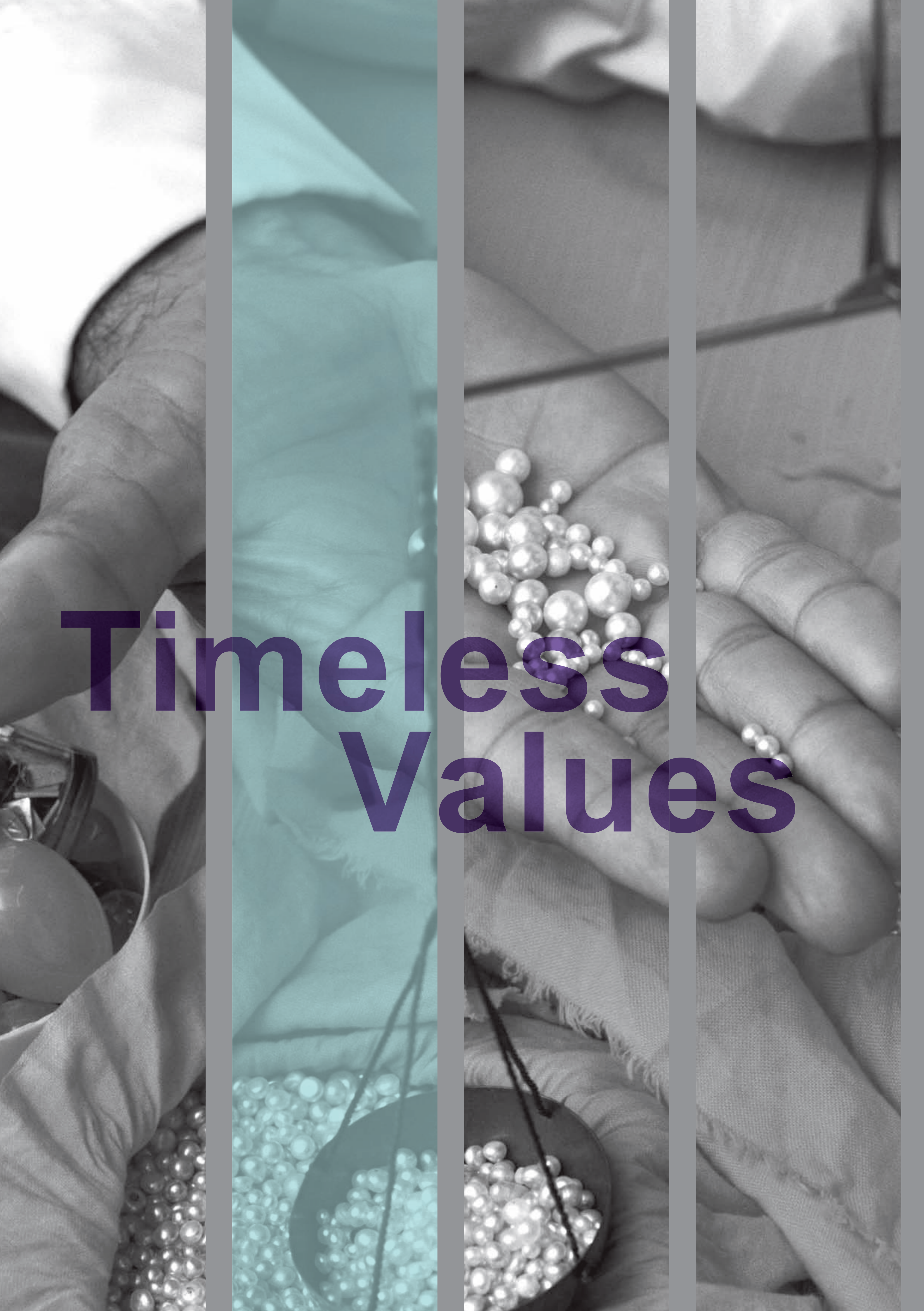
Timeless Values



Financial Statements

31 December 2008

Contents

Auditors' Report

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

We have audited the accompanying consolidated balance sheet of Bahrain Islamic Bank B.S.C. (the "Bank") and its subsidiary [together the "Group"] as of 31 December 2008, and the related consolidated statements of income, cash flow, changes in 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 Group'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. 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.

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2008, the results of its operations, its cash flows, changes in 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 the Accounting and Auditing Organization for Islamic Financial Institutions and the Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Group.

We confirm that, in our opinion, proper accounting records have been kept by the Group and the consolidated financial statements, and the contents of the Report of the Board of Directors relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Group, have occurred during the year ended 31 December 2008 that might have had a material adverse effect on the business of the Group or on its consolidated financial position and that the Group has complied with the terms of its banking licence.

Ernst & Young

21 January 2009
Manama, Kingdom of Bahrain

Consolidated Balance Sheet

31 December 2008

	Notes	2008 BD'000	2007 BD'000
ASSETS			
Cash and balances with Central Bank of Bahrain and other banks	3	**49,579**	18,349
Murabaha receivables	4	**368,563**	337,055
Mudaraba investments	5	**55,436**	36,372
Musharaka investments	6	**80,526**	39,426
Investments	7	**127,193**	156,353
Investments in associates	8	**7,423**	7,045
Investments in Ijarah assets	9	**9,901**	5,893
Ijarah Muntahia Bittamleek	10	**67,960**	13,574
Investments in properties	11	**97,829**	34,950
Ijarah rental receivables		**1,469**	2,963
Other assets	12	**8,088**	6,989
TOTAL ASSETS		**873,967**	658,969
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY			
LIABILITIES			
Customers' current accounts		**69,466**	60,963
Other liabilities	13	**13,935**	7,615
TOTAL LIABILITIES		**83,401**	68,578
UNRESTRICTED INVESTMENT ACCOUNTS	14	**624,119**	403,215
EQUITY	15		
Share capital		**66,235**	60,214
Share premium		**43,936**	50,869
Reserves		**42,387**	62,460
Proposed appropriations		**13,889**	13,633
TOTAL EQUITY		**166,447**	187,176
TOTAL LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY		**873,967**	658,969
COMMITMENTS AND CONTINGENT LIABILITIES	17	**37,434**	15,199

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

The attached Notes 1 to 32 form part of these consolidated financial statements.

