>
At 31 December	<u>913</u>	<u>884</u>

All the sukuks as of 31 December 2021 are classified under stage 1.

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As at 31 December 2021**

12. INVESTMENT IN AN ASSOCIATE

The Bank owns 30 % (2020: 30%) equity interest in Middle East Financial Investment Company (“MEFIC”) incorporated and domiciled in the Kingdom of Saudi Arabia.

Set out below is the movement in investment in an associate during the year:

	2021	2020
	KD 000	KD 000
As at 1 January	7,778	8,261
Share of results	306	(540)
Share of OCI	12	37
Foreign currency translation adjustment	(26)	20
At 31 December	8,070	7,778

Set out below is the summarised financial information of the associate:

	2021	2020
	KD 000	KD 000
Share of associate’s statement of financial position:		
Current assets	2,192	2,522
Non-current assets	8,031	6,995
Current liabilities	(1,277)	(818)
Non-current liabilities	(876)	(921)
Net assets	8,070	7,778
Share of associate’s results:		
Operating income	1,054	1,075
Profit (loss) for the year	306	(540)

Management has assessed whether there is any objective evidence that its investment in an associate is considered impaired. As a result of the exercise, the management has concluded that no impairment provision is considered necessary in the statement of profit or loss in the current year (2020: Nil).

The fair value of investment in the associate is not disclosed as the associate is unquoted and it does not have published quoted price.

13. INVESTMENT PROPERTIES

These represent properties acquired by the Bank and is recognised at cost less accumulated depreciation and impairment. For the purpose of impairment testing, investment properties were revalued by independent valuers using market comparable approach that reflects recent transaction prices for similar properties and is therefore classified under Level 2 of the fair value hierarchy. In estimating the fair value of investment properties, the highest and best use of the properties is their current use. There has been no change to the valuation technique during the year. The fair value of the investment properties at the reporting date is KD 20,651 thousand (2020: KD 18,508 thousand).

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**Notes to the Financial Statements
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13. INVESTMENT PROPERTIES (CONTINUED)

Movement for the year is as follows:

	2021 KD 000	2020 KD 000
At 1 January	18,360	29,230
Additions	5,551	-
Disposals	(3,986)	(10,387)
Impairment (Note 6)	-	(458)
Depreciation charge for the year	(6)	(25)
At 31 December	<u>19,919</u>	<u>18,360</u>

14. PREMISES AND EQUIPMENT

Premises and equipment include a revaluation increase of KD 107 thousand (2020: KD 370 thousand) in the value of freehold land based on valuations determined by independent valuation experts. Freehold land was revalued by independent valuers using significant valuation inputs based on observable market data and is classified under Level 2 of the fair value hierarchy.

15. OTHER ASSETS

	2021 KD 000	2020 KD 000
Profit receivable	6,326	8,626
Positive fair value of derivative financial instruments (Note 24)	957	74
Government grant receivables (Note 30)	10,120	-
Others	15,061	7,841
	<u>32,464</u>	<u>16,541</u>

16. DEPOSITS FROM CUSTOMERS

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

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

Saving Investment Accounts

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

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16 DEPOSITS FROM CUSTOMERS (CONTINUED)

Fixed-Term Deposit Investment Accounts

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

Open –Term Deposit Investment Accounts

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

Funds utilised in investments for each investment deposit are computed using ratios identified in the contracts for opening of these accounts with clients. The Bank guarantees to pay the remaining un-invested portion of these investment deposits. Accordingly, this portion is considered Qard Hassan from depositors to the Bank, in accordance with Islamic Sharia'a.

The fair values of deposits from customers do not differ significantly from their carrying values.

17. REPURCHASE AGREEMENTS WITH BANKS

During the previous year, the Bank entered into repurchase agreements amounting to KD 7,585 thousand, with a bank and the fair value of investment securities that had been provided as collateral was KD 7,945 thousand.

18. OTHER LIABILITIES

	2021 KD 000	2020 KD 000
Depositors' profit share payable	17,128	11,612
Provision for staff indemnity	6,425	6,780
Provision for non-cash credit facilities (Note 10)	7,287	8,030
Negative fair value of derivative financial instruments (Note 24)	4,366	14,894
Lease liabilities	5,738	6,046
Account payables, accruals and others	38,640	31,529
	<u>79,584</u>	<u>78,891</u>

19. EQUITY

- i) The authorised share capital as at 31 December 2021 comprises of 2,500,000,000 ordinary shares (2020: 2,500,000,000 shares) of 100 fils each and the issued and fully paid share capital as at 31 December 2021 comprises of 2,382,454,533 ordinary shares (2020: 2,165,867,757 shares) of 100 fils each.
- ii) The Board of Directors of the Bank have proposed cash dividend of 5% (2020 Nil) amounting to 5 fils per share (2020 nil) and bonus shares of 5% (2020: 10%). The proposed bonus shares are subject to the approval of the shareholders at the Bank's annual general assembly meeting (AGM). The shareholders' AGM held on 20 April 2021 approved the audited financial statements of the Bank for the year ended 31 December 2020 and issuance of bonus shares of 10 % (2019: 5% and distribution of cash dividends of 15 fils per share).

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19. EQUITY (CONTINUED)

- iii) The Bank is required by the Companies' Law and the Bank's Articles of Association to transfer 10% of the profit before taxation and Directors' remuneration to the statutory reserve. The Bank may resolve to discontinue such annual transfers when the statutory reserve equals 50% of the paid-up share capital. Accordingly, the Bank has transferred KD 3,262 thousand (2020: KD 3,142 thousand) to statutory reserve. Distribution of the statutory reserve is limited to the amount required to enable the payment of a dividend of up to 5% of share capital in years when retained earnings are not sufficient for the payment of such dividend.
- iv) The Articles of Association of the Bank requires that an amount of not less than 10% of the profit before taxation and Directors' remuneration should be transferred annually to a general reserve account. The Board of Directors have resolved to discontinue such transfer from the year ended 31 December 2007 onwards, which was approved by the shareholders at the Bank's AGM on 6 March 2008. General reserve is available to be distributed to shareholders at the discretion of the general assembly, in ways that may be deemed beneficial to the Bank.
- v) The balances of share premium and treasury shares reserve are not available for distribution. The balance in the property revaluation reserve is not available for distribution unless the relevant assets are derecognised.

