Bahrain Islamic Bank B.S.C.

UNIFIED SHARI'A SUPERVISORY BOARD REPORT, REPORT OF THE BOARD OF DIRECTORS, INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS AND CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2012

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مملكة البحرين
هاتف ١١١ ٥٤٦ ١٧ ٩٧٣+
فاكس ٨٠٨ ٥٣٥ ١٧ ٩٧٣+

بنك البحرين الإسلامي BisB

Sharia'a Supervisory Board report for 2012

In The Name of Allah, most Gracious, most Merciful Peace and Blessings Be Upon His Messenger.

To the shareholders of **Bahrain Islamic Bank B.S.C.**

Assalam Alaykum Wa Rahmatu Allah Wa Barakatoh.

Pursuant to the powers entrusted to the Sharia'a Supervisory Board to supervise the Bank's activities, we hereby submit the following report.

The Sharia'a Supervisory Board monitored the operations, related to the Bank throughout the year ended 31 December 2012 to express opinion on the Bank's adherence to the provisions and principles of Islamic Sharia'a in its activities by following the guidelines and decisions issued by the Sharia'a Supervisory Board. The Sharia'a Supervisory Board believes that ensuring the conformity of its activities and investments with the provisions of Islamic Sharia'a is the sole responsibility of the Bank's Management while the Sharia'a Supervisory Board is only responsible for expressing an independent opinion and preparing a report thereabout.

The Sharia'a Supervisory Board's monitoring function included the checking of documents and procedures to scrutinize each operation carried out by the Bank, whether directly or through the Sharia'a Internal Audit department. We planned with the Sharia'a Internal Audit department to carry out monitoring functions by obtaining all the information and clarifications that were deemed necessary to confirm that the Bank did not violate the principles and provisions of Islamic Sharia'a. The Sharia'a Internal Audit department audited the Bank's transactions and submitted a report to the Sharia'a Supervisory Board. The report confirmed the Bank's commitment and conformity to the Sharia'a Supervisory Board's opinions.

The Sharia'a Supervisory Board obtained data and clarifications it deemed necessary to confirm that the Bank did not violate the principles and provisions of Islamic Sharia'a. It held several meetings throughout the year ended 31 December 2012 and replied to inquiries, in addition to approving a number of new products presented by the Management. The Sharia'a Supervisory Board discussed with the Bank's officials all transactions carried out by the Management throughout the year and reviewed the Bank's conformity with the provisions and principles of Islamic Sharia'a as well as the resolutions and guidelines of the Sharia'a Supervisory Board.

The Sharia'a Supervisory Board believes that:

1. Contracts, operations and transactions conducted by the Bank throughout the year ended 31 December 2012 were in accordance with the standard contracts pre-approved by the Sharia'a Supervisory Board.
2. The distribution of profit on investment accounts was in line with the basis and principles approved by the Sharia'a Supervisory Board.
3. Any gains resulted from sources or means prohibited by the provisions and principles of Islamic Sharia'a, have been directed to the Charity and Donations Account according to SSB's resolution.
4. Zakah was calculated according to the provisions and principles of Islamic Sharia'a. And the shareholders should pay their portion of Zakah on their shares as stated in the financial report.
5. The Bank was committed to the Sharia'a standards issued by the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI).

We pray that Allah may grant all of us further success and prosperity.

Dr. Shaikh A. Latif Mahmood Al Mahmood
Chairman

Shaikh Mohammed Jaffar Al Juffairi
Vice Chairman

Shaikh Adnan Abdullah Al Qattan
Member

Shaikh Nedham M. Saleh Yacoubi
Member

Shaikh Dr. Essam Khalaf Al Onazi
Member

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بنك البحرين الإسلامي BisB

Bahrain Islamic Bank B.S.C.

REPORT OF THE BOARD OF DIRECTORS

The Directors have pleasure in submitting their report and the audited consolidated financial statements for the year ended 31 December 2012.

Principal activities and review of business developments

The Group principal activities are to carry out banking and other financial trading activities in accordance with the teachings of Islam (Shari'a). The Bank operates under a retail banking license issued by the Central Bank of Bahrain (CBB). The Bank's Shari'a Supervisory Board is entrusted to ensure the Bank's adherence to Shari'a rules and principles in its transactions and activities.

Results for the year

The Group incurred a loss of BD 36,195 thousand during the year ended 31 December 2012 as compared to a loss of BD 17,352 thousand in the previous year.

Movement in accumulated losses

	2012 ***BD '000***	*2011* *BD '000*
Balance as at 1 January	**(43,936)**	(26,626)
Transfer of accumulated losses to share premium	**43,936**	-
Transfer from fair value reserve on investment properties	**-**	42
Loss for the year	**(36,195)**	(17,352)
	(36,195)	(43,936)

Auditors

Ernst & Young have expressed their willingness to continue in office and a resolution proposing their appointment as auditors of the Group, for the year ending 31 December 2013, will be submitted to the Annual General Meeting.

Signed on behalf of the Board

Chairman

12 February 2013

Ernst & Young

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF BAHRAIN ISLAMIC BANK B.S.C.

We have audited the accompanying consolidated statement of financial position of Bahrain Islamic Bank B.S.C. ["the Bank"] and its subsidiaries ["the Group"] as of 31 December 2012, and the related consolidated statements of income, cash flows, changes in owners' equity, sources and uses of good faith qard fund and sources and uses of zakah and charity fund 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.

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 management, 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 financial position of the Group as of 31 December 2012, the results of its operations, its cash flows, changes in owners' equity, sources and uses of good faith qard fund and sources and uses of zakah and charity fund for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

Ernst & Young

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF BAHRAIN ISLAMIC BANK B.S.C.

Other Matters

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), 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 2012 that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by 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

12 February 2013
Manama, Kingdom of Bahrain

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2012

	Notes	2012 BD'000	2011 BD'000
ASSETS			
Cash and balances with banks and Central Bank	3	**43,893**	41,681
Due from banks and financial institutions	4	**132,424**	148,813
Murabaha receivables	5	**227,757**	201,972
Musharaka investments	6	**90,220**	92,853
Investments	7	**96,288**	109,922
Investment in associates	8	**7,143**	7,151
Investment in Ijarah assets	9	**10,599**	9,496
Ijarah muntahia bittamleek	10	**96,846**	97,416
Investment properties	11	**106,351**	115,008
Ijarah rental receivables		**13,766**	7,873
Other assets	12	**7,517**	6,958
TOTAL ASSETS		**832,804**	839,143
LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY			
Liabilities			
Customers' current accounts		**87,132**	85,096
Other liabilities	13	**14,649**	14,507
Total Liabilities		**101,781**	99,603
EQUITY OF INVESTMENT ACCOUNTHOLDERS			
Financial institutions' investment accounts	14	**87,690**	108,879
Customers' investment accounts	14	**573,570**	529,332
Total Equity of Investment Accountholders		**661,260**	638,211
Owners' Equity			
Share capital	15	**93,967**	93,967
Treasury shares		**(563)**	(563)
Share premium		**-**	43,936
Reserves		**(23,641)**	(36,011)
Total Owners' Equity		**69,763**	101,329
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY		**832,804**	839,143
COMMITMENTS AND CONTINGENT LIABILITIES	17	**10,285**	10,099

Khalid Abdulla Al Bassam Chairman	Nabil Ahmed Ameen Board Member	Mohammed Ebrahim Mohammed Chief Executive Officer

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

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2012

	Notes	*2012 BD'000*	*2011 BD'000*
INCOME			
Income from Islamic finances	18	**27,378**	29,676
Income from investment in sukuk		**3,284**	3,353
		30,662	33,029
Gross return to equity of investment accountholders		**28,496**	26,688
Group's share as a Mudarib		**(14,503)**	(11,946)
Return on equity of investment accountholders		**13,993**	14,742
Group's share of income from joint financing and investment accounts		**16,669**	18,287
Net income from investments	19	**2,172**	858
Gain on sale of equity type instruments carried at fair value through equity		**654**	1,315
Share of results of associates		**200**	165
Fee and commission income		**4,741**	3,930
Other income		**39**	1,637
Total income		**24,475**	26,192
EXPENSES			
Staff costs		**10,471**	9,959
Depreciation		**1,640**	1,690
Other expenses	20	**7,504**	7,919
Total expenses		**19,615**	19,568
Net income before fair value adjustment for investment properties and net provision for impairment		**4,860**	6,624
Fair value adjustment for investment properties	11	**(9,772)**	(2,570)
Net provision for impairment	21	**(31,283)**	(21,406)
NET LOSS FOR THE YEAR		**(36,195)**	(17,352)
BASIC AND DILUTED EARNINGS PER SHARE (fils)	23	**(38.67)**	(20.71)

Khalid Abdulla Al Bassam Chairman	Nabil Ahmed Ameen Board Member	Mohammed Ebrahim Mohammed Chief Executive Officer

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

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2012

	Notes	**2012 BD'000**	2011 BD'000
OPERATING ACTIVITIES			
Net loss for the year		**(36,195)**	(17,352)
Adjustments for non-cash items:			
Depreciation		**1,640**	1,690
Net provision for impairment	21	**31,283**	21,406
Fair value adjustment for investment properties		**9,772**	2,570
Gain on sale of equity type instruments carried at fair value through equity		**(654)**	(1,315)
Share of results of associates	8	**(200)**	(165)
Unrealised loss on equity type instruments carried at fair value through statement of income		**(271)**	293
Operating profit before changes in operating assets and liabilities		**5,375**	7,127
Working capital adjustments:			
Mandatory reserve with Central Bank of Bahrain		**(2,010)**	625
Due from banks and financial institutions		**(26,983)**	(815)
Murabaha receivables		**(34,169)**	7,820
Musharaka investments		**(4,538)**	(8,627)
Investment in Ijarah assets		**(1,234)**	-
Other assets		**(2,389)**	2,809
Customers' current accounts		**2,036**	3,436
Other liabilities		**2,794**	1,963
Net cash (used in) from operating activities		**(61,118)**	14,338
INVESTING ACTIVITIES			
Purchase of investment properties		**(1,116)**	(9,815)
Ijarah Muntahia Bittamleek		**(7,446)**	2,354
Purchase of investments		**(44,256)**	(28,848)
Proceeds from disposal of investments		**50,369**	40,951
Net cash (used in) from investing activities		**(2,449)**	4,642
FINANCING ACTIVITIES			
Rights Issue		**-**	21,108
Purchase of treasury shares		**-**	(256)
Financial institutions' investment accounts		**(21,189)**	(32,980)
Customers' investment accounts		**44,238**	(70,191)
Dividends paid		**(2,651)**	(9)
Zakah paid		**(1)**	(185)
Net cash from (used in) financing activities		**20,397**	(82,513)
NET CHANGE IN CASH AND CASH EQUIVALENTS		**(43,170)**	(63,533)
Cash and cash equivalents at 1 January		**163,063**	226,596
CASH AND CASH EQUIVALENTS AT 31 DECEMBER		**119,893**	163,063
Cash and cash equivalents at year end comprise of:			
Cash on hand		**7,157**	7,120
Balances with CBB, excluding mandatory reserve deposits		**3,715**	2,736
Balances with banks and other financial institutions		**4,766**	5,580
Due from banks and financial institutions with original maturities less than 90 days		**104,255**	147,627
		119,893	163,063

