KHALEEJI COMMERCIAL BANK BSC

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

for the year ended 31 December 2012 | BD 000's

	Notes	31 December 2012	31 December 2011
ASSETS			
Cash and bank balances	3	23,856	22,642
Placements with financial institutions	4	57,525	76,787
Financing assets	5	245,745	201,556
Investment securities	6	100,860	111,806
Assets acquired for leasing	7	20,938	11,712
Lease rentals receivable	7	3,035	1,946
Investment in associates	8	2,887	3,000
Investment property	9	6,583	6,583
Other assets	10	2,806	2,077
Property and equipment	11	8,924	9,406
Total assets		**473,159**	447,515
LIABILITIES			
Placements from financial institutions		67,732	45,435
Placements from non-financial institutions and individuals	12	53,416	46,647
Customers' current accounts		11,395	35,437
Other liabilities	13	4,739	5,706
Total liabilities		**137,282**	133,225
Equity of investment account holders	14	**216,429**	195,367
OWNER'S EQUITY			
Share capital	15	115,416	115,416
Share premium		1,535	1,485
Statutory reserve		6,425	6,350
Treasury shares		(6,060)	(6,043)
Unvested employee incentive scheme shares		(291)	(420)
Share grant reserve		-	120
Investments fair value reserve		-	54
Retained earnings		2,423	1,961
Total owner's equity (page 7)		**119,448**	118,923
Total liabilities, equity of investment account holders and owners' equity		**473,159**	447,515

The consolidated financial statements, which consist of pages 18 to 64, were approved by the Board of directors on 7 February 2013 and signed on its behalf by:

Dr. Fuad Abdulla Al-Omar
Chairman

Abdulrahman Mohamed Jamsheer
Vice-Chairman

Silvan Varghese
Acting CEO

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2012 | BD 000's

	Notes	2012	2011
Management fees		111	703
Income from placements with financial institutions		244	259
Income from financing assets and assets acquired for leasing		18,168	16,812
Income from investment securities	16	986	6,021
Share of loss from associate companies	8	(113)	(1,226)
Other income		421	360
Total income before return to investment account holders		**19,817**	22,929
Less: Return to investment account holders before Bank's share as Mudarib	14	(9,923)	(9,022)
Bank's share as a Mudarib	14	3,626	2,393
Return to investment account holders		**(6,297)**	(6,629)
Expense on placements from financial institutions, non-financial institutions and individuals		(2,823)	(1,576)
Total net income		**10,697**	14,724
Staff cost	17	4,580	5,849
Depreciation	11	1,153	1,169
Other expenses	19	3,310	3,599
Total expenses		**9,043**	10,617
Profit for the year before impairment allowances		**1,654**	4,107
Impairment allowances	18	(903)	(3,589)
PROFIT FOR THE YEAR		**751**	518
Earnings per share			
Basic earnings per share (fils)	24	**0.67**	0.46
Diluted earnings per share (fils)	24	**0.67**	0.46

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2012 | BD 000's

2012	Share Capital	Share premium	Statutory reserve	Treasury shares	Unvested employee incentive scheme shares	Share grant reserve	Investments fair value reserve	Retained earnings	Total
At 1 January 2012	115,416	1,485	6,350	(6,043)	(420)	120	54	1,961	118,923
Fair value changes	-	-	-	-	-	-	41	-	41
Transfer on disposal of investments	-	-	-	-	-	-	(95)	-	(95)
Profit for the year	-	-	-	-	-	-	-	751	751
Total recognised income and expense for the year	-	-	-	-	-	-	**(54)**	**751**	**697**
Transfer to statutory reserve	-	-	75	-	-	-	-	(75)	-
Treasury shares acquired	-	-	-	(17)	-	-	-	-	(17)
Adjustment for vesting and issue of shares	-	50	-	-	129	(50)	-	-	129
Vesting charge for the year (note 20)	-	-	-	-	-	(70)	-	-	(70)
Transfer to zakah fund (2011)	-	-	-	-	-	-	-	(214)	(214)
At 31 December 2012	**115,416**	**1,535**	**6,425**	**(6,060)**	**(291)**	**-**	**-**	**2,423**	**119,448**

2011	Share Capital	Share premium	Statutory reserve	Treasury shares	Unvested employee incentive scheme shares	Share grant reserve	Investments fair value reserve	Retained earnings	Total
At 1 January 2011	115,416	1,213	6,298	(6,018)	(937)	324	117	1,745	118,158
Fair value changes	-	-	-	-	-	-	(63)	-	(63)
Profit for the year	-	-	-	-	-	-	-	518	518
Total recognised income and expense for the year	-	-	-	-	-	-	(63)	518	455
Transfer to statutory reserve	-	-	52	-	-	-	-	(52)	-
Treasury shares acquired	-	-	-	(131)	-	-	-	-	(131)
Treasury shares sold	-	-	-	106	-	-	-	-	106
Adjustment for vesting and issue of shares	-	272	-	-	517	(272)	-	-	517
Vesting charge for the year (note 20)	-	-	-	-	-	68	-	-	68
Transfer to zakah fund (2010)	-	-	-	-	-	-	-	(250)	(250)
At 31 December 2011	115,416	1,485	6,350	(6,043)	(420)	120	54	1,961	118,923

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
for the year ended 31 December 2012 | BD 000's

	Notes	2012	2011
OPERATING ACTIVITIES			
(Disbursements of) / receipts from financing assets, net		(25,888)	13,183
Payment for asset acquired for leasing, net		(10,421)	(5,678)
Management fees received		111	703
Income from short-term placements received		244	259
Returns paid to investment account holders		(6,055)	(6,798)
Net receipts from / (withdrawal by) investment account holders		21,062	(2,465)
Payment for expenses		(9,292)	(9,981)
Other receipts		421	360
Payment for charity		(672)	(961)
(Withdrawals from)/ receipts in customers' current accounts		(24,042)	24,509
Net payment to CBB reserve account		(1,130)	(809)
Net cash (used in) / generated from operating activities		**(55,662)**	12,322
INVESTING ACTIVITIES			
Purchase of investment securities, net		(11,710)	(14,792)
Proceeds from sale / redemption of investment securities		22,031	9,819
Purchase of investment property		-	(2,640)
Dividend / income from investment securities received		608	1,724
Purchase of equipment and capital advances made		(671)	(608)
Net cash generated from / (used in) investing activities		**10,258**	(6,497)
FINANCING ACTIVITIES			
Placements from financial institutions, net		22,297	(20,482)
Placements from non-financial institutions and individuals, net		6,769	27,629
Purchase of treasury shares, net		(17)	(25)
Expense paid on placements		(2,823)	(1,576)
Net cash generated from financing activities		**26,226**	5,546
Net (decrease) / increase in cash and cash equivalents		**(19,178)**	11,371
Cash and cash equivalents at 1 January		90,264	78,893
Cash and cash equivalents at 31 December		**71,086**	90,264
Cash and cash equivalent comprise:			
Cash and bank balances (excluding CBB reserve)	3	13,561	13,477
Placements with financial institutions	4	57,525	76,787
		71,086	90,264

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS

for the year ended 31 December 2012 | BD 000's

2012	**Balance at 1 January 2012**			**Movements during the year**						**Balance at 31 December 2012**		
	No of units (000's)	Average value per share BD	Total	Invest-ment (with-drawals)	Revalu-ation	Gross income / (loss)	Dividends paid	Bank's fees as an agent	Admin-istration expens-es	No. of units (000's)	Average value per share BD	Total
Al Hareth French Property Fund	17.05	487.45	8,311	-	176[1]	-	-	-	-	17.05	497.81	8,487
Safana Investment WLL (RIA 1)	8,323	1.00	8,323	-	-	-	-	-	-	8,323	1.00	8,323
Janayen Holding Limited (RIA 4)	52,685	0.18	9,370	(484)	(1,519)	(1,232)	-	-	(603)	48,082	0.12	5,532
Shaden Real Estate Investment WLL (RIA 5)	8,100	1.00	8,100	-	-	-	-	-	-	8,100	1.00	8,100
Locata Corporation Pty Ltd (RIA 6)	3,427	0.38	1,292	-	-	-	-	-	-	3,427	0.38	1,292
			35,396	**(484)**	**(1,343)**	**(1,232)**	**-**	**-**	**(603)**			**31,734**

2011	Balance at 1 January 2011			Movements during the year						Balance at 31 December 2011		
	No of units (000's)	Average value per share BD	Total	Invest-ment (with-drawals)	Revalu-ation	Gross income / (loss)	Dividends paid	Bank's fees as an agent	Admin-istration expens-es	No. of units (000's)	Average value per share BD	Total
Al Hareth French Property Fund	17.05	504.40	8,600	-	(289)[1]	-	-	-	-	17.05	487.45	8,311
Safana Investment WLL (RIA 1)	9,563	1.00	9,563	(1,240)[2]	-	-	-	-	-	8,323	1.00	8,323
Janayen Holding Limited (RIA 4)	52,685	0.29	15,060	(765)	(3,102)	165	-	-	(1,988)	52,685	0.18	9,370
Shaden Real Estate Investment WLL (RIA 5)	8,100	1.00	8,100	-	-	-	-	-	-	8,100	1.00	8,100
Locata Corporation Pty Ltd (RIA 6)	3,427	0.38	1,292	-	-	-	-	-	-	3,427	0.38	1,292
			42,615	(2,005)	(3,391)	165	-	-	(1,988)			35,396

[1] Includes gain or loss on revaluation of foreign currency balances as at the year end.
[2] Please refer note 23.

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF SOURCES AND USES OF CHARITY AND ZAKAH FUND

for the year ended 31 December 2012 | BD 000's

	2012	2011
Sources of charity and zakah fund		
At 1 January	1,362	2,066
Contributions by the Bank	214	250
Non-Islamic income	6	7
Total sources	1,582	2,323
Uses of charity and zakah fund		
Contributions to charitable organisations	672	961
Total uses	672	961
Undistributed charity and zakah fund at 31 December (note 13)	910	1,362

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012

1 INCORPORATION AND PRINCIPAL ACTIVITY

Khaleeji Commercial Bank BSC ("the Bank"), a public shareholding company, was incorporated on 24 November 2004 in the Kingdom of Bahrain under Commercial Registration No. 55133. The Bank operates under an Islamic retail banking license granted by the Central Bank of Bahrain ("CBB") on 20 October 2003. The Bank's shares are listed on the Bahrain Bourse.

The Bank's activities are regulated by the Central Bank of Bahrain (CBB) and supervised by a Religious Supervisory Board to ensure adherence to Shari'a rules and principles in its transactions and activities.

The principal activities of the Bank include providing banking and investment products and services to retail customers, high net worth individuals, corporate entities, and financial institutions. These include commercial and corporate banking, consumer finance, wealth management, structured investment products and project financing facilities which comply with Islamic Shari'a rules and principles as determined by the Bank's Shari'a Supervisory Board.

