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 2010

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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 2010

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 2010 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 2010 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 2010 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. The Bank distributed Zakah on the statutory reserve, general reserve and retained earnings. 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

تقرير رئيس مجلس الإدارة

بالأصالة عن نفسي ونيابة عن أعضاء مجلس الإدارة، يسرني أن أقدم التقرير السنوي والبيانات المالية الموحدة لبنك البحرين الإسلامي عن العام المنتهي في 31 ديسمبر 2010م. في ظل استمرار تداعيات الأزمة المالية ومواصلة التباطؤ الاقتصادي على المستوى العالمي وتأثيراته السلبية على دول مجلس التعاون، كان العام المنصرم من أكثر الأعوام تحدياً بالنسبة للصناعة المصرفية و المالية.

وبفضل حرص البنك على تطبيق سياسات حذرة مع تركيزه على سوق البحرين والتزامه بتطبيق أحكام الشريعة الإسلامية، لم يتأثر البنك بشكل مباشر بتحديات الأزمة. إلا أن بنك البحرين الإسلامي قد تأثر بشكل غير مباشر بالتراجع الكبير في أسعار الأصول، خصوصاً في القطاع العقاري، وتأثيراته السلبية على بعض الشركات الإقليمية الكبيرة والتأثير على سوق التمويل للأفراد على نمو الأعمال، والذي استمر في التأثير على المنطقة في عام 2010م. وللعام الثاني على التوالي حيث التزم المستثمرون و المتعاملون مع البنوك بالحذر في تعاملاتهم. وكان نشاط تمويلات الرهن العقاري الأكثر تضرراً واستمرت قيمة الأصول في التراجع مع الضغوط على أسعار العقارات.

ونتيجة لذلك فقد حقق البنك خسائر دفترية بمبلغ 39.71 مليون دينار جاءت في الغالب نظير المخصصات وتحديداً لمحفظتي التمويل و الاستثمار والانخفاض في القيمة العادلة لبعض العقارات، مما أدي إلي انخفاض حقوق المساهمين إلى 100.06 مليون دينار ؛ ألا أن الوضع المالي للبنك ووضع السيولة مازال قوياً حيث زادت قيمة الأصول إلى 935.67 مليون دينار و بنسبة نمو قدرها 2.6% و الارتفاع في حجم ودائع العملاء إلى 681.7 مليون دينار وبارتفاع بنسبة 13.2%.

إن استعادة الثقة في زيادة النشاط الاقتصادي و التجاري والنظام المالي بالمنطقة يمثل أولوية مطلقة في عام 2011 حيث يمكن تحقيق ذلك بتطبيق رقابة تنظيمية أوسع وانتهاج ممارسات أشمل في الحوكمة وإدارة المخاطر. بالإضافة إلى ذلك يقوم البنك بانتقاء معاملاته والتدقيق بها بشكل أفضل من خلال فرض نظام دقيق لقياس وتقييم المعاملات.

و بالإشارة إلى أن المستقبل الاقتصادي لمملكة البحرين وبقية دول مجلس التعاون الخليجي ا ود أن أشير إلى انه لا يزال إيجابياً ومبشراً بالخير. فتمتلك دول المجلس احتياطيات كبيرة من النفط والغاز الطبيعي، كما أن مقوماتها الاقتصادية بشكل عام لا تزال سليمة وقوية ومن المتوقع أن يساعد استقرار أسعار النفط على المزيد من النمو في المستقبل من خلال زيادة الصرف على البنية التحتية وبعض المشاريع الأخرى الإستراتيجية الطويلة المدى. وسوف يكون لأي انتعاش اقتصادي نتائجه الإيجابية المباشرة على صناعة الخدمات المصرفية والمالية. كما أننا الآن أكثر تفاؤلاً بالنسبة للعام 2011م مقارنة بالعامين السابقين.

BisB بنك البحرين الإسلامي

وبالرغم من استمرار الظروف الصعبة في السوق، إلا أن بنك البحرين الإسلامي قد تمكن من الاحتفاظ بقدراته التنافسية ضمن القطاع المصرفي التجاري بمملكة البحرين, وعلى الصعيد التجاري، استمر البنك بتنمية حسابات الودائع المنخفضة الكلفة في عام 2010 وتنويع المنتجات والخدمات المصرفية للأفراد.