The cost of the Bank's own shares purchased, including directly attributable costs, is recognised in equity. In accordance with the instructions of the Central Bank of Kuwait and AGM, the Bank may purchase treasury shares up to 10% of its paid-up share capital.

20. TREASURY SHARES

There was no purchase or sale of treasury shares during the current year.

	2021	2020
Number of treasury shares	237,419,977	215,836,343
Treasury shares as a percentage of total shares issued	9.97%	9.97%
Cost of treasury shares (KD 000)	43,957	43,957
Market value of treasury shares (KD 000)	73,363	62,377
Weighted average market value per treasury share (fils)	306	284

Amount equivalent to cost of treasury shares are retained out of reserves as non-distributable throughout the holding period of the treasury shares.

21. PERPETUAL TIER 1 SUKUK

The Bank, through a Sharia'a compliant Sukuk arrangement, issued "Tier 1 Sukuk – 2016" Capital Certificates amounting to USD 200 million in October 2016, and "Tier 1 Sukuk – 2021" Capital Certificates amounting to USD 600 million in June 2021 (together "Tier 1 Sukuks"). Tier 1 Sukuks are perpetual securities in respect of which there are no fixed redemption dates and constitute direct, unsecured, deeply subordinated obligations (senior only to share capital) of the Bank subject to the terms and conditions of the Mudaraba Agreement. The Tier 1 Sukuks are listed on the Euronext Dublin and NASDAQ Dubai.

Tier 1 Sukuk - 2016 had a profit rate of 5.5% per annum, which were paid semi-annually in arrears subject to terms of the issue. In June 2021, the Bank announced a tender offer to the holders of the outstanding Tier 1 Sukuk- 2016 under the terms of the Tender Offer Memorandum and the Bank fully settled the accepted validly tendered Capital Certificates amounting to USD 39,185 thousands. Subsequently, in October 2021 (the "First Call Date"), the Bank redeemed all of the remaining outstanding certificates at their face amount of USD 160,815 thousands together with accrued and unpaid periodic profit distribution amounts.

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21. PERPETUAL TIER 1 SUKUK (CONTINUED)

Tier 1 Sukuk - 2021 bears a profit rate of 3.875% per annum to be paid semi-annually in arrears until the First Reset Date (5.5 years from the issue date) subject to terms of the issue. After that, the expected profit rate will be reset every fifth anniversary based on the then prevailing 5 years U.S Mid Swap Rate plus an initial margin of 3.011 % per annum. The First Call Date of Tier 1 Sukuk -2021 is after 5 years of the issuance date (June 2026). Tier 1 Sukuk – 2021 is callable by the Bank any day falling in the period commencing on (and including) the First Call Date and ending on (and including) the First Reset Date or on any profit payment date thereafter subject to certain redemption conditions including prior CBK approval.

The net proceeds of Tier 1 Sukuks are invested by way of Mudaraba with the Bank (as Mudareb) on an unrestricted basis and the Bank's general business activities are carried out through the general assets pool.

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

Semi-annual profits were paid during the year ended 31 December 2021.

22. TRANSACTIONS WITH RELATED PARTIES

The Bank enters into transactions with the Parent, associate, major shareholders, directors and key management, close members of their families and entities controlled, jointly controlled or significantly influenced by such parties in the ordinary course of business. The terms of these transactions are approved by the Bank's management.

The year-end balances and transactions included in the financial statements are as follows:

	Number of Board members or executive officers	Number of related parties	Parent KD'000	Others KD'000	Total KD'000
<i>As at 31 December 2021</i>					
Financing receivables	-	9	-	35,620	35,620
Deposits with other banks	-	5	109,160	15,393	124,553
Other assets	-	1	762	-	762
Deposits from banks and financial institutions	-	10	24,651	10,917	35,568
Deposits from customers	22	36	-	20,012	20,012
Other liabilities	-	2	4,363	158	4,521
Commitments and contingent liabilities	-	7	15,029	19,394	34,423
Islamic forward agreements (Notional amount)	-	1	9,626	-	9,626
Profit rate swaps (Notional amount)	-	1	188,852	-	188,852

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22. TRANSACTIONS WITH RELATED PARTIES (CONTINUED)

	Number of Board members or executive officers	Number of related parties	Parent KD'000	Others KD'000	Total KD'000
<i>As at 31 December 2020</i>					
Financing receivables	-	6	-	21,107	21,107
Deposits with other banks	-	4	135,494	289	135,783
Other assets	-	1	74	-	74
Deposits from banks and financial institutions	-	9	20,985	354,705	375,690
Deposits from customers	21	21	-	9,723	9,723
Other liabilities	-	2	14,855	381	15,236
Commitments and contingent liabilities	-	6	12,846	19,830	32,676
Islamic forward agreements (Notional amount)	-	1	3,048	-	3,048
Profit rate swaps (Notional amount)	-	1	233,391	-	233,391
			Parent KD'000	Others KD'000	Total KD'000
Transactions					
<i>For the year ended 31 December 2021</i>					
Financing income			1,068	1,469	2,537
Net payments from profit rate swaps			(3,294)	-	(3,294)
Distribution to depositors			(142)	(702)	(844)
Insurance expenses			-	(2,117)	(2,117)
<i>For the year ended 31 December 2020</i>					
Financing income			1,957	860	2,817
Net payments from profit rate swaps			(2,352)	-	(2,352)
Distribution to depositors			(271)	(10,121)	(10,392)
Insurance expenses			-	(2,001)	(2,001)
			2021 KD 000	2020 KD 000	
Directors:					
Board of Directors' remuneration				264	255
Key management compensation:					
Salaries and other short-term benefits				1,704	1,577
Post-employment benefits				135	157
			<u>1,839</u>	<u>1,734</u>	

Board of Directors' remuneration is subject to approval of shareholders in the AGM.

