# Al Salam Bank-Bahrain B.S.C.

## CONSOLIDATED FINANCIAL STATEMENTS

### 31 DECEMBER 2011

ERNST & YOUNG

P.O. Box 140
14th Floor - The Tower
Bahrain Commercial Complex
Manama, Kingdom of Bahrain
Tel: +973 1753 5455 Fax: +973 1753 5405
manama@bh.ey.com
www.ey.com/me
C.R. No. 6700

# INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AL SALAM BANK-BAHRAIN B.S.C.

## Report on the consolidated financial statements

We have audited the accompanying consolidated statement of financial position of Al Salam Bank-Bahrain B.S.C. ["the Bank"] and its subsidiary [together "the Group"] as of 31 December 2011, and the related consolidated statements of income, cash flows and changes in equity for the year then ended. These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a Rules and Principles are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

*Auditors' Responsibility*

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ["AAOIFI"]. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors, as well as evaluating the overall consolidated financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of 31 December 2011, the results of its operations, its cash flows and changes in equity for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

Ernst & Young

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF
AL SALAM BANK-BAHRAIN B.S.C. (continued)

**Report on other regulatory requirements**

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 2), we report that:

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

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2011 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position. Satisfactory explanations and information have been provided to us by the management in response to all our requests. The Bank has also complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

Ernst + Young

4 March 2012
Manama, Kingdom of Bahrain

Al Salam Bank-Bahrain B.S.C.

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 December 2011

| | Note | *31 December 2011 BD '000* | *(Restated) 31 December 2010 BD '000* |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with banks and Central Bank of Bahrain | 4 | **72,318** | 95,791 |
| Central Bank of Bahrain Sukuk | | **125,027** | 68,632 |
| Murabaha and Wakala receivables from banks | 5 | **135,698** | 137,299 |
| Corporate Sukuk | | **49,650** | 60,959 |
| Murabaha financing | 6 | **135,383** | 114,572 |
| Mudaraba financing | | **57,706** | 19,309 |
| Ijarah Muntahia Bittamleek | 8 | **66,477** | 56,756 |
| Musharaka financing | | **11,711** | 8,127 |
| Assets under conversion | 9 | **27,750** | 57,432 |
| Non-trading investments | 10 | **223,320** | 212,432 |
| Investment in an associate | 11 | **-** | 7,578 |
| Investment properties | | **2,500** | 3,373 |
| Receivables and prepayments | 12 | **15,278** | 12,479 |
| Premises and equipment | | **1,089** | 1,859 |
| **TOTAL ASSETS** | | **923,907** | 856,598 |
| **LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY** | | | |
| **LIABILITIES** | | | |
| Murabaha and Wakala payables to banks | | **104,573** | 101,300 |
| Wakala payables to non-banks | | **515,147** | 456,447 |
| Customers' current accounts | | **66,585** | 57,362 |
| Liabilities under conversion | 9 | **7,633** | 5,171 |
| Other liabilities | 13 | **13,088** | 15,993 |
| **TOTAL LIABILITIES** | | **707,026** | 636,273 |
| **EQUITY OF INVESTMENT ACCOUNTHOLDERS** | 14 | **16,256** | 18,465 |
| **OWNERS' EQUITY** | | | |
| Share capital | 15 | **149,706** | 149,706 |
| Treasury stock | | **(465)** | - |
| Reserves and retained earnings | | **47,228** | 48,165 |
| Total equity attributable to shareholders of the Bank | | **196,469** | 197,871 |
| Non-controlling interest | | **4,156** | 3,989 |
| **TOTAL OWNERS' EQUITY** | | **200,625** | 201,860 |
| **TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY** | | **923,907** | 856,598 |

Mohamed Ali Rashid Alabbar
Chairman

Yousif A. Taqi
Director and Chief Executive Officer

The attached notes 1 to 31 form part of these consolidated financial statements.

Al Salam Bank-Bahrain B.S.C.

## CONSOLIDATED INCOME STATEMENT

Year ended 31 December 2011

| | Note | 31 December 2011 BD '000 | 31 December 2010 BD '000 |
|---|---|---|---|
| **OPERATING INCOME** | | | |
| Income from financing contracts | 16 | **30,262** | 25,447 |
| Gains on sale of investments and sukuk | | **2,849** | 1,531 |
| Income from FVTPL investments | | **601** | 1,089 |
| Fair value changes on FVTPL investments | | **5,189** | 7,608 |
| Writedown of available for sale investments | | **(5,325)** | - |
| Fair value changes on investment properties | | **(873)** | - |
| Dividend income | | **1,156** | 402 |
| Fees, commissions and foreign exchange gains | 17 | **2,300** | 5,536 |
| | | **36,159** | 41,613 |
| Profit on Murabaha and Wakala payables to banks | | **(714)** | (617) |
| Profit on Wakala payables to non-banks | | **(16,403)** | (14,674) |
| Profit relating to equity of investment accountholders | 14 | **(153)** | (216) |
| Depreciation on Ijarah Muntahia Bittamleek | 8 | **(6,149)** | (3,742) |
| Total operating income | | **12,740** | 22,364 |
| **OPERATING EXPENSES** | | | |
| Staff costs | | **6,016** | 7,023 |
| Premises and equipment cost | | **1,168** | 1,144 |
| Depreciation | | **999** | 1,133 |
| Other operating expenses | | **3,415** | 4,255 |
| Total operating expenses | | **11,598** | 13,555 |
| Share of profit from an associate | | **-** | 15 |
| **NET PROFIT BEFORE PROVISIONS** | | **1,142** | 8,824 |
| Provision for impairment | 7 | **(645)** | (1,508) |
| **NET PROFIT FOR THE YEAR** | | **497** | 7,316 |
| ***Attributable to:*** | | | |
| Shareholders of the Bank | | **312** | 7,209 |
| Non-controlling interest | | **185** | 107 |
| | | **497** | 7,316 |
| **WEIGHTED AVERAGE NUMBER OF SHARES (in '000)** | | **1,491,779** | 1,497,064 |
| **BASIC AND DILUTED EARNINGS PER SHARE (FILS)** | | **0.2** | 4.8 |

The attached notes 1 to 31 form part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2011

| | 31 December 2011 BD '000 | (Restated) 31 December 2010 BD '000 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net profit for the year | 497 | 7,316 |
| Adjustments: | | |
| Depreciation | 999 | 1,133 |
| Gains on investments | 1,009 | (7,608) |
| Provision for impairment | 645 | 1,508 |
| Exchange differences on investment in an associate transferred to income statement | 96 | - |
| Share of profit from an associate | - | (15) |
| Operating income before changes in operating assets and liabilities | 3,246 | 2,334 |
| **Changes in operating assets and liabilities:** | | |
| Mandatory reserve with Central Bank of Bahrain | (303) | (1,600) |
| Central Bank of Bahrain Sukuk | (56,395) | (35,724) |
| Murabaha and Wakala receivables from banks with original maturities of 90 days or more | 9,990 | (10,888) |
| Corporate Sukuk | 11,309 | (43,579) |
| Murabaha financing | (20,811) | (28,806) |
| Mudaraba financing | (38,397) | (6,746) |
| Ijarah Muntahia Bittamleek | (10,221) | (23,004) |
| Musharaka financing | (3,584) | (2,743) |
| Assets under conversion | 29,348 | 41,304 |
| Non-trading investments, net | (4,520) | (20,914) |
| Receivables and prepayments | (2,799) | 14,423 |
| Murabaha and Wakala payables to banks | 3,273 | 11,902 |
| Wakala from non-banks | 58,407 | 119,130 |
| Customers' current accounts | 9,223 | 24,662 |
| Liabilities under conversion | 2,755 | (95,284) |
| Other liabilities | (3,005) | 1,016 |
| Net cash used in operating activities | (12,484) | (54,517) |
| **INVESTING ACTIVITIES** | | |
| Purchase of premises and equipment | (229) | (655) |
| Purchase of investment property | - | (2,196) |
| Net cash used in investing activities | (229) | (2,851) |
| **FINANCING ACTIVITIES** | | |
| Equity of investment accountholders | (2,209) | 9,056 |
| Purchase of treasury stock | (465) | - |
| Dividends | - | (7,129) |
| Net cash (used in) from financing activities | (2,674) | 1,927 |
| **NET CHANGE IN CASH AND CASH EQUIVALENTS** | (15,387) | (55,441) |
| Cash and cash equivalents at 1 January | 203,116 | 258,557 |
| **CASH AND CASH EQUIVALENTS AT 31 DECEMBER** | 187,729 | 203,116 |
| **Cash and cash equivalents comprise of:** | | |
| Cash and other balances with Central Bank of Bahrain (Note 5) | 45,410 | 73,945 |
| Balances with other banks (Note 5) | 7,638 | 2,879 |
| Murabaha and Wakala receivables from banks with original maturities of less than 90 days | 134,681 | 126,292 |
| | 187,729 | 203,116 |

The attached notes 1 to 31 form part of these consolidated financial statements.

Al Salam Bank-Bahrain B.S.C.

## CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

Year ended 31 December 2011

Amounts in BD '000s

| | *Attributable to Shareholders of the Bank* | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *Share capital* | *Treasury stock* | *Statutory reserve* | *Retained earnings* | *Investment reserve* | *Changes in fair value* | *Foreign exchange translation reserve* | *Share premium reserve* | *Total reserves* | *Proposed appropriations* | *Total* | *Non-controlling interest* | *Total owners' equity* |
| **Balance as of 1 January 2011** | **149,706** | **-** | **8,631** | **4,603** | **33,039** | **172** | **(96)** | **2,573** | **48,922** | **-** | **198,628** | **3,997** | **202,625** |
| Changes due to adoption of FAS 25 (note 2.3.1) | - | - | - | 33,039 | (33,039) | (757) | - | - | (757) | - | (757) | (8) | (765) |
| **As at 1 January 2011 (restated)** | **149,706** | **-** | **8,631** | **37,642** | **-** | **(585)** | **(96)** | **2,573** | **48,165** | **-** | **197,871** | **3,989** | **201,860** |
| Net profit for the year | - | - | - | 312 | - | - | - | - | 312 | - | 312 | 185 | 497 |
| Net change in fair value | - | - | - | - | - | (1,245) | - | - | (1,245) | - | (1,245) | (18) | (1,263) |
| Transfer to income statement | - | - | - | - | - | - | 96 | - | 96 | - | 96 | - | 96 |
| Treasury shares purchased | - | (465) | - | - | - | - | - | - | - | - | (465) | - | (465) |
| Transfer to statutory reserve | - | - | 31 | (31) | - | - | - | - | - | - | - | - | - |
| Charitable donations | - | - | - | (100) | - | - | - | - | (100) | - | (100) | - | (100) |
| **Balance at 31 December 2011** | **149,706** | **(465)** | **8,662** | **37,823** | **-** | **(1,830)** | **-** | **2,573** | **47,228** | **-** | **196,469** | **4,156** | **200,625** |
| Balance as of 1 January 2010 | 142,577 | - | 7,910 | 5,009 | 26,245 | (381) | - | 2,573 | 41,356 | 14,258 | 198,191 | 3,586 | 201,777 |
| Changes due to adoption of FAS 25 (note 2.3.1) | - | - | - | 26,245 | (26,245) | 507 | - | - | 507 | - | 507 | - | 507 |
| As at 1 January 2010 (restated) | 142,577 | - | 7,910 | 31,254 | - | 126 | - | 2,573 | 41,863 | 14,258 | 198,698 | 3,586 | 202,284 |
| Net profit for the year | - | - | - | 7,209 | - | - | - | - | 7,209 | - | 7,209 | 107 | 7,316 |
| Changes on investment in an associate | - | - | - | - | - | - | (96) | - | (96) | - | (96) | - | (96) |
| Net change in fair value | - | - | - | - | - | (711) | - | - | (711) | - | (711) | 296 | (415) |
| Bonus shares issued | 7,129 | - | - | - | - | - | - | - | - | (7,129) | - | - | - |
| Transfer to statutory reserve | - | - | 721 | (721) | - | - | - | - | - | - | - | - | - |
| Charitable donations | - | - | - | (100) | - | - | - | - | (100) | - | (100) | - | (100) |
| Dividends paid for 2009 | - | - | - | - | - | - | - | - | - | (7,129) | (7,129) | - | (7,129) |
| Balance at 31 December 2010 | 149,706 | - | 8,631 | 37,642 | - | (585) | (96) | 2,573 | 48,165 | - | 197,871 | 3,989 | 201,860 |

The attached notes 1 to 31 form part of these consolidated financial statements.