Consolidated Statement of Income

For the year ended 31 December 2008

	Notes	2008 BD'000	2007 BD'000
INCOME			
Income from jointly financed sales and investments	18	**36,934**	31,463
Return on unrestricted investment accounts before Group's share as a Mudarib		**30,885**	25,433
Group's share as a Mudarib		**(13,183)**	(9,824)
Return on unrestricted investment accounts		**17,702**	15,609
Group's share of income from joint financing and investment accounts		**19,232**	15,854
Income from investments	19	**18,279**	11,698
Gain on fair value adjustment for investments in properties		**11,436**	5,328
Share of results of associates		**663**	558
Fee and commission income	20	**4,990**	2,801
Other income		**1,038**	785
Total income		**55,638**	37,024
EXPENSES			
Staff costs		**10,528**	7,082
Depreciation		**929**	1,079
Other expenses	21	**5,971**	3,838
Total expenses		**17,428**	11,999
Net income before provisions		**38,210**	25,025
Provision for impairment	22	**(15,897)**	–
NET INCOME FOR THE YEAR		**22,313**	25,025
BASIC AND DILUTED EARNINGS PER SHARE (fils)	24	**33.69**	55.76

The attached Notes 1 to 32 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

For the year ended 31 December 2008

	Notes	2008 BD'000	2007 BD'000
OPERATING ACTIVITIES			
Net income for the year		**22,313**	25,025
Adjustments for non-cash items:			
Depreciation		**929**	1,079
Provision for impairment	22	**15,897**	–
Gain on sale of investment in properties		**(1,607)**	(190)
Gain on sale of investments		**(11,907)**	(8,141)
Fair value gain on investment in properties		**(11,436)**	(5,328)
Share of results of associates	8	**(663)**	(558)
Operating profit before changes in operating assets and liabilities		**13,526**	11,887
Working capital adjustments:			
Mandatory reserve with Central Bank of Bahrain		**(18,963)**	(4,770)
Murabaha receivables		**(38,460)**	(95,345)
Mudaraba investments		**(22,485)**	(21,429)
Musharaka investments		**(41,100)**	(25,472)
Ijarah rental receivables		**1,494**	(648)
Other assets		**(1,893)**	(377)
Customers' current accounts		**8,503**	9,570
Other liabilities		**5,772**	1,574
Net cash used in operating activities		**(93,606)**	(125,010)
INVESTING ACTIVITIES			
Purchase of investments in properties		**(57,056)**	(22,212)
Proceeds from disposal of investments in properties		**7,220**	2,765
Ijarah Muntahia Bittamleek		**(54,386)**	2,324
Purchase of investments in Ijarah assets		**(4,143)**	(719)
Purchase of investments		**(38,393)**	(59,235)
Proceeds from disposal of investments		**39,046**	22,230
Proceeds from associates		**480**	–
Net cash used in investing activities		**(107,232)**	(54,847)
FINANCING ACTIVITIES			
Increase in share capital		**–**	28,336
Increase in share premium		**–**	56,581
Increase in unrestricted investment accounts		**220,904**	99,097
Dividends paid		**(7,535)**	(5,667)
Directors' remuneration paid		**–**	(210)
Zakah paid		**(264)**	(170)
Net cash from financing activities		**213,105**	177,967
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**12,267**	(1,890)
Cash and cash equivalents at 1 January		**6,064**	7,954
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	3	**18,331**	6,064

The attached Notes 1 to 32 form part of these consolidated financial statements.

Consolidated
Statement of Changes in Equity

For the year ended 31 December 2008

	Share capital	Share premium	Statutory reserve (Reserves)	General reserve (Reserves)	Investments in properties fair value reserve (Reserves)	Cumulative changes in fair value of investments (Reserves)	Retained earnings	Proposed appropriations	Total equity
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
At 1 January 2008	**60,214**	**50,869**	**8,037**	**1,000**	**7,133**	**30,217**	**16,073**	**13,633**	**187,176**
Bonus shares issued (note 15)	**6,021**	**(309)**	**–**	**–**	**–**	**–**	**–**	**(5,712)**	**–**
Dividends paid	**–**	**–**	**–**	**–**	**–**	**–**	**(216)**	**(7,615)**	**(7,831)**
Zakah paid	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(306)**	**(306)**
Net income for the year	**–**	**–**	**–**	**–**	**–**	**–**	**22,313**	**–**	**22,313**
Transfer to statutory reserve	**–**	**–**	**2,231**	**–**	**–**	**–**	**(2,231)**	**–**	**–**
Unrealized gain on investments in properties	**–**	**–**	**–**	**–**	**11,436**	**–**	**(11,436)**	**–**	**–**
Realized gain on investments in properties	**–**	**–**	**–**	**–**	**(476)**	**–**	**476**	**–**	**–**
Net movement in cumulative changes in fair value of investments	**–**	**–**	**–**	**–**	**–**	**(34,905)**	**–**	**–**	**(34,905)**
Appropriations (note 15)	**–**	**(6,624)**	**–**	**–**	**–**	**–**	**(7,265)**	**13,889**	**–**
At 31 December 2008	**66,235**	**43,936**	**10,268**	**1,000**	**18,093**	**(4,688)**	**17,714**	**13,889**	**166,447**
At 1 January 2007	28,336	–	5,534	1,000	3,255	21,860	5,350	9,589	74,924
Right shares issued	28,336	56,581	–	–	–	–	–	–	84,917
Bonus shares issued	3,542	–	–	–	–	–	–	(3,542)	–
Dividends paid	–	–	–	–	–	–	–	(5,667)	(5,667)
Directors' remuneration paid	–	–	–	–	–	–	–	(210)	(210)
Zakah paid	–	–	–	–	–	–	–	(170)	(170)
Net income for the year	–	–	–	–	–	–	25,025	–	25,025
Transfer to statutory reserve	–	–	2,503	–	–	–	(2,503)	–	–
Unrealized gain on investments in properties	–	–	–	–	5,328	–	(5,328)	–	–
Realized gain on investments in properties	–	–	–	–	(1,450)	–	1,450	–	–
Net movement in cumulative changes in fair value of investments	–	–	–	–	–	8,357	–	–	8,357
Appropriations	–	(5,712)	–	–	–	–	(7,921)	13,633	–
At 31 December 2007	60,214	50,869	8,037	1,000	7,133	30,217	16,073	13,633	187,176

The attached Notes 1 to 32 form part of these consolidated financial statements.