The consolidated financial statements include the financial statements of the Bank and its subsidiaries (together "the Group"). The significant subsidiaries are as follows:

Name	Country of incorporation	% holding	Nature of business
Hawafiz Khaleeji Management Company BSC (c)	Bahrain	100%	To hold shares for the beneficial interest of the management incentive scheme. (refer note 20)
Binaa Investment 1	Cayman Islands	100%	To hold investments for the beneficial interest of the Bank.
Harbour Tower West 2 Real Estate SPC	Bahrain	100%	To hold property for the beneficial interest of the Bank.
Harbour Tower West 4 Real Estate SPC	Bahrain	100%	To hold property for the beneficial interest of the Bank.

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

The financial statements have been prepared in accordance with Financial Accounting Standards ('FAS') issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). In line with the requirement of AAOIFI and the CBB Rule Book, for matters that are not covered by AAOIFI standards, the Group uses guidance from the relevant International Financial Reporting Standards.

(b) Basis of preparation

The consolidated financial statements are presented in Bahraini Dinars, being the principal currency of the Bank's operations. They are prepared on the historical cost basis except for the measurement at fair value of certain investments carried at fair value.

The Group classifies its expenses in the income statement by the nature of expense method.

The preparation of consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and the Group's consolidated financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 21.

(c) Basis of consolidation

(i) Subsidiaries

The consolidated financial statements of the Group comprise the financial statements of the Bank and its subsidiaries. Subsidiaries are those enterprises (including special purpose entities) controlled by the Bank. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases.

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of a specific borrowing or investment transaction. An SPE is consolidated

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Basis of consolidation (continued)

(i) Subsidiaries (continued)

if, based on an evaluation of the substance of its relationship with the Group and the risks and rewards transferred by the SPE, the Group concludes that it controls the SPE. The assessment of whether the Group has control over an SPE is carried out at inception and normally no further reassessment of control is carried out in the absence of changes in the structure or terms of the SPE, or additional transactions between the Group and the SPE. Where the Group's voluntary actions, such as lending amounts in excess of existing liquidity facilities or extending terms beyond those established originally, change the relationship between the Group and an SPE, the Group performs a reassessment of control over the SPE. The Group in its fiduciary capacity manages and administers assets held in trust and other investment vehicles on behalf of investors.

The financial statements of these entities are not included in these consolidated financial statements except when the Group controls the entity. Information about the Group's fiduciary assets under management is set out in note 22.

(ii) Associates

Associates are those enterprises in which the Group holds, directly or indirectly, more than 20% of the voting power and exercises significant influence, but not control, over the financial and operating policies.

Investments in associates are initially recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued, except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

(iii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Intra-group gains on transactions between the Group and its equity accounted associates are eliminated to the extent of the Group's interest in the investees. Unrealised losses are also eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment. Accounting policies of the subsidiaries and associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

(d) Foreign currency transactions

Items included in the consolidated financial statements of the Group are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Bahraini Dinars, which is the Bank's functional and presentation currency.

Foreign currency transactions are translated using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary items carried at their fair value, such as certain equity securities measured at fair value through equity, are included in investments fair value reserve.

The other Group companies functional currencies are either denominated in Bahraini dinars or US dollars which is effectively pegged to the Bahraini dinar. Hence, the translation of financial statements of the group entities that have a functional currency different from the presentation currency do not result in exchange differences.

(e) Investment securities

Investment securities comprise equity investments and investments in sukuk (Islamic bonds). Investment securities exclude investments in subsidiaries and equity accounted associate companies (refer note 2(c)).

(i) Classification

The Group segregates its investment securities into debt-type instruments and equity-type instruments. Debt-type instruments are investments that have terms that provide fixed or determinable payments of profits and capital. Equity-type instruments are investments that do not exhibit features of debt-type instruments and include instruments that evidence a residual interest in the assets of an entity after deducting all its liabilities.

Debt-type Instruments:

Investments in debt-type instruments are classified in the following categories: 1) at amortised cost or 2) at fair value through income statement (FVTIS).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Investment securities (continued)

(i) Classification (continued)

A debt-type investment is classified and measured at amortised cost only if the instrument is managed on a contractual yield basis or the instrument is not held for trading and has not been designated at FVTIS. Debt-type investments at amortised cost include investments in medium to long-term sukuk.

Debt-type investment classified and measured at FVTIS include investments held for trading or designated at FVTIS. At inception, a debt-type investment managed on a contractual yield basis, can only be designated at FVTIS if it eliminates an accounting mismatch that would otherwise arise on measuring the assets or liabilities or recognising the gains or losses on them on different bases. Debt-type instruments at FVTIS include investments in medium to long-term (quoted) sukuk.

Equity-type investments:
Investments in equity type instruments are classified in the following categories: 1) at fair value through income statement (FVTIS) or 2) at fair value through equity (FVTE), consistent with its investment strategy.

Equity-type investments classified and measured at FVTIS include investments held for trading or designated at FVTIS.

An investment is classified as held for trading if acquired or originated principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin. Any investments that form part of a portfolio where there is an actual pattern of short-term profit taking are also classified as 'held for trading'. The Group has currently classified a long-term listed equity sukuk and a private equity investment under this category.

Equity-type investments designated at FVTIS include investments which are managed and evaluated internally for performance on a fair value basis. This category currently includes investment in private equity and certain closed companies.

On initial recognition, the Bank makes an irrevocable election to designate certain equity instruments that are not designated at FVTIS to be classified as investments at fair value through equity. These include investments in certain quoted and unquoted equity securities.

ii) Recognition and de-recognition
Investment securities are recognised at the trade date i.e. the date that the Group contracts to purchase or sell the asset, at which date the Group becomes party to the contractual provisions of the instrument.

Investment securities are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risk and rewards of ownership.

(iii) Measurement
Investment securities are measured initially at fair value, which is the value of the consideration given. For FVTIS investments, transaction costs are expensed in the income statement. For other investment securities, transaction costs are included as a part of the initial recognition.

Subsequent to initial recognition, investments carried at FVTIS and FVTE are re-measured to fair value. Gains and losses arising from a change in the fair value of investments carried at FVTIS are recognised in the income statement in the period in which they arise. Gains and losses arising from a change in the fair value of investments carried at FVTE are recognised in the consolidated statement of changes in equity and presented in a separate fair value reserve within equity. The fair value gains / losses are recognised taking into consideration the split between portions related to owners' equity and equity of investment account holders. When the investments carried at FVTE are sold, impaired, collected or otherwise disposed of, the cumulative gain or loss previously recognised in the statement of changes in equity is transferred to the income statement.

Investments at FVTE where the entity is unable to determine a reliable measure of fair value on a continuing basis, such as investments that do not have a quoted market price or other appropriate methods from which to derive reliable fair values, are stated at cost less impairment allowances.

Subsequent to initial recognition, debt type investments, other than those carried at FVTIS, are measured at amortised cost using the effective profit method less any impairment allowances.

(iv) Measurement principles
Amortised cost measurement
The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus capital repayments, plus or minus the cumulative amortisation using the effective profit method of any

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Investment securities (continued)

(iv) Measurement principles (continued)

Amortised cost measurement (continued)

difference between the initial amount recognised and the maturity amount, minus any reduction (directly or through use of an allowance account) for impairment or uncollectability. The calculation of the effective profit rate includes all fees and points paid or received that are an integral part of the effective profit rate.

Fair value measurement
Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date. The Group measures the fair value of quoted investments using the market bid-prices in an active market for that instrument.

For certain unquoted investments, the Group uses proprietary models, which usually are developed from recognised valuation models for fair valuation. Some or all of the inputs into these models may not be market observable, but are estimated based on assumptions. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

Valuation adjustments are recorded to allow for bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state the values of these investments.

(f) **Financing assets**
Financing assets comprise Shari'a compliant financing contracts with fixed or determinable payments. These include financing provided through Murabaha, Musharaka, Istisna and Wakala contracts. Financing assets are recognised on the date at which they are originated and are carried at their amortised cost less impairment allowances, if any.

(g) **Placements with and from financial institutions, non-financial institutions and individuals**
These comprise inter-bank and over the counter customer placements made/received using Shari'a compliant contracts. Placements are usually for short-term and are stated at their amortised cost.

(h) **Cash and cash equivalents**
For the purpose of the statement of cash flows, cash and cash equivalents comprise cash and bank balances (excluding CBB reserve account), and placement with financial institutions with maturities of three months or less when acquired which are subject to insignificant risk of changes in fair value and are used by the Group in the management of its short-term commitments.

(i) **Assets acquired for leasing**
Assets acquired for leasing (Ijarah Muntahia Bittamleek) are stated at cost less accumulated depreciation and any impairment in value. Under the terms of lease, the legal title of the asset passes to the lessee at the end of the lease term, provided that all lease instalments are settled. Depreciation is calculated on a straight line basis at rates that systematically reduce the cost of the leased assets over the period of the lease. The Group assesses at each statement of financial position date whether there is objective evidence that the assets acquired for leasing are impaired. Impairment losses are measured as the difference between the carrying amount of the asset (including lease rental receivables) and the estimated recoverable amount. Impairment losses, if any, are recognised in the income statement.

(j) **Investment property**
Properties held for rental, or for capital appreciation purposes, or both, are classified as investment property. Investment property are carried at cost less impairment allowances, if any. Cost includes expenditure that is directly attributable to the acquisition of the investment property. Investment property of the Group includes a plot of land held for capital appreciation purposes.

(k) **Property and equipment**
Property and equipment is stated at cost, net of accumulated depreciation and impairment allowances, if any. Property includes land which is not depreciated. Other equipment is depreciated using the straight-line method to write-off the cost of the assets over their estimated useful lives ranging from 3 to 5 years. The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each statement of financial position date.

(l) **Impairment of assets**
The Group assesses at each statement of financial position date whether there is objective evidence that an asset is impaired. Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of financing facility or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(l) Impairment of assets (continued)

Financial assets carried at amortised cost
These include debt-type instruments, financing assets and receivables. For financial assets carried at amortised cost impairment is measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses are recognised in income statement and reflected in an allowance account. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the income statement. The Group considers evidence of impairment for financial assets carried at amortised cost at both a specific asset and collective level.

All individually significant financial assets are assessed for specific impairment. All individually significant financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Financial assets that are not individually significant are collectively assessed for impairment by grouping together assets with similar risk characteristics.

Equity investments carried at fair value through equity (FVTE)
In the case of investments in equity securities classified as FVTE and measured at fair value, a significant or prolonged decline in the fair value of the security below its cost is an objective evidence of impairment. If any such evidence exists, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in income statement - is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are subsequently reversed through equity.