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

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

For the year ended 31 December 2012

				Reserves						
	Share capital BD'000	*Treasury shares BD'000*	*Share premium BD'000*	*Statutory reserve BD'000*	*General reserve BD'000*	*Fair value reserve on investment properties BD'000*	*Cumulative changes in fair value of investments BD'000*	*Accumulated losses BD'000*	*Proposed appropriations BD'000*	*Total owners' equity BD'000*
Balance at 1 January 2012	93,967	(563)	43,936	10,268	1,000	-	(3,343)	(43,936)	-	101,329
Net loss for the year	-	-	-	-	-	-	-	(36,195)	-	(36,195)
Net movement in cumulative changes in fair value of investments	-	-	-	-	-	-	4,629	-	-	4,629
Transfer of accumulated losses to share premium (note 15)	-	-	(43,936)	-	-	-	-	43,936	-	-
Balance at 31 December 2012	**93,967**	**(563)**	**-**	**10,268**	**1,000**	**-**	**1,286**	**(36,195)**	**-**	**69,763**
Balance at 1 January 2011	72,859	(307)	43,936	10,268	1,000	42	(1,278)	(26,626)	167	100,061
Right Issue	21,108	-	-	-	-	-	-	-	-	21,108
Purchase of treasury shares (note 15)	-	(256)	-	-	-	-	-	-	-	(256)
Zakah paid	-	-	-	-	-	-	-	-	(167)	(167)
Net loss for the year	-	-	-	-	-	-	-	(17,352)	-	(17,352)
Transfer from fair value reserve on investment properties	-	-	-	-	-	(42)	-	42	-	-
Net movement in cumulative changes in fair value of investments	-	-	-	-	-	-	(2,065)	-	-	(2,065)
Transfer of accumulated losses to share premium (note 15)	- -	-	-	-	-	-	-	-	-	-
Balance at 31 December 2011	93,967	(563)	43,936	10,268	1,000	-	(3,343)	(43,936)	-	101,329

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

CONSOLIDATED STATEMENT OF SOURCES AND USES OF GOOD FAITH QARD FUND

For the year ended 31 December 2012

	Qard hasan receivables BD'000	*Funds available for qard hasan BD'000*	*Total BD'000*
Balance at 1 January 2012	2	126	128
Uses of qard fund			
Marriage	53	(53)	-
Refurbishment	11	(11)	-
Medical treatment	15	(15)	-
Others	6	(6)	-
Total uses during the year	**85**	**(85)**	-
Repayments	(72)	72	-
Balance at 31 December 2012	**15**	**113**	**128**
Balance at 1 January 2011	4	124	128
Uses of qard fund			
Marriage	27	(27)	-
Refurbishment	16	(16)	-
Medical treatment	14	(14)	-
Others	11	(11)	-
Total uses during the year	68	(68)	-
Repayments	(70)	70	-
Balance at 31 December 2011	2	126	128

	2012 BD'000	*2011 BD'000*
Sources of qard fund		
Contribution by the Bank	**125**	125
Donation	**3**	3
	128	128

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

CONSOLIDATED STATEMENT OF SOURCES AND USES OF ZAKAH AND CHARITY FUND

For the year ended 31 December 2012

	2012	*2011*
	BD'000	*BD'000*
Sources of zakah and charity funds		
Undistributed zakah and charity funds at the beginning of the year	**209**	541
Zakah due from the Bank for the year	**-**	-
Non-Islamic income / late fee	**694**	67
Donations	**-**	200
Total sources of zakah and charity funds during the year	**903**	808
Uses of zakah and charity funds		
Philanthropic societies	**462**	311
Aid to needy families	**383**	288
Total uses of funds during the year	**845**	599
Undistributed zakah and charity funds at the end of the year	**58**	209

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

1 INCORPORATION AND ACTIVITIES

Bahrain Islamic Bank B.S.C. (the "Bank") was incorporated in the Kingdom of Bahrain in the year 1979 by Amiri Decree No.2 of 1979, under Commercial Registration (CR) number 9900, to carry out banking and other financial trading activities in accordance with the teachings of Islam (Shari'a). The Bank operates under a retail banking license issued by the Central Bank of Bahrain (CBB). The Bank's Shari'a Supervisory Board is entrusted to ensure the Bank's adherence to Shari'a rules and principles in its transactions and activities. The Bank is listed on Bahrain Bourse.

The Bank holds 100% of the share capital of both Abaad Real Estate Company B.S.C. (c) and BisB MMF Company B.S.C. (c) ("Subsidiaries");

Abaad Real Estate Company B.S.C. (c) ("Subsidiary")
The Subsidiary was incorporated in the Kingdom of Bahrain on 8 April 2003 with an authorised and fully paid-up share capital of BD 25 million. The Subsidiary has started operations during the year 2007. The main activities of the Subsidiary are the management and development of real estate (in accordance with the Islamic Shari'a rules and principles).

BisB MMF Company B.S.C. (c) ("Subsidiary")
The Subsidiary was incorporated in the Kingdom of Bahrain as a closed joint stock company and registered with the Ministry of Industry and Commerce under Commercial Registration (CR) number 81322-1. The postal address of the Company is registered at, Building 722, Road 1708, Block 317, Diplomatic Area, Kingdom of Bahrain. The purpose of the Subsidiary is limited to establishing funds (in accordance with the Islamic Shari'a rules and principles).

The Bank's registered office is at Building 722, Road 1708, Block 317, Manama, Kingdom of Bahrain.

The Bank has thirteen branches (2011: thirteen), all operating in the Kingdom of Bahrain.

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 12 February 2013.

2 SIGNIFICANT ACCOUNTING POLICIES

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

a. Basis of preparation
The consolidated financial statements have been prepared on a historical cost basis, except for "investment properties", "equity type instruments carried at fair value through equity" and "equity type instruments carried at fair value through statement of income" that have been measured at fair value.

The consolidated financial statements have been presented in Bahraini Dinars ("BD"), being the functional currency of the Group's operations. All the values are rounded to the nearest BD thousand except when otherwise indicated.

b. Statement of Compliance
The consolidated financial statements are prepared in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ('AAOIFI'), the Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Group, the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law and 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 In accordance with the requirements of AAOIFI, for matters for which no AAOIFI standard exists, the Group uses the relevant International Financial Reporting Standards ('the IFRS') issued by International Accounting Standards Board.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

c. Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries (together referred to as the "Group") as at 31 December each year. A subsidiary is an entity over which the Bank has power to control, which is other than fiduciary in nature. The financial statements of the subsidiaries is prepared for the same reporting year as the Bank, using consistent accounting policies.

The subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtained control, and continues to be consolidated until the date that such control ceases. Control is achieved where the Group has direct ownership of more than 50% of the voting rights over the subsidiaries. Where the Group has the power, directly or indirectly, to govern the financial and operating policies of the entity so as to obtain benefits from its activities.

Losses within the subsidiaries are attributed to the non-controlling interest even if that results in a deficit balance.

The results of the subsidiaries acquired or disposed off during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate.

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

The Bank has two fully owned subsidiaries, Abaad Real Estate Company B.S.C. (c) and BisB MMF Company B.S.C. (c) which are consolidated in these financial statements.

d. Cash and cash equivalents

For the purpose of the consolidated cash flows statement, "cash and cash equivalents" consist of cash on hand, balances with the Central Bank of Bahrain, balances with banks and other financial institutions, with original maturities of 90 days or less.

e. Due from banks and financial institutions

Due from banks and financial institutions comprise commodity murabaha receivables and wakala receivables. Commodity murabaha receivables are stated net of deferred profits and provision for impairment, if any. Wakala receivables are stated at cost less provision for impairment, if any.

f. Murabaha receivables

Murabaha receivables consist mainly of deferred sales transactions (Murabaha) which are stated net of deferred profits and provisions for impairment, if any.

Murabaha receivables are sales on deferred terms. The Group arranges a murabaha transaction by buying a commodity (which represents the object of the murabaha) and then resells this commodity to Murabeh (beneficiary) after computing a margin of profit over cost. The sale price (cost plus profit margin) is repaid in instalments by the Murabeh over the agreed period.

g. Musharaka

Musharaka is stated at the fair value of consideration given less impairment, if any.

Musharaka is a form of capital partnership. These are stated at fair value of consideration given less any impairment. Musharaka capital provided by the Group at inception in kind (if other than cash) is measured at the fair value of the assets. If the valuation of the assets results in difference between fair value and book value, such difference is recognised as profit or loss to the Group.

h. Investments

Investments comprise of debt type instrument carried at amortised cost, equity type instrument carried at fair value and equity type instrument carried at fair value through statement of income.

All investments, are initially recognised at cost, being the fair value of the consideration given including acquisition charges associated with the investment, except in the case of investment carried at fair value through statement of income.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

h. Investments (continued)

Debt type instrument carried at amortised cost
Investments which have fixed or determinable payments and where the Group has both the intent and ability to hold to maturity are classified as debt type instrument carried at amortised cost. Such investments are carried at amortised cost, less provision for impairment in value. Amortised cost is calculated by taking into account any premium or discount on acquisition. Any gain or loss on such type instruments recognised in the consolidated statement of income, when the type instruments de-recognised or impaired.