## 1 INCORPORATION AND PRINCIPAL ACTIVITIES

The parent company, Al Salam Bank-Bahrain B.S.C. ("the Bank") was incorporated in the Kingdom of Bahrain under the Bahrain Commercial Companies Law No. 21/2001 and was registered with Ministry of Industry and Commerce under Commercial Registration Number 59308 on 19 January 2006. The Bank is regulated and supervised by the Central Bank of Bahrain ("the CBB") and has an Islamic retail banking license. The Bank is operating under Islamic principles, and in accordance with all the relevant regulatory guidelines for Islamic banks issued by the CBB. The Bank's registered office is P.O. Box 18282, Building 22, Avenue 58, Block 436, Al Seef District, Kingdom of Bahrain.

The Bank and its subsidiary, BSB, (together known as "the Group") operate through eleven retail branches in the Kingdom of Bahrain. The Bank offers a full range of Shari'a-compliant banking services and products. The activities of the Bank include managing profit sharing investment accounts, offering Islamic financing contracts, dealing in Shari'a-compliant financial instruments as principal/agent, managing Shari'a-compliant financial instruments and other activities permitted for under the CBB's Regulated Banking Services as defined in the licensing framework. The Bank's Sharia Supervisory Board is entrusted to ensure the Bank's adherence to Sharia rules and principles in its transactions and activities. The Bank's ordinary shares are listed in the Bahrain Bourse B.S.C. (c) ("Bahrain Stock Exchange") and Dubai Financial Market.

In 2009, the Bank acquired a 90.31% stake in Bahraini Saudi Bank B.S.C. (BSB), a publicly listed commercial bank in the Kingdom of Bahrain. BSB operates under a retail banking license issued by the Central Bank of Bahrain. BSB has applied for an Islamic retail banking license with the CBB and is awaiting approval. Subsequent to acquisition by the Bank, BSB has discontinued new conventional activities and the conversion into a fully compliant Islamic operations is in progress. On 28 December 2011 the Sharia Supervisory Board of BSB has declared BSB an Islamic bank. Consequently, any income derived, net of related expenses, from conventional contracts will not form part of the Group's income statement but will be contributed to charity.

On 20 November 2011, the shareholders' of BSB have resolved to delist BSB from Bahrain Bourse. On 22 December 2011 the shareholders resolved to merge its operations with the parent subject to regulatory approval.

These consolidated financial statements have been authorised for issue in accordance with a resolution of the Board of Directors dated 4 March 2012.

## 2 SIGNIFICANT ACCOUNTING POLICIES

### 2.1 BASIS OF PREPARATION

The consolidated financial statements are prepared on a historical cost basis, except for investments held at fair value through profit or loss, available-for-sale equity investments and investment properties which are held at fair value. These consolidated financial statements incorporate all assets, liabilities and off balance sheet financial instruments held by the Group.

These consolidated financial statements are presented in Bahraini Dinars, being the functional and presentation currency of the Group, rounded to the nearest thousand [BD '000], except where otherwise indicated.

#### 2.1.a Statement of compliance

The consolidated financial statements of the Group are prepared in accordance with the Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law. For matters for which no AAOIFI standards exist, the Group uses the relevant International Financial Reporting Standard.

The Group presents its consolidated statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the consolidated statement of financial position date (current) and more than 12 months after the consolidated statement of financial position date (non-current) is presented in Note 22.

#### 2.1.b Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary. The financial statements of the Bank's subsidiary is prepared for the same reporting year as the Bank, using consistent accounting policies. Non-Shari'a compliant assets and liabilities of the subsidiary are consolidated as set out in Note 9.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.1 BASIS OF PREPARATION (continued)

**2.1.b Basis of consolidation (continued)**

Subsidiaries are fully consolidated from the date on which control is transferred to the Bank. Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired during the year are included in the consolidated income statement from the date of gaining control over the subsidiary. All intra-group transactions income and expenses and unrealised gains and losses resulting from intra-group transactions are eliminated in full.

Non-controlling interests represent the portion of profit or loss and net assets not owned, directly or indirectly, by the Group and are presented separately in the consolidated income statement and within equity in the consolidated statement of financial position, separately from parent shareholders' equity.

### 2.2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

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

Judgements are made in the classification of fair value through profit or loss, assets held for sale or held-to-maturity investments based on the management's intention at acquisition of the financial asset. As fully described below, judgements are also made in determination of the objective evidence that a financial asset is impaired.

*Classification of investments*

Management decides upon acquisition of an investment whether it should be classified as fair value through profit or loss, available for sale or held-to-maturity.

**Estimation uncertainty**

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

*Impairment losses on financial contracts*

The Group reviews its financial contracts on a regular basis to assess whether a provision for impairment should be recorded in the consolidated statement of income. In particular, considerable judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

*Impairment of available-for-sale equity investments*

The Group treats available-for-sale equity investments as impaired when there has been a significant or prolonged (judgemental) decline in the fair value below its cost or where other objective evidence of impairment exists. In addition, the Group evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the present value calculation factors for unquoted equities.

*Collective impairment provisions on financial contracts*

In addition to specific provisions against individually significant financial contracts, the Group also considers the need for a collective impairment provision against financial contracts which although not specifically identified as requiring a specific provision, have a greater risk of default than when originally granted. This collective provision is based on any deterioration in the status, as determined by the Group, of the financial contracts since they were granted (acquired). The amount of the provision is based on the historical loss pattern for other contracts within each grade and is adjusted to reflect current economic changes.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

**Estimation uncertainty (continued)**

*Valuation of unquoted private equity and real estate investments*
Valuation of above investments is normally based on one of the following:

- valuation by independent external valuers;
- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same;
- present value of expected cash flows at current rates applicable for items with similar terms and risk characteristics; or
- other valuation models.

The Group calibrates the valuation techniques periodically and tests these for validity using either prices from observable current market transactions in the same instrument or other available observable market data.

**Going concern**

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

### 2.3 ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated financial statements, which are consistent with those of prior year except for items disclosed in note 2.3.1.

#### 2.3.1 Adoption of new and amended standards

During 2010, AAOIFI amended its conceptual framework and issued new Financial Accounting Standard (FAS 25) "Investment in sukuk, shares and similar instruments", which is effective from 1 January 2011. The amended conceptual framework provides the basis for the financial accounting standards issued by AAOIFI. The amended framework introduces the concept of substance and form compared to the concept of form over substance. The framework states that it is necessary that information, transaction and other events are accounted for and presented in accordance with their substance and economic reality as well as the legal form.

The Group has adopted FAS 25 issued by AAOIFI which covers the recognition, measurement, presentation and disclosure of investment in sukuk, shares and similar investments that exhibit characteristics of debt or equity instruments made by Islamic financial institutions.

**2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.3.1 Adoption of new and amended standards (continued)**

The adoption of FAS 25 had an effect on the classification and measurement of the Group's financial assets. As a result of the application of this new standard, the classification of the investment portfolio was revisited and changes were made in classification to be in line with FAS 25. The corporate sukuk held by the Group have been reclassified retrospectively from available-for-sale investments to investments at amortised cost. Accordingly, the fair value adjustments previously recognised on these sukuk have been restated and the impact on the corporate sukuk balance as of 1 January 2011 was a reduction of BD 765 thousand. The adoption of FAS 25, did have not any impact on the non-trading investments held by the Group. The impact on the opening total owners' equity as of 1 January 2011 was a reduction of BD 765 thousand (1 January 2010: increase of BD 507 thousand).

Also, the investment reserve amounting BD 33,039 thousand as of 1 January 2011 (as of 1 January 2010: BD 26,245 thousand), which was previously disclosed as a separate component in the owners' equity, has now been transferred to the retained earnings as this reserve is no longer required to be disclosed separately under the new FAS 25.

**2.3.2 Summary of significant accounting policies**

**a) Financial contracts**

Financial contracts consist of balances with banks and the Central Bank of Bahrain, Central Bank of Bahrain Sukuk, Corporate Sukuk, Murabaha financing (net of deferred profit), Mudaraba, Musharaka and Ijarah Muntahia Bittamleek. Balances relating to these contracts are stated net of provisions for impairment.

**b) Corporate sukuk**

These are quoted securities and classified as investments at amortised cost in accordance with FAS 25 issued by AAOIFI.

**c) Murabaha receivables**

Murabaha is a contract whereby one party sells (Seller) an asset to the other party (the Purchaser) at cost plus profit and on a deferred payment basis, after the Seller have purchased the asset based on the Purchaser's promise to purchase the same on such Murabaha basis. The sale price comprises the cost of the asset and an agreed profit margin. The sale price (cost plus the profit amount) is paid by the Purchaser to the Seller on installment basis over the agreed finance tenure. Under the Murabaha contract the Group may act either as a Seller or a Purchaser, as the case may be.

The Group considers the promise to purchase made by the Purchaser in a Murabaha transaction in favor of the Seller to be binding.

Murabaha receivables are stated at amortised cost, net of deferred profits, provision for impairment, if any, and amounts settled.

**d) Mudaraba financing**

Mudaraba is a contract between two parties whereby one party is a fund provider (Rab Al Mal) who would provide a certain amount of funds (Mudaraba Capital), to the other party (Mudarib). Mudarib would then invest the Mudaraba Capital in a specific enterprise or activity deploying its experience and expertise for a specific pre-agreed share in the resultant profit. The Rab Al Mal is not involved in the management of the Mudaraba activity. The Mudarib would bear the loss in case of its default, negligence or violation of any of the terms and conditions of the Mudaraba contract; otherwise the loss would be borne by the Rab Al Mal. Under the Mudaraba contract the Group may act either as Mudarib or as Rab Al Mal, as the case may be.