For FVTE investments carried at cost less impairment due to the absence of reliable fair value, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

Other non-financial assets
The carrying amount of the Group's assets (other than for financial assets covered above), are reviewed at each statement of financial position date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. The recoverable amount of an asset is the greater of its value in use or fair value less costs to sell. An impairment loss is recognised whenever the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the 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. An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount. Separately recognised goodwill is not amortised and is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on separately recognised goodwill are not reversed.

(m) Customers' current accounts
Balances in current (non-investment) accounts are recognised when received by the Bank. The transaction are measured at the cash equivalent amount received by the Bank at the time of contracting. At the end of the accounting period, the accounts are measured at their book value.

(n) Equity of investment account holders
Equity of investment account holders are funds held by the Bank in unrestricted investment accounts, which it can invest at its own discretion. The investment account holder authorises the Bank to invest the account holders' funds in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested.

The Bank charges management fee (Mudarib fees) to investment account holders. Of the total income from investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions, reserves (Profit equalisation reserve and Investment risk reserve) and deducting the Bank's share of income as a Mudarib. The allocation of income is determined by the management of the Bank within the allowed profit sharing limits as per the terms and conditions of the investment accounts. Administrative expenses incurred in connection with the management of the funds are borne directly by the Bank and are not charged separately to investment accounts.

Investment accounts are carried at their book values and include amounts retained towards profit equalisation and investment risk reserves. Profit equalisation reserve is the amount appropriated by the Bank out of the Mudaraba income, before allocating the

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(n) Equity of investment account holders (continued)

Mudarib share, in order to maintain a certain level of return to the deposit holders on the investments. Investment risk reserve is the amount appropriated by the Bank out of the income of investment account holders, after allocating the Mudarib share, in order to cater against future losses for investment account holders. Creation of an these reserves results in an increase in the liability towards the pool of unrestricted investment accounts.

(o) **Restricted investment accounts**
Restricted investment accounts represents assets acquired by funds provided by holders of restricted investment accounts and their equivalent and managed by the Bank as an investment manager based on either a Mudaraba contract or agency contract. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders. Assets that are held in such capacity are not included as assets of the Bank in the consolidated financial statements.

(p) **Financial guarantees**
Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee contract is recognised from the date of its issue. The liability arising from a financial guarantee contract is recognised at the present value of any expected payment, when a payment under the guarantee has become probable.

(q) **Treasury shares**
The amount of consideration paid including all directly attributable costs incurred in connection with the acquisition of the treasury shares are recognised in equity. Consideration received on sale of treasury shares is presented in the financial statements as a change in equity. No gain or loss is recognised on the Group's income statement on the sale of treasury shares.

(r) **Statutory reserve**
The Bahrain Commercial Companies Law 2001 requires that 10 per cent of the annual net profit be appropriated to a statutory reserve which is normally distributable only on dissolution. Appropriations may cease when the reserve reaches 50 per cent of the paid up share capital.

(s) **Revenue recognition**
Fees and commission income that are integral to the effective profit rate on a financial asset carried at amortised cost are included in the measurement of the effective profit rate of the financial asset. Other fees and commission income, including account servicing fees, sales commission, management fees, placement and arrangement fees and syndication fees, are recognised as the related services are performed.

Income from Murabaha and Wakala contracts are recognised on a time-apportioned basis over the period of the contract using the effective profit method.

Profit or losses in respect of the Bank's share in **Musharaka financing** transaction that commence and end during a single financial period is recognised in the income statement at the time of liquidation (closure of the contract). Where the Musharaka financing continues for more than one financial period, profit is recognised to the extent that such profits are being distributed during that period in accordance with profit sharing ratio as stipulated in the Musharaka agreement.

Istisna'a revenue and the associated profit margin is recognised using the percentage of completion method.

Income from assets acquired for leasing (Ijarah Muntahia Bittamleek) are recognised proportionately over the lease term.

Income from sukuk and income / expenses on placements is recognised at its effective profit rate over the term of the instrument.

Dividend income is recognised when the right to receive is established.

(t) **Earnings prohibited by Shari'a**
The Bank is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Bank uses these funds for charitable purposes.

(u) **Zakah**
Zakah is calculated on the Zakah base of the Group in accordance with FAS 9 Zakah using the net assets method. Zakah is paid by the Group based on the statutory reserve and retained earnings balances at the end of the year and the remaining Zakah is payable by individual shareholders. The Bank calculates and notifies the shareholders of their pro-rata share of the Zakah payable annually. The calculations of Zakah is approved by the Shari'a Supervisory Board. Payment of Zakah on the unrestricted investment and other accounts is the responsibility of the investment account holders.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(v) Employee benefits

(i) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(ii) Post-employment benefits

Pensions and other social benefits for Bahraini employees are covered by the Social Insurance Organisation scheme, which is a “defined contribution scheme” in nature, and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis. Contributions by the Bank are recognised as an expense in income statement when they are due.
Expatriate employees on fixed contracts are entitled to leaving indemnities payable under the Bahraini Labour Law, based on length of service and final remuneration. Provision for this unfunded commitment has been made by calculating the notional liability had all employees left at the statement of financial position date.

These benefits are in the nature of “defined benefit scheme” and any increase or decrease in the benefit obligation is recognised in the income statement.

The Bank also operates a voluntary employees saving scheme under which the Bank and the employee contribute monthly on a fixed percentage of salaries basis. The scheme is managed and administered by a board of trustees who are employees of the Bank. The scheme is in the nature of a defined contribution scheme and contributions by the Bank are recognised as an expense in the income statement when they are due.

(iii) Share-based employee incentive scheme

The Bank operates a share-based incentive scheme for its employees (the ”Scheme”) whereby eligible employees are granted the Bank’s shares as compensation on achievement of certain non-market based performance conditions and additional service conditions (the ‘vesting conditions’).

The grant date fair value of equity instruments granted to employees is recognised as an employee expense, with a corresponding increase in equity (share grant reserve), over the period in which the employees become unconditionally entitled to the share awards. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of share awards that do meet the related service and non-market performance conditions at the vesting date.

The total share awards have been transferred to Hawafiz Khaleeji Management Company BSC (c) a special purpose entity formed to manage the scheme until the date of vesting. The unvested and forfeited shares, if any, are treated similar to treasury shares and are shown under ‘Unvested employee incentive scheme shares’ in equity. On the date of vesting, a transfer is made within components of equity to reflect the issue of shares to employees.

(w) Dividends and board remuneration

Dividends to shareholders and board remuneration are recognised as liabilities in the period in which they are declared.

(x) Trade date accounting

All “regular way” purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset.

(y) Offsetting

Financial assets and liabilities are offset only when there is a legal or Sharia’ based enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

(z) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012 | BD 000's

3. CASH AND BANK BALANCES

	31 December 2012	31 December 2011
Cash	2,586	2,155
Balances with banks	7,294	9,282
Balances with the Central Bank:		
- Current account	3,681	2,040
- Reserve account	10,295	9,165
	23,856	22,642

The reserve account with the Central Bank of Bahrain is not available for day-to-day operational purposes.

4. PLACEMENTS WITH FINANCIAL INSTITUTIONS

	31 December 2012	31 December 2011
Gross Murabaha and Wakala receivable	57,534	76,800
Less: Deferred profits	(9)	(13)
	57,525	76,787

The average profit rate on placement with financial institutions for 2012 was 0.69% per annum (31 December 2011: 0.62% per annum).

5. FINANCING ASSETS

	31 December 2012	31 December 2011
Murabaha	184,522	158,328
Musharaka	56,681	40,502
Wakala	20,257	19,999
Istisna	670	841
	262,130	219,670
Less: Impairment allowances - specific	(13,645)	(16,151)
Less: Impairment allowances - collective	(2,740)	(1,963)
	245,745	201,556

Murabaha financing receivables are net of deferred profits of BD 28,402 thousand (2011: BD 20,847 thousand).

Of the total financing asset portfolio, consumer financing receivables amounted to BD 12,772 thousand (2011: BD 6,044 thousand).

for the year ended 31 December 2012 | BD 000's

5. FINANCING ASSETS (continued)

The movement in impairment allowances are as follows:

2012	**Specific**	**Collective**	**Total**
At 1 January	16,151	1,963	18,114
Charge / (write back) during the year	(910)	777	(133)
Adjusted on write-off of assets	(1,596)	-	(1,596)
At 31 December	**13,645**	**2,740**	**16,385**

2011	Specific	Collective	Total
At 1 January	14,189	2,163	16,352
Charge / (write back) during the year	1,962	(200)	1,762
At 31 December	16,151	1,963	18,114

6. INVESTMENT SECURITIES

	31 December 2012	31 December 2011
Equity type instruments:		
At fair value through income statement		
- Unquoted equity securities (at fair value)	17,452	17,452
- Listed equity sukuk (at fair value)	3,858	-
At fair value through equity		
- Quoted equity securities (at fair value)	-	211
- Unquoted equity securities (carried at cost less impairment)	71,041	72,471
	92,351	90,134
Debt type instruments:		
Sukuk:		
- At amortised cost	7,493	21,672
- At fair value through income statement (quoted)	1,016	-
	8,509	21,672
	100,860	111,806

Unquoted equity securities at fair value through equity comprise investments in closed companies managed by external investment managers or represent investments in projects promoted by the Group. These investments are carried at cost less impairment in the absence of a reliable measure of fair value. The Group intends to exit these investments principally by means of private placements, strategic buy outs, sale of underlying assets or through initial public offerings.

During the year, impairment allowances of BD 975 thousand (31 December 2011: BD 1,795 thousand) was recognised on equity securities carried at cost.

Debt type instruments are net of collective impairment allowances of BD 4 thousand (2011: BD 83 thousand) and specific impairment allowances of BD 34 thousand (2011: Nil).

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for the year ended 31 December 2012 | BD 000's

7. ASSETS ACQUIRED FOR LEASING

	Property 2012	Property and Equipment 2011
Cost		
At 1 January	15,316	10,825
Additions during the year	13,199	8,113
Settlements / adjustments during the year	(2,224)	(3,622)
At 31 December	**26,291**	15,316
Accumulated depreciation		
At 1 January	3,604	4,846
Charge for year	3,973	1,944
Settlements during the year	(2,224)	(3,186)
At 31 December	**5,353**	3,604
Net book value at 31 December	**20,938**	11,712

At 31 December 2012, accrued lease rental receivable amounted to BD 3,035 thousand (2011: BD 1,946 thousand). Lease rental receivable is net of collective provision of BD 242 thousand (2011: BD 136 thousand).

Of the total net book value of assets acquired for leasing consumer financing amounted to BD 18,469 thousand (2011: BD 9,054 thousand).