Equity type instrument carried at fair value through equity
Subsequent to acquisition, equity type instruments are remeasured at fair value, with unrealised gains and losses recognised in a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment, the cumulative gain or loss previously recorded in equity is recognised in the consolidated statement of income for the year.

Impairment losses on equity type instruments carried at fair value through equity are not reversed through the consolidated statement of income and increases in their fair value after impairment are recognised directly in owners' equity.

Equity type instrument carried at fair value through statement of income
These are subsequently re-measured at fair value. All related realised and unrealised gains or losses are included in the consolidated statement of income.

i. Determination of fair value
For investments traded in organised financial markets, fair value is determined by reference to quoted market bid prices at the close of business on the consolidated statement of financial position date.

For investment where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the 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 at current profit rates for contracts with similar term and risk characteristics.

For Murabaha receivables the fair value is determined at the Bank at the end of the financial period at their cash equivalent value.

j. Investment in associates
The Group's investment in associates are accounted for under the equity method of accounting. Associates are entities over which the Group exercises significant influence but not control and which are neither subsidiaries nor joint ventures. Under the equity method, the investment in associates are carried in the consolidated statement of financial position at cost, plus post-acquisition changes in the Group's share of net assets of the associate, less any impairment in value. The consolidated statement of income reflects the Group's share of the results of its associates. Where there has been a change recognised directly in the equity of the associates, the Group recognises its share of any changes and discloses this, when applicable, in the consolidated statement of changes in owners' equity. Unrealised profits and losses resulting from transactions between the Group and its associate are eliminated to the extent of the Group's interest in the associate.

The Group determines at each consolidated statement of financial position date whether there is any objective evidence that the investment in associate is impaired. If this is the case the Group calculates the amount of impairment as being the difference between the fair value of the associate and the carrying value and recognises the amount in the consolidated statement of income.

The reporting dates of the associates and the Group are identical and the associates accounting policies conform to those used by the Group for like transaction and events in similar circumstances.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

k. Ijarah assets, Ijarah Muntahia Bittamleek

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

Depreciation is calculated using the straight-line method on all Ijarah Muntahia Bittamleek other than land (which is deemed to have indefinite life), at rates calculated to write off the cost of each asset over its useful life.

For Ijarah assets, the depreciation is calculated using the straight-line method, at rates calculated to write off the cost of the assets over its estimated useful life. The estimated useful lives of the assets for calculation of depreciation ranges between 10 to 35 years.

l. Investment properties

Properties held for rental, or for capital appreciation purposes, or both, are classified as Investment properties. Investment properties are initially recorded at cost, being the fair value of the consideration given and acquisition charges associated with the property. Subsequent to initial recognition, Investment properties are re-measured at fair value and changes in fair value are recognised in the consolidated statement of income.

In accordance with AAOIFI, such gains or losses are appropriated to fair value reserve on investment properties at year end. Upon realisation, these gain/losses are transferred to retained earnings from fair value reserve on investment properties.

m. Equipment

Equipment are initially recognised at cost. The cost of additions and major improvements are capitalised; maintenance and repairs are charged to the consolidated statement of income as incurred. Gains or losses on disposal are reflected in other income. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets.

The calculation of depreciation is on the following basis:

Office furniture and equipment	3 to 5 years
Vehicles	3 years
Others	1 to 3 years

n. Equity of investment accountholders

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

Equity of investment accountholders share of income is calculated based on the income generated from investment accounts after deducting Mudarib share. 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 income from jointly financed Islamic finances less shareholders' "Bank" income). Portion of the income generated from equity of investment accountholders will be deducted as Mudarib share and the remaining will be distributed to the equity of investment accountholders.

o. Investment risk reserve

Investment risk reserves are amounts appropriated out of the income of equity of investment accountholders, after allocating the Mudarib share, in order to cater against future losses for equity of investment accountholders.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

p. Profit equalisation reserve
The Group appropriates a certain amount in excess of the profit to be distributed to equity of investment accountholders after taking into consideration the Mudarib share of income. This is used to maintain a certain level of return on investment for equity of investment accountholders.

q. Zakah
Zakah is calculated on the Zakah base of the Group in accordance with FAS 9 issued by the AAOIFI using the net invested funds method. Zakah is paid by the Group based on the consolidated figures of statutory reserve, general reserve and retained earning balances at the beginning of the year. The remaining Zakah is payable by individual shareholders. Payment of Zakah on equity of investment accountholders and other accounts is the responsibility of investment accountholders.

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

s. Dividends
Dividends to shareholders are recognised as liabilities in the year in which they are declared.

t. Derecognition of financial assets and liabilities

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

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

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

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

u. Treasury shares
These are own equity instruments of the Group which are reacquired through its own broker. Treasury shares are deducted from equity and accounted for at weighted average cost. Consideration paid or received on the purchase, sale, issue or cancellation of the Group's own equity instruments is recognised directly in equity. No gain or loss is recognised in consolidated statement of income on the purchase, sale, issue or cancellation of own equity instruments.

v. Earnings prohibited by Shari'a
The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity fund where the Group uses these funds for social welfare activities.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

w. Joint and self financed

Investments, financing and receivables that are jointly funded by the Group and the equity of investment accountsholders are classified under the caption "jointly financed" in the consolidated financial statements. Investments, financing and receivables that are funded solely by the Bank are classified under "self financed".

x. Offsetting

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

y. Revenue recognition

Murabaha receivables

Income is recognised by proportionately allocating the attributable profits over the deferred period whereby each financial period carries its portion of profits irrespective of when cash is received. Income related to accounts that are 90 days overdue is excluded from the consolidated statement of income.

Musharaka investments

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

Due from banks and financial institutions

Income on amounts due from banks and financial institutions is recognised on a time apportioned basis over the period of the contract based on the principal amounts outstanding and the profit agreed with clients.

Ijarah Muntahia Bittamleek

Income from Ijarah Muntahia Bittamleek are recognised on a time-apportioned basis over the lease term. The Ijarah Muntahia Bittamleek Income is net of depreciation. Income related to non performing Ijarah Muntahia Bittamleek is excluded from the consolidated statement of income.

Dividends income

Dividends are recognised when the right to receive payment is established.

Income from Ijarah assets

Rental income is accounted for on a straight-line basis over the Ijarah terms.

Fee and commission income

Fee and commission income is recognised when earned.

Group's share as a Mudarib

The Group's share as a Mudarib for managing equity of investment accountholders is accrued based on the terms and conditions of the related mudaraba agreements.

Income allocation

Income is allocated proportionately between equity of investment accountholders and shareholders on the basis of the average balances outstanding during the year.

z. Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into Bahraini Dinars at the rate of exchange ruling at the consolidated statement of financial position date. All differences are taken to the consolidated statement of income.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

z. Foreign currencies (continued)

Translation gains or losses on non-monetary items carried at fair value are included in owners' equity as part of the fair value adjustment.

aa. Impairment of financial assets

An assessment is made at each consolidated financial position date to determine whether there is objective evidence that a specific financial asset or a group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the assessment by the Group of the estimated cash equivalent value, is recognised in the consolidated statement of income. Specific provisions are created to reduce all impaired financial contracts to their realisable cash equivalent value. Financial assets are written off only in circumstances where effectively all possible means of recovery have been exhausted. Impairment is determined as follows:

(a) For assets carried at fair value, impairment is the difference between cost and fair value, less any impairment loss previously recognised in the consolidated statement of income;

(b) For assets carried at cost, impairment is the difference between carrying value and the present value of future cash flows discounted at the current market rate of return for a similar financial asset; and

(c) For assets carried at amortised cost, impairment is the difference between carrying amount and the present value of future cash flows discounted at the original effective profit rate.

For equity type instruments carried at fair value through equity, impairment losses recognised in the consolidated statement of income for an investment equity instrument shall not be reversed through the consolidated statement of income and should be recorded as increases in cumulative changes in fair value through equity.

bb. Use of estimates and judgements in preparation of the consolidated financial statements

In the process of applying the Group's accounting policies, management has made estimates and judgements in determining the amounts recognised in the consolidated financial statements. The most significant use of judgments and estimates are as follows:

Going concern

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

Impairment

The Group assesses at each consolidated statement of financial position date whether there is objective evidence that a specific asset or a group of assets may be impaired. An asset or a group of assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred "loss event") and that loss event(s) have an impact on the estimated future cash flows of the asset or the group of the assets that can be reliably estimated.

Collective impairment provision

Impairment is assessed collectively for losses on Islamic financing facilities that are not individually significant and for individually significant facilities where there is not yet objective evidence of individual impairment. Collective impairment is evaluated on each reporting date with each portfolio receiving a separate review.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

bb. Use of estimates and judgements in preparation of the consolidated financial statements (continued)

Fair valuation of investments
The determination of fair values of unquoted investments requires management to make estimates and assumptions that may affect the reported amount of assets at the date of the consolidated financial statements. The valuation of such investments is based on the fair value criteria explained in note 2.k above.

Nonetheless, the actual amount that is realised in a future transaction may differ from the current estimate of fair value and may still be outside management estimates, given the inherent uncertainty surrounding valuation of unquoted investments.

Classification of investments
Management decides on acquisition of a financial asset whether it should be classified as equity type instrument carried at fair value through equity or through statement of income.

Fair value of investment properties
The fair value of investment properties are determined by independent real estate valuation experts based on recent real estate transactions with similar characteristics and locations.

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

dd. Employees' end of service benefits
Provision is made for amounts payable under the Bahrain Labour law applicable to non-Bahraini employees' accumulated periods of service at the date of the consolidated statement of financial position, subject to completion of a minimum period of employment.

Bahraini employees of the Group are covered by contributions made to the General Organisation of Social Insurance Scheme (GOSI) as a percentage of the employees' salaries. The Group's obligations are limited to these contributions, which are expensed when due.

ee. Shari'a supervisory board
The Group's business activities are subject to the supervision of a Shari'a Supervisory Board consisting of five members appointed by the general assembly.