23. COMMITMENTS AND CONTINGENT LIABILITIES

a) Credit-related commitments

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

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

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23. COMMITMENTS AND CONTINGENT LIABILITIES (CONTINUED)

a) Credit- related commitments (continued)

Commitment to extend credit represents contractual commitments to financing and revolving credits. Commitments generally have fixed expiration dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements. The Bank has the following credit related commitments:

	2021	2020
	KD 000	KD 000
Acceptances	37,759	30,829
Letters of credit	72,729	41,014
Guarantees	411,110	427,738
	521,598	499,581

Irrevocable credit commitments to extend credit at the reporting date amounted to KD 2,106 thousand (2020: KD 2,300 thousand).

An analysis of the carrying amounts of commitment and contingent liabilities, and the corresponding Expected Credit Losses based on the staging criteria under IFRS 9 in accordance with CBK regulations.

	<i>As at 31 December 2021</i>			
	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
<i>31 December 2021</i>	<i>KD 000's</i>	<i>KD 000's</i>	<i>KD 000's</i>	<i>KD 000's</i>
High	303,051	10	-	303,061
Standard	196,906	20,729	-	217,635
Past due or impaired	-	-	3,008	3,008
	499,957	20,739	3,008	523,704
<i>31 December 2020</i>				
High	287,399	10	-	287,409
Standard	186,438	23,926	-	210,364
Past due or impaired	-	-	4,108	4,108
	473,837	23,936	4,108	501,881

The expected credit losses and impairment for the period for commitments and contingent liabilities is as follows:

	<i>31 December 2021</i>			
	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
	<i>KD 000's</i>	<i>KD 000's</i>	<i>KD 000's</i>	<i>KD 000's</i>
As at 1 January 2021	2,091	8,432	3,674	14,197
Impact due to transfer between stages	5	(8)	3	-
(Reversal) additional ECL for the period	1,410	(3,199)	(875)	(2,664)
At 31 December 2021	3,506	5,225	2,802	11,533

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23. COMMITMENTS AND CONTINGENT LIABILITIES (CONTINUED)

	31 December 2020			
	Stage 1 KD 000's	Stage 2 KD 000's	Stage 3 KD 000's	Total KD 000's
As at 1 January 2020	1,939	2,820	4,495	9,254
Impact due to transfer between stages (Reversal) additional ECL for the period	(3)	(52)	55	-
	155	5,664	(876)	4,943
At 31 December 2020	2,091	8,432	3,674	14,197

b) Capital commitment

The capital commitment for purchase of assets as at 31 December 2021 is KD 324 thousand (2020: KD 661 thousand).

24. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING

Islamic forward agreements (Waad)

In the ordinary course of business, the Bank enters into various types of transactions that involve financial instruments represented in forward foreign exchange agreements (Waad) to mitigate foreign currency risk. A Waad is a financial transaction between two parties where payments are dependent upon movements in price of one or more underlying financial instruments, reference rate or index in accordance with Islamic Sharia'a.

The notional amount, disclosed gross, is the amount of a Waad's underlying asset/liability and is the basis upon which changes in the value are measured.

The notional amounts indicate the volume of transactions outstanding at the year-end and are neither indicative of the market risk nor credit risk.

Most of the Bank's islamic forward agreements relate to deals with customers, which are normally matched by entering into reciprocal deals with counterparties.

Profit rate swaps

Profit rate swaps are contractual agreements between two parties and may involve exchange of profit or exchange of both principal and profit for a fixed period of time based on contractual terms.

The notional amounts indicate the volume of transactions outstanding at the period-end and are neither indicative of the market risk nor credit risk. Most of the Bank's profit rate swaps are held for hedging.

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24. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING (CONTINUED)

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

2021	Assets (Positive) KD 000	Liabilities (Negative) KD 000	<i>Notional amount</i>				Total KD 000
			Less than 1 month KD 000	1 to 3 months KD 000	3 to 12 months KD 000	More than 12 months KD 000	
Waad Profit rate swaps (held as fair value hedge)	196	181	8,999	2,178	8,088	-	19,265
	761	4,185	-	1,210	4,311	183,331	188,852
	<u>957</u>	<u>4,366</u>	<u>8,999</u>	<u>3,388</u>	<u>12,399</u>	<u>183,331</u>	<u>208,117</u>

2020	Assets (Positive) KD 000	Liabilities (Negative) KD 000	<i>Notional amount</i>				Total KD 000
			Less than 1 month KD 000	1 to 3 months KD 000	3 to 12 months KD 000	More than 12 months KD 000	
Waad Profit rate swaps (held as fair value hedge)	41	39	1,184	-	4,911	-	6,095
	33	14,855	-	-	18,386	215,005	233,391
	<u>74</u>	<u>14,894</u>	<u>1,184</u>	<u>-</u>	<u>23,297</u>	<u>215,005</u>	<u>239,486</u>

Fair value hedges

The net fair value of Profit rate swaps held as fair value hedges as at 31 December 2021 is negative KD 3,424 thousands (2020: KD 14,822 thousands) which is offset by gain recognised on the hedged items at 31 December 2021, attributable to the hedged risk KD 3,424 thousand (2020: KD 14,822 thousand). These offsetting gains and losses are included in 'Foreign exchange gains' in the statement of profit or loss during the years ended 31 December 2021 and 2020.

Hedging instruments are issued to hedge against profit rate risk pertaining to hedged items. Hedged items include certain investment securities at amortised cost amounting to KD 230,478 thousand (2020: KD 256,121 thousand).