8. INVESTMENT IN ASSOCIATES

	2012	2011
At 1 January	3,000	4,226
Share of losses for the year	(113)	(1,226)
At 31 December	**2,887**	3,000

Investment in associates comprise:

Name	Country of incorporation	% holding	Nature of business
Capital Real Estate Projects Company BSC (c)	Bahrain	30.0%	Real estate holding and development
Amlak II SPV	Cayman Islands	23.1%	Purchase and sale of real estate in Bahrain

Summarised financial information of associates that have been equity accounted not adjusted for the percentage ownership held by the Group (based on their most recent unaudited management accounts):

	2012	2011
Total assets	12,731	21,406
Total liabilities	2,345	8,192
Total revenues	2,978	631
Total net losses	(209)	(4,626)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012 | BD 000's

9. INVESTMENT PROPERTY

The Bank owns two plots of land in the Bahrain Financial Harbour project which were received in consideration for sale of an investment in 2010. Of the two plots of land received, one plot is intended for the Group's own use and has been classified under "Property and equipment" (refer note 11). The second plot of land is held for capital appreciation purposes and hence has been classified as "Investment property".

10. OTHER ASSETS

	31 December 2012	31 December 2011
Income from sukuk receivable	81	94
Prepayments	648	650
Other receivables	2,077	1,333
	2,806	2,077

Other receivables is net of impairment provision of BD 773 thousand (2011: BD 773 thousand).

11. PROPERTY AND EQUIPMENT

	Land (note 9)	Furniture and fixtures	Computers	Motor Vehicle	Other equipment	Work-in-progress	2012 Total	2011 Total
Cost								
At 1 January	6,714	3,791	2,593	73	217	290	13,678	13,072
Additions	-	226	97	4	37	307	671	808
Capitalisation	-	-	196	-	-	(196)	-	-
Disposal/transfers	-	-	(1)	-	-	-	(1)	(202)
At 31 December	**6,714**	**4,017**	**2,885**	**77**	**254**	**401**	**14,348**	13,678
Accumulated depreciation								
At 1 January	-	2,031	2,068	52	121	-	4,272	3,107
Charge for year	-	773	325	15	40	-	1,153	1,169
Disposals	-	-	(1)	-	-	-	(1)	(4)
At 31 December	**-**	**2,804**	**2,392**	**67**	**161**	**-**	**5,424**	4,272
Net book value at 31 December 2012	**6,714**	**1,213**	**493**	**10**	**93**	**401**	**8,924**	9,406
Net book value at 31 December 2011	6,714	1,760	525	21	96	290	9,406	

12. PLACEMENTS FROM NON-FINANCIAL INSTITUTIONS AND INDIVIDUALS

	31 December 2012	31 December 2011
Non-financial institutions	25,196	28,424
Individuals	28,220	18,223
	53,416	46,647

These represent placements in the form of Murabaha and Wakala contracts.

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for the year ended 31 December 2012 | BD 000's

13. OTHER LIABILITIES

	31 December 2012	31 December 2011
Employee related accruals	367	996
Mudaraba profit accrual	2,032	1,789
Charity and zakah payable (page 12)	910	1,362
Payable for Istisna'a contracts	128	128
Other payables and accrued expenses	1,302	1,431
	4,739	5,706

14. EQUITY OF INVESTMENT ACCOUNT HOLDERS

The funds received from investment account holders have been commingled and jointly invested with the Bank in the following asset classes as at 31 December:

	31 December 2012	31 December 2011
Balances with banks	7,294	9,282
CBB reserve account	10,295	9,165
Placements with financial institutions	57,525	76,787
Debt type instruments - sukuk	8,509	21,672
Equity type instrument - sukuk	3,858	-
Financing assets	128,948	78,461
	216,429	195,367

The investors' share of the return on jointly invested assets and distribution to investment account holders were as follows:

	31 December 2012	31 December 2011
Returns from jointly invested assets	9,923	9,022
Banks share as Mudarib	(3,626)	(2,393)
Return to investment account holders'	**6,297**	6,629
Investment risk reserve utilised, net	-	-
Profit equalisation reserve utilised, net	-	169
Distributions to investment account holders'	**6,297**	6,798

Approximately 3.26% (31 December 2011: 3.61%) was distributed to investors and the balance was either set aside for provisions and/or retained by the Bank as a Mudarib fee. Investment accounts include profit equalisation reserve of Nil (2011: Nil) and investment risk reserve of Nil (2011: Nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012 | BD 000's

15. SHARE CAPITAL

	31 December 2012	31 December 2011
Authorised:		
3,000,000,000 ordinary shares of BD 0.100 each	300,000	300,000
Issued and fully paid up:		
1,154,161,084 ordinary shares (2011: 1,154,161,084) of BD 0.100 each	115,416	115,416

The Bank has only one class of equity shares and the holders of these shares have equal voting rights. At 31 December 2012, the Bank holds 28,621,332 as treasury shares (2011: 28,180,132).

Distribution schedule of equity shares, setting out the number of holders and percentage in the following categories:

Categories*	Number of Shares	Number of Shareholders	% of total outstanding shares
Less than 1%	179,187,784	524	15.53
1% up to less than 5% **	166,877,574	8	14.45
5% up to less than 10%	103,950,000	1	9.01
10% up to less than 20%	161,700,000	1	14.01
20% and less than 50%	542,445,726	1	47.00
	1,154,161,084	**535**	**100.00**

* Expressed as a percentage of total outstanding shares of the Bank.
** Includes treasury shares and unvested employee incentive scheme shares.

Names and nationalities of the major shareholders and the number of equity shares held in which they have an interest of 5% or more of outstanding shares:

	Nationality	Number of shares	% of total outstanding shares
Gulf Finance House BSC *	Bahrain	542,445,726	47.00
Al Imtiaz Investment Company KSCC	Kuwait	161,700,000	14.01
Emirates Islamic Bank PJSC	UAE	103,950,000	9.01

As at 31 December 2012, these shares representing 47.00% were held by KHCB Asset Company on behalf of Gulf Finance House BSC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012 | BD 000's

16. INCOME FROM INVESTMENT SECURITIES

	2012	2011
Income from equity-type investments:		
- Dividend and other investment income	302	373
- Fair value gain on investment	71	4,656
	373	5,029
Income from debt-type investments:		
- Income from Sukuk	478	583
- Gain on sale of Sukuk	120	409
- Fair value gain on investments	15	-
	986	6,021

17. STAFF COST

	2012	2011
Salaries and benefits	3,901	4,549
Social insurance expenses	558	570
Other staff expenses	121	730
	4,580	5,849

18. IMPAIRMENT ALLOWANCES

	2012	2011
Financing assets (note 5)	(133)	1,762
Lease rental receivable (note 7)	106	-
Investments at fair value through equity (note 6)	975	1,795
Investments at amortised cost (note 6)	(45)	32
	903	3,589

19. OTHER EXPENSES

	2012	2011
Premises cost	924	922
Advertisement and marketing expenses	650	811
Information technology expenses	463	299
Professional fees	396	391
Board expenses	118	217
Communication expenses	128	158
Distribution channel expenses	106	240
Other administrative expenses	525	561
	3,310	3,599

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012

20. SHARE-BASED EMPLOYEE INCENTIVE SCHEME

The Bank operates an equity-settled share-based incentive scheme for its employees (the "Scheme") whereby eligible employees are granted the Bank's shares as a compensation on achievement of certain non-market performance conditions.

The Group has incorporated a special purpose vehicle, Hawafiz Khaleeji Management Company BSC (c) ('Hawafiz'), to hold the shares for the beneficial interest of the Scheme until they vest.

The shares granted vest to eligible employees in a staggered manner over a 5 year vesting period ('service condition'). The shares granted shall be eligible to receive dividends. The vested shares will be settled by physical delivery on completion of vesting conditions.

In case the employee leaves before satisfying the vesting conditions, he/ she would be entitled for a cash payment for the unvested shares in accordance with the terms of the Scheme. Such unvested shares will be retained by Hawafiz and may be offered to other employees as per the terms of the Scheme.

The maximum number of shares to be issued to employees under the scheme is 30.4 million ordinary shares at an exercise price of BD 0.120 per share, to be issued over the vesting period in accordance with the terms of the Scheme. Up to 31 December 2012, being the last year of vesting under the scheme, on a cumulative basis, 30.4 million share grants have been awarded of which 27.97 million shares (2011: 22.903 million shares) have vested up to 31 December 2012 and 2.43 million shares (2011: 1.456 million shares) were forfeited due to failure to satisfy the service condition. No new grants have been made since 2009. The vesting expense for the year, net of reversals due to forfeitures, amounted to a reversal of BD 70 thousand (31 December 2011: charge of BD 68 thousand).

21. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances.

Judgements

Classification of investments

In the process of applying the Group's accounting policies, management decides on acquisition of an investment whether it should be classified as debt type instruments carried at fair value through equity or amortised cost, or equity-type instruments carried at fair value through equity or fair value through income statement. The classification of each investment reflects the management's intention in relation to each investment and is subject to different accounting treatments based on such classification [refer note 2 (e)].

Special purpose entities

The Bank sponsors the formation of special purpose entities (SPE's) primarily for the purpose of allowing clients to hold investments. The Bank provides corporate administration, investment management and advisory services to these SPE's, which involve the Group making decisions on behalf of such entities. The Bank administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments.

The Bank does not consolidate SPE's that it does not have the power to control. In determining whether the Bank has the power to control an SPE, judgements are made about the objectives of the SPE's activities, its exposure to the risks and rewards, as well as about the Group's intention and ability to make operational decisions for the SPE and whether the Group derives benefits from such decisions.

Estimations

Impairment of equity investments

The Group determines that equity securities carried at fair value are impaired when there is an objective evidence of impairment and there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment.

In case of quoted equity securities, the Group considers a decline of more than 30% in the fair value below cost to be significant and considers a decline below cost which persists for more than 6 months as prolonged. Where fair values are not readily available and the investments are carried at cost, the recoverable amount of such investment is estimated to test for impairment.

For unquoted investments carried at cost, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

In making this judgment, the Bank evaluates among other factors, evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

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21. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

Estimations (continued)

Fair value of unquoted equity securities
The Group determines the fair value of unquoted investments by using valuation techniques. This includes using recent arm's length transactions between knowledgeable, willing parties (if available), discounted cash flow analysis or market multiples for similar instruments. Fair value estimates are made at a specific point in time, based on market conditions and information about the investee companies/funds. These estimates involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. There is no certainty about future events (such as continued operating profits and financial strengths). It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the investments.

Significant judgment is required to be made by the Group and the Board of Directors in the selection of an approach that would reflect the best measure of fair value of the investments. The choice of the models used for valuation on each reporting period may have a significant impact on the fair value of investments and the amounts reported in the consolidated financial statements. The Bank has adopted the market approach for valuation of its unquoted equity security.

The potential effect of using reasonable possible alternative assumptions for valuing the investments resulting in 5% decrease / increase in the market multiple would increase / decrease the reported fair value by BD 3,599 thousands. The corresponding impact would be on the profit or loss reported by the Group.

Impairment of financing assets
Financing assets are evaluated for impairment on a basis described in accounting policy, refer to note 2 (l). Each counterparty exposure is evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realisable value of any underlying assets / collaterals. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently evaluated by the Risk Management Department.