3 CASH AND BALANCES WITH BANKS AND CENTRAL BANK

	2012	*2011*
	BD'000	*BD'000*
Cash on hand	**7,157**	6,550
Balances with CBB, excluding mandatory reserve deposits	**3,715**	2,736
Balances with banks and other financial institutions	**4,766**	6,150
	15,638	15,436
Mandatory reserve with CBB	**28,255**	26,245
	43,893	41,681

The mandatory reserve with CBB is not available for use in the day-to-day operations.

4 DUE FROM BANKS AND FINANCIAL INSTITUTIONS

	Jointly financed **2012** **BD'000**	*Jointly financed* 2011 BD'000
Commodity murabaha	**61,589**	112,408
Deferred profits	**(32)**	(37)
	61,557	112,371
Wakala receivables	**70,867**	36,442
	132,424	148,813

5 MURABAHA RECEIVABLES

	Jointly financed **2012** **BD'000**	*Jointly financed* 2011 BD'000
Tawarooq	**103,845**	108,207
Tasheel	**144,528**	101,105
Letters of credit	**13,275**	53,829
Motor vehicles	**13,002**	11,965
Credit cards	**8,588**	6,092
Building	**339**	592
Building materials	**144**	348
Land	**182**	298
Furniture	**154**	159
	284,057	282,595
Qard fund	**15**	2
Gross receivables	**284,072**	282,597
Deferred profits	**(35,252)**	(28,207)
Net provision for impairment (note 21)*	**(21,063)**	(52,418)
	227,757	201,972

Non-performing Murabaha receivables outstanding as of 31 December 2012 amounted to BD 63,306 thousand (2011: BD 92,697 thousand).

The Group considers the promise made in the Murabaha to the purchase orderer as obligatory.

* This includes collective impairment provision of BD 2,688 thousand (2011: BD 5,513 thousand).

The composition of the gross Murabaha receivables portfolio before provision for impairment geographically and by sector is as follows:

	2012			*2011*		
	Europe BD'000	**Middle East BD'000**	**Total BD'000**	Europe BD'000	Middle East BD'000	Total BD'000
Commercial	**-**	**67,703**	**67,703**	-	120,016	120,016
Financial institutions	**7,061**	**25,306**	**32,367**	-	24,914	24,914
Others including retail	**-**	**148,750**	**148,750**	-	109,460	109,460
	7,061	**241,759**	**248,820**	-	254,390	254,390

6 MUSHARAKA INVESTMENTS

	Jointly financed 2012 BD'000	*Jointly financed 2011 BD'000*
Musharaka investment in real estate	**97,687**	93,149
Net provision for impairment (note 21)	**(7,467)**	(296)
	90,220	92,853

Non-performing Musharaka investments outstanding as of 31 December 2012 amounted to BD 33,056 thousand (2011: BD 25,650 thousand).

7 INVESTMENTS

	2012			*2011*		
	Self financed BD'000	***Jointly financed BD'000***	***Total BD'000***	*Self financed BD'000*	*Jointly financed BD'000*	*Total BD'000*
i) Debt type instruments carried at amortised cost						
Unquoted investments						
Sukuk						
At 1 January	-	**56,851**	**56,851**	-	65,075	65,075
Acquisitions	-	**25,462**	**25,462**	-	22,833	22,833
Disposals and redemptions	-	**(37,907)**	**(37,907)**	-	(31,057)	(31,057)
At 31 December	-	**44,406**	**44,406**	-	56,851	56,851
ii) Equity type instruments carried at fair value through equity						
Quoted investments						
Equity shares						
At 1 January	**18,793**	-	**18,793**	20,309	-	20,309
Acquisitions	**10,495**	-	**10,495**	3,837	-	3,837
Movement in fair market value	**1,265**	-	**1,265**	(1,173)	-	(1,173)
Disposals	**(5,633)**	-	**(5,633)**	(4,180)	-	(4,180)
At 31 December	**24,920**	-	**24,920**	18,793	-	18,793
Unquoted investments						
Equity shares						
At 1 January	**14,129**	-	**14,129**	14,320	-	14,320
Disposals	-	-	-	(191)	-	(191)
At 31 December	**14,129**	-	**14,129**	14,129	-	14,129
Managed funds						
At 1 January	**37,760**	-	**37,760**	40,025	-	40,025
Acquisitions	**2,746**	-	**2,746**	188	-	188
Movement in fair market value	**1,851**	-	**1,851**	-	-	-
Disposals	**(270)**	-	**(270)**	(2,453)	-	(2,453)
At 31 December	**42,087**	-	**42,087**	37,760	-	37,760

7 INVESTMENTS (continued)

iii) Equity type instruments carried at fair value through statement of income

Quoted investments						
Equity shares						
At 1 January	**1,163**	**-**	**1,163**	1,191	-	1,191
Acquisitions	**5,553**	**-**	**5,553**	413	-	413
Movement in fair market value	**269**	**-**	**269**	-	-	-
Disposals	**(6,559)**	**-**	**(6,559)**	(441)	-	(441)
At 31 December	**426**	**-**	**426**	1,163	-	1,163
Total investment before provision for impairment at 31 December	**81,562**	**44,406**	**125,968**	71,845	56,851	128,696
Net provision for impairment on						
Debt type instruments (note 21)	**-**	**(3,357)**	**(3,357)**	-	(153)	(153)
Equity type instruments (note 21)	**(26,323)**	**-**	**(26,323)**	(18,621)	-	(18,621)
	(26,323)	**(3,357)**	**(29,680)**	(18,621)	(153)	(18,774)
	55,239	**41,049**	**96,288**	53,224	56,698	109,922

8 INVESTMENT IN ASSOCIATES

Investments in associates comprise the following:

	Ownership %	*Country of incorporation*	*Self financed 2012 BD'000*	*Self financed 2011 BD'000*
Quoted				
Insurance				
*Takaful International Company B.S.C.**	**22.75%**	**Kingdom of Bahrain**	**1,650**	1,830
Unquoted				
Financial Institution				
Liquidity Management Centre B.S.C. (c)	**25.00%**	**Kingdom of Bahrain**	**5,493**	5,321
			7,143	7,151

* Takaful International Company B.S.C. is a listed company on the Bahrain Bourse. The latest available quoted price of BD 0.290 per share was as of 10 January 2010, no further trades have commenced on the company's shares since this date.

The following table summarises the latest associates' financial information :

	2012				
	Total assets BD'000	***Total liabilities BD'000***	***Total contingent liabilities BD'000***	***Total revenue BD'000***	***Net profit BD'000***
Takaful International Company B.S.C.	**34,878**	**26,184**	**-**	**9,299**	**552**
Liquidity Management Centre B.S.C. (c)	**62,952**	**40,981**	**5,833**	**3,042**	**636**

8 INVESTMENT IN ASSOCIATES (continued)

	2011				
	Total assets BD'000	*Total liabilities BD'000*	*Total contingent liabilities BD'000*	*Total revenue BD'000*	*Net profit BD'000*
Takaful International Company B.S.C.	31,058	23,013	-	8,524	608
Liquidity Management Centre B.S.C. (c)	77,025	55,741	7,500	2,733	123

Takaful International Company B.S.C. was incorporated in 1989, it carries out takaful and retakaful activities in accordance with the teachings of Islamic Shari'a. The total revenue represents both the revenue of the General Takaful and Family Takaful for the year ended 31 December 2012 and does not represent the shareholders' revenue only.

Liquidity Management Centre B.S.C. (c) was incorporated in 2002 to facilitate the creation of an Islamic inter-bank market that will allow Islamic financial services institutions to effectively manage their assets and liabilities.

9 INVESTMENT IN IJARAH ASSETS

	2012 Self financed			2011 Self financed		
	Land BD'000	buildings BD'000	Total BD'000	Land BD'000	buildings BD'000	Total BD'000
Book value:						
At 1 January	6,600	5,640	12,240	6,600	5,640	12,240
Acquisition during the year	1,234	-	1,234	-	-	-
At 31 December	7,834	5,640	13,474	6,600	5,640	12,240
Depreciation:						
At 1 January	-	2,744	2,744	-	2,605	2,605
Provided during the year	-	131	131	-	139	139
At 31 December	-	2,875	2,875	-	2,744	2,744
Net book value:						
At 31 December	7,834	2,765	10,599	6,600	2,896	9,496

10 IJARAH MUNTAHIA BITTAMLEEK

	2012 Jointly financed					2011 Jointly financed				
	Land BD'000	Buildings BD'000	Aviation related assets BD'000	Others BD'000	Total BD'000	Land BD'000	Buildings BD'000	Aviation related assets BD'000	Others BD'000	Total BD'000
Cost:										
At 1 January	37,391	47,075	16,102	6,413	106,981	36,420	58,370	11,833	6,332	112,955
Additions	3,505	14,396	363	1,718	19,982	2,629	11,591	13,962	81	28,263
Disposals	(1,983)	(4,699)	(5,308)	(546)	(12,536)	(1,658)	(22,886)	(9,693)	-	(34,237)
At 31 December	38,913	56,772	11,157	7,585	114,427	37,391	47,075	16,102	6,413	106,981
Depreciation:										
At 1 January	-	6,080	1,401	392	7,873	-	6,315	1,254	-	7,569
Provided during the year	-	5,243	744	531	6,518	-	2,781	590	392	3,763
Relating to disposed assets	-	(625)	-	-	(625)	-	(3,016)	(443)	-	(3,459)
At 31 December	-	10,698	2,145	923	13,766	-	6,080	1,401	392	7,873
Net provision for impairment (note 21)	(2,501)	(1,314)	-	-	(3,815)	-	(1,692)	-	-	(1,692)
Net book value:										
As at 31 December	36,412	44,760	9,012	6,662	96,846	37,391	39,303	14,701	6,021	97,416

Impaired Ijarah Muntahia Bittamleek as of 31 December 2012 is BD 32,630 thousand (2011: BD 29,549 thousand).