Mudaraba investments are recognized at fair value of the Mudaraba assets net of provision for impairment, if any, and Mudaraba capital amounts settled. If the valuation of the Mudaraba assets results in difference between fair value and book value, such difference is recognized as profit or loss to the Group.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.3.2 Summary of significant accounting policies (continued)

**e) Ijarah Muntahia Bittamleek**

Ijara (Muntahia Bittamleek) is an agreement whereby the Group (as lessor) leases an asset to the customer (as lessee) (after purchasing/acquiring the specified asset, either from a third party seller or from the customer itself, according to the customer's request and promise to lease) against certain rental payments for a specific lease term/periods, payable on fixed or variable rental basis.

The Ijara agreement specifies the leased asset, duration of the lease term, as well as, the basis for rental calculation, the timing of rental payment and responsibilities of both parties during the lease term. The customer (lessee) provides the Group (lessor) with an undertaking to renew the lease periods and pay the relevant rental payment amounts as per the agreed schedule and applicable formula throughout the lease term.

The Group (lessor) retains the ownership of the assets throughout the lease term. At the end of the lease term, upon fulfillment of all the obligations by the customer (lessee) under the Ijara agreement, the Group (lessor) will sell the leased asset to the customer (lessee) for a nominal value based on sale undertaking given by the Group (lessor). Leased assets are usually residential properties, commercial real estate or aircrafts.

Depreciation is provided on a systematic basis on all Ijarah Muntahia Bittamleek assets other than land (which is deemed to have an indefinite life), at rates calculated to write off the cost of each asset over the shorter of either the lease term or economic life of the asset.

**f) Musharaka**

Musharaka is used to provide venture capital or project finance. The Group and customer contribute towards the capital of the Musharaka. Usually a special purpose company or a partnership is established as a vehicle to undertake the Musharaka. Profits are shared according to a pre-agreed profit distribution ratio but losses are borne by the partners according to the capital contributions of each partner. Capital contributions may be in cash or in kind, as valued at the time of entering into the Musharaka.

Musharaka is stated at amortised cost, less any impairment.

**g) Assets and liabilities under conversion**

These represent assets and liabilities of BSB which are under conversion to Shari'a compliant products. These are initially measured at fair value at the date of acquisition and the subsequent measurement is as follows:

***Assets under conversion:***

*Due from Banks and Loans and advances to customers:*
At amortised cost less any amounts written off and provision for impairment, if any.

*Investments:*
These are classified as available-for-sale investments and are fair valued based on criteria set out in Note 2.3 h. Any changes in fair values subsequent to acquisition date are recognized in equity.

***Liabilities under conversion:***
These are remeasured at amortised cost.

**h) Non-trading investments**

These are classified as held-to-maturity, available-for-sale or fair value through profit or loss.

All investments are initially recognised at cost, being the fair value of the consideration given including acquisition costs associated with the investment. Acquisition cost relating to investments designated as fair value through profit or loss is charged to consolidated income statement.

Following the initial recognition of investments, the subsequent period-end reporting values are determined as follows:

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.3.2 Summary of significant accounting policies (continued)

**h) Non-trading investments (continued)**

***Investments held-to-maturity***

Investments which have fixed or determinable payments and fixed maturity which are intended to be held-to-maturity, are carried at amortised cost, less provision for impairment in value.

***Investments available-for-sale***

After initial recognition, equity investments which are classified as investments at fair value through equity are disclosed as "available-for-sale investments". These are normally remeasured at fair value, unless the fair value cannot be reliably determined, in which case they are measured at cost less impairment. Fair value changes are reported in equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as "changes in fair value" within equity, is included in the consolidated income statement.

***Investments carried at fair value through profit or loss***

Investments in this category are designated as such on initial recognition if these investments are evaluated on a fair value basis in accordance with the Group's risk management policy and its investment strategy. These include all private equity investments including those in joint ventures and associates which are not strategic in nature.

Investments at fair value through profit or loss are recorded in the consolidated statement of financial position at fair value. Changes in fair value are recorded as "Gains on investments designated at fair value through profit or loss" in the consolidated income statement.

**i) Investments in associates**

The Group's investments in its associates, that are acquired for strategic purposes, are accounted for under the equity method of accounting. Other equity investments in associates are accounted for as fair value through profit or loss by availing the scope exemption under FAS 24, Investments in associates. An associate is an entity over which the Group has significant influence and which is neither a subsidiary nor a joint venture. An entity is considered as an associate if the Group has more than 20% ownership of the entity or the Group has significant influence through any other mode.

Under the equity method, the investment in the associate is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associate. Losses in excess of the cost of the investment in an associate are recognised when the Group has incurred obligations on its behalf. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised. The consolidated income statement reflects the Group's share of results of operations of the associate. Where there has been a change recognised directly in the equity of the associate, the Group recognises its share of any changes and discloses this, when applicable, in the consolidated statement of changes in equity.

The reporting dates of the associate and the Group are identical and the associates accounting policy conform to those used by the Group for like transactions and events in similar transactions.

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

Profit and losses resulting from transactions between the Group and the associates are eliminated to the extent of the interest in associates.

Foreign exchange translation gains/losses arising out of the above investment in the associate are included in the equity.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.3.2 Summary of significant accounting policies (continued)

**j) Investment properties**

Investment properties are those held to earn rentals and/or for capital appreciation. These are initially recorded at cost, including acquisition charges associated with the property.

Subsequent to initial recognition, all investment properties are remeasured at fair value and changes in fair value are recognised in the consolidated statement of income as gain or loss in investment properties. The fair value of the investment properties is determined either based on valuations made by independent valuers or using internal models with consistent assumptions.

**k) Premises and equipment**

Premises and equipment are stated at cost less accumulated depreciation and any impairment in value. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment, other than freehold land and capital work-in-progress.

| | |
|---|---|
| - Computer equipment | 3 to 5 years |
| - Furniture and office equipment | 3 to 5 years |
| - Motor vehicle | 5 years |
| - Leasehold improvements | Over the lease period |

**l) Subsidiaries acquired with a view to sell**

A subsidiary acquired with a view to subsequent disposal within twelve months is classified as "held-for-sale" when the sale is highly probable. Related assets and liabilities of the subsidiary are shown separately on the consolidated statement of financial position as "Assets held-for-sale" and "Liabilities relating to assets held-for-sale". Assets that are classified as held-for-sale are measured at the lower of carrying amount and fair value less costs to sell. Any resulting impairment loss reduces the carrying amount of the assets. Assets that are classified as held-for-sale are not depreciated.

**m) Business combinations and goodwill**

Business combinations are accounted for using the purchase method of accounting. This involves recognising identifiable assets (including previously unrecognised intangible assets) and liabilities (including contingent liabilities and excluding future restructuring) of the acquired business at fair value. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. If the cost of acquisition is less than the fair values of the identifiable net assets acquired, the discount on acquisition (negative goodwill) is recognised directly in the consolidated income statement in the year of acquisition.

Goodwill acquired in a business combination is initially measured at cost, being the excess of the cost of the business combination over the Bank's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Gain on business combination, being the excess of the Bank's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired over the cost of business acquisition is recognised as gain in the consolidated statement of income.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually, or more frequently, if events or changes in circumstances indicate that the carrying value may be impaired.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.3.2 Summary of significant accounting policies (continued)

**n) Impairment and uncollectability of financial assets**

An assessment is made at each reporting date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, any impairment loss, is recognised in the consolidated income statement.

Impairment is determined as follows:

(i) for assets carried at amortised cost, impairment is based on estimated cash flows based on the original effective profit rate;

(ii) for assets carried at fair value, impairment is the difference between cost and fair value; and

(iii) for assets carried at cost, impairment is based on present value of anticipated cash flows based on the current market rate of return for a similar financial asset.

For available-for-sale equity investments reversal of impairment losses are recorded as increases in cumulative changes in fair value through equity.

In addition, a collective provision is made to cover impairment for specific assets where there is a measurable decrease in estimated future cash flows.

**o) Offsetting**

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

**p) Provisions**

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

**q) Employees' end of service benefits**

The Group provides end of service benefits to its expatriate employees. Entitlement to these benefits is based upon the employees' final salary and length of service, subject to completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

For Bahraini employees, the Group makes contributions to Social Insurance Organisation calculated as a percentage of the employees' salaries. The Group's obligations are limited to these contributions, which are expensed when due.

**r) Revenue recognition**

*Murabaha receivables*

As the income is quantifiable and contractually determined at the commencement of the contract, income is recognized on a straight-line basis over the deferred period. Recognition of income is suspended when the Group believes that the recovery of these amounts may be doubtful or normally when the payments of Murabaha installments are overdue by 90 days, whichever is earlier.

*Corporate sukuk*

Income on Corporate sukuk is recognized on a time-proportionate basis based on underlying rate of return of the respective type of sukuk. Recognition of income is suspended when the Group believes that the recovery of these amounts may be doubtful or normally when the payments are overdue by 90 days, whichever is earlier.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.3.2 Summary of significant accounting policies (continued)

**r) Revenue recognition (continued)**

*Mudaraba*
Income on Mudaraba transactions are recognised when the right to receive payment is established or these are declared by the Mudarib, whichever is earlier. In case of losses in mudaraba, the Group's share of loss is recognized to the extent that such losses are being deducted from its share of the mudaraba capital.

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

*Ijarah Muntahia Bittamleek*
Ijarah Muntahia Bittamleek income is recognised on a time-proportionate basis over the lease term. Income related to non-performing Ijarah Muntahia Bittamleek is suspended. Accrual of income is suspended when the Group believes that the recovery of these amounts may be doubtful or normally when the rental payments are overdue by 90 days, whichever is earlier.

*Musharaka*
Income on Musharaka is recognized when the right to receive payment is established or on distributions. In case of losses in musharaka, the Group's share of loss is recognized to the extent that such losses are being deducted from its share of the musharaka capital.

*Fees and commission income*
The Group earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following main categories:

Fee income on financing transactions: Fee earned on financing transactions including up-front fees and early settlement fees are recognised when earned. To the extent the fees are deemed yield enhancement they are recognised over the period of the financing contracts.

Fee income from transaction services: Fee arising from corporate finance, corporate advisory, arranging the sale of assets and wealth management are recognised when earned or on a time proportionate basis when the fee is linked to time.

*Fair value of financial assets*
For investments that are traded in organised financial markets, fair value is determined by reference to the prevailing market bid price on the reporting date.

For investments where there is no quoted market price, a reasonable estimate of fair value is determined by reference to valuation by independent external valuers or based on recent arm's length market transactions. Alternatively, the estimate would also be based on current market value of another instrument, which is substantially the same, or is based on the assessment of future cash flows. The cash equivalent values are determined by the Group by calculating the present value of future cash flows at current profit rates for contracts with similar terms and risk characteristics.

For investments having fixed or determinable payments, fair value is based on the net present value of estimated future cash flows determined by the Group using current profit rates for investments with similar terms and risk characteristics.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.3.2 Summary of significant accounting policies (continued)

**s) Foreign currencies**

Foreign currency transactions are recorded at rates of exchange prevailing at the dates of the transactions. Monetary assets and liabilities in foreign currencies at the consolidated statement of financial position date are retranslated at market rates of exchange prevailing at that date. Gains and losses arising on translation are recognised in the consolidated income statement. Non-monetary assets that are measured in terms of historical cost in foreign currencies are recorded at rates of exchange prevailing at the value dates of the transactions. Translation gains or losses on non-monetary items classified as "available-for-sale" and investment in associates are included in consolidated statement of changes in equity until the related assets are sold or derecognised at which time they are recognised in the consolidated income statement. Translation gains on non-monetary assets classified as "fair value through profit or loss" are directly recognised in the consolidated income statement.