For evaluation of the portfolio for impairment on a collective basis, management, where available, uses estimates based on historical loss experience for assets and loss experience in the industry for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio. For the purposes of a collective evaluation of impairment, financing assets are grouped on the basis of similar credit risk characteristics (that is, on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). The methodology and assumptions used for the grading process and estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. In view of the management, the current level of provisioning is adequate and no additional impairment allowances are required on a collective basis.

22. ASSETS UNDER MANAGEMENT
The Bank provides corporate administration, investment management and advisory services to its investment entities, which involve the Group making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the statement of financial position date, the Group had assets under management of BD 384.42 million (2011: BD 384.83 million). During the year, the Bank has charged management fees amounting to BD 111 thousands (31 December 2011: BD 618 thousands) for the management of these assets.

23. RELATED PARTY TRANSACTIONS
Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include the significant shareholders and entities over which the Bank and the shareholders exercises significant influence, directors and executive management of the Bank.

A significant portion of the Bank's income from management fees arises from entities (assets under management) over which the Bank or its significant shareholders exercises influence. Although these entities are considered related parties, the Bank administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments.

Details of Directors' interests in the Bank's ordinary shares as at the end of the year were:

Categories*	Number of Shares	Number of Directors
Less than 1%	8,358,250	4
1% up to 10%	20,468,219	1

* Expressed as a percentage of total outstanding shares of the Bank.

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23. RELATED PARTY TRANSACTIONS (continued)

Compensation of key management personnel

Key management personnel of the Bank comprise of the Board of Directors and key members of management having authority and responsibility for planning, directing and controlling the activities of the Bank.

The key management personnel compensation during the year is as follows:

	2012	2011
Board member fees	93	76
Board member allowances	120	120
Salaries and other short-term benefits	570	862

Transactions with restricted investment accounts

Transactions involving transfer/sale of assets to restricted investment accounts are generally executed based on the pre-agreed values as per the terms of the contracts for each restricted investment product. During 2011, in its normal course of business, the Bank has bought certain investments at agreed contractual values amounting to BD 1,240 thousands.

The related party balances and transactions (except for compensation of key managerial personnel) included in these consolidated financial statements are as follows:

31 December 2012	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
Financing assets	1,041	-	-	9,754	10,795
Investment securities	-	-	-	45,606	45,606
Investment in associates	2,887	-	-	-	2,887
Other assets	298	-	-	1,198	1,496
Liabilities					
Customers' current accounts	424	6	18	733	1,181
Equity of investment account holders	37	6	5,681	11,734	17,458
Transactions					
Purchase of property	-	-	-	280	280

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23. RELATED PARTY TRANSACTIONS (continued)

31 December 2011	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
Financing assets	1,359	-	-	12,076	13,435
Investment securities	-	-	-	47,715	47,715
Investment in associates	3,000	-	-	-	3,000
Other assets	411	-	-	558	969
Liabilities					
Placement from financial institutions	-	-	1,132	-	1,132
Customers' current accounts	207	1	19	433	660
Other liabilities	-	421	13	-	434
Equity of investment account holders	104	7	331	19,966	20,408
Transactions					
Purchase of property	-	-	2,640	-	2,640

2012	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
Management fees	-	-	-	83	83
Income from financing assets and assets acquired for leasing	83	-	-	652	735
Income from investment securities	-	-	-	225	225
Share of losses from associates	(113)	-	-	-	(113)
Expenses					
Return to investment account holders	1	5	92	280	378
Staff cost	-	570	-	-	570
Other expenses	-	-	-	43	43
Impairment allowances	-	-	-	859	859

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23. RELATED PARTY TRANSACTIONS (continued)

2011	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
Management fees	-	-	-	618	618
Income from financing assets and assets acquired for leasing	91	-	-	548	639
Income from investment securities	-	-	-	243	243
Share of losses from associates	(1,226)	-	-	-	(1,226)
Expenses					
Return to investment account holders	2	5	13	402	422
Expenses on placements from financial institutions	-	-	53	-	53
Staff cost	-	862	-	-	862
Other expenses	-	-	-	11	11
Impairment allowances	-	-	-	795	795

24. EARNINGS PER SHARE
Basic earnings per share is calculated by dividing the profit for the year by the weighted average number of equity shares outstanding during the year. The Bank has dilutive equity instruments in the form of share grants in issue.

Basic EPS	**2012**	2011
Profit for the year (BD 000's)	751	518
Weighted average number of equity shares (Nos. in 000's)	1,122,963	1,116,785
Basic earnings per share (in fils)	0.67	0.46
Diluted EPS	**2012**	2011
Profit for the year (BD 000's)	751	518
Weighted average number of equity shares (Nos. in 000's)	1,122,963	1,116,785
Diluted earnings per share (in fils)	0.67	0.46

During the period, all outstanding unvested share awards were fully vested and hence, there are no outstanding potentially dilutive instruments (refer note 20).

25. SHARI'A SUPERVISORY BOARD
The Bank's Shari'a Supervisory Board consists of three Islamic scholars who review the Bank's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Bank to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

26. ZAKAH
Zakah is directly borne by the shareholders on distributed profits and investment account holders. The Bank currently does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually. During the year, the Shari'a Supervisory Board has computed Zakah payable of BD 1,903 thousand (2011: BD 1,853 thousand) of which BD 228 thousand (2011: BD 214 thousand) represents the Zakah computed on the cumulative statutory reserve and retained earnings as at 31 December 2012, payable by the Bank (refer note 32). The remaining Zakah balance amounting to BD 1,675 thousand or 2.485 fils per share (2011: BD 1,639 thousand or 1.420 fils per share) is due and payable by the shareholders.

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27. SEGMENT REPORTING

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, whose operating results are regularly reviewed by the Group's chief operating decision maker (Board of Directors) to make decisions about resource allocation to each segment and assess its performance and for which discrete financial information is available. An operating segment is divided into business segment and geographic segments. For management purposes, the Group is organised into two major business segments:

Commercial banking

Providing customer services such as accepting Mudaraba deposits, savings account and current account facilities, fund transfer facilities, bill payment facilities. It also provides financing facilities (in the form of Commodity Murabaha, Musharaka, Istisna'a and Ijarah facilities) to corporate clients and High-Networth-Individuals and consumer finance products. Provides money market and treasury services in the form of short term Commodity Murabaha to banks, financial institutions and corporate, investments in sukuk and also used to manage funding of the Group.

Investment banking

Primarily relates to conceptualising of investment deals and performing roles of an arranger, lead manager, and administrator of the funds (involves structuring of deals, raising of funds through private placement and fund administration). Also offers products like Restricted Investment Accounts (RIA) and management of funds raised through the RIA structures. Also involves carrying out strategic investments in the form of equity contribution (either in the funds created and managed by the Bank or other institutions).

Segment performance is measured based on results for each department as mentioned in the internal management reports that are reviewed by the Board of directors on a quarterly basis. Segment results is used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate in these industries.

The Bank reports directly attributable revenue and cost relating to transactions originating from respective segments as segment revenue and segment cost respectively. Indirect costs and corporate overheads are treated as unallocated. The internal management reports are designed to reflect revenue and cost for respective segments which are measured against the budgeted figures.

The Group primarily operates from Bahrain and does not have any overseas branches/divisions. The geographic concentration of assets and liabilities is disclosed in note 29 (b) to the consolidated financial statements.

These segments are the basis on which the Group reports its primary segment information. Transactions between segments (if any) are conducted on an arm's length basis.

31 December 2012	Investment Banking	Commercial Banking	Unallocated	Total
Cash and bank balances	-	23,856	-	**23,856**
Placements with financial institutions	189	57,336	-	**57,525**
Financing assets	-	245,745	-	**245,745**
Investment securities	88,493	12,367	-	**100,860**
Assets acquired for leasing (including lease rentals receivable)	-	23,973	-	**23,973**
Investment in associates	2,887	-	-	**2,887**
Investment property	6,583	-	-	**6,583**
Other assets	1,376	174	1,256	**2,806**
Property and equipment	-	-	8,924	**8,924**
Total segment assets	**99,528**	**363,451**	**10,180**	**473,159**
Placements from financial institutions	-	67,732	-	**67,732**
Placements from non - financial institutions and individuals	-	53,416	-	**53,416**
Customers' current accounts	189	11,206	-	**11,395**
Other liabilities	37	3,309	1,393	**4,739**
Total segment liabilities	**226**	**135,663**	**1,393**	**137,282**
Equity of investment account holders	**11,734**	**204,695**	**-**	**216,429**
Restricted investment accounts	**31,734**	**-**	**-**	**31,734**

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27. SEGMENT REPORTING (continued)

2012	Investment Banking	Commercial Banking	Unallocated	Total
Management fees	111	-	-	**111**
Income from placements with financial institutions	1	243	-	**244**
Income from financing assets and assets acquired for leasing	-	18,168	-	**18,168**
Income from investment securities	302	684	-	**986**
Share of losses from associate companies	(113)	-	-	**(113)**
Other income	192	229	-	**421**
Total income before return to investment account holders	**493**	**19,324**	**-**	**19,817**
Less: Return to investment account holders before Bank's share as Mudarib	(441)	(9,482)	-	**(9,923)**
Bank's share as a Mudarib	161	3,465	-	**3,626**
Return to investment account holders	**(280)**	**(6,017)**	**-**	**(6,297)**
Less: Expense on placements from financial institutions, non-financial institutions and individuals	-	(2,823)	-	**(2,823)**
Total segment revenue	**213**	**10,484**	**-**	**10,697**
Staff cost	458	1,832	2,290	**4,580**
Depreciation	-	-	1,153	**1,153**
Other expenses	43	387	2,880	**3,310**
Total segment cost	**501**	**2,219**	**6,323**	**9,043**
Segment results before impairment allowances	**(288)**	**8,265**	**(6,323)**	**1,654**
Write-back/ (charge) of impairment allowances	(975)	72	-	(903)
Segment results	**(1,263)**	**8,337**	**(6,323)**	**751**

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27. SEGMENT REPORTING (continued)

31 December 2011	Investment Banking	Commercial Banking	Unallocated	Total
Cash and bank balances	-	22,642	-	22,642
Placements with financial institutions	286	76,501	-	76,787
Financing assets	572	200,984	-	201,556
Investment securities	90,134	21,672	-	111,806
Assets acquired for leasing (including lease rentals receivable)	-	13,658	-	13,658
Investment in associates	3,000	-	-	3,000
Investment property	6,583	-	-	6,583
Other assets	968	94	1,015	2,077
Property and equipment	-	-	9,406	9,406
Total segment assets	101,543	335,551	10,421	447,515
Placements from financial institutions	-	45,435	-	45,435
Placements from non - financial institutions and individuals	-	46,647	-	46,647
Customers' current accounts	286	35,151	-	35,437
Other liabilities	-	1,789	3,917	5,706
Total segment liabilities	286	129,022	3,917	133,225
Equity of investment account holders	19,966	175,401	-	195,367
Restricted investment accounts	35,396	-	-	35,396