Consolidated Statement of Sources and Uses of Good Faith Qard Fund

For the year ended 31 December 2008

	Qard hasan receivables BD'000	Funds available for qard hasan BD'000	Total BD'000
At 1 January 2008	**27**	**101**	**128**
Uses of qard fund:			
Marriage	**17**	**(17)**	**–**
Refurbishment	**16**	**(16)**	**–**
Medical treatment	**14**	**(14)**	**–**
Others	**11**	**(11)**	**–**
Total uses during the year	**58**	**(58)**	**–**
Repayments	**(75)**	**75**	**–**
At 31 December 2008	**10**	**118**	**128**
At 1 January 2007	35	93	128
Uses of qard fund:			
Marriage	20	(20)	–
Refurbishment	16	(16)	–
Medical treatment	17	(17)	–
Others	12	(12)	–
Total uses during the year	65	(65)	–
Repayments	(73)	73	–
At 31 December 2007	27	101	128

	2008 BD'000	2007 BD'000
Sources of Qard Fund		
Contribution by the Bank	**125**	125
Donation	**3**	3
Total of sources during the year	**128**	128

The attached Notes 1 to 32 form part of these consolidated financial statements.

Consolidated Statement Of Sources and Uses of Zakah and Charity Fund

For the year ended 31 December 2008

	2008 BD'000	2007 BD'000
Sources of zakah and charity funds		
Undistributed zakah and charity funds at 1 January	**486**	365
Zakah due from the Bank for the year	**641**	306
Non-Islamic income	**–**	25
Donations / late fee	**238**	14
Total sources of funds during the year	**1,365**	710
Uses of zakah and charity funds		
Philanthropic societies	**33**	76
Aid to needy families	**283**	148
Total uses of funds during the year	**316**	224
Undistributed zakah and charity funds at 31 December	**1,049**	486

The attached Notes 1 to 32 form part of these consolidated financial statements.

Notes to the 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 licence 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 holds 100% of the share capital of Abaad Real Estate Company B.S.C. (c) ("Subsidiary"). The Subsidiary was incorporated in the Kingdom of Bahrain on 8 April 2003 with an authorized 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.

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

The Bank has twelve branches (2007: twelve), 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 21 January 2009.

2 SIGNIFICANT ACCOUNTING POLICIES

Following is a summary of the significant accounting policies adopted in preparing the consolidated financial statements. These accounting policies are consistent with those used in the previous year except for the following:

On 30 October 2008, Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) issued a guidance statement on accounting for investments and amendment in Financial Accounting Standard 17 Investments. This amendment allows Islamic Financial Institutions to carry unrealised losses from re-measurement of investments in shares in the statement of equity under the cumulative changes in fair value reserve. Previously, any net negative unrealised losses were to be taken to the consolidated statement of income. The amendment is effective from 1 July 2008 and has been adopted by the Group.

Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis, except for investment in properties and certain "available for sale" investments 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.

The consolidated financial statements of the Group have been prepared in accordance with the Financial Accounting Standards (FAS) issued by the AAOIFI, the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank, the Bahrain Commercial Companies Law, CBB and the Financial Institutions Law. In accordance with the requirement of AAOIFI, for matters for which no AAOIFI standards exist, the Group uses the relevant International Financial Reporting Standards.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary (together referred to as the "Group").

The Subsidiary is fully consolidated from the date of acquisition, being the date on which the Group obtained control, and continue to be consolidated until the date that such control ceases. Control is achieved where the Group has the power to govern the financial and operating policies of the subsidiary so as to obtain benefits from its activities.

The financial statements of the subsidiary are prepared for the same reporting year as the Bank, using consistent accounting policies.

2 SIGNIFICANT ACCOUNTING POLICIES Continued

Basis of consolidation Continued

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

Murabaha receivables

Murabaha receivables consist mainly of murabaha and international commodities stated net of deferred profits and provisions for impairment.

Mudaraba and Musharaka investments

These are stated at the fair value of consideration given less provision for impairment.

Investments

These are classified as either held-to-maturity or available-for-sale.

All investments are initially recognised at cost, being the fair value of the consideration given including acquisition charges associated with the investment.

Held-to-maturity

Investments that have fixed or determinable payments, which are intended to be held-to-maturity, are carried at amortised cost, less provision for impairment in value. Any gain or loss on such investments is recognised in the consolidated statement of income when the investment is derecognised or impaired.

Available-for-sale

After initial recognition, investments are remeasured at fair value. Fair value changes are reported as 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 reported is included in the consolidated statement of income for the year.

Impairment losses on equity investments are not reversed through the consolidated statement of income; increases in their fair value after impairment are recognised directly in equity.

Investments for which fair value cannot be determined or cannot be remeasured to fair value are carried at cost or at a previously revalued amount, less provision for any impairment.

Investments in associates

The Group's investments 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 investments in associates are carried in the balance sheet 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 equity.

The Group determines at each balance sheet 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.

Unrealized 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.

2 SIGNIFICANT ACCOUNTING POLICIES Continued

Ijarah assets, Ijarah Muntahia Bittamleek

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

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.

Investments in properties

Properties held for rental, or for capital appreciation purposes, or both, are classified as investments in properties. Investments in 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, investments in properties are 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 investments in properties fair value reserve at year end. Upon realization, these gain/losses are transferred to retained earnings from investments in properties fair value reserve.

Unrestricted investment account holders

All unrestricted investment accounts are carried at cost plus profit and related reserves less amounts settled.

Unrestricted investment account holders 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 unrestricted investment account holders' share of income is (total income from jointly financed Islamic finances less shareholders' "Bank" income). Portion of the income generated from unrestricted investment account holders will be deducted as mudarib share and the remaining will be distributed to the unrestricted investment account holders.

Investment risk reserve

The Group deducts 10% from the profit distributable to unrestricted investment accounts as an investment risk reserve, after allocating the mudarib share in order to cater against future losses for unrestricted investment account holders.

Profit equalisation reserve

The Group appropriates a certain amount in excess of the profit to be distributed to unrestricted investment accounts after taking into consideration the mudarib share of income. This is used to maintain a certain level of return on investment for unrestricted investment account holders.

Zakah

Zakah is calculated on the Zakah base of the Group in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions using the net invested funds method. Zakah is paid by the Group based on 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 unrestricted investment and other accounts is the responsibility of investment account holders.

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.

2 SIGNIFICANT ACCOUNTING POLICIES Continued

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 derecognized when the obligation specified in the contract is discharged, cancelled or expire.

Earnings prohibited by Shari'a

The Group is committed to avoid recognizing 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.

Joint and self financed

Investments, financing and receivables that are jointly owned by the Group and the unrestricted investment accounts holders are classified under the caption "jointly financed" in the consolidated financial statements. Investments, financing and receivables that are financed solely by the Bank are classified under "self financed".