كما أن عام 2011م سوف يشهد بإذن الله تعالى زيادة رأس مال البنك قبل نهاية الربع الأول من أجل تلبية احتياجات البنك التمويلية والاستفادة من الفرص السانحة للاستثمار وتنويع وتقوية أصول البنك لمنح المساهمين عوائد أكبر على استثماراتهم.

وقد تم خلال العام حصد عدد من الجوائز التقديرية المتخصصة في الخدمات المصرفية، كان آخرها حصول البنك على جائزة أفضل موقع مرئي في مملكة البحرين – البنوك الإسلامية – من قبل أكاديمية المواقع الالكترونية العربية – لبنان.

وللمحافظة على هذه الانجازات فإننا نعي تماماً بأن علينا أن نتوخى الحذر لذلك سوف نستمر في تطبيق إستراتيجية البنك الموضوعة لمدة ثلاث سنوات قادمة, من قبل مجلس الإدارة، وهي تتضمن عدة جوانب هامة منها زيادة الدخل الأساسي المتكرر والعمل على تعزيزه، إلى جانب تحسين دخل الرسوم لدعم وتقوية الوضع المالي وتعزيز خدمات الزبائن مع تحقيق تواجد و حضور أكبر في السوق المحلي من خلال خدمات التمويل للأفراد والشركات مع التركيز على الشركات الصغيرة والمتوسطة، حيث لدينا من القدرة والخبرة ما يمكننا من تطوير وتنمية خدماتنا في هذا المجال. كما نخطط إلى زيادة مشاركتنا في مشاريع البنية التحتية التي تنفذها الحكومة. وإجمالاً فبالرغم من أن عام 2010 كان أكثر الأعوام تحدياً في تاريخ البنك، إلا أننا نود أن نؤكد أن البنك لديه من الإمكانيات والمقومات التي سوف تمكنه من العودة التدريجية والمستدامة للربحية من جديد بإذن الله تعالى.

وأخيراً فإنني أنتهز هذه الفرصة لأتقدم بالشكر لقيادتنا السياسية الرشيدة لبعد نظرها وحكمتها ودعمها لصناعة الخدمات المالية في البحرين عموماً وللصناعة المالية الإسلامية على وجه الخصوص، ولمصرف البحرين المركزي ولوزارة التجارة والصناعة وجميع المؤسسات الحكومية الأخرى لتوجيهاتهم ودعمهم المتواصل، ولهيئة الرقابة الشرعية تقديراً لدورها المهم في التوجيه والإشراف، ولمساهمينا والعملاء الكرام وأن أشيد بدعمهم وولائهم المستمر، ولإدارة البنك وجميع العاملين لمهنيتهم العالية ولتفانيهم و جهودهم المخلصة.

خالد عبدالله البسام

رئيس مجلس الإدارة

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 subsidiary ["the Group"] as of 31 December 2010, and the related consolidated statements of income, 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. 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 2010, 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 AAOIFI.

Other Matters

We confirm that, in our opinion, proper accounting records have been kept by the Bank 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 Bank, have occurred during the year ended 31 December 2010 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position and that the Bank has complied with the terms of its banking licence and has also complied with Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

Ernst + Young

18 January 2011
Manama, Kingdom of Bahrain

Bahrain Islamic Bank B.S.C.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2010

	Notes	*2010* BD'000	*2009* BD'000
ASSETS			
Cash and balances with Central Bank of Bahrain and other banks	3	**45,831**	36,093
Murabaha receivables	4	**431,692**	332,519
Mudaraba investments	5	**37,360**	53,370
Musharaka investments	6	**80,246**	80,919
Investments	7	**94,667**	134,195
Investment in associates	8	**6,778**	7,448
Investment in Ijarah assets	9	**9,635**	9,771
Ijarah Muntahia Bittamleek	10	**105,386**	119,244
Investment in properties	11	**105,192**	123,030
Ijarah rental receivables		**7,569**	3,603
Other assets	12	**11,318**	11,758
TOTAL ASSETS		**935,674**	911,950
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY			
LIABILITIES			
Customers' current accounts		**81,660**	79,724
Other liabilities	13	**12,571**	11,432
Total Liabilities		**94,231**	91,156
UNRESTRICTED INVESTMENT ACCOUNTS			
Financial institutions' investment accounts	14	**141,358**	157,914
Customers' investment accounts	14	**600,024**	522,379
Total Unrestricted Investment Accounts		**741,382**	680,293
EQUITY	15		
Share capital		**72,859**	72,859
Treasury shares		**(307)**	(173)
Share premium		**43,936**	43,936
Reserves		**(16,594)**	23,132
Proposed appropriations		**167**	747
Total Equity		**100,061**	140,501
TOTAL LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY		**935,674**	911,950
COMMITMENTS AND CONTINGENT LIABILITIES	17	**13,230**	18,765