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25. FAIR VALUE MEASUREMENT

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

Fair value measurement hierarchy for assets and liabilities as at 31 December 2021 is as follows:

2021	Level: 1 KD 000	Level: 2 KD 000	Level: 3 KD 000	Total KD 000
Assets measured at fair value				
Financial assets				
Investments securities	-	677	4,429	5,106
Derivative financial instruments				
Waad	-	196	-	196
Profit rate swaps	-	761	-	761
	-	957	-	957
	-	1,634	4,429	6,063
2021				
	Level: 1 KD 000	Level: 2 KD 000	Level: 3 KD 000	Total KD 000
Liability measured at fair value				
Derivative financial instruments				
Waad	-	181	-	181
Profit rate swap	-	4,185	-	4,185
	-	4,366	-	4,366
2020				
	Level: 1 KD 000	Level: 2 KD 000	Level: 3 KD 000	Total KD 000
Assets measured at fair value				
Financial assets				
Investments securities	11	1,352	4,224	5,587
Derivative financial instruments				
Waad	-	41	-	41
Profit rate swaps	-	33	-	33
	-	74	-	74
	11	1,426	4,224	5,661
2020				
	Level: 1 KD 000	Level: 2 KD 000	Level: 3 KD 000	Total KD 000
Liability measured at fair value				
Derivative financial instruments				
Waad	-	39	-	39
Profit rate swap	-	14,855	-	14,855
	-	14,894	-	14,894

Investments classified under Level 1 are valued based on the quoted bid price. Equity securities and funds classified under Level 2 are valued based on market multiples and declared NAV's. Equity securities and funds classified under Level 3 are valued based on discounted cash flows and dividend discount models. The movement in Level 3 is mainly on account of change in fair value of financial assets during the year.

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25. FAIR VALUE MEASUREMENT (CONTINUED)

The significant inputs for valuation of unquoted equity securities classified under Level 3 are annual growth rate of cash flows and discount rates and for funds it is the illiquidity discount. Lower growth rate and higher discount rate, illiquidity discount will result in a lower fair value.

The impact on the statement of financial position or the statement of shareholders' equity would be immaterial if the relevant risk variables used to fair value the unquoted equity securities were altered by 5 per cent. There were no material changes in the valuation techniques used for the purpose of measuring fair value of investment securities as compared to the previous year.

The fair value of sukuk measured at amortised cost as at 31 December 2021 is KD 381,933 thousand (2020: KD 389,421 thousand). Other financial assets and liabilities are carried at amortised cost and the carrying values are not materially different from their fair values as most of these assets and liabilities are of short-term maturities or are repriced immediately based on market movement in profit rates. Fair values of remaining financial assets and liabilities carried at amortised cost are estimated mainly using based on discounted cash flows, with most significant inputs being the discount rate that reflects the credit risk of counterparties.

26. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below summarises the maturity profile of the Bank's assets and liabilities analysed according to remaining contractual maturity:

2021	Up to 3 months KD 000	3 to 12 months KD 000	Over 1 year KD 000	Total KD 000
ASSETS				
Cash and balances with banks	183,320	-		183,320
Deposits with the Central Bank of Kuwait	120,103	64,167	-	184,270
Deposits with other banks	187,638	195,456	-	383,094
Financing receivables	2,347,277	437,749	557,122	3,342,148
Investment securities	13,314	47,001	320,525	380,840
Investment in an associate	-	-	8,070	8,070
Investment properties	-	-	19,919	19,919
Premises and equipment	-	-	39,310	39,310
Other assets	26,002	3,843	2,619	32,464
Total assets	2,877,654	748,216	947,565	4,573,435
LIABILITIES				
Deposits from banks and other financial institutions	626,765	100,038	9,471	736,274
Deposits from customers	2,591,286	497,430	21,206	3,109,922
Other liabilities	30,915	15,565	33,104	79,584
Total liabilities	3,248,966	613,033	63,781	3,925,780
NET LIQUIDITY GAP	(371,312)	135,183	883,784	647,655

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26. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

2020	Up to 3 months KD 000	3 to 12 months KD 000	Over 1 year KD 000	Total KD 000
ASSETS				
Cash and balances with banks	184,276	-	-	184,276
Deposits with the Central Bank of Kuwait	190,158	84,318	-	274,476
Deposits with other banks	225,370	96,911	-	322,281
Financing receivables	2,233,445	332,599	547,641	3,113,685
Investment securities	50,702	41,363	300,427	392,492
Investment in an associate	-	-	7,778	7,778
Investment properties	-	-	18,360	18,360
Premises and equipment	-	-	40,109	40,109
Other assets	11,372	3,428	1,741	16,541
Total assets	2,895,323	558,619	916,056	4,369,998
LIABILITIES				
Deposits from banks and other financial institutions	707,862	64,235	-	772,097
Deposits from customers	2,248,360	728,321	31,541	3,008,222
Repurchase agreements with banks	7,585	-	-	7,585
Other liabilities	18,860	17,227	42,804	78,891
Total liabilities	2,982,667	809,783	74,345	3,866,795
NET LIQUIDITY GAP	(87,344)	(251,164)	841,711	503,203

27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

STRATEGY IN USING FINANCIAL INSTRUMENTS

As an Islamic commercial bank, the Bank's activities are principally related to the sourcing of funds through Sharia'a compliant financial instruments, within the guidelines prescribed by the Central Bank of Kuwait ('the CBK') and deploying these funds in Sharia'a compliant financing and investment activities, to earn a profit. The profit is shared between the shareholders and profit-sharing deposit account holders, as per the Bank's policies approved by the Board of Directors and Fatwa and Sharia'a Supervisory Board. The funds raised vary in maturity between short and long term and are mainly in Kuwaiti Dinars, apart from major foreign currencies and GCC currencies. While deploying the funds, the Bank focuses on the safety of the funds and maintaining sufficient liquidity to meet all claims that may fall due. Safety of shareholder and depositor funds is further enhanced by diversification of financing activities across economic and geographic sectors, and types of financed parties.

RISK MANAGEMENT

The use of financial instruments also brings with it associated inherent risks. The Bank recognises the relationship between returns and risks associated with the use of financial instruments and the management of risks forms an integral part of the Bank's strategic objectives.

The strategy of the Bank is to maintain a strong risk management culture and manage the risk/reward relationship within and across each of the Bank's major risk-based lines of business. The Bank continuously reviews its risk management policies and practices to ensure that it is not subject to large asset valuation and earnings volatility.

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27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

STRATEGY IN USING FINANCIAL INSTRUMENTS (CONTINUED)

RISK MANAGEMENT (CONTINUED)

During the year 2020, the outbreak of COVID-19 pandemic brought disruptions in business operations of the Bank, its clients and the economies in which the Bank operates. Consistent with its risk management framework, the management continues to follow prudent steps in minimizing the impact on key risk parameters.