11 INVESTMENT PROPERTIES

	Self financed 2012 BD'000	*Self financed 2011 BD'000*
Book value:		
At 1 January	**115,008**	105,150
Additions	**1,115**	12,386
Book value at 31 December	**116,123**	117,536
Fair value adjustment for investment properties	**(9,772)**	(2,570)
Transfer from fair value reserve on investment properties	**-**	42
Fair value at 31 December	**106,351**	115,008

Investment properties comprises of properties located in the Kingdom of Bahrain and United Arab Emirates.

Investment properties are stated at fair value, which have been determined based on valuations performed by independent valuators and industry specialists in valuing these types of investment properties.

12 OTHER ASSETS

	2012 BD'000	*2011 BD'000*
Fixed assets (net)	**5,623**	4,590
Receivables from related parties	**1,855**	2,130
Staff advances	**864**	1,123
Other Receivables	**756**	756
Prepaid expenses	**400**	407
Income receivable	**388**	355
Receivables under letter of credit	**196**	196
Others	**1,044**	650
	11,126	10,207
Net provision for impairment (note 21)	**(3,609)**	(3,249)
	7,517	6,958

13 OTHER LIABILITIES

	2012 BD'000	*2011 BD'000*
Payable to vendors	**4,566**	2,328
Accrued expenses	**2,582**	2,318
Unearned income	**1,829**	1,050
Managers' cheques	**1,722**	1,580
Life insurance fees payable	**1,644**	1,635
Dividends payable	**817**	3,468
Provision for employees' end of service benefits and leave	**564**	546
Zakah and charity fund	**58**	209
Margin on letters of credit	**44**	47
Others	**823**	1,326
	14,649	14,507

14 EQUITY OF INVESTMENT ACCOUNTHOLDERS

The Group maintains an investment risk reserve amounted to BD 63 thousand (2011: nil) and did not maintain a profit equalisation reserve throughout the year ended 31 December 2012 and 2011 respectively.

As equity of investment accountholders' funds are commingled with the Group's funds for investment, no priority is granted to any party for the purpose of investments and distribution of profits.

The Group's share, as Mudarib, in the profits of equity of investment accountholders is up to a maximum of 65% (2011: 65%).

14.1 Profit Distribution by Type of Account

The following table represents the distribution of profit by type of equity of investment accountholders:

	2012		*2011*	
Account Type	***Percentage of funds invested***	***Distributed profit rate***	*Percentage of funds invested*	*Distributed profit rate*
Defined deposits	**85%**	**1.91%**	87%	1.95%
Specific investment deposits	**85%**	**3.54%**	95%	3.49%
Investment certificates	**85%**	**3.93%**	90%	4.00%
Savings accounts	**45%**	**0.57%**	45%	0.70%
Iqra	**90%**	**2.88%**	85%	3.00%
Tejoori	**45%**	**0.56%**	45%	0.70%
Vevo	**45%**	**0.57%**	45%	0.70%

14.2 Equity of Investment Accountholders Balances

Type of Equity of Investment Accountholders	***2012 BD'000***	*2011 BD'000*
Financial Institutions investment accounts		
Contractual basis*	**87,669**	108,773
Others	**21**	106
	87,690	108,879
Customer investment accounts		
Balances on demand	**192,850**	170,624
Contractual basis*	**376,643**	355,281
Others	**4,077**	3,427
	573,570	529,332
	661,260	638,211

* These can be withdrawn subject to a monetary penalty

15 OWNERS' EQUITY

		2012 BD'000	2011 BD'000
(i)	Share capital		
a)	*Authorised*		
	2,000,000,000 shares (2011: 2,000,000,000 shares) of BD 0.100 each	**200,000**	200,000
b)	*Issued and fully paid up*		
	939,673,499 shares (2011: 939,673,499 shares) of BD 0.100 each	**93,967**	93,967

a) Authorised Share Capital
The shareholders in their extra-ordinary general meeting held on 8 February 2011 resolved to increase the Bank's authorised share capital from 1,000,000,000 shares of BD 0.100 each to 2,000,000,000 shares of BD 0.100 each.

b) Share Capital
The shareholders in their extra-ordinary general meeting held on 8 February 2011 resolved to increase the Bank's paid up capital by BD 54.64 million through rights issue to existing shareholders at a price of BD 0.100 per share. The Bank collected subscriptions of BD 21.11 million up to 22 June 2011, and the Board of Directors has decided to close the capital increase at this amount. The total number of shares issued and fully paid as of 31 December 2012 is BD 939,673,499 (31 December 2011: BD 939,673,499).

c) Share premium
Amounts collected in excess of the par value of the issued share capital during any new issue of shares, net of issue expenses, are treated as share premium. This amount is not available for distribution, but can be utilised as stipulated by the Bahrain Commercial Companies Law.

During the year the Bank has proposed netting accumulated losses amounting to BD 43,936 thousand against the share premium. This proposed netting was approved by the shareholders in their annual general meeting held on 21 March 2012.

(ii) Treasury Shares	2012		2011
	Number of Shares	BD'000	BD'000
At 1 January	**3,620,609**	**563**	307
Purchase of treasury shares	**-**	**-**	256
At 31 December	**3,620,609**	**563**	563

	2012 BD'000
Cost of treasury shares	**563**
Market value of treasury shares	**297**

The treasury shares as a percentage of total shares in issue is 0.39%

Owners' equity instruments which are reacquired are deducted from equity. No gain or loss is recognised in the consolidated statement of income on the purchase, sale, issue or cancellation of the Group's own equity instruments.

15 OWNERS' EQUITY (continued)

(iii) Reserves

Statutory reserve
As required by Bahrain Commercial Companies Law and the Group's articles of association, 10% of the net income for the year should be transferred to the statutory reserve. The Group may resolve to discontinue such annual transfers when the reserve totals 50% of paid up share capital. No transfer has been made for the current year as there was a net loss for the year. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of CBB.

General reserve
The general reserve is established in accordance with the articles of association of the Group and is distributable following a resolution of shareholders at a general meeting and the approval of CBB. The Group may transfer any amount to the general reserve, as approved by the shareholders at a general meeting, out of the net income for the year after appropriating statutory reserve.

Fair value reserve on investment properties
This represents cumulative unrealised revaluation gains or losses on investment properties. This reserve is transferred to the retained earnings upon sale of the investment properties.

Cumulative changes in fair value of investments
This represents the net unrealised gains or losses on equity investments relating to self financed investments.

(iv) Additional information on shareholding pattern
1) Names and nationalities of the major shareholders and the number of shares in which they have an interest of 5% or more of outstanding shares:

		2012		*2011*	
Names	***Nationality***	***Number of shares***	***% holding***	*Number of shares*	*% holding*
The Investment Dar Company	Kuwait	**372,632,690**	**39.66%**	372,632,690	39.66%
Islamic Development Bank	Saudi	**165,804,485**	**17.64%**	165,804,485	17.64%
Kuwait Investment Company S.A.K	Kuwait	**110,962,471**	**11.81%**	110,962,471	11.81%
General Council of Kuwaiti Awaqaf	Kuwait	**67,946,033**	**7.23%**	67,946,033	7.23%

2) The Group has only one class of shares and the holders of these shares have equal voting rights.

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

	2012			*2011*		
	Number of shares	***Number of shareholders***	***% of total outstanding shares***	*Number of shares*	*Number of shareholders*	*% of total outstanding shares*
Less than 1%	**154,442,981**	**3,412**	**16.44%**	154,442,981	3,441	16.44%
1% up to less than 5%	**67,884,839**	**3**	**7.22%**	67,884,839	3	7.22%
5% up to less than 10%	**67,946,033**	**1**	**7.23%**	67,946,033	1	7.23%
10% up to less than 50%	**649,399,646**	**3**	**69.11%**	649,399,646	3	69.11%
	939,673,499	**3,419**	**100.00%**	939,673,499	3,448	100.00%

15 OWNERS' EQUITY (continued)

(iv) Additional information on shareholding pattern (continued)

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

Categories:

	2012		*2011*	
	No. of shares	***No. of directors***	*No. of shares*	*No. of directors*
Less than 1%	**4,042,601**	**9**	3,854,371	6

The following is the number of shares, and percentage of shareholding of Directors, Shari'a supervisory members and Senior management (Assistant General Managers and above):

	2012		*2011*	
	No. of shares	***Percentage Shareholdin***	*No. of shares*	*Percentage Shareholdin*
Directors	**4,042,601**	**0.43%**	3,854,371	0.41%
Shari'a supervisory members	**205,725**	**0.02%**	205,725	0.02%
Senior management	**100,000**	**0.01%**	161,687	0.02%
	4,348,326	**0.46%**	4,221,783	0.45%

16 CAPITAL ADEQUACY

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

The Group's capital structure is primarily made of its paid-up capital, including share premium and reserves. From regulation's perspective, the significant amount of the Group's capital are in Tier 1 form as defined by the CBB, i.e. most of the capital are of permanent nature.

The Group's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of financing facilities growth expectations for each business group, expected growth in off-balance sheet facilities and future sources and uses of funds.

The classification of the Group's capital in accordance with the regulatory requirements is as follows:

	2012	*2011*
	BD'000	*BD'000*
Core capital - Tier 1:		
Issued and fully paid ordinary shares	**93,404**	93,404
General reserves	**1,000**	1,000
Legal / statutory reserves	**10,267**	10,268
Share premium	**-**	43,936
Retained earnings / losses (excluding current year net income/loss)	**-**	(25,000)
Less:		
Net loss for the year	**(36,195)**	(17,100)
Unrealised gross losses arising from fair valuing equity securities	**(638)**	(4,611)
Tier 1 Capital before deductions	**67,838**	101,897
Supplementary capital - Tier 2:		
Asset revaluation reserve (45% only)	**-**	-
Unrealised gains arising from fair valuing equities (45% only)	**593**	315
Investment risk reserve	**63**	315
Other reverse	**2,688**	-
Tier 2 Capital before deductions	**3,344**	630
Total available capital	**71,182**	102,527
Deductions		
Significant minority interest in banking, securities and financial entities	**(5,493)**	(5,321)
Excess amount over materiality threshold	**-**	(10,741)
Investment in insurance entity greater than or equal to 20%	**(1,650)**	(1,830)
Excess amount over maximum permitted large exposure limit	**-**	(12,057)
Total eligible capital	**64,039**	72,578

To assess its capital adequacy requirements in accordance to the CBB requirements, the Group adopts the Standardised Approach for its Credit Risk, Basic Indicator Approach for its Operational Risk and Standardised Measurement Approach for its Market Risk. The Capital requirements for these risks are as follows:

16 CAPITAL ADEQUACY (continued)

	2012 BD'000	2011 BD'000
Total Credit Risk Weighted Assets	**459,478**	467,064
Total Market Risk Weighted Assets	**17,063**	14,288
Total Operational Risk Weighted Assets	**43,497**	52,968
Total Regulatory Risk Weighted Assets	**520,038**	534,319
Capital Adequacy Ratio	**12.31%**	13.58%
Minimum requirement	**12%**	12%

17 COMMITMENTS AND CONTINGENT LIABILITIES

Credit related commitments

These include commitments to enter into financing contracts which are designed to meet the requirements of the Group's customers.