Offsetting

Financial assets and financial liabilities are only offsetted and the net amount reported in the consolidated balance sheet 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.

Revenue recognition

Murabaha receivables

Where the income is quantifiable and contractually determined at the commencement of the contract, income is recognised on a time-apportioned basis over the period of the contract based on the principal amounts outstanding.

Where the income from a contract is not quantifiable, it is recognised when realised. Income related to non performing accounts is excluded from the consolidated statement of income.

Musharaka investments

Income is recognised on the due dates of the installments or when received. Income related to non performing accounts is excluded from the consolidated statement of income.

Mudaraba investments

Income is recognised when it is quantifiable or on distribution by the Mudarib, whereas the losses are charged to income on their declaration by the Mudarib.

2 SIGNIFICANT ACCOUNTING POLICIES Continued

Revenue recognition Continued

Ijarah and Ijarah Muntahia Bittamleek

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

Return on unrestricted investment accounts

Unrestricted investment accounts holders' share of income is calculated based on the underlining individual mudaraba contract. The income is generated from joint investment accounts after deducting the expenses related to investment pool "mudarib expenses". Mudarib expenses include all expenses incurred by the Group, including specific provisions, but excluding staff cost and depreciation. The Group's "mudarib profit" is deducted from investors' share of income before distributing such income.

Group's share of unrestricted investment income as a Mudarib

The Group's share as a mudarib for managing unrestricted investment accounts is accrued based on the terms and conditions of the related mudaraba agreements.

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.

Income allocation

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

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 balance sheet date. All differences are taken to the consolidated statement of income.

Translation gains or losses on non-monetary items carried at fair value are included in equity as part of the fair value adjustment on securities available-for-sale.

Cash and cash equivalents

For the purpose of consolidated cash flow statement, "cash and cash equivalents" consist of cash in hand, bank balances, balances with the Central Bank of Bahrain with original maturities of 90 days or less.

Taxation

There is no tax on corporate income in the Kingdom of Bahrain.

Impairment of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, any impairment loss is recognised in the consolidated statement of income. Impairment is determined as follows:

2 SIGNIFICANT ACCOUNTING POLICIES Continued

Impairment of financial assets Continued

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

Judgments and estimates

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

Impairment

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset 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 value to it of anticipated future cash flows, is recognised in the consolidated statement of income. Specific provisions are created to reduce all impaired financial contracts to their expected realisable value.

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.

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 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.

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.

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 balance sheet.

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.

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 CENTRAL BANK OF BAHRAIN AND OTHER BANKS

	2008	2007
	BD'000	BD'000
Cash in hand	**3,974**	2,664
Balances with CBB, excluding mandatory reserve deposits	**3,015**	1,208
Balances with other banks	**11,342**	2,192
Cash and cash equivalents	**18,331**	6,064
Mandatory reserve with CBB	**31,248**	12,285
At 31 December	**49,579**	18,349

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

4 MURABAHA RECEIVABLES

	Jointly financed 2008	Jointly financed 2007
	BD'000	BD'000
Murabaha with banks:		
International commodities	**95,756**	146,521
Other murabaha:		
Tawarooq	**142,562**	83,188
Letters of credit	**49,746**	30,537
Commodities murabaha with non-banks	**35,421**	34,846
Tasheel	**37,992**	17,129
Land	**2,702**	13,820
Building	**9,816**	8,440
Motor vehicles	**15,590**	8,418
Building materials	**2,570**	4,991
Furniture	**182**	94
Others	**1,552**	2,488
	298,133	203,951
Qard fund	**125**	125
	298,258	204,076
Gross receivables	**394,014**	350,597
Deferred profits	**(16,584)**	(11,627)
* Provision for impairment (note 22)	**(8,867)**	(1,915)
At 31 December	**368,563**	337,055

* This includes collective impairment provision of BD 5,343 thousand (2007: nil).

4 MURABAHA RECEIVABLES Continued

Non-performing murabaha receivables outstanding as of 31 December 2008 amounted to BD 4,809 thousand (2007: BD 5,304 thousand).

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

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

	Europe BD'000	Arab World BD'000	2008 Total BD'000	2007 Total BD'000
Commercial	**14,376**	**142,276**	**156,652**	30,537
Financial institutions	**18,258**	**18,118**	**36,376**	176,775
Secured by real estate	**–**	**15,088**	**15,088**	18,716
Others including retail	**–**	**185,898**	**185,898**	124,569
At 31 December 2008	**32,634**	**361,380**	**394,014**	
At 31 December 2007	10,673	339,924		350,597

5 MUDARABA INVESTMENTS

	Jointly financed 2008 BD'000	Jointly financed 2007 BD'000
Mudaraba investments	**58,857**	36,372
Provision for impairment (note 22)	**(3,421)**	–
At 31 December	**55,436**	36,372

The Group's Mudaraba investments transactions consist of investment in funds operated by other banks and financial institutions and participation in the financing transactions through other banks and financial institutions.

Impaired Mudaraba investments as of 31 December 2008 amounted to BD 10,095 thousand (2007: nil).

6 MUSHARAKA INVESTMENTS

	Jointly financed 2008 BD'000	Jointly financed 2007 BD'000
Real estate	**80,576**	39,476
Provision for impairment (note 22)	**(50)**	(50)
At 31 December	**80,526**	39,426

Non-performing Musharaka investments outstanding as of 31 December 2008 amounted to BD 3,754 thousand (2007: BD 921 thousand).

7 INVESTMENTS

	2008			2007		
	Self financed	**Jointly financed**	**Total**	Self financed	Jointly financed	Total
	BD'000	**BD'000**	**BD'000**	BD'000	BD'000	BD'000
i) Held to maturity						
Unquoted investments						
Sukuk	**–**	**66,065**	**66,065**	–	84,498	84,498
	–	**66,065**	**66,065**	–	84,498	84,498
ii) Available for sale						
Quoted investments						
Equity shares	**21,016**	**–**	**21,016**	43,577	–	43,577
Unquoted investments						
Equity shares	**36,509**	**–**	**36,509**	25,926	–	25,926
Sukuk	**–**	**9,427**	**9,427**	–	2,667	2,667
	57,525	**9,427**	**66,952**	69,503	2,667	72,170
	57,525	**75,492**	**133,017**	69,503	87,165	156,668
Provision for impairment (note 22)	**(4,781)**	**(1,043)**	**(5,824)**	(315)	–	(315)
At 31 December	**52,744**	**74,449**	**127,193**	69,188	87,165	156,353

8 INVESTMENTS IN ASSOCIATES

The Group has the following investments in associates:

	Country of incorporation	**Ownership**	
		2008	2007
Takaful International Company B.S.C.	Kingdom of Bahrain	**22.75%**	22.75%
Liquidity Management Centre B.S.C. (c)	Kingdom of Bahrain	**25.00%**	25.00%

Takaful International Company B.S.C. (incorporated in 1989) carries out takaful and retakaful activities in accordance with the teachings of Islamic Shari'a.