The Bank's objectives, policies and process for managing its risk are explained in detail in the Pillar 3 disclosures of the Annual Report. The following sections describe the several risks inherent in the banking process, their nature, techniques used to minimise the risks, their significance and impact on profit and loss and equity due to future expected changes in market conditions.

A. CREDIT RISK

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Bank attempts to control risk by monitoring credit exposures, limiting transactions with reputable counterparties, and continually assessing the creditworthiness of counterparties.

Bank has revisited the macro economic outlook after the Covid-19 and the resultant lockdown. Significant corporate exposures under impacted credit sectors have been individually re-assessed to identify any significant increase in credit risk. Moreover, investments were also reviewed in terms of geographical and sectoral concentration. The economic slowdown required the Bank to continue facilitating clients who were affected badly as well as remain prudent in new financing and investments.

Concentration of credit risk arises 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.

Concentration of credit risk indicates the relative sensitivity of the Bank's performance to developments, affecting a particular industry or geographic location.

The Bank seeks to manage its credit risk exposure through diversification of financing activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses. It also obtains collateral, when appropriate. 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 include charges over bank deposits and balances, listed securities acceptable to the Bank, real estate, plant and equipment, inventory and trade receivables.

Management monitors the market value of collateral on a daily basis for quoted shares and periodically for others, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

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27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

STRATEGY IN USING FINANCIAL INSTRUMENTS (CONTINUED)

RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

Assessment of expected credit losses

Definition of default

The Bank considers a financial asset to be in default and therefore Stage 3 (credit impaired) for ECL calculations when for those facilities where any payment of principal or profit is overdue by more than 90 days or there are any known difficulties in the cash flows including the sustainability of the counterparty's business plan, credit rating downgrades, breach of original terms of the contract, its ability to improve performance once a financial difficulty has arisen, deterioration in the value of collateral etc. In such cases, the Bank recognises a loss allowance for the lifetime ECL.

Any credit impaired or stressed facility that has been restructured during the year would also be considered as in default. The Bank considers externally rated exposures with ratings 'D' for S&P and Fitch, and 'C' for Moody's as defaulted.

The Bank considers a variety of indicators that may indicate unlikeliness to pay as part of a qualitative assessment of whether a customer is in default. Such indicators include:

- ▶ breaches of covenants
- ▶ customer having past due liabilities to public creditors or employees
- ▶ customer is deceased

Significant increase in credit risk

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12 months ECL or lifetime ECL, the Bank assess whether there has been a significant increase in credit risk since initial recognition. The Bank applies a consistent quantitative criterion for internally and externally rated portfolio to assess significant increase in credit risk.

Internal rating and Probability of default (PD) estimation process

Bank's internal grading system uses various qualitative assessments. Other than the staging rules mentioned in Note 2.5.1, the Bank also complies with the guidelines mentioned in the CBK Instructions, as follows:

- Credit facilities except consumer financing, are classified under Stage 2 where there has been a default in principal or profit payment for more than 30 days and for consumer financing, the default period is more than 60 days;
- Credit facilities are classified under Stage 2 when there has been a downgrade in the facility's credit rating by 2 grades for the facilities with Investment Grade and by 1 grade for those with Non-Investment Grade;

IFRS 9 requires the use of separate PD for a 12-month duration and lifetime duration depending on the stage allocation of the obligor. A PD used for IFRS 9 should reflect the Bank's estimate of the future asset quality. The Bank uses Point In Time PD (PIT PD) for each rating to calculate the ECL. The minimum PD is 0.75% for Investment Grade credit facilities and 1% for Non-Investment Grade credit facilities except for credit facilities granted to Government and Groups rated as Investment Grade by an external rating agency and financing transactions related to consumer and instalment financing (except for credit cards).

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27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

Assessment of expected credit losses (continued)

Measurement of ECLs

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

Incorporation of forward-looking information

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

The Bank employs statistical models to incorporate macro-economic factors on historical default rates. Incorporating forward looking information increases the level of judgement as to how changes in these macro-economic factors will affect the Expected Credit Loss (ECL) applicable to the stage 1 and stage 2 exposures which are considered as performing. The methodologies and assumptions involved, including any forecasts of future economic conditions, are reviewed periodically.

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The Bank uses mathematical function which links the credit cycle index (CCI) with PD as a key input to ECL. These economic variables and their associated impact on the PD, EAD and LGD vary by financial instrument. Forecasts of these economic variables (the “base economic scenario”) are updated from the World economic outlook: IMF country data and economic forecast periodically published by Economic Intelligence Unit, which provide the best estimate view of the economy and commodity prices over the coming one to four years. The macro-economic variable forecasts till remaining lifetime of the exposures post four years is obtained through time series analysis i.e. moving average/ mean reversion as applicable.

Scenarios are incorporated through the forward looking factors selected which are essentially credit cycle index factors (CCI) that are conditioned and then used as an input to the various ECL components. The CCI calculation is derived through the construction of suitable credit cycles based on economic variables that can be used as proxy to describe credit activities. CCI can be derived from a number of historical factors, such as risky yields, credit growth, credit spreads, default or NPL rates data. Interdependency exists between macro-economic factors as well as risk drivers for a range of scenarios and the CCI, given its integral part in driving the economic or business cycles.

The most significant period-end assumptions used for the ECL estimate as at 31 December 2021 were Reserves to debt ratio (2022: 73.13%, 2023: 75.29%, 2024:74.16%, 2025:74.16%) and Government debt to GDP ratio % (2022: 4.78%, 2023: 10.96%, 2024:14.02%, 2025:14.02%).

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27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

The weightings assigned to each macro-economic scenario based on CCI, as at 31 December 2021, were 30% to Base Case, 60% to Downside and 10% Upside Case (2020: 30% to Base Case, 60% to Downside and 10% Upside Case).

The table below shows the loss allowance on financing receivables from customers assuming each forward-looking scenario (e.g. base, upside and downside) were weighted 100% instead of applying scenario probability weights across the three scenarios.