Letters of credit and guarantees commit the Group to make payments on behalf of customers.

The Group has the following credit related commitments and contingent liabilities on behalf of customers:

	2012 BD'000	2011 BD'000
Letters of credit and acceptances	**2,239**	1,650
Guarantees	**7,522**	7,934
Operating lease commitments *	**524**	515
	10,285	10,099

* The Group has entered into commercial leases for certain branches. These leases have an average life of between 4 months and 5 years with renewal terms included in the contracts. Renewals are at the option of the specific entity that holds the lease. There are no restrictions placed upon the lessee by entering into these leases.

Future minimum rentals payable under non-cancellable operating leases as at 31 December are as follows:

	2012 BD'000	2011 BD'000
Within one year	**219**	289
After one year but not more than five years	**305**	226
	524	515

18 INCOME FROM JOINTLY FINANCED SALES AND INVESTMENTS

	2012 *BD'000*	*2011* *BD'000*
Income from Islamic finances:		
Income from Murabaha receivables	**14,679**	14,687
Income on amounts due from banks and financial institutions	**814**	1,028
Income from Musharaka investments	**5,321**	6,240
Income from Ijarah Muntahia Bittamleek - net *	**6,564**	7,721
	27,378	29,676

* The details of Income from Ijarah Muntahia Bittamleek is as follows:

	2012 *BD'000*	*2011* *BD'000*
Income from Ijarah Muntahia Bittamleek – gross	**13,082**	11,484
Depreciation during the year (note 10)	**(6,518)**	(3,763)
	6,564	7,721

19 NET INCOME FROM INVESTMENTS

	2012 *BD'000*	*2011* *BD'000*
Dividend income	**1,487**	865
Unrealised gain / (loss) on equity type instruments carried at fair value through statement of income	**271**	(293)
Income from investment in ijarah assets	**414**	286
	2,172	858

20 OTHER EXPENSES

	2012 *BD'000*	*2011* *BD'000*
Marketing and advertisement expenses	**1,623**	1,688
Professional, consultancy, and lawyer fees	**1,199**	650
Credit and debit cards expenses and charges	**1,074**	641
Communication expenses	**867**	874
Information technology related expenses	**724**	1,077
Premises Expenses	**624**	593
Expenses on Ijarah assets	**414**	415
Travelling and transportation expenses	**241**	186
Board of directors sitting fees	**210**	240
Stationary expenses	**175**	237
Brokerage fees and commission	**40**	76
Gifts and donations	**24**	224
Shari'a supervisory board fees	**11**	38
Shari'a supervisory board remuneration	**-**	34
Other miscellaneous expenses	**278**	946
	7,504	7,919

21 PROVISION FOR IMPAIRMENT

2012	*Murabaha receivables BD'000*	*Ijarah muntahia bittamleek BD'000*	*Musharaka investments BD'000*	*Investments BD'000*	*Other assets BD'000*	*Total BD'000*
Provisions at 1 January	52,418	1,692	296	18,774	3,249	76,429
Written off	(40,446)	-	-	(1,632)	-	(42,078)
Witten back	(3,955)	(669)	-	(86)	-	(4,710)
Provided	13,046	2,792	7,171	12,624	360	35,993
	9,091	2,123	7,171	12,538	360	31,283
Net provisions at 31 December	21,063	3,815	7,467	29,680	3,609	65,634
Non-performing	63,306	32,630	33,056	51,331	3,609	183,932
Notes	5	10	6	7	12	

2011	*Murabaha receivables BD'000*	*Ijarah muntahia bittamleek BD'000*	*Musharaka investments BD'000*	*Investments BD'000*	*Other assets BD'000*	*Total BD'000*
Provisions at 1 January	31,608	3,502	3,363	13,537	3,249	55,259
Written off	(236)	-	-	-	-	(236)
Witten back	(2,375)	(1,939)	(3,126)	(2,373)	-	(9,813)
Provided	23,421	129	59	7,610	-	31,219
	21,046	(1,810)	(3,067)	5,237	-	21,406
Net provisions at 31 December	52,418	1,692	296	18,774	3,249	76,429
Non-performing	92,697	29,549	25,650	23,582	3,249	174,727
Notes	5	10	6	7	12	

The fair value of collateral that the Group holds relating to non performing facilities at 31 December 2012 amounts to BD 142,617 thousand (31 December 2011: BD 97,573 thousand). The collateral consists of cash, securities and properties. The utilisation of the above collaterals will be on a customer by customer basis and will be limited to the customer's total exposure.

The Group has taken all the provision allocated to the non performing assets to their own capital. Hence the equity of investment accountholders was not charged for any of the provision for impairment.

22 ZAKAH

The total Zakah payable as of 31 December 2012 amounted to BD 1,163 thousand (2011: BD 2,188 thousand) of which the Bank has no Zakah payable (2011: BD nil) on the statutory reserve, general reserve and retained earning as at 1 January 2012. The Zakah balance amounting to BD 1,163 thousand or 1.2 fils per share (2011: BD 2,188 thousand or 2.3 fils per share) is due and payable by the shareholders.

23 EARNINGS PER SHARE

Basic and diluted earnings per share is calculated by dividing the net loss for the year by the weighted average number of shares during the year as follows:

	2012	*2011*
Net loss for the year in BD'000	**(36,195)**	(17,352)
Weighted average number of shares	**936,053**	837,718
Basic and diluted earnings per share (fils)	**(38.67)**	(20.71)

23 EARNINGS PER SHARE (continued)

There have been no transactions during the year which caused dilution of the earnings per share.

24 RELATED PARTY TRANSACTIONS

Related parties represent associated companies, major shareholders, directors, key management personnel of the Group and Shari'a Supervisory Board members.

The balances and values of major transactions with the related parties are as follows:

Related party	*Transaction*	*Income (expense)* 2012 BD'000	*Income (expense)* 2011 BD'000	*Balances at 31 December* 2012 BD'000	*Balances at 31 December* 2011 BD'000
Shareholders*	Sukuk	-	-	**4,197**	4,197
Shareholders**	Tawarooq	-	509	**7,817**	7,817
Shareholders	Investment properties	-	-	**14,200**	15,693
Shareholders***	Receivable	-	-	**1,855**	2,130
Associate	Wakala	**61**	57	**9,592**	3,533
Associate	Investment	**200**	165	**7,143**	7,151
Board of Directors	Musharaka	**3**	24	-	79
Board of Directors	Expenses	**(210)**	(240)	-	-
Board of Directors	Tawarooq	-	-	**24**	-
Shari'a Supervisory Board	Expenses	**(11)**	(72)	-	-
Shari'a Supervisory Board	Murabaha	**4**	41	**39**	594
Shari'a Supervisory Board	Musharaka	**10**	13	**293**	148
Shari'a Supervisory Board	Tawarooq	**50**	47	**596**	675
Shari'a Supervisory Board	Letter of credit	**49**	38	**668**	564
Key management personnel	Staff advances	-	-	**275**	332
Key Management personnel	Staff - Credit Cards	-	-	**47**	38
Board of Directors	Credit Cards	-	-	**26**	195
Shari'a Supervisory Board	Credit Cards	-	-	**12**	9
Associate	Customers' investment accounts	**(5)**	(6)	**2,373**	252
Associate	Current accounts	-	-	**581**	1,164
Associate	Life Insurance - Liabilities	-	-	**1,644**	1,635
Board of Directors	Customers' current accounts	-	-	**38**	2
Board of Directors	Customers' investment accounts	**(9)**	-	**363**	-
Shari'a Supervisory Board	Customers' investment accounts	**(3)**	-	**80**	44
Shari'a Supervisory Board	Customers' current accounts	-	-	**421**	181

* An amount of BD 4,197 thousand (2011: BD 4,197 thousand) is considered as impaired for which provision of BD 3,357 (2011: BD nil) has been made.

** An amount of BD 7,817 thousand (2011: BD 7,817 thousand) is considered as impaired for which provision of BD 3,428 thousand (2011: BD 2,052 thousand) has been made.

*** An amount of BD 1,553 (2011: BD 1,553 thousand) is considered as impaired for which provision of BD 1,553 (2011: BD 1,553 thousand) has been made.

Compensation of the key management personnel is as follows:
Key management personnel includes the staff in grade of assistant general manager and above.

	2012 BD'000	*2011 BD'000*
Short term employee benefits	**921**	959
Other long term benefits	**149**	116
	1,070	1,075

25 RISK MANAGEMENT

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. These risks and the processes to mitigate these risks have not significantly altered from the previous year.

The Group is exposed mainly to credit, liquidity, market and operational risks.

Risk management objectives
The risk management philosophy of the Group is to identify, capture, monitor and manage the various dimensions of risk with the objective of protecting asset values and income streams such that the interest of the Group's shareholders (and others to whom the Group owes a liability) are safeguarded, while maximising the returns intended to optimise the Group's shareholder return while maintaining it's risk exposure within self-imposed parameters.

The Group has defined its risk appetite within the parameters of its risk strategy. The Group reviews and realigns its risk appetite as per the evolving business plan of the Group with changing economic and market scenarios. The Group also assesses its tolerance for specific risk categories and its strategy to manage these risks.