Khalid Abdulla Al Bassam	Khalid Mohammed Najeeb	Mohammed Ebrahim Mohammed
Chairman	Board Member	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 2010

	Notes	**2010 BD'000**	2009 BD'000
INCOME			
Income from Islamic finances	18	**28,073**	30,300
Income from sukuk and commodities	18	**5,010**	5,394
		33,083	35,694
Gross return to unrestricted investment accounts		**28,188**	29,155
Group's share as a Mudarib		**(10,467)**	(11,517)
Return on unrestricted investment accounts		**17,721**	17,638
Group's share of income from joint financing and investment accounts		**15,362**	18,056
Net income from investments	19	**901**	3,164
Loss on sale of available for sale investments		**(1,429)**	(2,005)
Share of results of associates		**(717)**	(174)
Fee and commission income		**2,661**	4,418
Other income		**616**	433
Total income		**17,394**	23,892
EXPENSES			
Staff costs		**9,711**	9,812
Depreciation		**1,554**	1,320
Other expenses	20	**7,473**	5,750
Total expenses		**18,738**	16,882
Net (loss) income before fair value adjustment for investment in properties and provisions		**(1,344)**	7,010
Fair value adjustment for investment in properties	11	**(18,051)**	-
Provision for impairment	21	**(20,317)**	(26,407)
NET LOSS FOR THE YEAR		**(39,712)**	(19,397)
BASIC AND DILUTED EARNINGS PER SHARE (fils)	23	**(54.60)**	(26.67)

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

Bahrain Islamic Bank B.S.C.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2010

	Notes	*2010* *BD'000*	*2009* *BD'000*
OPERATING ACTIVITIES			
Net loss for the year		**(39,712)**	(19,397)
Adjustments for non-cash items:			
Depreciation		**1,554**	1,320
Provision for impairment	21	**20,317**	26,407
Fair value adjustment for investment in properties		**18,051**	-
Loss on sale of available for sale investments		**1,429**	2,005
Share of results of associates	8	**717**	174
Operating profit before changes in operating assets and liabilities		**2,356**	10,509
Working capital adjustments:			
Mandatory reserve with Central Bank of Bahrain		**(3,460)**	7,838
Murabaha receivables		**(104,823)**	16,363
Mudaraba investments		**10,829**	1,986
Musharaka investments		**(3,594)**	(351)
Ijarah rental receivables		**(3,966)**	(2,134)
Other assets		**(2,674)**	(6,408)
Customers' current accounts		**1,936**	10,258
Other liabilities		**1,277**	(5,255)
Net cash (used in) from operating activities		**(102,119)**	32,806
INVESTING ACTIVITIES			
Purchase of investment in properties		**(213)**	(6,157)
Ijarah Muntahia Bittamleek		**13,858**	(51,284)
Purchase of investment in Ijarah assets		**-**	(5)
Purchase of investments		**(24,121)**	(60,275)
Proceeds from disposal of investments		**58,056**	28,013
Movement in investment in associates		**-**	(234)
Net cash from (used in) investing activities		**47,580**	(89,942)
FINANCING ACTIVITIES			
Purchase of treasury shares		**(134)**	(173)
Decrease in financial institutions' investment accounts		**(16,556)**	(37,968)
Increase in customers' investment accounts		**77,645**	94,142
Dividends paid		**(59)**	(3,801)
Zakah paid		**(79)**	(712)
Net cash from financing activities		**60,817**	51,488
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**6,278**	(5,648)
Cash and cash equivalents at 1 January		**12,683**	18,331
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	3	**18,961**	12,683
Cash and cash equivalents at year end comprise of:			
Cash in hand		**7,605**	5,927
Balances with CBB, excluding mandatory reserve deposits		**3,150**	1,044
Balances with banks and other financial institutions		**8,206**	5,712
		18,961	12,683