Liquidity Management Centre B.S.C. (c) was set up 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.

8 INVESTMENTS IN ASSOCIATES Continued

The following tables illustrate summarised financial information relating to the Group's associates:

	2008 BD'000	2007 BD'000
Carrying amount of investments in associates		
At 1 January	**7,045**	6,652
Share of results	**663**	558
Dividends paid	**(480)**	(361)
Cumulative change in fair value	**195**	196
At 31 December	**7,423**	7,045

9 INVESTMENTS IN IJARAH ASSETS

	2008					2007				
	Self financed		Jointly financed			Self financed		Jointly financed		
	Land	Buildings	Land	Buildings	Total	Land	Buildings	Land	Buildings	Total
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
Cost:										
At 1 January	**2,453**	**5,640**	**–**	**–**	**8,093**	1,380	5,640	–	–	7,020
Additions	**4,147**	**–**	**–**	**–**	**4,147**	1,073	–	–	–	1,073
At 31 December	**6,600**	**5,640**	**–**	**–**	**12,240**	2,453	5,640	–	–	8,093
Depreciation:										
At 1 January	**–**	**2,200**	**–**	**–**	**2,200**	–	2,022	–	–	2,022
Provided during the year	**–**	**139**	**–**	**–**	**139**	–	178	–	–	178
At 31 December	**–**	**2,339**	**–**	**–**	**2,339**	–	2,200	–	–	2,200
Net book value:										
At 31 December	**6,600**	**3,301**	**–**	**–**	**9,901**	2,453	3,440	–	–	5,893

10 IJARAH MUNTAHIA BITTAMLEEK

	2008					2007				
	Self financed		Jointly financed			Self financed		Jointly financed		
	Land	Buildings	Land	Buildings	Total	Land	Buildings	Land	Buildings	Total
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
Cost:										
At 1 January	–	–	1,669	14,868	16,537	–	–	9,733	8,304	18,037
Additions	–	–	31,859	27,691	59,550	–	–	1,678	15,593	17,271
Disposals	–	–	(1,236)	(5,103)	(6,339)	–	–	(9,130)	(7,885)	(17,015)
Repayments	–	–	–	(319)	(319)	–	–	(612)	(1,144)	(1,756)
At 31 December	–	–	32,292	37,137	69,429	–	–	1,669	14,868	16,537
Depreciation:										
At 1 January	–	–	–	2,963	2,963	–	–	–	2,551	2,551
Provided during the year	–	–	–	1,282	1,282	–	–	–	412	412
Relating to disposed assets	–	–	–	(2,776)	(2,776)	–	–	–	–	–
At 31 December	–	–	–	1,469	1,469	–	–	–	2,963	2,963
Net book value:										
At 31 December	–	–	32,292	35,668	67,960	–	–	1,669	11,905	13,574

Non-performing Ijarah Muntahia Bittamleek as of 31 December 2008 is nil (2007: BD 140 thousand).

11 INVESTMENTS IN PROPERTIES

	2008			2007		
	Self financed	Jointly financed	Total	Self financed	Jointly financed	Total
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
Cost:						
At 1 January	27,817	–	27,817	6,730	–	6,730
Additions	57,056	–	57,056	22,212	–	22,212
Disposals	(5,137)	–	(5,137)	(1,125)	–	(1,125)
At 31 December	79,736	–	79,736	27,817	–	27,817
Fair value adjustments	18,093	–	18,093	7,133	–	7,133
At 31 December	97,829	–	97,829	34,950	–	34,950

Investments in properties comprises of plots of land located in GCC.

Investments in properties are stated at fair value, which has been determined based on valuations performed by independent valuers, industry specialists in valuing these types of investment properties.

12 OTHER ASSETS

	2008	2007
	BD'000	BD'000
Equipment	**3,635**	2,567
Receivables under letter of credit	**1,339**	556
Staff advances	**751**	427
Income receivable	**576**	472
Others	**1,787**	2,967
At 31 December	**8,088**	6,989

13 OTHER LIABILITIES

	2008	2007
	BD'000	BD'000
Payable to vendors	**3,684**	–
Accrued expenses	**3,149**	2,613
Clearance cheques	**1,426**	–
Murabaha bills payable	**1,249**	837
Managers' cheques	**1,189**	1,417
Dividends payable	**713**	417
Zakah and charity fund	**408**	180
Margin on letters of credit	**216**	423
Provision for employees' end of service benefits and leave	**280**	160
Others	**1,621**	1,568
At 31 December	**13,935**	7,615

14 UNRESTRICTED INVESTMENT ACCOUNTS

	2008	2007
	BD'000	BD'000
Investment accounts:		
Customers	**425,702**	237,506
Banks and other financial institutions	**195,882**	163,218
Profit equalisation reserve (note 14.1)	**2,368**	2,491
Investment risk reserve (note 14.2)	**167**	–
At 31 December	**624,119**	403,215

14 UNRESTRICTED INVESTMENT ACCOUNTS Continued

14.1 Movement in profit equalisation reserve

	2008 BD'000	2007 BD'000
At 1 January	**2,491**	2,491
Transferred to income from jointly financed sales	**(123)**	–
At 31 December	**2,368**	2,491

14.2 Movement in investment risk reserve

	2008 BD'000	2007 BD'000
At 1 January	**–**	–
Amount apportioned from income allocable to unrestricted investment account holders	**167**	–
At 31 December	**167**	–

The profit equalisation reserve will revert to Unrestricted Investment Accounts as per terms and conditions of the Mudaraba contract.

As unrestricted investment account holder's 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 unrestricted investment accounts is up to a maximum of 65% (2007: 65%).

The following table represents the distribution of profit to unrestricted investment account holders.