**t) Trade and settlement date accounting**

Purchases and sales of financial assets and liabilities are recognised on the trade date, i.e. the date that the Group contracts to purchase or sell the asset or liability.

**u) Derecognition of financial assets**

Financial assets 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.

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

**v) Derecognition of financial liabilities**

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same source on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the consolidated statement of income.

**w) Fiduciary assets**

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

**x) Dividend on ordinary shares**

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders. Dividends for the year that are approved after the reporting date are included in the equity and are disclosed as an event after the balance sheet date.

**y) Equity of investment account holders**

All equity of investment accountholders are carried at cost plus profit and related reserves less amounts settled.

Share of income for equity of investment accountholder is calculated based on the income generated by the assets funded by such investment accounts after deducting Mudarib share (as Mudarib and Rabalmal). Operating expenses are charged to shareholders' funds and not included in the calculation.

The basis applied by the Group in arriving at the equity of investment accountholders' share of income is total investment income less shareholders' income. Portion of the income generated from equity of investment accountholders is transferred to profit equalization reserve, mudarib share and investment risk reserve and the remaining is distributed to the equity of investment accountholders.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.3.2 Summary of significant accounting policies (continued)

**z) Zakah**
In accordance with the revised Articles of Association of the Bank, the responsibility to pay Zakah is on the shareholders of the Bank.

**aa) Cash and cash equivalents**
Cash and cash equivalents comprise of cash and balances with Central Bank of Bahrain and Murabaha receivables from banks with original maturities of less than 90 days.

**ab) Wakala payables**
The Group accepts deposits from banks and customers under Wakala arrangement under which a return may be payable to customers. There is no restriction on the Group for the use of funds received under wakala agreement.

**ac) Jointly financed and self financed**
Investments, financing and receivables that are jointly funded by the Group and the equity of investment accountholders are classified under the caption "jointly financed" in the consolidated financial statements. Investments, financing and receivables that are funded solely by the Group are classified under "self financed".

The equity of investment accountholders is used to finance the Murabaha and Wakala receivables from banks and non-banks.

**ad) Investment risk reserve**
This is the amount appropriated by the Group out of the income of investment account holders, after allocating the mudarib share, in order to compensate future losses for investment account holders.

**ae) Earnings prohibited by Shari'a**
The Group is committed to contributing to charity any income generated from non-Islamic sources. Accordingly, any earning prohibited by Shari'a is credited to charity funds to be used for social welfare purposes.

## 3 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

As at 31 December 2011, financial instruments have been classified as follows:

| | *Financial assets at fair value through profit or loss* | *Available for sale* | *Financial assets at cost / amortised cost* | *Total* |
|---|---|---|---|---|
| | *BD '000* | *BD '000* | *BD '000* | *BD '000* |
| **ASSETS** | | | | |
| Cash and balances with Central Bank of Bahrain | - | - | 72,318 | 72,318 |
| Central Bank of Bahrain Sukuk | - | - | 125,027 | 125,027 |
| Murabaha and Wakala receivables from banks | - | - | 135,698 | 135,698 |
| Corporate Sukuk | - | - | 49,650 | 49,650 |
| Murabaha and Mudaraba financing | - | - | 193,089 | 193,089 |
| Ijarah Muntahia Bittamleek | - | - | 66,477 | 66,477 |
| Musharaka financing | - | - | 11,711 | 11,711 |
| Assets under conversion | - | 8,122 | 19,628 | 27,750 |
| Non-trading investments | 203,937 | 19,383 | - | 223,320 |
| Receivables | - | - | 14,856 | 14,856 |
| | 203,937 | 27,505 | 688,454 | 919,896 |

| | *Financial liabilities at fair value through profit or loss* | *Available for sale* | *Financial liabilities at amortised cost* | *Total* |
|---|---|---|---|---|
| | *BD '000* | *BD '000* | *BD '000* | *BD '000* |
| **LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS** | | | | |
| Murabaha and Wakala payables to banks | - | - | 104,573 | 104,573 |
| Wakala from non-banks | - | - | 515,147 | 515,147 |
| Customers' current accounts | - | - | 66,585 | 66,585 |
| Liabilities under conversion | - | - | 7,633 | 7,633 |
| Other financial liabilities | - | - | 10,371 | 10,371 |
| Equity of investment accountholders | - | - | 16,256 | 16,256 |
| | - | - | 720,565 | 720,565 |

## 3 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (continued)

As at 31 December 2010, financial instruments were classified as follows:

| | *Financial assets at fair value through profit or loss* | *Available for sale* | *Financial assets at cost / amortised cost* | *Total* |
|---|---|---|---|---|
| | *BD '000* | *BD '000* | *BD '000* | *BD '000* |
| ASSETS | | | | |
| Cash and balances with Central Bank of Bahrain | - | - | 95,791 | 95,791 |
| Central Bank of Bahrain Sukuk | - | - | 68,632 | 68,632 |
| Murabaha receivables from banks | - | - | 137,299 | 137,299 |
| Corporate Sukuk | - | - | 60,959 | 60,959 |
| Murabaha and Mudaraba financing | - | - | 133,881 | 133,881 |
| Ijarah Muntahia Bittamleek | - | - | 56,756 | 56,756 |
| Musharaka financing | - | - | 8,127 | 8,127 |
| Assets under conversion | - | 8,803 | 48,629 | 57,432 |
| Non-trading investments | 199,335 | 13,097 | - | 212,432 |
| Receivables | - | - | 11,763 | 11,763 |
| | 199,335 | 21,900 | 621,837 | 843,072 |

| | *Financial liabilities at fair value through profit or loss* | *Available for sale* | *Financial liabilities at amortised cost* | *Total* |
|---|---|---|---|---|
| | *BD '000* | *BD '000* | *BD '000* | *BD '000* |
| LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS | | | | |
| Murabaha and Wakala payables to banks | - | - | 101,300 | 101,300 |
| Wakala from non-banks | - | - | 456,447 | 456,447 |
| Customers' current accounts | - | - | 57,362 | 57,362 |
| Liabilities under conversion | - | - | 5,171 | 5,171 |
| Other financial liabilities | - | - | 12,697 | 12,697 |
| Equity of investment accountholders | - | - | 18,465 | 18,465 |
| | - | - | 651,442 | 651,442 |

## 4 CASH AND BALANCES WITH BANKS AND CENTRAL BANK OF BAHRAIN

| | ***2011*** | *2010* |
|---|---|---|
| | ***BD '000*** | *BD '000* |
| Mandatory reserve with Central Bank of Bahrain | **19,270** | 18,967 |
| Cash and other balances with Central Bank of Bahrain | **45,410** | 73,945 |
| Balances with other banks | **7,638** | 2,879 |
| | **72,318** | 95,791 |

## 5 MURABAHA AND WAKALA RECEIVABLES FROM BANKS

| | ***2011*** | *2010* |
|---|---|---|
| | ***BD '000*** | *BD '000* |
| GCC | **133,813** | 137,299 |
| Europe | **1,885** | - |
| | **135,698** | 137,299 |

This includes certain Wakala receivables for investment in commodity Murabaha. In addition to above amounts, deferred profits on Murabaha receivables from banks amounted to BD 15,000 (2010: BD 107,000).

## 5 MURABAHA AND WAKALA RECEIVABLES FROM BANKS (continued)

This consists of BD 10,759 thousands (2010: BD 18,465 thousands) of jointly financed assets and BD 124,939 thousands (2010: BD 188,834 thousands) of self financed assets.

## 6 MURABAHA FINANCING

| | *2011* BD '000 | *2010* BD '000 |
|---|---|---|
| Murabaha financing - gross | **137,036** | 116,080 |
| Less: Provision for impairment | **(1,653)** | (1,508) |
| Murabaha financing - net | **135,383** | 114,572 |

Murabaha financing are shown net of deferred profits of BD 23,957,000 (2010: BD 23,480,000).

This consists of BD 5,497 thousands (2010: nil) of jointly financed assets and BD 187,592 thousands (2010: BD 133,881 thousands) of self financed assets.

## 7 MOVEMENTS IN PROVISIONS

| | *2011* BD '000 | *2010* BD '000 |
|---|---|---|
| Balance at beginning of the year | **1,508** | - |
| Provisions made during the year | **645** | 1,508 |
| Balance at end of the year | **2,153** | 1,508 |

## 8 IJARAH MUNTAHIA BITTAMLEEK

This represents net investments in assets leased for periods which either approximate or cover major parts of the estimated useful lives of such assets. The lease documentations provide that the lessor undertakes to transfer the leased assets to the lessee at the end of the lease term upon the lessee fulfilling all its obligations under the lease agreement.

| Movements in Ijarah Muntahia Bittamleek assets are as follows: | *2011* BD '000 | *2010* BD '000 |
|---|---|---|
| At 1 January | **56,756** | 33,246 |
| Additions during the year | **16,370** | 27,252 |
| Ijarah assets depreciation | **(6,149)** | (3,742) |
| Provision | **(500)** | - |
| At 31 December | **66,477** | 56,756 |

| The future minimum lease receivable in aggregate are as follows: | *2011* BD '000 | *2010* BD '000 |
|---|---|---|
| Due within one year | **18,162** | 18,860 |
| Due in one to five years | **29,096** | 23,340 |
| Due after five years | **19,219** | 14,556 |
| | **66,477** | 56,756 |

## 8 IJARAH MUNTAHIA BITTAMLEEK (continued)

| | *2011* | *2010* |
|---|---|---|
| | *BD '000* | *BD '000* |
| Ijarah Muntahia Bittamleek is divided into the following asset classes: | | |
| Air crafts | **2,735** | 3,114 |
| Machinery | **3,137** | 3,555 |
| Land and buildings | **60,605** | 50,087 |
| | **66,477** | 56,756 |

The accumulated depreciation on Ijarah Muntahia Bittamleek assets amounted to BD 6,008,000 (2010:BD 4,402,000).

## 9 ASSETS AND LIABILITIES UNDER CONVERSION

These represent interest bearing assets and liabilities of BSB, a majority owned subsidiary of the Bank. At the consolidated statement of financial position date, the conversion of the subsidiary into a fully Islamic compliant operations is in progress, accordingly these assets and liabilities have been reported as separate line items on the face of the consolidated statement of financial position. The details of these assets and liabilities under conversion are as follows:

| | *2011* | *2010* |
|---|---|---|
| | *BD '000* | *BD '000* |
| **Assets** | | |
| Due from banks and financial institutions | **-** | 757 |
| Loans and advances to customers | **19,628** | 47,872 |
| Non-trading investments | **8,122** | 8,803 |
| | **27,750** | 57,432 |
| **Liabilities** | | |
| Due to banks and financial institutions | **7,633** | 5,171 |
| | **7,633** | 5,171 |

Loans and advances to customers given above, are stated net of write down of BD 3,983,000 made by the Group against assets held by the Subsidiary at the time of acquisition. This write down comprise of BD 1,508,000 (2010:BD 2,133,000) of specific adjustments against identified facilities and a general write down of BD 2,475,000 (2010: BD 1,850,000) as fair value adjustments as required by IFRS 3, Business Combinations. The Subsidiary carries these assets at amortized cost, less impairment, as per its accounting policy for Loans and Receivables Originated by an enterprise. Included in the non-trading investments are certain investments against which the Group has taken a fair value write down amounting to BD330,000 (2010: BD 330,000).