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2010

				Reserves						
	Share capital BD'000	*Treasury shares BD'000*	*Share premium BD'000*	*Statutory reserve BD'000*	*General reserve BD'000*	*Investment in properties fair value reserve BD'000*	*Cumulative changes in fair value of investments BD'000*	*Accumulated losses BD'000*	*Proposed appropriations BD'000*	*Total equity BD'000*
Balance at 1 January 2010	72,859	(173)	43,936	10,268	1,000	18,093	(1,431)	(4,798)	747	140,501
Purchase of treasury shares (note 15)	-	(134)	-	-	-	-	-	-	-	(134)
Zakah paid	-	-	-	-	-	-	-	-	(747)	(747)
Net loss for the year	-	-	-	-	-	-	-	(39,712)	-	(39,712)
Transfer to investment in properties fair value reserve	-	-	-	-	-	(18,051)	-	18,051	-	-
Net movement in cumulative changes in fair value of investments	-	-	-	-	-	-	153	-	-	153
Appropriations (note 15)	-	-	-	-	-	-	-	(167)	167	-
Balance at 31 December 2010	**72,859**	**(307)**	**43,936**	**10,268**	**1,000**	**42**	**(1,278)**	**(26,626)**	**167**	**100,061**
Balance at 1 January 2009	66,235	-	43,936	10,268	1,000	18,093	(4,688)	17,714	13,889	166,447
Bonus shares issued (note 15)	6,624	-	-	-	-	-	-	-	(6,624)	-
Purchase of treasury shares (note 15)	-	(173)	-	-	-	-	-	-	-	(173)
Dividends paid	-	-	-	-	-	-	-	-	(6,624)	(6,624)
Zakah paid	-	-	-	-	-	-	-	-	(641)	(641)
Net loss for the year	-	-	-	-	-	-	-	(19,397)	-	(19,397)
Net movement in cumulative changes in fair value of investments	-	-	-	-	-	-	889	-	-	889
Transfer of changes in fair value reserve	-	-	-	-	-	-	2,368	(2,368)	-	-
Appropriations (note 15)	-	-	-	-	-	-	-	(747)	747	-
Balance at 31 December 2009	**72,859**	**(173)**	**43,936**	**10,268**	**1,000**	**18,093**	**(1,431)**	**(4,798)**	**747**	**140,501**

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 2010

	Qard hasan receivables BD'000	*Funds available for qard hasan BD'000*	*Total BD'000*
Balance at 1 January 2010	2	126	128
Uses of qard fund			
Marriage	27	(27)	-
Refurbishment	16	(16)	-
Medical treatment	14	(14)	-
Others	13	(13)	-
Total uses during the year	**70**	**(70)**	**-**
Repayments	(68)	68	-
Balance at 31 December 2010	**4**	**124**	**128**
Balance at 1 January 2009	10	118	128
Uses of qard fund			
Marriage	18	(18)	-
Refurbishment	16	(16)	-
Medical treatment	14	(14)	-
Others	11	(11)	-
Total uses during the year	59	(59)	-
Repayments	(67)	67	-
Balance at 31 December 2009	2	126	128

	2010 BD'000	*2009 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 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 2010

	2010	*2009*
	BD'000	*BD'000*
Sources of zakah and charity funds		
Undistributed zakah and charity funds at the beginning of the year	**1,092**	1,049
Zakah due from the Bank for the year	**167**	747
Non-Islamic income / late fee	**398**	206
Total sources of Zakah and Charity funds during the year	**1,657**	2,002
Uses of zakah and charity funds		
Philanthropic societies	**696**	677
Aid to needy families	**420**	233
Total uses of funds during the year	**1,116**	910
Undistributed zakah and charity funds at the end of the year	**541**	1,092

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 Stock Exchange.

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 thirteen branches (2009: 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 18 January 2011.

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 in properties", "available for sale" and "trading securities" 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.

b. Statement of Compliance

The consolidated financial statements of the Group have been prepared in accordance with the Financial Accounting Standards ("FAS") issued by the Accounting and Auditing Organization for Financial Institutions ("AAOIFI"), the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank, the Bahrain Commercial Companies Law, Central Bank of Bahrain ("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 ("the IFRS").

c. Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary (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 Subsidiary is prepared for the same reporting year as the Bank, using consistent accounting policies.