	2021 KD 000	2020 KD 000
100% Base case, loss allowance would be higher / (lower) by	(26,090)	(11,092)
100% Upside case, loss allowance would be higher / (lower) by	(30,114)	(18,787)
100% Downside case, loss allowance would be higher / (lower) by	18,064	8,677

Maximum exposure to credit risk

The table below shows the maximum exposure net of provision to credit risk for the components of the statement of financial position and off-balance sheet items without taking account of any collateral and other credit enhancements.

	Maximum exposure 2021 KD 000	Maximum exposure 2020 KD 000
Credit risk exposures relating to statement of financial position items:		
Balances with banks	168,786	168,351
Deposits with the Central Bank of Kuwait	184,270	274,476
Deposits with other banks	383,094	322,281
Financing receivables	3,342,148	3,113,685
Investment securities	375,734	386,905
Other assets	29,844	14,214
	4,483,876	4,279,912
	Maximum exposure 2021 KD 000	Maximum exposure 2020 KD 000
Credit risk exposures relating to off - balance sheet items: (Note 23a)		
Acceptances, letters of credit, and guarantees	521,598	499,581
Irrevocable credit commitments	2,106	2,300
	523,704	501,881

The gross maximum credit exposure to a single client or counterparty as of 31 December 2021 is KD 92,741 thousand (2020: KD 73,400 thousand) before taking account of any collaterals.

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27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

Maximum exposure to credit risk (continued)

Geographical and industry-wise concentration of assets and off-balance sheet items are as follows:

2021	Assets representing credit risk KD 000	Contingencies & commitments representing credit risk KD 000
Geographic region:		
Kuwait	3,892,883	420,299
Other GCC	440,737	37,323
Europe	48,128	51,720
North America	18,738	2,436
Other countries	83,390	11,926
	4,483,876	523,704
2021		
	Assets representing credit risk KD 000	Contingencies & commitments representing credit risk KD 000
Industry sector:		
Trading and manufacturing	598,258	212,598
Banks and financial institutions	1,034,929	76,362
Construction and real estate	1,532,629	146,370
Other	1,318,060	88,374
	4,483,876	523,704
2020		
	Assets representing credit risk KD 000	Contingencies & commitments representing credit risk KD 000
Geographic region:		
Kuwait	3,665,300	405,447
Other GCC	486,539	33,712
Europe	11,808	55,146
North America	18,455	1,936
Other countries	97,810	5,640
	4,279,912	501,881

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27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

Maximum exposure to credit risk (continued)

2020	Assets representing credit risk KD 000	Contingencies & commitments representing credit risk KD 000
Industry sector:		
Trading and manufacturing	618,019	188,327
Banks and financial institutions	1,028,895	76,552
Construction and real estate	1,324,083	150,409
Other	1,308,915	86,593
	<u>4,279,912</u>	<u>501,881</u>

Credit quality of the financial assets is managed by the Bank with a combination of external and internal ratings mechanisms. It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates management to focus on the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk.

All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The credit quality of class of assets with underlying credit risks are as follows:

Neither past due nor impaired	(KD 000)			
2021	High grade	Standard grade	Closely monitored	Total
Balances with banks	168,786	-	-	168,786
Deposits with the Central Bank of Kuwait	184,270	-	-	184,270
Deposits with other banks	383,094	-	-	383,094
Financing receivables	3,178,334	101,212	12,648	3,292,194
Investment securities	375,734	-	-	375,734
Other assets	29,844	-	-	29,844
	<u>4,320,062</u>	<u>101,212</u>	<u>12,648</u>	<u>4,433,922</u>

Neither past due nor impaired	(KD 000)			
2020	High grade	Standard grade	Closely monitored	Total
Balances with banks	168,351	-	-	168,351
Deposits with the Central Bank of Kuwait	274,476	-	-	274,476
Deposits with other banks	322,281	-	-	322,281
Financing receivables	2,889,459	151,338	21,294	3,062,091
Investment securities	386,905	-	-	386,905
Other assets	14,214	-	-	14,214
	<u>4,055,686</u>	<u>151,338</u>	<u>21,294</u>	<u>4,228,318</u>

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27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

RISK MANAGEMENT (CONTINUED)

A. CREDIT RISK (CONTINUED)

Maximum exposure to credit risk (continued)

Financial assets by class that are past due but not impaired:

2021	Past due up to 30 days KD 000	Past due 31 to 60 days KD 000	Past due 61 to 90 days KD 000	Total KD 000
	Financing receivables			
-Retail financing	6,838	2,398	1,010	10,246
-Commercial financing	2,411	728	118	3,257
	<u>9,249</u>	<u>3,126</u>	<u>1,128</u>	<u>13,503</u>
Fair value of collateral				<u>3,011</u>
2020	Past due up to 30 days KD 000	Past due 31 to 60 days KD 000	Past due 61 to 90 days KD 000	Total KD 000
Financing receivables				
-Retail financing	6,863	2,712	2,828	12,403
-Commercial financing	2,325	882	823	4,030
	<u>9,188</u>	<u>3,594</u>	<u>3,651</u>	<u>16,433</u>
Fair value of collateral				<u>3,953</u>

Financial assets by class that are impaired:

2021	Gross exposure KD 000	Impairment provision KD 000	Fair value of collateral KD 000
	Financing receivables		
-Retail financing	5,952	4,384	-
-Commercial financing	58,564	23,681	34,995
	<u>64,516</u>	<u>28,065</u>	<u>34,995</u>
2020	Gross exposure KD 000	Impairment provision KD 000	Fair value of collateral KD 000
Financing receivables			
-Retail financing	5,681	4,659	-
-Commercial financing	57,428	23,289	27,022
	<u>63,109</u>	<u>27,948</u>	<u>27,022</u>

The factors the Bank considered in determining impairment are disclosed in the accounting policy given in Note 2.5.1 *Financial instruments*.

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27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

RISK MANAGEMENT (CONTINUED)

B. LIQUIDITY RISK

Liquidity risk is the risk that the Bank will be unable to meet its net funding requirements. Liquidity risk can also be caused by market disruptions or credit downgrades which may cause certain sources of funding to dry up immediately. To guard against this risk, management has diversified funding sources and assets are managed with liquidity in mind, maintaining an adequate balance of cash, cash equivalents, and readily marketable securities.