	2008		2007		2006	
	Percentage of funds invested	**Percentage distribution**	Percentage of funds invested	Percentage distribution	Percentage of funds invested	Percentage distribution
Defined deposits	**85**	**3.37**	85	4.49	85	4.41
Specific investment deposits	**100**	**3.5 – 4.5**	100	4.50 – 5.00	100	4.80 – 5.05
Investment certificates	**90**	**4.00**	90	5.00	90	4.76
Savings accounts	**43**	**0.70**	45	0.80	50	0.80
Education and shifa	**83**	**4.00**	90	4.50	90	4.38
Iqra	**83**	**2.67**	–	–	–	–
Tejoori	**43**	**0.67**	–	–	–	–

15 EQUITY

	2008 BD'000	2007 BD'000
(i) Share capital		
a) Authorised		
1,000,000,000 shares of BD 0.100 each	**100,000**	100,000
b) Issued and fully paid up		
662,354,000 shares (2007: 602,140,000 shares) of BD 0.100 each	**66,235**	60,214

During the year the Group has issued bonus shares of 60,214 thousand at one share for every ten shares held amounting to BD 6,021 thousand.

(ii) 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.

(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 is transferred to the statutory reserve. The Group may resolve to discontinue such annual transfers when the reserve totals 50% of paid up share capital. The reserve is not distributable except in such circumstances as stipulated in the 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.

Investments in properties fair value reserve

This represents cumulative unrealized revaluation gains on investments in 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 unrealized gains / (loss) on available-for-sale investments relating to self financed investments.

15 EQUITY Continued

(iv) Appropriations

	2008	2007
	BD'000	BD'000
Proposed dividend	**6,624**	7,615
Bonus shares	**6,624**	5,712
Zakah (note 23)	**641**	306
Total	**13,889**	13,633

The directors have proposed a cash dividend of 10% (2007: 13%) and bonus shares of 10% (2007: 15%) based on the outstanding number of shares during the year. This will be submitted for formal approval at the Annual General Meeting. This issuance of bonus shares is also subject to relevant approval from the Ministry of Industry and Commerce and CBB.

The cash dividend of BD 7,615 thousand and bonus shares of BD 5,712 thousand proposed and approved for the year 2007 were paid in 2008 for BD 7,831 thousand and BD 6,021 thsousand respectively, excess payments of BD 216 thousand for cash dividend and BD 309 thousand for bonus shares to be ratified by the Annual General Meeting to be held in 2009.

16 CAPITAL ADEQUACY

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

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or 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.

16 CAPITAL ADEQUACY Continued

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

	2008 BD'000	2007 BD'000
Core capital - Tier 1:		
Issued and fully paid ordinary shares	**66,235**	60,214
General reserves	**1,000**	1,000
Legal / statutory reserves	**8,037**	8,037
Share premium	**50,560**	50,869
Retained earnings / losses (other than current year net income)	**14,272**	(8,952)
Less:		
Unrealized gross losses arising from fair valuing equity securities	**(5,811)**	–
Tier 1 Capital before deductions	**134,293**	111,168
Supplementary capital - Tier 2:		
Current year net income	**9,934**	25,025
Asset revaluation reserve - Equipment (45% only)	**6,085**	3,210
Unrealized gains arising from fair valuing equities (45% only)	**329**	13,598
Tier 2 Capital before deductions	**16,349**	41,833
Total available capital	**150,642**	153,001
Deductions		
Significant minority interest in banking, securities and financial entities	**(5,710)**	–
Excess amount over materiality threshold	**(2,440)**	–
Investment in insurance entity greater than or equal to 20%	**(1,322)**	(1,380)
Total eligible capital	**141,170**	151,621

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

	2008 BD'000	2007 BD'000
Total Credit Risk Weighted Assets	**390,344**	239,577
Total Market Risk Weighted Assets	**54,733**	119,214
Total Operational Risk Weighted Assets	**36,965**	28,210
Total Regulatory Risk Weighted Assets	**482,042**	387,001
Capital Adequacy Ratio	**29.29%**	39.18%
Minimum requirement	**12%**	12%

Starting from 2008, the Group has adopted the Basel II guidelines for calculation of the capital adequacy ratio.

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:

	2008	2007
	BD'000	BD'000
Letters of credit and acceptances	**27,578**	9,125
Guarantees	**9,564**	5,850
Operating lease commitments *	**292**	224
At 31 December	**37,434**	15,199

* The Group has entered into commercial leases for certain branches. These leases have an average life of between 5 and 10 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:

	2008	2007
	BD'000	BD'000
Within one year	**60**	132
After one year but not more than five years	**224**	84
More than five years	**8**	8
At 31 December	**292**	224

Credit Lines Commitment

The Group has provided credit line to its associate of BD 9,425 thousand (2007:BD 5,655 thousand) for liquidity purposes which is fully utilised as of 31 December 2008 (2007: 2,267 thousand).

18 INCOME FROM JOINTLY FINANCED SALES AND INVESTMENTS

	2008	2007
	BD'000	BD'000
Income from Murabaha receivables	**20,455**	18,999
Income from Mudaraba investments	**2,250**	3,181
Income from Musharaka investments	**6,678**	2,290
Income from investments in Sukuk	**4,012**	4,973
Income from Ijarah Muntahia Bittamleek - net *	**3,539**	2,020
Total	**36,934**	31,463

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

	2008	2007
	BD'000	BD'000
Income from Ijarah Muntahia Bittamleek – gross	**4,821**	2,432
Depreciation provided during the year (note 10)	**(1,282)**	(412)
Total	**3,539**	2,020

19 INCOME FROM INVESTMENTS

	2008	2007
	BD'000	BD'000
Gain on sales of investments	**11,907**	8,141
Dividend income	**4,191**	2,829
Income from Ijarah assets	**574**	538
Gain on sale of investments in properties	**1,607**	190
Total	**18,279**	11,698

20 FEE AND COMMISSION INCOME

	2008	2007
	BD'000	BD'000
Commission income	**4,557**	2,465
Fees and others	**433**	336
Total	**4,990**	2,801

21 OTHER EXPENSES

	2008 BD'000	2007 BD'000
Marketing, advertisement and re-branding expenses	**1,664**	1,182
Computer maintenance expenses	**676**	275
Board remuneration	**586**	333
Expenses on Ijarah assets	**506**	294
Communication expenses	**438**	230
Professional services and consultancy fees	**331**	785
Stationery expenses	**270**	140
Travelling and transportation expenses	**258**	132
Brokerage fees and commission	**255**	146
Shari'a committee remuneration and board expenses	**144**	42
Miscellaneous	**843**	279
Total	**5,971**	3,838