Income from financing contracts includes BD 1,727 thousands (2010: BD 4,963 thousands) arising from assets under conversion. Profit on Wakala from non-banks includes BD 18 thousands (2010: BD 1,557 thousands) arising from liabilities under conversion.

In addition to the above assets under conversion, the subsidiary has a conventional deposit of BD 16,088 thousands (2010: BD 14,655 thousands) with the Central Bank of Bahrain.

## 10 NON-TRADING INVESTMENTS

Fair value of available-for-sale financial assets is dervied from quoted market prices in active markets, if available.

Fair value of unquoted available-for-sale financials assets is estimated using appropriate valuation techniques.

**Fair value hierarchy**

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

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

Level 2: other techniques for which all inputs that have a significant effect on the recorded fair value are observable, either directly or indirectly;

Level 3: techniques that use inputs that have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of the financial instruments carried at fair value in the consolidated statement of financial position:

| **31 December 2011** | *Level 1* | *Level 2* | *Level 3* | *Total* |
|---|---|---|---|---|
| | *BD '000* | *BD '000* | *BD '000* | *BD '000* |
| Financial assets at fair value through profit or loss | **4,735** | **460** | **198,742** | **203,937** |
| Available-for-sale financial assets | **14,105** | **-** | **5,278** | **19,383** |
| | **18,840** | **460** | **204,020** | **223,320** |

During the reporting period ended 31 December 2011 and 2010, there were no transfers between Level 1 and Level 2 fair value measurments.

| **31 December 2010** | *Level 1* | *Level 2* | *Level 3* | *Total* |
|---|---|---|---|---|
| | *BD '000* | *BD '000* | *BD '000* | *BD '000* |
| Financial assets at fair value through profit or loss | 9,093 | 482 | 189,759 | 199,334 |
| Available-for-sale financial assets | 13,098 | - | - | 13,098 |
| | 22,191 | 482 | 189,759 | 212,432 |

The fair values of investments in Sukuk, compared to carrying amounts are as follows:

| | *2011* | *2010* |
|---|---|---|
| | *BD '000* | *BD '000* |
| Carrying value | **174,677** | 129,590 |
| Fair value | **175,417** | 130,355 |

## 11 INVESTMENT IN AN ASSOCIATE

The Group has investment in Al Salam Bank Algeria (ASBA), an unlisted bank incorporated in Algeria. This was reported as an Investment in Associate till 2010. Subsequent to dilution of ownership, the Group does not have significant influence. Accordingly, this investment is now reported as part of the Non-trading investments in the consolidated statement of financial position.

## 12 RECEIVABLES AND PREPAYMENTS

| | *2011* *BD '000* | *2010* *BD '000* |
|---|---|---|
| Profit receivable on Murabaha and Mudaraba | **1,590** | 1,807 |
| Rental receivable on Ijarah Muntahia Bittamleek assets | **479** | 683 |
| Profit receivable on Sukuk | **1,359** | 650 |
| Prepayments | **422** | 716 |
| Other receivables | **11,428** | 8,623 |
| | **15,278** | 12,479 |

Other receivables include BD 4,060 thousands (2010: BD 1,623 thousands) relating to sale of investments.

## 13 OTHER LIABILITIES

| | *2011* *BD '000* | *2010* *BD '000* |
|---|---|---|
| Profit payable | **4,325** | 4,626 |
| Accounts payable and accruals | **5,379** | 7,029 |
| Dividends payable | **2,438** | 3,440 |
| End of service benefits | **670** | 669 |
| Charity payable | **276** | 229 |
| | **13,088** | 15,993 |

Charity payable includes BD 7,000 (2010: BD 8,000) of Shari'a prohibited income allocated for charitable purposes.

## 14 EQUITY OF INVESTMENT ACCOUNTHOLDERS

Equity of investment account holders funds is commingled with the Group's funds and used to fund / invest in Islamic modes of finance and no priority is granted to any party for the purpose of investments and distribution of profits. According to the terms of acceptance of the unrestricted investment accounts, 100% of the funds are invested taking into consideration the relevant weightage, if any. The Mudarib's share of profit ranges between 40% and 50%. Operating expenses are charged to shareholders' funds and not included in the calculation.

The balances consists savings accounts of BD 7,829,000 (2010: BD 6,537,000) and call accounts of BD 8,427,000 (2010: BD 11,928,000).

The return on joint invested assets and distribution to unrestricted investment account holders were as follows:

| | *2011* *BD '000* | *2010* *BD '000* |
|---|---|---|
| Gross return from commingled assets | **278** | 393 |
| Group's share as Mudarib | **(125)** | (177) |
| **Distributions to unrestricted investment account holders** | **153** | 216 |

The average profit rate for the holders is 1.00% (2010: 1.00%).

## 15 OWNERS' EQUITY

| | 2011 BD '000 | 2010 BD '000 |
|---|---|---|
| **15.1 Share capital** | | |
| Authorised: | | |
| 2,000,000,000 ordinary shares of BD 0.100 each | **200,000** | 200,000 |
| Issued and fully paid at BD 0.100 per share: | | |
| Balance at beginning - 1,497,063,825 (2010: 1,425,775,075) shares | **149,706** | 142,577 |
| Issued during the year - nil (2010: 71,288,750 ) shares | **-** | 7,129 |
| | **149,706** | 149,706 |

Pursuant to a shareholders' resolution, during the year 2010, the Bank issued one bonus share for every twenty shares held. This amounted to 5% of the paid up capital resulting in an utilization of BD 7,129,000 from the retained earnings to this effect.

### 15.2 Statutory reserve

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

### 15.3 Investment reserve

The reserve represents unrealised gains and losses from revaluation of investments and investment properties carried at fair value though profit or loss, and is not available for distribution under the Bank's policies until transferred back to retained earnings upon disposal of the assets and realisation of the gains. As a result of adoption of FAS 25, this reserve is no longer required to be disclosed separately.

## 16 INCOME FROM FINANCING CONTRACTS

| | 2011 BD '000 | 2010 BD '000 |
|---|---|---|
| Income from Murabaha and Wakala receivables from banks | **585** | 1,331 |
| Income from Murabaha and Mudaraba financing | **12,336** | 13,747 |
| Income from Musharaka | **773** | 673 |
| Income from Sukuk investments | **6,106** | 2,715 |
| Income from Ijarah Muntahia Bittamleek* | **10,462** | 6,981 |
| | **30,262** | 25,447 |

*The depreciation on Ijarah Muntahia Bittamleek has been disclosed in the consolidated income statement.

## 17 FEES, COMMISSIONS AND FOREIGN EXCHANGE GAINS

| | 2011 BD '000 | 2010 BD '000 |
|---|---|---|
| Financing and transaction related fees and commissions | **675** | 1,269 |
| Fiduciary and other fees | **517** | 876 |
| Foreign exchange gains | **1,108** | 839 |
| Other income | **-** | 2,552 |
| | **2,300** | 5,536 |

## 18 RELATED PARTY TRANSACTIONS

Related parties comprise major shareholders, directors of the Group, senior management, close members of their families, entities owned or controlled by them and companies affiliated by virtue of common ownership or directors with that of the Group. The transactions with these parties were made on commercial terms.

The significant balances with related parties at 31 December 2011 were as follows:

| | 2011 | | | |
|---|---|---|---|---|
| | *Associates and joint ventures* | *Directors and related entities* | *Senior management* | *Total* |
| | ***BD '000*** | ***BD '000*** | ***BD '000*** | ***BD '000*** |
| **Assets:** | | | | |
| Murabaha financing | 35,621 | 778 | 150 | 36,549 |
| Ijarah Muntahia Bittamleek | - | 118 | 140 | 258 |
| Musharaka financing | 2,100 | - | 79 | 2,179 |
| Receivables and prepayments | 1,333 | 16 | 7 | 1,356 |
| **Liabilities and Equity of Investment accountholders:** | | | | |
| Wakala payables to non-banks | 3,289 | 1,090 | 453 | 4,832 |
| Customers' current accounts | 4,029 | 355 | 189 | 4,573 |
| Equity of investment accountholders | - | 130 | 74 | 204 |
| Commitments | 3,380 | - | - | 3,380 |
| Contingent liabilities | - | - | - | - |

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

| | 2011 | | | |
|---|---|---|---|---|
| | *Associates and joint ventures* | *Directors and related entities* | *Senior management* | *Total* |
| | ***BD '000*** | ***BD '000*** | ***BD '000*** | ***BD '000*** |
| **Income:** | | | | |
| Income from financing contracts | 1,812 | 16 | 12 | 1,840 |
| **Expenses:** | | | | |
| Profit on Wakala payables to non-banks | 34 | 35 | 52 | 121 |
| Share of profits on equity of investment account holders | 1 | 1 | 1 | 3 |

## 18 RELATED PARTY TRANSACTIONS (continued)

The significant balances with related parties at 31 December 2010 were as follows:

| | 2010 | | | |
|---|---|---|---|---|
| | *Associates and joint ventures BD '000* | *Directors and related entities BD '000* | *Senior management BD '000* | *Total BD '000* |
| **Assets:** | | | | |
| Murabaha financing | 21,653 | 54 | 37 | 21,744 |
| Ijarah Muntahia Bittamleek | 15,068 | 3,114 | 175 | 18,357 |
| Musharaka financing | 7,830 | - | 89 | 7,919 |
| Assets under conversion | - | - | 21 | 21 |
| Receivables and prepayments | 3,260 | 8 | 6 | 3,274 |
| **Liabilities and Equity of Investment accountholders:** | | | | |
| Wakala from non-banks | 3,451 | 1,297 | 125 | 4,873 |
| Customers' current accounts | 7,428 | 161 | 333 | 7,922 |
| Equity of investment accountholders | 35 | 91 | 1,292 | 1,418 |
| Commitments | 4,310 | - | - | 4,310 |
| Contingent liabilities | 1,549 | 63 | - | 1,612 |

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

| | 2010 | | | |
|---|---|---|---|---|
| | *Associates and joint ventures BD '000* | *Directors and related entities BD '000* | *Senior management BD '000* | *Total BD '000* |
| **Income:** | | | | |
| Income from financing contracts | 2,945 | 150 | 17 | 3,112 |
| **Expenses:** | | | | |
| Profit paid on Wakala from non-banks | 118 | 54 | 43 | 215 |
| Share of profits on equity of investment account holders | 3 | 1 | 1 | 5 |

Compensation of key management personnel, consisting solely of short-term benefits, for the year was BD 1,438 thousands (2010: BD 1,695 thousands).