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27. SEGMENT REPORTING (continued)

2011	Investment Banking	Commercial Banking	Unallocated	Total
Management fees	703	-	-	703
Income from placements with financial institutions	1	258	-	259
Income from financing assets and assets acquired for leasing	-	16,812	-	16,812
Income from investment securities	5,438	583	-	6,021
Share of losses from associate companies	(1,226)	-	-	(1,226)
Other income	258	102	-	360
Total income before return to investment account holders	5,174	17,755	-	22,929
Less: Return to investment account holders before Bank's share as Mudarib	(547)	(8,475)	-	(9,022)
Bank's share as a Mudarib	145	2,248	-	2,393
Return to investment account holders	(402)	(6,227)	-	(6,629)
Less: Expense on placements from financial institutions, non-financial institutions and individuals	-	(1,576)	-	(1,576)
Total segment revenue	4,772	9,952	-	14,724
Staff cost	877	1,754	3,218	5,849
Depreciation	-	-	1,169	1,169
Other expenses	46	456	3,097	3,599
Total segment cost	923	2,210	7,484	10,617
Segment results before impairment allowances	3,849	7,742	(7,484)	4,107
Charge of impairment allowances	(1,795)	(1,794)	-	(3,589)
Segment results	2,054	5,948	(7,484)	518

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28. MATURITY PROFILE

The maturity profile of placements with and from financial institutions, financing assets, assets acquired for leasing, (including lease rental receivable), investment in sukuk (non-trading), and equity of investment account holders has been presented using their contractual maturity period. For other balances, maturity profile is based on expected cash flows/ settlement profile of the respective assets and liabilities.

31 December 2012	Up to 3 months	3 to 6 months	6 months - 1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	23,856	-	-	-	-	23,856
Placements with financial institutions	57,525	-	-	-	-	57,525
Financing assets	46,415	13,528	6,437	90,192	89,173	245,745
Investment securities	7,654	1,885	15,567	71,739	4,015	100,860
Assets acquired for leasing (including lease rental receivable)	-	-	22	3,571	20,380	23,973
Investment in associates	-	-	-	-	2,887	2,887
Investment property	-	-	-	-	6,583	6,583
Other assets	685	-	-	2,121	-	2,806
Property and equipment	-	-	-	-	8,924	8,924
Total assets	**136,135**	**15,413**	**22,026**	**167,623**	**131,962**	**473,159**
Liabilities						
Placements from financial institutions	50,216	-	-	17,516	-	67,732
Placements from non-financial institutions and individuals	12,319	7,594	27,072	5,129	1,302	53,416
Customers' current account	11,319	76	-	-	-	11,395
Other liabilities	1,347	440	579	2,373	-	4,739
Total liabilities	**75,201**	**8,110**	**27,651**	**25,018**	**1,302**	**137,282**
Equity of investment account holders	119,794	37,572	54,097	4,966	-	**216,429**
Restricted Investment accounts	5,531	-	1,292	24,911	-	**31,734**
Commitments	9,394	4,497	12,402	1,563	286	**28,142**

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28. MATURITY PROFILE (continued)

31 December 2011	Up to 3 months	3 to 6 months	6 months - 1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	22,642	-	-	-	-	22,642
Placements with financial institutions	76,787	-	-	-	-	76,787
Financing assets	33,769	6,368	4,177	64,770	92,472	201,556
Investment securities	3,358	11,673	-	4,424	92,351	111,806
Assets acquired for leasing (including lease rental receivable)	-	-	-	1,521	12,137	13,658
Investment in associates	-	-	-	-	3,000	3,000
Investment property	-	-	-	-	6,583	6,583
Other assets	-	-	35	1,941	101	2,077
Property and equipment	-	-	-	-	9,406	9,406
Total assets	136,556	18,041	4,212	72,656	216,050	447,515
Liabilities						
Placements from financial institutions	45,435	-	-	-	-	45,435
Placements from non-financial institutions and individuals	1,789	6,812	37,376	328	342	46,647
Customers' current account	35,323	114	-	-	-	35,437
Other liabilities	1,581	582	698	2,646	199	5,706
Total liabilities	84,128	7,508	38,074	2,974	541	133,225
Equity of investment account holders	133,437	24,363	36,950	617	-	195,367
Restricted Investment accounts	9,370	16,635	9,391	-	-	35,396
Commitments	2,245	827	8,670	5,955	-	17,697

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29. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS

(a) Industry sector

31 December 2012	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	23,856	-	-	23,856
Placements with financial institutions	57,525	-	-	57,525
Financing assets	47,098	81,339	117,308	245,745
Investments securities	26,026	60,622	14,212	100,860
Assets acquired for leasing (including lease rentals receivable)	1,545	21,175	1,253	23,973
Investment in associates	-	2,887	-	2,887
Investment property	-	6,583	-	6,583
Other assets	259	1,473	1,074	2,806
Property and equipment	-	6,715	2,209	8,924
Total assets	**156,309**	**180,794**	**136,056**	**473,159**
Liabilities				
Placements from financial institutions	67,732	-	-	67,732
Placements from non-financial institutions and individuals	-	2,045	51,371	53,416
Customers' current accounts	19	2,542	8,834	11,395
Other liabilities	-	-	4,739	4,739
Total liabilities	**67,751**	**4,587**	**64,944**	**137,282**
Equity of investment account holders	5,573	3,433	207,423	**216,429**
Restricted investment accounts	-	30,442	1,292	**31,734**
Commitments	-	8,389	19,753	**28,142**

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29. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (continued)

(a) Industry sector (continued)

31 December 2011	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	22,642	-	-	22,642
Placements with financial institutions	76,787	-	-	76,787
Financing assets	16,708	92,487	92,361	201,556
Investments securities	24,389	62,944	24,473	111,806
Assets acquired for leasing (including lease rentals receivable)	2,103	11,555	-	13,658
Investment in associates	-	3,000	-	3,000
Investment property	-	6,583	-	6,583
Other assets	638	837	602	2,077
Property and equipment	-	6,715	2,691	9,406
Total assets	143,267	184,121	120,127	447,515
Liabilities				
Placements from financial institutions	45,435	-	-	45,435
Placements from non-financial institutions and individuals	-	8,781	37,866	46,647
Customers' current accounts	23,437	1,955	10,045	35,437
Other liabilities	-	-	5,706	5,706
Total liabilities	68,872	10,736	53,617	133,225
Equity of investment account holders	7,105	13,970	174,292	195,367
Restricted investment accounts	-	34,104	1,292	35,396
Commitments	5,655	6,120	5,922	17,697

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29. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (continued)

(b) Geographic sector

31 December 2012	GCC countries	Europe	USA	Asia	Australia	Africa	Total
Assets							
Cash and bank balances	21,304	267	2,228	5	52	-	23,856
Placements with financial institutions	55,525	-	-	2,000	-	-	57,525
Financing assets	235,384	10,361	-	-	-	-	245,745
Investment securities	71,043	1,376	-	24,008	4,433	-	100,860
Assets acquired for leasing (including lease rentals receivable)	23,973	-	-	-	-	-	23,973
Investment in associates	2,887	-	-	-	-	-	2,887
Investment property	6,583	-	-	-	-	-	6,583
Other assets	2,450	-	-	313	43	-	2,806
Property and equipment	8,924	-	-	-	-	-	8,924
Total assets	**428,073**	**12,004**	**2,228**	**26,326**	**4,528**	**-**	**473,159**
Liabilities							
Placements from financial institutions	67,732	-	-	-	-	-	67,732
Placements from non-financial institutions and individuals	53,416	-	-	-	-	-	53,416
Customers' current accounts	11,027	305	-	63	-	-	11,395
Other liabilities	4,739	-	-	-	-	-	4,739
Total liabilities	**136,914**	**305**	**-**	**63**	**-**	**-**	**137,282**
Equity of investment account holders	207,610	361	-	8,458	-	-	**216,429**
Restricted investment accounts	21,954	8,488	-	-	1,292	-	**31,734**
Commitments	25,453	2,689	-	-	-	-	**28,142**

Concentration by location for financing assets is measured based on the location of the counterparty, which has a high correlation with the location of the collateral for the exposure.

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29. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (continued)

(b) Geographic sector (continued)

31 December 2011	GCC countries	Europe	USA	Asia	Australia	Africa	Total
Assets							
Cash and bank balances	14,515	663	7,333	7	124	-	22,642
Placements with financial institutions	61,098	15,689	-	-	-	-	76,787
Financing assets	191,539	9,366	651	-	-	-	201,556
Investment securities	79,003	2,927	-	24,008	4,605	1,263	111,806
Assets acquired for leasing (including lease rentals receivable)	13,658	-	-	-	-	-	13,658
Investment in associates	3,000	-	-	-	-	-	3,000
Investment property	6,583	-	-	-	-	-	6,583
Other assets	1,820	39	-	175	43	-	2,077
Property and equipment	9,406	-	-	-	-	-	9,406
Total assets	380,622	28,684	7,984	24,190	4,772	1,263	447,515
Liabilities							
Placements from financial institutions	43,171	-	-	2,264	-	-	45,435
Placements from non-financial institutions and individuals	46,647	-	-	-	-	-	46,647
Customers' current accounts	35,052	360	-	25	-	-	35,437
Other liabilities	5,706	-	-	-	-	-	5,706
Total liabilities	130,576	360	-	2,289	-	-	133,225
Equity of investment account holders	185,114	354	-	9,899	-	-	195,367
Restricted investment accounts	25,792	8,312	-	-	1,292	-	35,396
Commitments	14,628	3,069	-	-	-	-	17,697

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30. FAIR VALUE

a) *Fair value of financial instruments*

Fair value is an amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair values of quoted Sukuk carried at amortised cost of BD 636 thousand (31 December 2011: BD 8,209 thousand) amounts to BD 633 thousand as at 31 December 2012 (31 December 2011: BD 7,899 thousand).

Other than equity investments carried at cost of BD 71,041 thousand (2011: BD 72,471 thousand), the estimated fair values of the Bank's other financial instruments are not significantly different from their carrying values.

b) *Fair value hierarchy*

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

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

31 December 2012	**Level 1**	**Level 2**	**Level 3**	**Total**
Investment securities				
Equity type instruments carried at fair value through income statement	3,858	-	17,452	21,310
Debt type instruments carried at fair value through income statement	1,016	-	-	1,016
	4,874	**-**	**17,452**	**22,326**

31 December 2011	Level 1	Level 2	Level 3	Total
Investment securities				
Equity type instruments carried at fair value through income statement	-	-	17,452	17,452
Equity type instruments carried at fair value through equity	211	-	-	211
	211	-	17,452	17,663

The table below shows the reconciliation of movements in value of investments measured using Level 3 inputs:

	2012	2011
At 1 January	17,452	12,796
Total gains or losses:		
- In profit or loss	-	4,656
Purchases	-	-
At 31 December	**17,452**	17,452

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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31. RISK MANAGEMENT

Introduction and overview
The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risks
- operational risks

This note presents information about the Group's exposure to each of the above risks, it's objectives, policies and processes for measuring and managing risk, and the Bank's management of capital.