Risk appetite of the Group is articulated in terms of the following dimensions:

1. Adequate capital level;
2. Stable profitability and growth;
3. Sufficient liquidity; and
4. Sound reputation.

Structure and Organization of Risk Management Function
Risk Management Structure includes all levels of authorities, organizational structure, people and systems required for the smooth functioning of risk management processes in the Group. The responsibilities associated with each level of risk management structure and authorities include the following:

The Board retains ultimate responsibility and authority for all risk matters, including:

a. Establishing overall policies and procedures; and
b. Delegating authority to Executive Committee, Credit Committee, Chief Executive Officer and further delegation to the management to approve and review.

Executive Committee (EC) comprises three designated members of the Board of Directors. The Executive Committee is delegated authorities by the Board to manage the ongoing activities of the Group. Decisions are taken by the Executive Committee either at periodic meetings or if the need arises, by circulation.

Credit and Investment Committee (CIC): As delegated by the Board of Directors and as per approved terms of reference, the Committee has been delegated with the authorities and responsibilities including, approving extension or renewal of credit facilities, granting temporary excesses to customers with credit facilities approved by the Board, approving early repayments of facilities, monitoring the performance and quality of the Group's credit portfolio and overseeing the administration and effectiveness of and compliance with, the Group's credit policies through the review of such processes, reports and other information as it deems appropriate.

Risk Measurement and Reporting Systems
Based on the risk appetite, the Group has put in place various limits. These limits have been approved by the Board. Any limit breach is reported by Risk Management Department (RMD) to the Credit Committee. The limits are reviewed and revised, if necessary at least annually (or earlier if required).

25 RISK MANAGEMENT (continued)

a) 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.

Type of credit risk

Financing contracts mainly comprise of commodity Murabaha, Wakala receivables, Murabaha receivables, Musharaka investments and Ijarah Muntahia Bittamleek.

Due from banks and financial institutions

Due from banks and financial institutions comprise commodity murabaha receivables and wakala receivables.

Murabaha receivables

The Group finances these transactions through buying the commodity which represents the object of the Murabaha contract and then resells this commodity to the Murabeh (beneficiary) at a profit. The sale price (cost plus profit margin) is repaid in instalments by the Murabeh over the agreed period. The transactions are secured at times by the object of the Murabaha contract (in case of real estate finance) and other times by a total collateral package securing the facilities given to the Murabeh.

Musharaka investments

Musharaka is a form of partnership between the Group and its clients whereby each party contributes to the capital of partnership in equal or varying degrees to establish a new project or share in an existing one, whereby each of the parties becomes an owner of the capital on a permanent or declining basis. Profits are shared in an agreed ratio, but losses are shared in proportion to the amount of capital contributed.

Ijarah Muntahia Bittamleek

The legal title of the assets under Ijarah Muntahia Bittamleek only passes to the lessee at the end of the Ijarah term, through gift, consideration or gradual sale, provided that all Ijarah instalments are settled.

Credit Risk Mitigation

Credit risk mitigation refers to the use of a number of techniques, like collaterals, guarantees and credit derivatives (Shari'a compliant protection) to mitigate the credit risks that the Group is exposed to. Credit risk mitigants reduce the credit risk by allowing the Group to protect against counterparty non-performance of credit contracts through collaterals, netting agreements, guarantees and credit derivatives (Shari'a compliant protection).

Generally, the Group extends credit facilities only where supported by adequate tangible collateral security and/or audited financial statements. Facilities may be considered without adequate tangible collateral security, when audited financial statements reveal satisfactory financial position/repayment ability and the facilities are properly structured supported by assignments, guarantees, etc. as appropriate. Name lending (i.e. lending without audited financial statements and tangible collateral security) is discouraged and is approved only on an exceptional basis after careful analysis of the quality of the customer, market reputation, approximate personal net worth etc.

In general, personal guarantees of the partners/promoters/directors of the borrowing entity are obtained in support of credit facilities. In all cases, a statement of net worth of the guarantor is to be compiled by the Account Officer, so that adequate information is available at a future date in case the guarantees need to be enforced.

Notwithstanding the above, when facilities are extended to family owned limited liability entities, the following is normally obtained;

a. Collateral security, fully covering the exposure; or

b. Joint and several guarantees of shareholders directly involved in managing the entity as well as of shareholders owing at least 80% of the shares of the entity.

25 RISK MANAGEMENT (continued)

a) Credit Risk (continued)

Credit Risk Mitigation (continued)

Third party guarantees in support of credit facilities are accepted only after review and approval of appropriate guarantor lines.

(i) Gross maximum exposure to credit risk

The market value of tangible collateral security are properly evaluated by the Group approved valuators (for properties) or based on publicly available quotations. Only the Loan-able Value of such security are taken into account while considering credit facilities.

From time to time, the CIC reviews and approves the Loan-able Value of securities. It has also approved a list of acceptable securities.

The table below shows the gross maximum exposure to credit risk for the components of the consolidated statement of financial position, including credit related commitments. The figures represent gross exposure, without taking account of any collateral held or other credit enhancements.

	2012 ***BD'000***	*2011* *BD'000*
Cash and balances with the banks and Central Bank	**36,736**	35,131
Due from banks and financial institutions	**132,424**	148,813
Murabaha receivables	**227,757**	201,972
Musharaka investments	**90,220**	92,853
Investments	**96,288**	109,922
Ijarah muntahia bittamleek	**96,846**	97,416
Ijarah rental receivables	**13,766**	7,873
Other assets	**1,166**	1,968
	695,203	695,948
Letters of credit, guarantees and acceptances	**9,761**	9,584

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

Concentrations of credit risk 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 of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location. The Group seeks to manage its credit risk exposure through diversification of financing activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses.

25 RISK MANAGEMENT (continued)

a) Credit Risk (continued)

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

The distribution of the Group's assets, liabilities, equity of investment accountholders, commitments and contingent liabilities by geographic region and industry sector is as follows:

	Assets		*Liabilities and equity of investment accountholders*		*Commitments and contingent liabilities*	
	31 December 2012 BD'000	*31 December 2011 BD'000*	***31 December 2012 BD'000***	*31 December 2011 BD'000*	***31 December 2012 BD'000***	*31 December 2011 BD'000*
Geographical region						
North America	**2,289**	2,194	**78**	-	-	-
Europe	**18,399**	24,306	**5,826**	5,587	**325**	325
Middle East	**811,109**	811,081	**757,133**	732,223	**9,960**	9,774
Rest of Asia	**1,007**	1,562	**4**	4	-	-
	832,804	839,143	**763,041**	737,814	**10,285**	10,099
Industry sector						
Trading and manufacturing	**40,637**	59,925	**28,333**	54,902	**3,437**	3,132
Aviation	**22,797**	22,944	**15,590**	22,891	**956**	731
Real Estate	**235,979**	242,611	**31,261**	13,070	**1,356**	1,017
Banks and financial institutions	**215,973**	231,269	**133,151**	154,308	**2,277**	2,307
Personal / Consumer	**227,597**	181,964	**390,405**	345,294	**274**	663
Government Organization	**28,342**	39,451	**84,538**	83,604	-	-
Others	**61,479**	60,979	**79,763**	63,745	**1,985**	2,249
	832,804	839,143	**763,041**	737,814	**10,285**	10,099

(iii) Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group using internal credit ratings. The table below shows the credit quality by class of asset, based on the Group's credit rating system.

	31 December 2012				
	Neither past due nor impaired				
	High grade BD'000	***Standard grade BD'000***	***Past due but not impaired BD'000***	***Individually impaired BD'000***	***Total BD'000***
Murabaha receivables	**-**	**163,528**	**21,986**	**63,306**	**248,820**
Musharaka investments	**2,605**	**48,564**	**13,462**	**33,056**	**97,687**
Ijarah muntahia bittamleek	**-**	**58,880**	**9,151**	**32,630**	**100,661**
Ijarah rental receivables	**-**	**13,766**	**-**	**-**	**13,766**
	2,605	**284,738**	**44,599**	**128,992**	**460,934**

25 RISK MANAGEMENT (continued)

a) Credit Risk (continued)

(iii) Credit quality per class of financial assets (continued)

	31 December 2011				
	Neither past due nor impaired				
	High grade BD'000	*Standard grade BD'000*	*Past due but not impaired BD'000*	*Individually impaired BD'000*	*Total BD'000*
Murabaha receivables	8,590	127,386	25,717	92,697	254,390
Musharaka investments	3,359	52,214	11,926	25,650	93,149
Ijarah muntahia bittamleek	-	55,714	13,845	29,549	99,108
Ijarah rental receivables	-	7,873	-	-	7,873
	11,949	243,187	51,488	147,896	454,520

* Restructured facilities during the year amounting to BD 35,057 thousand (2011: BD 72,040 thousand), the facilities restructured include BD 2,341 thousand (2011: BD 23,080 thousand) past due more than 90 days.

(iv) Aging analysis of past due but not impaired Islamic financing facilities per class of financial assets

2012	***Less than 30 days BD'000***	***31 to 60 days BD'000***	***61 to 90 days BD'000***	***Total BD'000***
Murabaha receivable	**21,721**	**205**	**60**	**21,986**
Musharaka investments	**13,018**	**438**	**6**	**13,462**
Ijarah muntahia bittamleek	**9,138**	**10**	**3**	**9,151**
	43,877	**653**	**69**	**44,599**

2011	*Less than 30 days BD'000*	*31 to 60 days BD'000*	*61 to 90 days BD'000*	*Total BD'000*
Murabaha receivable	17,570	5,708	2,439	25,717
Musharaka investments	11,697	77	152	11,926
Ijarah muntahia bittamleek	5,238	8,389	218	13,845
	34,505	14,174	2,809	51,488

b) Liquidity Risk

Liquidity risk is the risk that the Group will be unable to meet its net funding requirements when they fall due. Liquidity risk can be caused by market disruptions or credit downgrades which may cause certain sources of funding to cease immediately. To guard against this risk, the Group has a large customer base and assets are managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents, commodity Murabaha, Wakala receivables, credit lines and quoted investments.