22 PROVISIONS

2008	**Murabaha receivables BD'000**	**Mudaraba investments BD'000**	**Musharaka investments BD'000**	**Investments BD'000**	**Total BD'000**
At 1 January	**1,915**	**–**	**50**	**315**	**2,280**
Written off during the year	**(15)**	**–**	**–**	**–**	**(15)**
	1,900	**–**	**50**	**315**	**2,265**
Provided during the year	**6,967**	**3,421**	**–**	**5,509**	**15,897**
At 31 December	**8,867**	**3,421**	**50**	**5,824**	**18,162**
Notes	4	5	6	7	

2007	Murabaha receivables BD'000	Mudaraba investments BD'000	Musharaka investments BD'000	Investments BD'000	Total BD'000
At 1 January	1,915	–	50	315	2,280
Written off during the year	–	–	–	–	–
	1,915	–	50	315	2,280
Provided during the year	–	–	–	–	–
At 31 December	1,915	–	50	315	2,280
Notes	4	5	6	7	

23 ZAKAH

The total Zakah payable as of 31 December 2008 amounted to BD 3,687 thousand (2007: BD 1,373 thousand) of which BD 641 thousand (2007: BD 306 thousand) represent the Zakah on the statutory reserve, general reserve and retained earning as at 1 January 2007, is payable by the Bank. The remaining Zakah balance amounting to BD 3,046 thousand or 4.6 fils per share (2007: BD 1,067 thousand or 3.3 fils per share) is due and payable by the shareholders.

24 EARNINGS PER SHARE

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

	2008	2007
	BD'000	BD'000
Net income for the year	**22,313**	25,025
Weighted average number of shares	**662,354**	448,798
Basic and diluted earnings per share (fils)	**33.69**	55.76

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

25 RELATED PARTY TRANSACTIONS

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

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

		Income (expense)		**Balance at 31 December**	
Related party	Transaction	**2008**	2007	**2008**	2007
		BD'000	BD'000	**BD'000**	BD'000
Shareholders	Sukuk	**629**	1,181	**11,700**	14,582
Shareholders	Tawarooq	**2,705**	460	**40,870**	18,003
Shareholders	Real Estate	**–**	–	**18,850**	–
Associate	Ijarah Muntahia Bittamleek	**–**	63	**–**	848
Associate	Sukuk	**220**	362	**9,427**	2,266
Associate	Murabaha	**–**	92	**–**	8,294
Associate	Murabaha	**–**	89	**–**	7,540
Associate	Mudaraba	**59**	47	**2,770**	1,041
Board of Directors	Ijarah Muntahia Bittamleek	**52**	16	**356**	660
Board of Directors	Musharaka	**223**	137	**941**	1,054
Shari'a Supervisory Board	Remuneration	**54**	24	**–**	–
Total		**3,942**	2,471	**84,914**	54,288

25 RELATED PARTY TRANSACTIONS Continued

Key management personnel include the staff in assistant general manager grade and above.

Compensation of the key management personnel is as follows:

	2008 BD'000	2007 BD'000
Short term employee benefits	**803**	581
Other long term benefits	**183**	59
Total	**986**	640

26 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.

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 maximizing the returns intended to optimize 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 include all levels of authorities, organizational structure, people & 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 of, including:

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

26 RISK MANAGEMENT Continued

Executive Committee (EC) comprises six 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 & 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 & Reporting Systems

Based on risk appetite, the Group has put in place various limits. These limits have been approved by the Board. Any limit breaches are 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).

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 Murabaha receivables, Mudaraba investments, Musharaka investments and Ijarah Muntahia Bittamleek.

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 installments 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.

Mudaraba investments

The Group enters into Mudaraba contracts by investing in funds operated by other banks and financial institutions for a definite period of time.

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).

26 RISK MANAGEMENT Continued

a) CREDIT RISK Continued

Credit Risk Mitigation Continued

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.

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

The market value of tangible collateral security are properly evaluated by the Group approved value (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.

(i) Gross maximum exposure to credit risk without taking account of any collateral and other credit enhancements

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

	Jointly financed 2008 BD'000	Jointly financed 2007 BD'000
Murabaha receivables	**377,430**	338,970
Mudaraba investments	**58,857**	36,372
Musharaka investments	**80,576**	39,476
Investments	**66,065**	84,498
Ijara income receivables	**1,469**	2,963
Total	**584,397**	502,279
Letters of credit, guarantees and acceptances	**37,142**	14,975
Irrevocable commitments to provide trading facilities	**292**	224
Total	**37,434**	15,199

26 RISK MANAGEMENT Continued

a) CREDIT RISK Continued

Credit Risk Mitigation Continued

(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.

The distribution by geographic region and industry sector is as follows:

	Assets		Liabilities and unrestricted investment accounts		Commitments and contingent liabilities	
	2008	2007	**2008**	2007	**2008**	2007
	BD'000	BD'000	**BD'000**	BD'000	**BD'000**	BD'000
Geographical region						
North America	**5,995**	6,660	**–**	–	**113**	46
Europe	**48,053**	34,854	**–**	–	**6,913**	2,807
Middle East	**809,078**	617,120	**707,520**	471,793	**21,569**	8,757
Asia	**10,841**	335	**–**	–	**8,839**	3,589
At 31 December	**873,967**	658,969	**707,520**	471,793	**37,434**	15,199
Industry sector						
Trading and manufacturing	**76,892**	45,393	**62,836**	64,486	**36,427**	14,790
Banks and financial institutions	**397,000**	414,222	**193,676**	171,685	**–**	–
Others	**400,075**	199,354	**451,008**	235,622	**1,007**	409
At 31 December	**873,967**	658,969	**707,520**	471,793	**37,434**	15,199

26 RISK MANAGEMENT Continued

a) CREDIT RISK Continued

Credit Risk Mitigation Continued

(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 2008				
	Neither past due nor impaired				
	High grade	Standard grade	Past due but not impaired	Individually impaired	Total
	BD'000	BD'000	BD'000	BD'000	BD'000
Balances with CBB and other banks	**49,579**	**–**	**–**	**–**	**49,579**
Murabaha receivables	**10,159**	**362,463**	**2,680**	**2,128**	**377,430**
Mudaraba investments	**–**	**58,857**	**–**	**–**	**58,857**
Musharaka investments	**–**	**76,822**	**3,692**	**62**	**80,576**
Investments	**7,059**	**125,958**	**–**	**–**	**133,017**
Ijarah rental receivables	**–**	**1,469**	**–**	**–**	**1,469**
Total	**66,797**	**625,569**	**6,372**	**2,190**	**700,928**