Risk management framework
The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established an Executive Risk Management Committee, which is responsible for developing and monitoring the Bank's risk management policies in the specified areas. The committee also continuously monitors consistent implementation of the Board approved policies in the Bank and reports deviations, if any, to the Board. The committee consists of heads of business and other functional units in the Bank and reports regularly to the Risk Management Committee of the Board.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Bank's Audit Committee is responsible for monitoring compliance with the risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

CREDIT RISK
Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's exposures to placements with financial institutions, financing assets, outstanding assets acquired for leasing, investment in sukuk and receivables classified under other assets. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual and group exposure risk, country and sector concentration risk, related party exposure, etc.). The Bank monitors the total exposure to assets acquired for leasing (including lease rentals receivable) on a cumulative basis for monitoring of market risk and credit risk.

The Board of Directors has delegated responsibility for the management of credit risk to its Executive Risk Management Committee (ERMC). A separate Risk and Credit Management Department (RMD), reporting to the ERMC is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements and submitting the same for approval to the Board of Directors.

- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are not at present allocated to business units. Smaller exposures are approved by the Executive Credit & Investment Committee consisting of heads of business units and the Chief Operating Officer. Larger facilities require approval by the Chief Executive Officer, Chairman, Board Investment and Credit Committee or the full Board, as the case may be.

- Reviewing and assessing credit risk. RMD assesses all credit exposures and signs off on the relevant proposals prior to approval of the facilities by the appropriate authorities. Renewal and review of facilities are subject to the same process.

- Limiting concentrations of exposure to counterparties, countries and industries in respect of financing assets, assets acquired for leasing as well as investments.

- Developing and maintaining the Bank's risk grading's in order to categorise exposures according to the degree of probable risk of financial loss to focus management on the attendant risks. The risk grading system is also used to identify specific exposures for which impairment provisions may be required. The risk grading framework for the Bank's financing portfolio consists of ten grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. Investments in equity securities are not currently being graded and are evaluated individually on a case-by-case basis. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate on the recommendations of the RMD. Risk grades are subject to regular reviews by RMD.

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31. RISK MANAGEMENT (continued)

CREDIT RISK (continued)

- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are submitted to the Board on the compliance levels. RMD also provides advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.

- Each business unit is required to implement the Bank credit policies and procedures in respect of exposures assumed by them and are responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, irrespective of the approving authority for the exposure. Regular audits of business units and Bank credit processes are undertaken by Internal Audit.

Exposure to credit risk

31 December 2012	Placements with financial institutions	Financing assets	Assets acquired for leasing (including lease rental receivable)	Investment securities-Sukuk	Other financial assets	Total
Impaired						
Grade 9: Impaired	-	26,389	2,194	687	-	29,270
Unrated	-	-	-	-	773	773
Allowance for impairment	-	(13,645)	-	(34)	(773)	(14,452)
Carrying amount	**-**	**12,744**	**2,194**	**653**	**-**	**15,591**
Past due but not impaired						
Grade 1-6 Low-Fair Risk	-	27,032	1,875	-	-	28,907
Grade 7-8 Watch list	-	19,867	175	1,314	-	21,356
Past due comprises:						
0-30 days	-	13,358	1,875	-	-	15,233
30-60 days	-	6,756	-	-	-	6,756
60-90 days	-	2,547	-	-	-	2,547
90-180days	-	8,032	175	-	-	8,207
180 days +	-	16,206	-	1,314	-	17,520
Carrying amount	**-**	**46,899**	**2,050**	**1,314**	**-**	**50,263**
Neither past due nor impaired						
Grade 1-6 Low-Fair Risk	57,525	184,930	19,426	10,404	-	272,285
Grade 7-8 Watch list	-	3,912	545	-	-	4,457
Unrated	-	-	-	-	2,806	2,806
Carrying amount	**57,525**	**188,842**	**19,971**	**10,404**	**2,806**	**279,548**
Less:						
Collective impairment provisions	-	(2,740)	(242)	(4)	-	(2,986)
Total	**57,525**	**245,745**	**23,973**	**12,367**	**2,806**	**342,416**

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31. RISK MANAGEMENT (continued)

CREDIT RISK (continued)

Exposure to credit risk (continued)

31 December 2011	Placements with financial institutions	Financing assets	Assets acquired for leasing (including lease rental receivable)	Investment securities-Sukuk	Other financial assets	Total
Impaired						
Grade 9: Impaired	-	41,137	2,020	-	-	43,157
Unrated	-	-	-	-	773	773
Allowance for impairment	-	(16,151)	-	-	(773)	(16,924)
Carrying amount	-	24,986	2,020	-	-	27,006
Past due but not impaired						
Grade 1-6 Low-Fair Risk	-	19,896	1,457	-	-	21,353
Grade 7-8 Watch list	-	16,876	-	1,314	-	18,190
Past due comprises:						
0-30 days	-	28,250	1,166	-	-	29,416
30-60 days	-	921	291	-	-	1,212
60-90 days	-	1,061	-	-	-	1,061
90-180days	-	3,119	-	-	-	3,119
180 days +	-	3,421	-	1,314	-	4,735
Carrying amount	-	36,772	1,457	1,314	-	39,543
Neither past due nor impaired						
Grade 1-6 Low-Fair Risk	76,787	140,581	10,317	20,441	-	248,126
Grade 7-8 Watch list	-	1,180	-	-	-	1,180
Unrated	-	-	-	-	2,077	2,077
Carrying amount	76,787	141,761	10,317	20,441	2,077	251,383
Less:						
Collective impairment provisions	-	(1,963)	(136)	(83)	-	(2,182)
Total	76,787	201,556	13,658	21,672	2,077	315,750

Impaired financial assets
Impaired financial assets are those for which the Bank determines that it is probable that it will be unable to collect all or part of the principal and profit due according to the contractual terms of the exposure. Generally these assets fall under risk grades 9 or 10, for other financial assets impairment is assessed on an individual basis for each exposure under the Bank's internal credit risk grading system.

Past due but not impaired exposures
The exposure pertains to financing assets where contractual profit or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of subsequent collections, the level of security / collateral available and / or the stage of collection of amounts owed to the Bank.

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31. RISK MANAGEMENT (continued)

Renegotiated facilities
Exposures classified as neither past due nor impaired financing facilities include facilities renegotiated during the year amounting to BD 54,412 thousand (2011: BD 41,209 thousand) that would otherwise be past due as per their original repayment terms. The renegotiated terms usually require settlement of profits accrued till date on the facility and / or part payment of the principal and / or obtaining of additional collateral coverage. The renegotiated facilities are subject to revised credit assessments and independent review by the RMD. Of the total past due facilities of BD 50,263 thousands (2011: BD 39,543 thousand) only instalments of BD 11,849 thousands (2011: BD 6,696 thousand) are past due as at 31 December 2012.

Allowances for impairment
The Bank makes provisions for impairment on individual assets classified under grades 9 and 10. This is done on the basis of the present value of projected future cash flows from the assets themselves and consideration of the value of the collateral securities available. On a collective basis, the Bank has provided for impairment losses based on management's judgment of the extent of losses incurred but not identified based on the current economic and credit conditions.

Write-off policy
The Bank writes off an asset / security balance (net of any related allowances for impairment losses) when it determines that the asset / security are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the counterparty's financial position such that he can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. During the year, the Bank has written off financing facility of BD 1,589 against provisions on final settlement with a customer.

Collaterals
The Bank holds collateral against financing assets and receivables from assets acquired for leasing in the form of mortgage / pledge over property, listed / unlisted securities, other assets and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and updated periodically, generally at annual intervals. Collateral generally is not held against exposure to other banks and financial institutions. An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below. This includes the value of financial guarantees from banks, but not corporate and personal guarantees as the values thereof are not readily quantifiable. The collateral values considered for disclosure are restricted to the extent of the outstanding exposures.

	As at 31 December 2012			As at 31 December 2011		
	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total
Against impaired						
Property	6,475	1,680	8,155	15,362	1,431	16,793
Equities	1,339	-	1,339	2,114	-	2,114
Other	1,531	-	1,531	2,485	-	2,485
Against past due but not impaired						
Property	34,824	1,424	36,248	19,668	1,705	21,373
Equities	4,051	-	4,051	4,060	-	4,060
Other	269	-	269	465	-	465
Against neither past due nor impaired						
Property	77,863	20,460	98,323	79,906	10,061	89,967
Equities	277	-	277	267	-	267
Other	62,207	-	62,207	20,529	-	20,529
Total	188,836	23,564	212,400	144,856	13,197	158,053

The average collateral coverage ratio on secured facilities is 159.48% at 31 December 2012 (31 December 2011: 90.20%).

For analysis of concentration of total assets and liabilities refer note 29.

Further, for financing assets and assets acquired for leasing the Bank monitors concentrations of credit risk by sector and by geographic location.

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31. RISK MANAGEMENT (continued)

Collaterals (continued)

An analysis of concentrations of credit risk at the reporting date is shown below:

Concentration by Sector	As at 31 December 2012			As at 31 December 2011		
	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total
Banking and finance	47,098	1,545	48,643	16,708	2,103	18,811
Real estate:						
- Property	51,625	21,175	72,800	61,146	11,555	72,701
- Infrastructure Development	17,027	-	17,027	17,200	-	17,200
- Land	12,687	-	12,687	14,142	-	14,142
Construction	18,804	-	18,804	12,173	-	12,173
Trading	55,171	-	55,171	52,539	-	52,539
Manufacturing	4,021	-	4,021	4,459	-	4,459
Others	39,312	1,253	40,565	23,189	-	23,189
Total carrying amount	**245,745**	**23,973**	**269,718**	201,556	13,658	215,214

Settlement risk
The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed.

Settlement limits form part of the credit approval / limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from RMD.

LIQUIDITY RISK
Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial assets.

Management of liquidity risk
The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

Financial Control Department (FCD) collates data from treasury and other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. FCD communicates the information to the treasury who manages the Bank's portfolio of short-term liquid assets, largely made up of short-term placements with other banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

The daily liquidity position is monitored by FCD. The Bank has in place a Liquidity Contingency Plan, the elements of which are periodically tested. Tools for implementation of regular stress testing under various scenarios are in place. All liquidity policies and procedures are subject to review by ALCO and approval by appropriate authorities. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO members.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012

31. RISK MANAGEMENT (continued)

LIQUIDITY RISK (continued)

Exposure to liquidity risk
The key measure used by the Bank for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For computation of this, net liquid assets are considered as including cash and bank balances and placements with financial Institutions and certain investments in sukuks less placements from financial institution, and deposits comprise current accounts, placements from non-financial institutions and individuals, and equity of investment account holders.