25 RISK MANAGEMENT (continued)

b) Liquidity Risk (continued)

Maturity profile of Group's assets and liabilities
The table below summarises the maturity profile of the Group's assets and liabilities. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period at the consolidated statement of financial position date to the contractual maturity date and do not take account of the effective maturities as indicated by the Group's retention history of its equity of investment accountholders.

The maturity profile of assets, liabilities and equity of investment accountholders at 31 December 2012 was as follows:

	Up to 1 month	*1 to 3 months*	*3 to 6 months*	*6 months to 1 year*	*1 to 3 years*	*Over 3 years*	*No fixed maturity*	*Total*
	BD '000	*BD '000*	*BD '000*	*BD '000*	*BD '000*	*BD '000*	*BD '000*	*BD '000*
ASSETS								
Cash and balances with the banks and Central Bank	15,638	-	-	-	-	-	28,255	43,893
Due from banks and financial institutions	119,992	8,863	912	2,657	-	-	-	132,424
Murabaha receivables	2,054	14,892	4,102	13,254	20,394	173,061	-	227,757
Musharaka investments	4,046	2,619	253	768	11,348	71,186	-	90,220
Investments	5,356	21,153	-	-	9,061	52,288	8,430	96,288
Investment in associates	-	-	-	-	-	-	7,143	7,143
Investment in Ijarah assets	-	-	-	-	-	-	10,599	10,599
Ijarah Muntahia Bittamleek	-	-	205	1,884	4,351	90,406	-	96,846
Investment properties	-	-	-	-	-	-	106,351	106,351
Ijarah rental receivables	-	-	13,766	-	-	-	-	13,766
Other assets	209	655	528	-	-	502	5,623	7,517
Total assets	147,295	48,182	19,766	18,563	45,154	387,443	166,401	832,804
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS								
Customers' current accounts	87,132	-	-	-	-	-	-	87,132
Other liabilities	14,650	-	-	-	-	-	-	14,650
Equity of investment accountholders	189,199	114,997	80,367	270,725	3,568	-	2,404	661,260
Total liabilities and equity of investment accountholders	290,981	114,997	80,367	270,725	3,568	-	2,404	763,042
Liquidity gap	(143,686)	(66,815)	(60,601)	(252,162)	41,586	387,443	163,997	69,762
Cumulative liquidity gap	(143,686)	(210,501)	(271,102)	(523,264)	(481,678)	(94,235)	69,762	-

25 RISK MANAGEMENT (continued)

b) Liquidity risk (continued)

The maturity profile of assets, liabilities and equity of investment accountholders at 31 December 2011 was as follows:

	Up to 1 month	*1 to 3 months*	*3 to 6 months*	*6 months to 1 year*	*1 to 3 years*	*Over 3 years*	*No fixed maturity*	*Total*
ASSETS	*BD '000*	*BD '000*	*BD '000*	*BD '000*	*BD '000*	*BD '000*	*BD '000*	*BD '000*
Cash and balances with the banks and Central Bank	15,436	-	-	-	-	-	26,245	41,681
Due from banks and financial institutions	121,418	26,209	1,186	-	-	-	-	148,813
Murabaha receivables	911	8,367	7,717	22,974	20,921	141,082	-	201,972
Musharaka investments	3,245	3,359	49	411	12,007	73,782	-	92,853
Investments	-	14,493	1,131	9,966	13,322	60,043	10,967	109,922
Investment in associates	-	-	-	-	-	-	7,151	7,151
Investment in Ijarah assets	-	-	-	-	-	-	9,496	9,496
Ijarah Muntahia Bittamleek	66	-	4	-	11,190	86,156	-	97,416
Investment properties	-	-	-	-	-	-	115,008	115,008
Ijarah rental receivables	-	-	7,873	-	-	-	-	7,873
Other assets	-	-	2,368	-	-	-	4,590	6,958
Total assets	141,076	52,428	20,328	33,351	57,440	361,063	173,457	839,143
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS								
Customers' current accounts	85,096	-	-	-	-	-	-	85,096
Other liabilities	14,507	-	-	-	-	-	-	14,507
Equity investment accountholders	185,682	135,438	79,133	227,182	8,963	5	1,808	638,211
Total liabilities and equity of investment accountholders	285,285	135,438	79,133	227,182	8,963	5	1,808	737,814
Liquidity gap	(144,209)	(83,010)	(58,805)	(193,831)	48,477	361,058	171,649	101,329
Cumulative liquidity gap	(144,209)	(227,219)	(286,024)	(479,855)	(431,378)	(70,320)	101,329	-

25 RISK MANAGEMENT (continued)

c) Market Risk

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

(i) Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and equity of investment accountholders as the repricing of assets, liabilities and equity of investment accountholders occur at similar intervals. The profit distribution to equity of investment accountholders is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

However, the profit sharing agreements will result in displaced commercial risk when the Group's results do not allow the Group to distribute profits inline with the market rates.

(ii) Equity price risk

Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the investment portfolio. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

In order to measure the risk of equity on its financial positions, the Group adopts a sensitivity analysis on its quoted equity portfolio for 10% increase of the portfolio value with all other variables remain constant. The effect of a similar decrease in equity prices is expected to be equal and opposite to the effect of the increase shown.

Equity price risk variation as of 31 December is as follows;

2012	*Increase in equity price*	*Sensitivity of profit or loss*	*Sensitivity of equity*
	%	*BD'000*	*BD'000*
Bahrain Bourse	**+10**	**12**	**588**
Saudi Stock Exchange (TADAWUL)	**+10**	**14**	**610**
Oman Stock Exchange	**+10**	**16**	**394**
Kuwait Stock Exchange	**+10**	**0**	**-**
Qatar Stock Exchange	**+10**	**-**	**407**

2011	*Increase in equity price*	*Sensitivity of profit or loss*	*Sensitivity of equity*
	%	*BD'000*	*BD'000*
Bahrain Bourse	+10	29	671
Saudi Stock Exchange (TADAWUL)	+10	69	311
Oman Stock Exchange	+10	14	351
Kuwait Stock Exchange	+10	5	-
Qatar Stock Exchange	+10	-	-

As at consolidated statement of financial position date, the Group has unquoted (equities and sukuk) of BD 50 million (31 December 2011: BD 68 million). The impact of changes in the value of these unquoted equities and sukuk and the related impact on equity will only be reflected when the financial instrument is sold or deemed to be impaired.

25 RISK MANAGEMENT (continued)

c) Market Risk (continued)

iii) Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group views the Bahraini Dinar as its functional currency. The Board has set limits on positions by currency. Positions are monitored on a daily basis to ensure they are maintained within established limits.

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

	Equivalent Long (short) 2012 BD '000	*Equivalent Long (short) 2011 BD '000*
Currency		
Pound Sterling	**(1,041)**	(1,040)
Euro	**(750)**	(886)
Kuwaiti Dinars	**(14,957)**	(12,257)

As the Bahraini Dinar is pegged to the US Dollar, positions in US Dollars are not considered to represent significant currency risk.

Moreover, as the Group does not have significant exposure to other currencies, movement of the currency exchange risk against the Bahraini Dinar with other variables held constant will have an immaterial impact on the consolidated statement of income and owners' equity.

d) Operational Risk

Operational risk is the risk of loss arising from system failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

26 SEGMENTAL INFORMATION

For management purposes, the Group is organised into three major business segments;

Corporate	Principally handling corporates' equity of investment accountholders', current accounts, and providing islamic financing facilities.
Retail	Principally handling individual customers' equity of investment accountholders', current accounts, and providing islamic financing facilities.
Investment	Principally handling banks' and financial institutions' equity of investment accountholders, providing money market, trading and treasury services as well as the management of the Group's investment activities. Investment activities involve handling investments in local and international markets and investment in properties.

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 2012			
	Corporate BD'000	***Retail BD'000***	***Investment BD'000***	***Total BD'000***
Total income	**6,146**	**16,176**	**2,153**	**24,475**
Total expenses	**(3,139)**	**(13,463)**	**(3,013)**	**(19,615)**
Fair value adjustment for investment properties	**-**	**-**	**(9,772)**	**(9,772)**
Net provision for impairment	**(16,331)**	**(2,054)**	**(12,898)**	**(31,283)**
Net income (loss) for the year	**(13,324)**	**659**	**(23,530)**	**(36,195)**
Other information				
Segment assets	**213,284**	**249,645**	**369,875**	**832,804**
Segment liabilities, and equity	**243,967**	**427,159**	**161,678**	**832,804**

	31 December 2011			
	Corporate BD'000	*Retail BD'000*	*Investment BD'000*	*Total BD'000*
Total income	9,723	12,885	3,776	26,384
Total expenses	(3,371)	(13,258)	(3,131)	(19,760)
Fair value adjustment for investment properties	-	-	(2,570)	(2,570)
Net provision for impairment	(19,708)	3,538	(5,236)	(21,406)
Net income (loss) for the year	(13,356)	3,165	(7,161)	(17,352)
Other information				
Segment assets	228,799	203,450	406,894	839,143
Segment liabilities, and equity	229,284	387,410	222,449	839,143

The Group operates solely in the Kingdom of Bahrain and, as such, no geographical segment information is presented.

27 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable and willing parties in an arm's length transaction. Consequently, differences can arise between carrying values and fair value estimates.

Included under investments are equity type instruments carried at fair value through equity amounting to BD 8,842 thousand (2011: BD 10,967 thousand) which are carried at cost due to lack of other reliable methods for arriving at a reliable fair value for these investments.

The estimated fair value of the Group's financial instruments are not significantly different from their book values as at the consolidated statement of financial position.

28 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a qard fund account where the Group uses these funds for various social welfare activities. The movements in these funds is shown in statement of sources and uses of good faith qard fund. The non-Islamic income includes the penalties charged on late repayments for Islamic facilities.

29 SHARI'A SUPERVISORY BOARD

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

30 SOCIAL RESPONSIBILITY

The Group discharges its social responsibilities through zakah and charity fund's expenditures and donations to good faith qard fund for marriage, refurbishment, medical treatments, etc.

31 COMPARATIVE FIGURES

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