## 19 CONTINGENT LIABILITIES AND COMMITMENTS

The Group has the following commitments:

| | *2011* *BD '000* | *2010* *BD '000* |
|---|---|---|
| **Contingent liabilities on behalf of customers** | | |
| Guarantees | **5,270** | 6,773 |
| Letters of credit | **1,301** | 1,645 |
| Acceptances | **406** | 432 |
| | **6,977** | 8,850 |
| **Irrevocable Unutilised commitments** | | |
| Unutilised financing commitments | **25,591** | 27,970 |
| Unutilised non-funded commitments | **8,283** | 7,583 |
| Unutilised capital commitments | **1,398** | 1,502 |
| | **35,272** | 37,055 |
| | **42,249** | 45,905 |

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

Commitments generally have fixed expiration dates, or other termination clauses. Since commitment may expire without being utilized, the total contract amounts do not necessarily represent future cash requirements.

**Operating lease commitment - Group as lessee**

The Group has entered into a five-year operating lease for its premises. Future minimal rentals payable under the non-cancellable lease are as follows:

| | *2011* *BD '000* | *2010* *BD '000* |
|---|---|---|
| Within 1 year | **646** | 429 |
| After one year but not more than five years | **1,133** | 85 |
| | **1,779** | 514 |

## 20 RISK MANAGEMENT

### 20.1 Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to early settlement risk and operational risks.

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

***Risk management structure***

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

## 20 RISK MANAGEMENT (continued)

### 20.1 Introduction (continued)

***Board of Directors***

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

***Executive Committee***

The Executive Committee has the responsibility to monitor the overall risk process within the Group.

***Shari'a Supervisory Board***

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

***Credit/ Risk Committee***

Credit/ Risk committee recommends the risk policy and framework to the Board. Its primary role is selection and implementation of risk management systems, portfolio monitoring, stress testing, risk reporting to the Board, Board Committees, Regulators and Executive management. In addition, individual credit transaction approval and monitoring is an integral part of the responsibilities of Credit/Risk Committee.

***Asset and Liability Committee***

The Asset and Liability Committee establishes policy and objectives for the asset and liability management of the Group's financial position in terms of structure, distribution, risk and return and its impact on profitability. It also monitors the cash flow, tenor and cost/yield profiles of assets and liabilities and evaluates the Group's financial position both from profit rate sensitivity and liquidity points of view, making corrective adjustments based upon perceived trends and market conditions, monitoring liquidity, monitoring foreign exchange exposures and positions.

***Board Audit Committee***

The Audit Committee is appointed by the Board of Directors who are non-executive directors of the Bank. The Board Audit Committee assists the Board in carrying out its responsibilities with respect to assessing the quality and integrity of financial reporting, the audit thereof, the soundness of the internal controls of the Group, the measurement system of risk assessment and relating these to the Group's capital, and the methods for monitoring compliance with laws, regulations and supervisory and internal policies.

***Internal Audit***

Risk management processes throughout the Group are audited by the internal audit function, that examines both the adequacy of the procedures and the Group's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Board Audit Committee.

***Risk measurement and reporting systems***

The Group's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Group also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

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

## 20 RISK MANAGEMENT (continued)

### 20.1 Introduction (continued)

***Risk measurement and reporting systems (continued)***

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Board of Directors, the Credit / Risk Committee, and the head of each business division. The report includes aggregate credit exposure, credit metric forecasts, hold limit exceptions, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Board of Directors receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Group.

For all levels throughout the Group, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information. A daily briefing is given to the Chief Financial Officer and all other relevant members of the Group on the utilisation of market limits, proprietary investments and liquidity, plus any other risk developments.

**Excessive risk concentration**

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

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

### 20.2 Credit risk

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

In addition to monitoring credit limits, the Group manages the credit exposures by entering into collateral arrangements with counterparties in appropriate circumstances and by limiting the duration of the exposure.

**20 RISK MANAGEMENT (continued)**

**20.2 Credit risk (continued)**

**Maximum exposure to credit risk without taking account of any collateral and other credit enhancements**
The table below shows the maximum exposure (excluding sovereign exposure) to credit risk for the components of the consolidated statement of financial position. The maximum exposure is shown net of provision, before the effect of mitigation through the use of master netting and collateral agreements.

| | ***Gross maximum exposure 2011 BD '000*** | *Gross maximum exposure 2010 BD '000* |
|---|---|---|
| **ASSETS** | | |
| Balances with other banks | **7,638** | 2,879 |
| Murabaha receivables from banks | **135,698** | 137,299 |
| Corporate Sukuk | **49,650** | 61,724 |
| Murabaha and Mudaraba financing | **148,243** | 100,642 |
| Ijarah Muntahia Bittamleek | **63,277** | 65,777 |
| Musharaka financing | **11,711** | 8,127 |
| Assets under conversion | **8,708** | 48,629 |
| Receivables | **14,017** | 9,399 |
| Total | **438,942** | 434,476 |
| Contingent liabilities and commitments | **34,848** | 33,652 |
| **Total credit risk exposure** | **473,790** | 468,128 |

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

***Type of credit risk***
Various contracts entered into by the Group comprise Murabaha financing, Mudaraba financing, Musharaka financing, Sukuk, Musharaka and Ijarah Muntahia Bittamleek contracts. Murabaha financing contracts cover land, buildings, commodities, motor vehicles and others. Mudaraba financing consist of financing transactions entered through other Islamic banks and financial institutions. The various financial instruments are:

*Murabaha financing*
The Bank arranges Murabaha transactions by buying an asset (which represents the object of the Murabaha) and then selling this asset to customers (beneficiary) after adding a margin of profit over the cost. The sale price (cost plus profit margin) is paid in installments over the agreed period.

*Ijarah Muntahia Bittamleek*
The legal title of the leased asset under Ijarah Muntahia Bittamleek passes to the lessee at the end of the Ijarah term, provided that all Ijarah installments are settled.

**20 RISK MANAGEMENT (continued)**

**20.2 Credit risk (continued)**

a) The credit quality of balances with banks and Murabaha receivables from banks subject to credit risk is as follows:

| | *31 December 2011* | | | | |
|---|---|---|---|---|---|
| | *Neither past due nor impaired* | | | *Past due or individually impaired* | |
| | *'A' Rated BD '000* | *'B' Rated BD '000* | *Unrated BD '000* | *BD '000* | *Total BD '000* |
| Balances with banks | 7,460 | 54 | 123 | - | 7,637 |
| Murabaha and Wakala receivables from banks | 65,804 | 29,706 | 40,188 | - | 135,698 |
| | **73,264** | **29,760** | **40,311** | - | **143,335** |

| | *31 December 2010* | | | | |
|---|---|---|---|---|---|
| | *Neither past due nor impaired* | | | *Past due or individually impaired* | |
| | *'A' Rated BD '000* | *'B' Rated BD '000* | *Unrated BD '000* | *BD '000* | *Total BD '000* |
| Balances with Banks | 2,604 | 36 | 239 | - | 2,879 |
| Murabaha and Wakala receivables from banks | 84,853 | 15,084 | 37,362 | - | 137,299 |
| | 87,457 | 15,120 | 37,601 | - | 140,178 |

The ratings referred to in the above tables are by one or more of the 4 international rating agencies (Standards & Poors, Moody's, Fitch and Capital Intelligence). The unrated exposures are with various high quality Middle East financial institutions, which are not rated by a credit rating agency. In the opinion of the management, these are equivalent to "A" rated banks.

## 20 RISK MANAGEMENT (continued)

### 20.2 Credit risk (continued)

b) The credit quality of Corporate sukuk, Murabaha and Mudaraba financing, Ijarah Muntahia Bittamleek, Musharaka financing, Assets under conversion and financing that are subject to credit risk, based on internal credit ratings, is as follows:

| | *31 December 2011* | | | | | |
|---|---|---|---|---|---|---|
| | *Neither past due nor impaired* | | | | | |
| | *Satisfactory* | *Watch List* | *Substandard but not impaired* | *Past due but not impaired* | *Impaired* | *Total* |
| | | *BD '000* | *BD '000* | *BD '000* | *BD '000* | *BD '000* |
| Corporate Sukuk | **49,650** | - | - | - | - | **49,650** |
| Murabaha and Mudaraba financing | **120,382** | - | **9,019** | **15,250** | **3,592** | **148,243** |
| Ijarah Muntahia Bittamleek | **45,081** | **6,499** | **3,336** | **7,979** | **382** | **63,277** |
| Musharaka financing | **11,492** | **159** | - | **60** | - | **11,711** |
| Assets under conversion | **8,708** | - | - | - | - | **8,708** |
| Receivables | **13,925** | **48** | **44** | - | - | **14,017** |
| | **249,238** | **6,706** | **12,399** | **23,289** | **3,974** | **295,606** |

| | *31 December 2010* | | | | | |
|---|---|---|---|---|---|---|
| | *Neither past due nor impaired* | | | | | |
| | *Satisfactory* | *Watch List* | *Substandard but not impaired* | *Past due but not impaired* | *Impaired* | *Total* |
| | | *BD '000* | *BD '000* | *BD '000* | *BD '000* | *BD '000* |
| Corporate sukuk | 61,724 | - | - | - | - | 61,724 |
| Murabaha and Mudaraba financing | 86,476 | 1,958 | - | 9,260 | 2,948 | 100,642 |
| Ijarah Muntahia Bittamleek | 53,408 | - | 195 | 12,174 | - | 65,777 |
| Musharaka financing | 8,127 | - | - | - | - | 8,127 |
| Assets under conversion | 48,629 | - | - | - | - | 48,629 |
| Receivables | 11,276 | 41 | - | - | - | 11,317 |
| | 269,640 | 1,999 | 195 | 21,434 | 2,948 | 296,216 |

All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's rating policy. The attributable risk ratings are assessed and updated regularly.

## 20 RISK MANAGEMENT (continued)

### 20.2 Credit risk (continued)

c) Past due but not impaired Murabaha and Mudaraba financing, and Ijarah Muntahia Bittamleek are analysed as follows:

| | 31 December 2011 | | | |
|---|---|---|---|---|
| | *0-30 days* | *31-90 days* | *> 90 days* | *Total* |
| | *BD '000* | *BD '000* | *BD '000* | *BD '000* |
| Murabaha and Mudaraba financing | 4,815 | 58 | 10,378 | 15,251 |
| Ijarah Muntahia Bittamleek | 1,639 | 149 | 6,190 | 7,978 |
| Musharaka Financing | - | - | 60 | 60 |
| | 6,454 | 207 | 16,628 | 23,289 |

| | 31 December 2010 | | | |
|---|---|---|---|---|
| | *0-30 days* | *31-90 days* | *> 90 days* | *Total* |
| | *BD '000* | *BD '000* | *BD '000* | *BD '000* |
| Murabaha and Mudaraba financing | - | 7,726 | 1,534 | 9,260 |
| Ijarah Muntahia Bittamleek | - | 61 | 12,113 | 12,174 |
| | - | 7,787 | 13,647 | 21,434 |

All the past due but not impaired Murabaha and Mudaraba financing and Ijara financing are covered by collateral of BD 27,310 thousands (2010: BD 29,933 thousands). As of 31 December 2011, the Group had BD 2,975 thousands (2010: BD 2,475 thousands) as collective impairment provision and writedown of assets.

The maximum credit risk, without taking into account the fair value of any collateral and Shari'a-compliant netting agreements, is limited to the amounts on the consolidated statement of financial position plus commitments to customers disclosed in Note 19 except capital commitments.

During the year BD 30,039,000 (2010: BD 22,148,000) of financing facilities were renegotiated. All renegotiated facilities are performing and are fully secured.