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities based on contractual undiscounted repayment obligations including profit share. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment earlier than the contractual date and the table also does not reflect the expected cash flows indicated by the Bank's deposit retention history.

	Less than 1 month KD 000	1 to 3 months KD 000	3 to 12 months KD 000	1 to 5 years KD 000	Total KD 000
2021					
Deposits from banks and other financial institutions	557,868	69,190	101,194	9,647	737,899
Deposits from customers	1,670,746	923,351	501,988	21,757	3,117,842
Other liabilities	19,003	11,911	15,565	33,105	79,584
	<u>2,247,617</u>	<u>1,004,452</u>	<u>618,747</u>	<u>64,509</u>	<u>3,935,325</u>
	Less than 1 month KD 000	1 to 3 months KD 000	3 to 12 months KD 000	1 to 5 years KD 000	Total KD 000
2020					
Deposits from banks and other financial institutions	541,910	166,403	64,687	-	773,000
Deposits from customers	1,431,754	819,134	734,187	32,061	3,017,136
Repurchase agreements with banks	-	7,596	-	-	7,596
Other liabilities	12,122	6,738	17,227	42,804	78,891
	<u>1,985,786</u>	<u>999,871</u>	<u>816,101</u>	<u>74,865</u>	<u>3,876,623</u>

The table below shows the contractual expiry by maturity of the Bank's credit related contingent liabilities and commitments as disclosed in Note 23:

	Less than 1 month KD 000	1 to 3 months KD 000	3 to 12 months KD 000	1 to 5 years KD 000	Over 5 years KD 000	Total KD 000
2021						
Credit related contingent liabilities	26,125	87,454	231,686	157,674	18,659	521,598
Irrevocable credit commitments	-	-	-	1,341	765	2,106
	<u>26,125</u>	<u>87,454</u>	<u>231,686</u>	<u>159,015</u>	<u>19,424</u>	<u>523,704</u>

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27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

RISK MANAGEMENT (CONTINUED)

B. LIQUIDITY RISK (CONTINUED)

	Less than 1 month KD 000	1 to 3 months KD 000	3 to 12 months KD 000	1 to 5 years KD 000	Over 5 years KD 000	Total KD 000
2020						
Credit related contingent liabilities	22,961	66,784	216,495	176,945	16,396	499,581
Irrevocable credit commitments	-	-	-	-	2,300	2,300
	<u>22,961</u>	<u>66,784</u>	<u>216,495</u>	<u>176,945</u>	<u>18,696</u>	<u>501,881</u>

C. MARKET RISK

The Bank defines market risk as the uncertainty in future earnings on the Bank's on and off-balance sheet positions resulting from changes in market variables such as profit rate risk, currency risk and equity price risk.

C.1 PROFIT RATE RISK

In accordance with the provisions of Islamic Shari'a, the Bank generates assets and liabilities that have cash inflows and outflows, or fair values and their profitability and performance is evaluated through the sensitivity of profit rates fluctuations. The Bank manages the risk arising from these exposures to maximise profit for shareholders and depositors.

C.2 CURRENCY RISK

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rates. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within established limits.

The Bank had the following net exposures denominated in foreign currencies.

The effect on profit before tax, as a result of change in currency rate, with all other variables held constant is shown below:

Currency	Change in currency rate in %	Effect on profit before tax	
		2021 KD 000	2020 KD 000
US Dollars	+/-5 %	42	53

A 5 percent decrease of the above currency against the Kuwaiti Dinar would have had equal, but opposite, effect of the amount shown above, on the basis that all other variables remain constant.

Sensitivity to currency rate movements will be on a symmetric basis, as financial instruments giving rise to non-symmetric movements are not significant. There is no significant impact on the equity.

C.3 EQUITY PRICE RISK

Equity price risk is the risk that the fair values of equity investments decrease as a result of the changes in the level of equity indices and the value of the individual stocks. The non-trading equity price risk exposure arises from the Bank's investment portfolio.

The Bank does not have any material exposure to equity price risk on its listed equity investments.

At the reporting date, the exposure to non-listed equity investments at fair value was KD 5,106 thousand (2020: KD 4,919 thousand).

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Notes to the Financial Statements

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27. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

RISK MANAGEMENT (CONTINUED)

D. OPERATIONAL RISK

The Bank has a set of policies and procedures approved by the Board of Directors and are applied to identify, assess and supervise operational risk in addition to other types of risk relating to the banking and financial activities of the Bank. Operational risk is managed by the Risk Management Division. This Division ensures compliance with policies and procedures to identify, assess, supervise and monitor operational risk as part of overall Global Risk Management.

The Bank manages operational risks in line with the Central Bank of Kuwait instructions dated 14 November 1996 regarding general guidelines for internal control systems and directives issued on 13 October 2003 regarding “Sound Practices for the Management and Control of Operational Risks”.

28. SEGMENT REPORTING

The Bank’s operating segments are determined based on the reports reviewed by the Chief Operating decision maker that are used for strategic decisions. These segments are strategic business units having similar economic characteristics that offer different products and services. These operating segments are monitored separately by the Bank for the purpose of making decisions about resource allocation and performance assessment.

These operating segments meet the criteria for reportable segments and are as follows:

- Retail and Commercial Banking – comprising a full range of banking operations covering credit and deposit services provided to customers and correspondent banking. The Bank uses a common marketing and distribution strategy for its commercial banking operations.
- Treasury and Investment Management – comprising clearing, money market, foreign exchange, sukuk, other treasury and miscellaneous operations, proprietary investment, securities trading activities and fiduciary fund management activities.

Segment results include revenue and expenses directly attributable to a segment and an allocation of overhead cost.

The Bank measures the performance of operating segments through measure of segment profit or loss net of taxes in management and reporting systems.

Segment assets and liabilities comprise those operating assets and liabilities that are directly attributable to the segment.