	31 December 2007				
	Neither past due nor impaired				
	High grade	Standard grade	Past due but not impaired	Individually impaired	Total
	BD'000	BD'000	BD'000	BD'000	BD'000
Balances with CBB and other banks	18,349	–	–	–	18,349
Murabaha receivables	10,211	323,455	2,957	2,347	338,970
Mudaraba investments	–	36,372	–	–	36,372
Musharaka investments	–	38,555	906	15	39,476
Investments	20,392	136,276	–	–	156,668
Ijarah rental receivables	–	2,963	–	–	2,963
Total	48,952	537,621	3,863	2,362	592,798

26 RISK MANAGEMENT Continued

a) CREDIT RISK Continued

Credit Risk Mitigation Continued

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

2008	**Less than 30 days BD'000**	**31 to 60 days BD'000**	**61 to 90 days BD'000**	**Total BD'000**
Murabaha receivable	**4,668**	**13,197**	**766**	**18,631**
Mudaraba investments	**–**	**–**	**–**	**–**
Musharaka investments	**2,507**	**157**	**33**	**2,697**
Total	**7,175**	**13,354**	**799**	**21,328**

2007	Less than 30 days BD'000	31 to 60 days BD'000	61 to 90 days BD'000	Total BD'000
Murabaha receivable	2,769	7,828	454	11,051
Mudaraba investments	–	–	–	–
Musharaka investments	1,253	78	16	1,347
Total	4,022	7,906	470	12,398

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, international commodity Murabaha, credit lines and quoted investments.

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 balance sheet 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 unrestricted investment accounts.

26 RISK MANAGEMENT Continued

b) LIQUIDITY RISK Continued

The maturity profile of assets, liabilities, unrestricted investment accounts and equity at 31 December 2008 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 CBB and other banks	15,316	–	–	–	–	–	34,263	49,579
Murabaha receivables	142,380	57,020	72,305	33,920	18,078	44,860	–	368,563
Mudaraba investments	1,995	–	20,668	–	–	32,773	–	55,436
Musharaka investments	5,650	867	10,339	11,394	20,029	32,247	–	80,526
Investments	9,427	21,016	2,268	–	43,164	19,782	31,536	127,193
Investments in associates	–	–	–	–	–	–	7,423	7,423
Investments in Ijarah assets	–	–	–	–	–	–	9,901	9,901
Ijarah Muntahia Bittamleek	17,262	1,437	1,615	–	173	47,473	–	67,960
Investments in properties	–	–	–	–	–	–	97,829	97,829
Ijarah rental receivables	–	–	1,469	–	–	–	–	1,469
Other assets	–	–	4,453	–	–	–	3,635	8,088
Total	192,030	80,340	113,117	45,314	81,444	177,135	184,587	873,967
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY								
Customers' current accounts	69,466	–	–	–	–	–	–	69,466
Other liabilities	13,935	–	–	–	–	–	–	13,935
Unrestricted investment accounts	340,886	118,223	54,793	105,048	2,633	–	2,536	624,119
Equity	–	–	–	–	–	–	166,447	166,447
Total	424,287	118,223	54,793	105,048	2,633	–	168,983	873,967
Liquidity gap	(232,257)	(37,883)	58,324	(59,734)	78,811	177,135	15,604	–
Cumulative liquidity gap	(232,257)	(270,140)	(211,816)	(271,550)	(192,739)	(15,604)	–	–

26 RISK MANAGEMENT Continued

b) LIQUIDITY RISK Continued

The maturity profile of assets, liabilities, unrestricted investment accounts and equity at 31 December 2007 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 CBB and other banks	6,064	–	–	–	–	–	12,285	18,349
Murabaha receivables	128,432	92,504	31,440	47,421	12,696	24,562	–	337,055
Mudaraba investments	5,121	5,331	4,373	–	–	21,547	–	36,372
Musharaka investments	1,135	480	1,118	4,969	18,877	12,847	–	39,426
Investments	–	2,308	10,803	4,662	2,329	67,063	69,188	156,353
Investments in associates	–	–	–	–	–	–	7,045	7,045
Investments in Ijarah assets	–	–	–	–	–	–	5,893	5,893
Ijarah Muntahia Bittamleek	869	4,077	3,585	867	183	3,993	–	13,574
Investments in properties	–	–	–	–	–	–	34,950	34,950
Ijarah rental receivables	–	–	2,963	–	–	–	–	2,963
Other assets	–	–	4,422	–	–	–	2,567	6,989
Total	141,621	104,700	58,704	57,919	34,085	130,012	131,928	658,969
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY								
Customers' current accounts	60,963	–	–	–	–	–	–	60,963
Other liabilities	7,615	–	–	–	–	–	–	7,615
Unrestricted investment accounts	219,408	54,229	55,810	67,218	4,059	–	2,491	403,215
Equity	–	–	–	–	–	–	187,176	187,176
Total	287,986	54,229	55,810	67,218	4,059	–	189,667	658,969
Liquidity gap	(146,365)	50,471	2,894	(9,299)	30,026	130,012	(57,739)	–
Cumulative liquidity gap	(146,365)	(95,894)	(93,000)	(102,299)	(72,273)	57,739	–	–

26 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 unrestricted investment accounts as the repricing of assets, liabilities and unrestricted investment accounts occur at similar intervals. The profit distribution to unrestricted investment accounts 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 and decrease of the portfolio's value:

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

	Outstanding balance	**Variance after 10 % appreciation**	**Variance after 10 % depreciation**
2008	**BD'000**	**BD'000**	**BD'000**
Bahrain Stock Exchange	**18,606**	**20,467**	**16,745**
Kuwait Stock Exchange	**2,107**	**2,318**	**1,896**

	Outstanding balance	Variance after 10 % appreciation	Variance after 10 % depreciation
2007	BD'000	BD'000	BD'000
Bahrain Stock Exchange	47,717	52,489	42,945

As at balance sheet date, the Group has unquoted (equities and sukuk) of BD 112 million (31 December 2007: BD 113.1 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.

26 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) 2008 BD'000	Equivalent Long (short) 2007 BD'000
Currency		
Pound Sterling	**1,451**	177
US Dollar	**89,684**	49,034

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 BD with other variables held constant will have an immaterial impact on the consolidated statement of income and 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.

27 SEGMENTAL INFORMATION

The activities of the Group are performed on an integrated basis. Therefore, any segmentation of operating income, expenses, assets and liabilities is not relevant. As such, operating income, expenses, assets and liabilities are not segmented.

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

28 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.

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

29 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

The Group is committed to avoid recognising any income generated from non-Islamic source. 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.

30 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'ah 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.

31 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.

32 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 equity.