Details of the reported Bank ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	2012 %	2011 %
At 31 December	8.23	23.21
Average for the period	11.87	11.68
Maximum for the period	19.67	23.21
Minimum for the period	5.35	6.54

For maturity profile of assets and liabilities refer note 28.

MARKET RISK
Market risk is the risk that changes in market prices, such as profit rate, equity prices, foreign exchange rates and credit spreads will affect the Bank's income, future cash flows or the value of its holdings of financial instruments. Market risk comprises three types of risk: currency risk, profit rate risk and other price risk. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks
The Bank separates its exposure to market risk between trading and non-trading portfolios. The Bank has no trading positions in equity or commodities and the main source of market risk for the Bank is its foreign exchange exposure and profit rate gap.

The Bank does not do any trading in foreign exchange. The Bank does not engage in proprietary trading of foreign exchange derivatives. However, the Bank enters into Shari'a compliant foreign exchange risk management transactions to hedge economic risks to cover significant open positions under its risk management guidelines. All foreign exchange income / losses arising out of customer transactions and revaluation of statement of financial position assets and liabilities are booked by the treasury operations. The responsibility for monitoring and managing the related risks also rests with the Treasury department.

Overall authority for market risk management is vested with ALCO. The RMD is responsible for the development of detailed risk management policies (subject to review and approval by appropriate approval authorities) and the Financial Control Department is responsible for the day-to-day review of their implementation.

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31. RISK MANAGEMENT (continued)

MARKET RISK (continued)

Exposure to profit rate risk–non–trading portfolios
The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for re-pricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by the Bank's Risk Management Department in its day-to-day monitoring activities.

A summary of the Bank's profit rate gap position at 31 December 2012 is as follows:

31 December 2012	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	57,525	-	-	-	-	57,525
Financing assets	46,415	13,528	6,437	90,192	89,173	245,745
Assets acquired for leasing (including lease rentals receivable)	-	-	22	3,571	20,380	23,973
Investments securities (sukuk)	7,448	-	905	-	4,015	12,368
Total profit rate sensitive assets	**111,388**	**13,528**	**7,364**	**93,763**	**113,568**	**339,611**
Liabilities and investment accounts						
Placements from financial institutions	50,216	-	-	17,516	-	67,732
Placements from non-financial institutions and individuals	12,319	7,594	27,072	5,129	1,302	53,416
Customers' current accounts	189	-	-	-	-	189
Equity of investments account holders	119,794	37,572	54,097	4,966	-	216,429
Total profit rate sensitive liabilities and investment accounts	**182,518**	**45,166**	**81,169**	**27,611**	**1,302**	**337,766**
Profit rate gap	**(71,130)**	**(31,638)**	**(73,805)**	**66,152**	**112,266**	**1,845**

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31. RISK MANAGEMENT (continued)

MARKET RISK (continued)

31 December 2011	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	76,787	-	-	-	-	76,787
Financing assets	33,769	6,368	4,177	64,770	92,472	201,556
Assets acquired for leasing (including lease rentals receivable)	-	-	-	1,521	12,137	13,658
Investments securities (sukuk)	3,330	11,673	-	4,424	2,245	21,672
Total profit rate sensitive assets	113,886	18,041	4,177	70,715	106,854	313,673
Liabilities and investment accounts						
Placements from financial institutions	45,435	-	-	-	-	45,435
Placements from non-financial institutions and individuals	1,789	6,812	37,376	328	342	46,647
Customers' current accounts	286	-	-	-	-	286
Equity of investments account holders	133,437	24,363	36,950	617	-	195,367
Total profit rate sensitive liabilities and investment accounts	180,947	31,175	74,326	945	342	287,735
Profit rate gap	(67,061)	(13,134)	(70,149)	69,770	106,512	25,938

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis point parallel fall or rise across all yield curves and a 50 bp rise or fall of all yield curves.

An analysis of the Bank's sensitivity to an increase or decrease in market profit rates (assuming no asymmetrical movement in yield curves and a constant statement of financial position position) is as follows:

	100bp parallel increase / decrease	**50bp increase / decrease**
At 31 December 2012	±18	±9
At 31 December 2011	±258	±129

Overall non-trading profit rate risk positions are managed by Treasury department, which uses short term investment securities, placement with banks and placement from banks to manage the overall position arising from the Bank's non-trading activities.

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31. RISK MANAGEMENT (continued)

MARKET RISK (continued)

Exposure to foreign exchange risk
Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group had the following significant net exposures denominated in foreign currency as of 31 December:

	2012 BHD Equivalent	2011 BHD Equivalent
US Dollars*	106,717	89,140
Other GCC Currencies *	10,535	8,363
Euros	5,004	5,860
Australian Dollars	4,485	4,730
Kuwaiti Dinars	2,479	3,083
Sterling Pounds	1,222	1,477
Indian Rupee	5	7

(*) The exposure in US dollars and other GCC currencies does not create any foreign exchange risk for the Bank since Bahrain Dinars and other GCC currencies are effectively pegged to the US Dollars.

The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various foreign exchange scenarios. Standard scenarios that are considered on a monthly basis include a 5% plus/minus increase in exchange rates, for currencies other than US Dollars, other GCC currencies.

An analysis of the Bank's sensitivity to an increase or decrease in foreign exchange rates (assuming all other variables, primarily profit rates, remain constant) is as follows:

	2012 BHD Equivalent	2011 BHD Equivalent
Euros	±250	±293
Australian Dollars	±224	±237
Kuwaiti Dinars	±124	±154
Sterling Pounds	±61	±74
Indian Rupees	±0.25	±0.35

Exposure to other price risks–non–trading portfolios
Credit spread risk on debt securities is subject to regular monitoring by RMD, but is not currently significant in relation to the overall financial position of the Bank.

The Group's unquoted equity securities carried at cost are exposed to risk of changes in equity values. Refer to note 21 for significant estimates and judgments in relation to impairment assessment of unquoted equity investments carried at cost. The Group manages exposure to other price risks by actively monitoring the performance of the equity securities. The performance assessment is performed on a quarterly basis and is reported to the Board Investment and Credit Committee.

OPERATIONAL RISK
Operational risk is the risk of loss arising from systems and control failures, fraud and human errors, which can result in financial and reputation loss, and legal and regulatory consequences. The Bank manages operational risk through appropriate controls, instituting segregation of duties and internal checks and balances, including internal audit and compliance. The Risk Management Department is in charge of identifying, monitoring and managing operational risk in the bank. The Bank already has an approved policy for doing this and all required organisational and physical infrastructure are in place.

The Bank has completed conducting one cycle of Risk Control Self-Assessment (RCSA) of Operational risk for majority of the departments of the Bank to identify the important Key Risk Areas, Key Risk Indicators and Key Risk Triggers: the RCSA process is a continuous process and will be conducted at regular frequencies across the Bank. A software for monitoring these triggers and recording actual and near miss losses is already in place. The medium term objective of the Bank is to generate statistically reliable data to upgrade to more sophisticated modes of Operational Risk Control both to manage the risk better and to reduce capital commitment.

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31. RISK MANAGEMENT (continued)

CAPITAL MANAGEMENT

The Central Bank of Bahrain (CBB), sets and monitors capital requirements for the Bank as a whole. In implementing current capital requirements CBB requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. Capital adequacy regulations of CBB is based on the principles of Basel II of the IFSB guidelines.

The Bank's regulatory capital is analysed into two tiers:

- Tier 1 capital, includes ordinary share capital, disclosed reserves including share premium, general reserves, legal / statutory reserve as well as retained earnings after deductions for goodwill and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes. As on 31 December 2012, the deductions to Tier 1 were Nil.

- Tier 2 capital, includes interim retained profits reviewed by the auditors and an allowed portion profit equalisation reserve (PER) and investment risk reserves (IRR). As per CBB, the PER & IRR can be up to a maximum amount equal to the capital charge pertaining to 30% of the risk weighted assets financed by unrestricted investment accounts.

Certain limits are applied to elements of the capital base in line with regulatory requirements. Tier 1 capital should represent at least half of the total eligible capital, i.e., Tier 2 capital is limited to 100% of Tier 1 capital. The limit on Tier 2 capital is based on the amount of Tier 1 capital after all deductions of investments pursuant to Prudential Consolidation and Deduction Requirements (PCD) Module of the CBB. The PCD Module sets out the regulatory rules for prudential consolidation, pro-rata consolidation or deduction where the own controlling or significant minority stakes in regulated financial entities, insurance entities and have significant exposures to investment in commercial entities. It also sets out the framework for the prudential deductions from capital for various instances including exposures to counterparties exceeding the large exposure limits as set out by CBB. As on 31 December 2012, the Bank was not required to make any deductions under the requirements of the PCD Module.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

For computation of credit risk on assets financed by equity of investment account holders, 30% of risk weight assets are considered as against 100% for assets self-financed.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank has adopted the standardised approach to credit and basic indicator approach for management of operational risk under the CBB capital adequacy framework. The Bank on a conservative basis for capital management does not claim any of the benefits for permissible credit risk mitigants against credit exposure.

The Bank's regulatory capital position at 31 December was as follows:

	31 December 2012	31 December 2011
Total risk weighted assets	430,731	429,049
Tier 1 capital	119,448	116,308
Tier 2 capital	2,986	2,207
Total regulatory capital	122,434	118,515
Total regulatory capital expressed as a percentage of total risk weighted assets	28.42	27.62

The Bank has complied with all externally imposed capital requirements throughout the year.

Capital allocation

The allocation of capital between specific operations and activities is primarily driven by regulatory requirements. The Bank's capital management policy seeks to maximise return on risk adjusted while satisfying all the regulatory requirements. The Bank's policy on capital allocation is subject to regular review by the Board.

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32. PROPOSED APPROPRIATIONS

The Board of Directors propose the following appropriations for 2012 which are subject to shareholders approval in the ensuing Annual General Meeting:

	2012	2011
Directors' remuneration	-	-
Charity	-	-
Zakah	228	214

33. COMMITMENTS

The commitments contracted in the normal course of business of the Bank:

	2012	2011
Undrawn commitments to extend finance	15,405	4,619
Financial guarantees	12,737	7,423
Commitment to investments	-	5,655
	28,142	17,697

Performance obligations

During the ordinary course of business, the Group may enter into performance obligations in respect of certain of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2012 due to the performance of any of its projects.

34. SOCIAL RESPONSIBILITY

The Bank discharges its social responsibilities through donations to charitable causes and organisations.

35. COMPARITIVES

Certain prior period amounts have been regrouped to conform to current year's presentation. Such regrouping did not affect previously reported profit or equity.