At 31 December 2011, the amount of credit exposure in excess of 15% of the Group's regulatory capital to individual counterparties was nil (2010: nil).

The Group has pledged certain Sukuk with a financial institution having a carrying value of BD 11,502 thousands as at 31 December 2011 (2010: nil) against which the borrowing as at 31 December 2011 amount to BD 8,465 thousands (2010: nil). These borrowings are included in Murabaha and Wakala payables to banks.

### 20.3 Legal risk and claims

Legal risk is the risk arising from the potential that unenforceable contracts, lawsuits or adverse judgments can disrupt or otherwise negatively affect the operations of the Group. The Group has developed controls and procedures to identify legal risks and believes that losses will be minimized.

As at 31 December 2011, legal suits amounting to BD 2,030,000 (2010: BD 1,686,000) were pending against the Group. Based on the opinion of the Group's legal counsel, the total estimated liability arising from these cases is not considered to be material to the Group's consolidated financial position as the Group also has filed counter cases against these parties.

## 21 CONCENTRATIONS

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location. The Group manages its credit risk exposure through diversification of financing activities to avoid undue concentrations of risks with customers in specific locations or businesses.

The distribution of assets, liabilities and equity of investment account holders by geographic region and industry sector was as follows:

| | *Assets* 2011 BD '000 | *Liabilities, equity of investment account holders and owners' equity* 2011 BD '000 | *Contingent liabilities and Commitments* 2011 BD '000 | *Assets* 2010 BD '000 | *Liabilities, equity of investment account holders and owners' equity* 2010 BD '000 | *Commitments* 2010 BD '000 |
|---|---|---|---|---|---|---|
| **Geographic region** | | | | | | |
| GCC | 820,079 | 703,561 | 42,607 | 777,684 | 644,613 | 43,494 |
| Arab World | 5,282 | 3,774 | - | 7,584 | 3,855 | 64 |
| Europe | 32,563 | 13,257 | - | 12,088 | 3,265 | - |
| Asia | 54,459 | 2,429 | 1,421 | 49,907 | 2,737 | 2,861 |
| North America | 10,159 | 261 | - | 6,990 | 268 | - |
| Others | 1,365 | - | - | 2,345 | - | - |
| | 923,907 | 723,282 | 44,028 | 856,598 | 654,738 | 46,419 |
| Owners' equity | - | 200,625 | - | - | 201,860 | - |
| | 923,907 | 923,907 | 44,028 | 856,598 | 856,598 | 46,419 |

| | *Assets* 2011 BD '000 | *Liabilities, equity of investment account holders and owners' equity* 2011 BD '000 | *Contingent liabilities and Commitments* 2011 BD '000 | *Assets* 2010 BD '000 | *Liabilities, equity of investment account holders and owners' equity* 2010 BD '000 | *Commitments* 2010 BD '000 |
|---|---|---|---|---|---|---|
| **Industry sector** | | | | | | |
| Trading and manufacturing | 11,008 | 76,298 | 9,828 | 12,158 | 22,726 | 5,436 |
| Banks and financial institutions | 206,540 | 128,681 | 263 | 207,495 | 142,136 | 211 |
| Real estate | 256,175 | 77,670 | 11,190 | 221,884 | 102,717 | 11,732 |
| Aviation | 12,573 | 29 | - | 12,872 | 29 | - |
| Individuals | 53,179 | 336,464 | 1,853 | 49,611 | 232,667 | 2,499 |
| Government and public sector | 258,711 | 71,429 | 9,180 | 228,176 | 86,357 | 24,071 |
| Others | 125,721 | 32,711 | 11,714 | 124,402 | 68,106 | 2,470 |
| | 923,907 | 723,282 | 44,028 | 856,598 | 654,738 | 46,419 |
| Owners' Equity | - | 200,625 | - | - | 201,860 | - |
| | 923,907 | 923,907 | 44,028 | 856,598 | 856,598 | 46,419 |

## 22 MARKET RISK

Market risk arises from fluctuations in global yields on financial instruments and foreign exchange rates that could have an indirect effect on the Group's assets value and equity prices. The Board has set limits on the risk that may be accepted. This is monitored on a regular basis by the Asset and Liability Committee of the Group.

### 22.1 Equity price risk

Equity price risk arises from fluctuations in equity prices. The Board has set limits on the amount and type of investments that may be accepted. This is monitored on an ongoing basis by the Group's Investment Committee.

The effect on income (as a result of changes in the fair values of non-trading investments held at fair value through profit or loss and available-for-sale investments) solely due to reasonably possible changes in equity prices, is as follows:

| | *2011* | | | |
|---|---|---|---|---|
| | *10% increase* | | *10% decrease* | |
| | ***Effect on net profit BD '000*** | ***Effect on equity BD '000*** | ***Effect on net profit BD '000*** | ***Effect on equity BD '000*** |
| Quoted: | | | | |
| GCC | **318** | **521** | **(693)** | **(146)** |
| Arab World | **-** | **528** | **(528)** | **-** |
| Asia | **-** | **1,036** | **(718)** | **(318)** |
| Unquoted | **4,436** | **295** | **(4,436)** | **(295)** |

| | *2010* | | | |
|---|---|---|---|---|
| | *10% increase* | | *10% decrease* | |
| | *Effect on net profit BD '000* | *Effect on equity BD '000* | *Effect on net profit BD '000* | *Effect on equity BD '000* |
| Quoted: | | | | |
| GCC | 321 | 667 | (321) | (667) |
| Asia | - | 805 | - | (805) |
| Unquoted | 19,612 | 173 | (19,612) | (173) |

Assets under conversion (Note 9) include quoted equities of BD 1,457 thousands (2010: BD 1,632 thousands) and unquoted equities of BD 2,945 thousands (2010: BD 1,733 thousands). In determining the effect of price volatility on above, equity positions included in assets under conversion have been considered.

### 22.2 Profit return risk

The Group has exposure to fluctuations in the profit rates on its assets and liabilities. The Group recognises income on certain financial assets on a time-apportioned basis. The Group has set limits for profit return risk and these are monitored on an ongoing basis by the Group's Asset Liability Committee (ALCO).

The Group manages exposures to the effects of various risks associated with fluctuations in the prevailing levels of market profit rates on its financial position and cash flows.

## 22 MARKET RISK (continued)

### 22.2 Profit return risk (continued)

The effect on income solely due to reasonably possible immediate and sustained changes in profit return rates, affecting both floating rate assets and liabilities and fixed rate assets and liabilities with maturities less than one year are as follows:

| | *2011* | | | |
|---|---|---|---|---|
| | *Change in rate %* | *Effect on net profit BD '000* | *Change in rate %* | *Effect on net profit BD '000* |
| US dollars | **0.25** | **202** | **(0.25)** | **(202)** |
| Bahraini dinars | **0.25** | **409** | **(0.25)** | **(409)** |
| Sterling pounds | **0.25** | **27** | **(0.25)** | **(27)** |

| | *2010* | | | |
|---|---|---|---|---|
| | *Change in rate %* | *Effect on net profit BD '000* | *Change in rate %* | *Effect on net profit BD '000* |
| US dollars | 0.25 | 246 | (0.25) | (246) |
| Bahraini dinars | 0.25 | 483 | (0.25) | (483) |
| Sterling pounds | 0.25 | 25 | (0.25) | (25) |

In addition to profit generating Islamic financing and investment products considered in arriving at the effect on net profits, the assets under conversion includes BD 24,475,000 (2010: BD 52,150,000) financial assets and BD 7,633,000 (2010: BD 5,171,000) of financial liabilities which are interest bearing. The Group is in the process of converting these into Shari'a compliant contracts. If all the interest bearing assets and liabilities were converted into Shari'a complaint contracts on 1 January 2012, the change in profit rate by 0.25% would result in a profit or loss of BD 42,000 (2010: BD 117,000).

### 22.3 Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on positions by currency. Positions are monitored on a periodic basis by the Group's Asset Liability Committee to ensure positions are maintained within established limits.

Substantial portion of the Group's assets and liabilities are denominated in Bahrain dinars or US dollars. The Group had the following significant net long positions in foreign currencies as of 31 December :

| | ***2011*** ***BD '000*** | *2010* *BD '000* |
|---|---|---|
| US dollars | **48,825** | 24,268 |
| Saudi riyals | **43,125** | 48,003 |

## 22 MARKET RISK (continued)

### 22.3 Currency risk (continued)

The effect on income solely due to reasonably possible immediate and sustained changes in exchange rates is as follows:

| | *2011* | | | |
|---|---|---|---|---|
| | ***Change in rate %*** | ***Effect on net profit BD '000*** | ***Change in rate %*** | ***Effect on net profit BD '000*** |
| US dollars to Bahraini dinars | **1** | **488** | **(1)** | **(488)** |
| Saudi riyals to Bahraini dinars | **1** | **431** | **(1)** | **(431)** |

| | *2010* | | | |
|---|---|---|---|---|
| | *Change in rate %* | *Effect on net profit BD '000* | *Change in rate %* | *Effect on net profit BD '000* |
| US dollars to Bahraini dinars | 1 | 243 | (1) | (243) |
| Saudi riyals to Bahraini dinars | 1 | 480 | (1) | (480) |

## 23 LIQUIDITY RISK

Liquidity risk is the risk that the Group will be unable to meet its liabilities as they fall due. Liquidity risk can be caused by market disruptions or credit downgrades which may impact certain sources of funding. To mitigate this risk, management has diversified funding sources and assets are managed with liquidity in mind, maintaining an adequate balance of cash, cash equivalents and readily marketable securities. Liquidity position is monitored on an ongoing basis by the Group's Asset Liability Committee.