	<i>Retail and Commercial Banking</i>		<i>Treasury and Investment Management</i>		<i>Total</i>	
	2021 KD 000	2020 KD 000	2021 KD 000	2020 KD 000	2021 KD 000	2020 KD 000
Net financing income	50,001	48,908	27,644	26,389	77,645	75,297
Fees, commissions and others	6,592	6,000	7,194	9,415	13,786	15,415
Total operating income	56,593	54,908	34,838	35,804	91,431	90,712
Provision and impairment losses	(21,789)	(25,181)	(1,301)	(914)	(23,090)	(26,095)
Operating expenses and taxation	(30,240)	(27,831)	(6,880)	(7,057)	(37,120)	(34,888)
Segment result	4,564	1,896	26,657	27,833	31,221	29,729
Profit for the year					31,221	29,729

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28. SEGMENT REPORTING (CONTINUED)

	<i>Retail and Commercial Banking</i>		<i>Treasury and Investment Management</i>		<i>Total</i>	
	2021 KD 000	2020 KD 000	2021 KD 000	2020 KD 000	2021 KD 000	2020 KD 000
Segment assets	<u>3,391,363</u>	<u>3,188,341</u>	<u>1,182,072</u>	<u>1,181,657</u>	<u>4,573,435</u>	<u>4,369,998</u>
Segment liabilities	<u>2,671,242</u>	<u>2,457,916</u>	<u>1,254,538</u>	<u>1,408,879</u>	<u>3,925,780</u>	<u>3,866,795</u>

The Bank primarily operates in Kuwait.

29. CAPITAL MANAGEMENT

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

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

The Bank's regulatory capital and capital adequacy ratios (Basel III) for the year ended 31 December 2021 are calculated in accordance with the CBK circular number 2/RB, RBA/336/2014 dated 24 June 2014 are shown below:

	2021 KD'000	2020 KD'000
Risk weighted assets	<u>3,866,658</u>	<u>3,542,714</u>
Total capital required	<u>425,332</u>	<u>389,699</u>
Capital available		
Tier 1 capital	656,056	514,107
Tier 2 capital	46,767	42,802
Total capital	<u>702,823</u>	<u>556,909</u>
Tier 1 capital adequacy ratio	16.97%	14.51%
Total capital adequacy ratio	18.18%	15.72%

The Bank's financial leverage ratio for the year ended 31 December 2021 is calculated in accordance with the CBK circular number 2/IBS/ 343/2014 dated 21 October 2014 is shown below:

	2021 KD'000	2020 KD'000
Tier 1 capital	<u>656,056</u>	<u>514,107</u>
Total exposure	<u>5,244,722</u>	<u>5,078,988</u>
Financial leverage ratio	12.51%	10.12%

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Notes to the Financial Statements As at 31 December 2021

30. IMPACT OF COVID-19 OUTBREAK

The Bank considered the potential impact of the uncertainties caused by the COVID-19 pandemic together with the associated economic support and relief measures of government and central bank in its estimation of ECL requirements for the year ended 31 December 2021.

Significant increase in credit risk

The Bank considered the following aspects to assess if there was significant increase in credit risk or objective evidence of impairment in the light of COVID-19 situation.

- ▷ Temporary financial difficulties of the customers are distinguished from longer-term or permanent impact
- ▷ Customers operating in certain sectors or industries are likely to be more severely impacted
- ▷ Deferral of instalments or profit payments on financing facilities will not automatically trigger significant increase in credit risk
- ▷ Retail facilities to certain customer segment are more likely to have significant increase in credit risk arising from job losses and pay cuts
- ▷ Significant corporate exposures are individually assessed to identify significant increase in credit risk as and when reliable data is available

The above assessment has resulted in staging downgrade of certain exposures and corresponding increase in ECL.

Macro-economic factors

The Bank considered of volatility witnessed in the range of macroeconomic factors and in the scenarios used for determination of ECL. In particular, given the continuing uncertainty stemming from fast evolving Covid-19, the Bank revised certain assumptions reflected through constructing a plausible forward-looking view of the macroeconomic environment. The Bank applies a high probability weightage to the severe scenario combined with the revised forecasts of macro-economic factors which are considered on a very conservative basis. These adjustments resulted in significant increase in the amount of ECL requirements for the year ended 31 December 2021.

Notwithstanding the above, ECL requirement for financing receivables estimated as at 31 December 2021 continues to be lower than the provisions required as per the CBK instructions. In accordance with the Bank's accounting policy, the higher amount, being the provision required as per the CBK instructions, is therefore recognised as the provision requirement for credit losses on financing receivables.

Covid-19 support measures

In 2020, Central Bank of Kuwait (CBK) implemented various measures targeted at reinforcing the banking sectors' ability to play a vital role in the economy. Those measures are disclosed in the Bank's annual financial statements for the year ended 31 December 2020.

2021 consumer and other instalments financing deferral scheme

Kuwait banks announced postponement of payment of consumer and instalment financing to eligible customer, upon request, in accordance with the CBK circular No. 2/BS/IBS/IS/IIS/FS/476/2021 dated 18 April 2021 concerning the implementing provisions of Article No. (2) of Law No. (3) of 2021 ("the Law") regarding the deferral of the financial obligations for a six-month period with cancellation of profits resulting from this deferral ("the 2021 scheme"). The cost of the instalment deferrals are fully borne by the Government of Kuwait in accordance with the Law.

The Bank implemented the 2021 scheme by postponing the instalments for a six-month period from the customer request date with the corresponding extension of the facility tenure. The instalment deferral resulted in a loss to the Bank arising from the modification of contractual cash-flows amounting to KD 10,120 thousand in accordance with IFRS 9. This loss was offset by an equivalent amount receivable from Government of Kuwait as Government Grant in accordance with the Law. The Bank has recorded the Government grant income by setting it off against the modification loss from the 2021 scheme. The Government grant receivable is included in other assets in the statement of financial position.

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Notes to the Financial Statements

As at 31 December 2021

30. IMPACT OF COVID-19 OUTBREAK (CONTINUED)

Other impacts

The Bank considered the potential impact of the current economic volatility on the reported amounts of the Bank's financial and non-financial assets. The reported amounts best represent management's assessment based on observable information. Markets, however, remain volatile and asset carrying values remain sensitive to market fluctuations. The impact of the highly uncertain economic environment remains judgmental and the Bank will accordingly continue to reassess its position and the related impact on a regular basis.