The table below summarises the expected maturity profile of the Group's assets and liabilities as at 31 December 2011 and 2010:

| | *31 December 2011* | | | | |
|---|---|---|---|---|---|
| | *Up to 3 months BD '000* | *3 months to 1 year BD '000* | *1 to 5 years BD '000* | *Over 5 years BD '000* | *Total BD '000* |
| **ASSETS** | | | | | |
| Cash and balances with banks and Central Bank of Bahrain | 68,218 | - | 4,100 | - | 72,318 |
| Central Bank of Bahrain Sukuk | 12,070 | 24,600 | 77,039 | 11,318 | 125,027 |
| Murabaha and Wakala receivables from banks | 135,698 | - | - | - | 135,698 |
| Corporate Sukuk | - | - | 49,650 | - | 49,650 |
| Murabaha and Mudaraba financing | 33,175 | 58,707 | 81,932 | 19,275 | 193,089 |
| Ijarah Muntahia Bittamleek | 9,309 | 8,853 | 29,096 | 19,219 | 66,477 |
| Musharaka financing | 5,781 | 407 | 5,329 | 194 | 11,711 |
| Assets under conversion | 6,042 | 6,248 | 12,000 | 3,460 | 27,750 |
| Non-trading investments | - | 14,105 | 201,263 | 7,952 | 223,320 |
| Investment in an associate | - | - | - | - | - |
| Investment properties | - | - | - | 2,500 | 2,500 |
| Receivables and prepayments | 14,886 | 392 | - | - | 15,278 |
| Premises and equipment | - | - | 1,089 | - | 1,089 |
| | 285,179 | 113,312 | 461,498 | 63,918 | 923,907 |
| **LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS** | | | | | |
| Murabaha and Wakala payables to banks | - | 10,457 | 94,116 | - | 104,573 |
| Wakala payables to non-banks | - | 284,748 | 230,399 | - | 515,147 |
| Customers' current accounts | 66,585 | - | - | - | 66,585 |
| Liabilities under conversion | 7,633 | - | - | - | 7,633 |
| Other liabilities | 10,848 | 2,101 | 139 | - | 13,088 |
| Equity of investment accountholders | - | - | 16,256 | - | 16,256 |
| | 85,066 | 297,306 | 340,910 | - | 723,282 |

## 23 LIQUIDITY RISK (continued)

| | *31 December 2010* | | | | |
|---|---|---|---|---|---|
| | *Up to 3 months BD '000* | *3 months to 1 year BD '000* | *1 to 5 years BD '000* | *Over 5 years BD '000* | *Total BD '000* |
| ASSETS | | | | | |
| Cash and balances with banks and Central Bank of Bahrain | 76,824 | - | 18,967 | - | 95,791 |
| Central Bank of Bahrain Sukuk | 20,230 | 14,510 | 33,892 | - | 68,632 |
| Murabaha and Wakala receivables from banks | 137,299 | - | - | - | 137,299 |
| Corporate Sukuk | - | - | 60,959 | - | 60,959 |
| Murabaha and Mudaraba financing | 25,016 | 37,985 | 59,607 | 11,273 | 133,881 |
| Ijarah Muntahia Bittamleek | 8,330 | 8,058 | 27,702 | 12,666 | 56,756 |
| Musharaka financing | 5,853 | 2,044 | 190 | 40 | 8,127 |
| Assets under conversion | 14,047 | 43,385 | - | - | 57,432 |
| Non-trading investments | - | 13,097 | 199,335 | - | 212,432 |
| Investment in an associate | - | - | 7,578 | - | 7,578 |
| Investment properties | - | - | - | 3,373 | 3,373 |
| Receivables and prepayments | 11,394 | 1,085 | - | - | 12,479 |
| Premises and equipment | - | - | 1,859 | - | 1,859 |
| | 298,993 | 120,164 | 410,089 | 27,352 | 856,598 |
| LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS | | | | | |
| Murabaha and Wakala payables to banks | - | - | 101,300 | - | 101,300 |
| Wakala payables to non-banks | - | 296,807 | 159,640 | - | 456,447 |
| Customers' current accounts | 57,362 | - | - | - | 57,362 |
| Liabilities under conversion | 5,171 | - | - | - | 5,171 |
| Other liabilities | 13,411 | 1,838 | 744 | - | 15,993 |
| Equity of investment accountholders | - | - | 18,465 | - | 18,465 |
| | 75,944 | 298,645 | 280,149 | - | 654,738 |

## 23 LIQUIDITY RISK (continued)

The table below summarizes the maturity profile of the Group's financial liabilities at 31 December, 2011 and 2010 based on contractual undiscounted payment obligation:

| | *31 December 2011* | | | | | |
|---|---|---|---|---|---|---|
| | *On demand BD '000* | *Up to 3 months BD '000* | *3 months to 1 year BD '000* | *1 to 5 years BD '000* | *Over 5 years BD '000* | *Total BD '000* |
| **LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS' COMMITMENTS AND CONTINGENT LIABILITIES** | | | | | | |
| Murabaha and Wakala payables to banks | - | 101,120 | 3,453 | - | - | 104,573 |
| Wakala payables to non-banks | - | 284,748 | 219,476 | 10,923 | - | 515,147 |
| Customers' current accounts | 66,585 | - | - | - | - | 66,585 |
| Liabilities under conversion | - | 7,633 | - | - | - | 7,633 |
| Equity of investment accountholders | - | 16,256 | - | - | - | 16,256 |
| Unutilised commitments | 14,576 | 901 | 5,361 | 3,578 | 9,458 | 33,874 |
| Unutilised capital commitments | - | - | - | 1,398 | - | 1,398 |
| Contingent liabilities | 6,145 | 342 | 490 | - | - | 6,977 |
| Other financial liabilities | - | 8,783 | 1,449 | 139 | - | 10,371 |
| Profit due on financing contracts | - | 2,071 | 6,864 | 811 | - | 9,746 |
| | 87,306 | 421,854 | 237,093 | 16,849 | 9,458 | 772,560 |

| | *31 December 2010* | | | | | |
|---|---|---|---|---|---|---|
| | *On demand BD '000* | *Up to 3 months BD '000* | *3 months to 1 year BD '000* | *1 to 5 years BD '000* | *Over 5 years BD '000* | *Total BD '000* |
| LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS' COMMITMENTS AND CONTINGENT LIABILITIES | | | | | | |
| Murabaha and Wakala payables to banks | - | 100,810 | 490 | - | - | 101,300 |
| Wakala payables to non-banks | - | 296,807 | 140,251 | 19,389 | - | 456,447 |
| Customers' current accounts | 57,362 | - | - | - | - | 57,362 |
| Liabilities under conversion | - | 5,171 | - | - | - | 5,171 |
| Equity of investment accountholders | - | 18,465 | - | - | - | 18,465 |
| Unutilised commitments | 12,560 | 2,513 | 1,641 | 5,749 | 13,090 | 35,553 |
| Unutilised capital commitments | - | - | - | 1,502 | - | 1,502 |
| Contingent liabilities | 1,191 | 2,277 | 4,888 | 494 | - | 8,850 |
| Other financial liabilities | - | 11,583 | 1,114 | - | - | 12,697 |
| Profit due on financing contracts | - | 1,743 | 3,442 | 2,288 | - | 7,473 |
| | 71,113 | 439,369 | 151,826 | 29,422 | 13,090 | 704,820 |

## 24 SEGMENT INFORMATION

**Primary segment information**

For management purposes, the Group is organised into four major business segments:

**Banking** - principally managing Shari'a compliant profit sharing investment accounts, and offering Shari'a compliant financing contracts and other Shari'a-compliant products. This segment comprises corporate banking, retail banking and private banking and wealth management.

**Treasury** - principally handling Shari'a-compliant money market, trading and treasury services including short-term commodity Murabaha.

**Investments** - principally the Banks' proprietary portfolio and serving clients with a range of investment products, funds and alternative investments.

**Capital** - manages the undeployed capital of the bank by investing it in high quality financial instruments, incurs all expenses in managing such investments and accounts for the capital governance related expenses.

These segments are the basis on which the Group reports its primary segment information. Transactions between segments are conducted at estimated market rates on an arm's length basis. Transfer charges are based on a pool rate which approximates the cost of funds.

Segment information is disclosed as follows:

| | *31 December 2011* | | | | |
|---|---|---|---|---|---|
| | ***Banking*** ***BD '000*** | ***Treasury*** ***BD '000*** | ***Investments*** ***BD '000*** | ***Capital*** ***BD '000*** | ***Total*** ***BD '000*** |
| Operating income | **7,881** | **4,581** | **(2,421)** | **2,699** | **12,740** |
| Segment result | **2,926** | **3,638** | **(4,357)** | **(1,710)** | **497** |
| **Other information** | | | | | |
| Segment assets | **228,470** | **322,645** | **294,722** | **78,070** | **923,907** |
| Segment liabilities, and equity | **585,102** | **118,818** | **8,494** | **211,493** | **923,907** |

| | *31 December 2010* | | | | |
|---|---|---|---|---|---|
| | *Banking* *BD '000* | *Treasury* *BD '000* | *Investments* *BD '000* | *Capital* *BD '000* | *Total* *BD '000* |
| Operating income | 11,854 | 2,890 | 5,108 | 2,527 | 22,379 |
| Segment result | 3,855 | 1,866 | 2,070 | (475) | 7,316 |
| **Other information** | | | | | |
| Segment assets | 195,713 | 324,322 | 249,994 | 86,569 | 856,598 |
| Segment liabilities, and equity | 517,737 | 120,220 | 8,318 | 210,323 | 856,598 |

**Secondary segment information**

The Group primarily operates in the GCC and derives substantially all its operating income and incurs all operating expenses in the GCC.

## 25 FIDUCIARY ASSETS

Funds under management at the year-end amounted to BD 54,759 thousands (2010: BD 48,137 thousands). These assets are held in a fiduciary capacity and are not included in the consolidated statement of financial position.

## 26 SHARI'A SUPERVISORY BOARD

The Group's Shari'a Supervisory Board consists of four Islamic scholars who review the Group's compliance with general Shari'a principles and specific fatwa's, rulings and guidelines issued by the Group's Shari'a supervisory Board. Their review includes examination of evidence relating to the documentation and procedures adopted by the Group to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

## 27 FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Group's financial instruments are not significantly different from their carrying values as at 31 December 2011 and 2010.

## 28 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

During the year, the Bank received income totaling BD 7,000 (2010: BD 8,000) from conventional financial institutions on current account balances during the year. These funds were held as payable to charity as they are in the nature of Shari'a prohibited income.

## 29 SOCIAL RESPONSIBILITY

The Group discharges its social responsibility through charity fund expenditures and donations to the good faith qard fund which is used for charitable purposes. During the year the Group paid an amount of BD 60,000 (2010: BD 213,000) on account of charitable donations.

## 30 ZAKAH

Pursuant to a resolution of the shareholders in an EGM held on 12 November 2009, it was resolved to amend the articles of association of the Bank to inform the shareholders of their obligation to pay Zakah on income and net worth. Consequently, Zakah is not recognized in the consolidated income statement as an expense. The total Zakah payable by the shareholders for 2011 has been determined by the Shari'a supervisory board as 3.4 fils (2010: 3.5 fils) per share.

Pursuant to the Shari'a Supervisory Board's directive, the prohibited income earned from the subsidiary's operations should be purified by the Group from the date of conversion. Since the Subsidiary's operations are not fully compliant with Shari'a Rules and Principles, the prohibited income has been calculated and disclosed (Note 9). The Shareholders should purify the amount of prohibited income attributable to each share by donating the relevant amounts of such prohibited income to charity. The prohibited income to be donated by each shareholder for 2011 has been determined by the Shari'a Supervisory Board as 1.05 fils per share (2010: 2.06 fils).

## 31 CAPITAL ADEQUACY

The adequacy of the Group's capital is monitored using, primarily, the rules and ratios established by the Basel Committee on Grouping Supervision and adopted by the Central Bank of Bahrain. The primary objective of the Group's capital management is to ensure that it complies with externally imposed capital requirements. The Group complied in full with all externally imposed capital requirements during the years ended 31 December 2011 and 31 December 2010.

The risk assets ratio calculations, in accordance with the 'Basel II' capital adequacy guidelines of the Central Bank of Bahrain are as follows:

| | ***2011*** | *2010* |
|---|---|---|
| | ***BD '000*** | *BD '000* |
| Capital base (Tier 1) | **172,872** | 172,765 |
| Credit risk weighted exposures | **653,391** | 631,566 |
| Market risk weighted exposures | **3,416** | 9,700 |
| Operational risk weighted exposures | **36,767** | 58,372 |
| Total risk weighted exposure | **693,574** | 699,638 |
| Capital adequacy | **24.9%** | 24.7% |
| Minimum requirement | **12.0%** | 12.0% |