The Subsidiary is 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 subsidiary.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

c. Basis of consolidation (continued)

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

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

The Bank has one fully owned subsidiary, Abaad Real Estate Company B.S.C. (c), which is 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 in hand, balances with the Central Bank of Bahrain, balances with banks and other financial institutions, with original maturities of 90 days or less.

e. Murabaha receivables

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

f. Mudaraba and Musharaka investments

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

g. Investments

Investments comprise of held to maturity investment, available for sale investment and trading securities.

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 which have fixed or determinable payments and where the Group has both the intent and ability to hold to maturity are classified as held to maturity. 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 investment is recognised in the consolidated statement of income, when the investment is de-recognised or impaired.

Available for sale

Subsequent to acquisition, available for sale investments 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 investments are not reversed through the consolidated statement of income and increases in their fair value after impairment are recognised directly in equity.

Trading securities

These are initially recognised at cost, being the fair value of the consideration given excluding acquisition costs. These are subsequently re-measured at fair value. All related realised and unrealised gains or losses are included in the consolidated statement of income.

h. 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

h. Fair value (continued)

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

i. 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 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.

j. 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 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.

k. Investment in properties

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

l. 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

l. Equipment (continued)

The calculation of depreciation is on the following basis:

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

m. 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.

n. Investment risk reserve

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

o. 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.

p. Zakah

Zakah is calculated on the Zakah base of the Group in accordance with the "FAS" 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 unrestricted investment and other accounts is the responsibility of investment account holders.

q. 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.

r. Dividends

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

s. 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

s. Derecognition of financial assets and liabilities (continued)

Financial assets (continued)
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 expired.

t. 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.

u. 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.

v. 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".

w. 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.

x. 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 when the right to receive payment is established or on distribution by the Musharek, whereas the losses are charged to income on their declaration by the Musharek. Income related to non performing accounts is excluded from the consolidated statement of income.

Mudaraba investments
Income is recognised when the right to receive payment is established or on distribution by the Mudarib, whereas the losses are charged to income on their declaration by the Mudarib.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

x. 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. 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 unrestricted investment accounts is accrued based on the terms and conditions of the related mudaraba agreements.

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

y. 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.

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

z. Impairment of financial assets
An assessment is made at each 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 available for sale equity investments impairment losses recognised in the statement of income for an investment equity instrument shall not be reversed through the statement of income and should be recorded as increases in cumulative changes in fair value through equity.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

aa. Use of estimates in preparation of the consolidated financial statements

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

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.

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.

bb. Judgments

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which effects the amounts recognised in the financial statements:

Classification of investments

Management decides on acquisition of a financial asset whether it should be classified as "trading security", "available for sale" or "held to maturity".

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 CENTRAL BANK OF BAHRAIN AND OTHER BANKS

	2010		*2009*	
	Self financed BD'000	***Jointly financed BD'000***	*Self financed BD'000*	*Jointly financed BD'000*
Cash in hand	**7,605**	**-**	5,927	-
Balances with CBB, excluding mandatory reserve deposits	**3,150**	**-**	1,044	-
Balances with banks and other financial institutions	**8,206**	**-**	5,712	-
Cash and cash equivalents	**18,961**	**-**	12,683	-
Mandatory reserve with CBB	**-**	**26,870**	-	23,410
	18,961	**26,870**	12,683	23,410
		45,831		36,093

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

4 MURABAHA RECEIVABLES

	Jointly financed 2010 BD'000	*Jointly financed 2009 BD'000*
Murabaha with banks:		
International commodities	**195,875**	76,319
Other murabaha:		
Tawarooq	**131,134**	143,166
Letters of credit	**55,741**	60,343
Commodities murabaha with non-banks	**7,547**	18,743
Tasheel	**77,340**	58,843
Land	**594**	1,120
Building	**2,459**	5,803
Motor vehicles	**13,740**	14,983
Building materials	**784**	1,782
Furniture	**190**	253
Others	**4,133**	2,520
	293,662	307,556
Qard fund	**4**	2
	293,666	307,558
Gross receivables	**489,541**	383,877
Deferred profits	**(23,652)**	(22,810)
Provision for impairment (note 21) *	**(34,197)**	(28,548)
	431,692	332,519

* This includes collective impairment provision of BD 193 thousand (2009: BD 4,976 thousand).

Non-performing Murabaha receivables outstanding as of 31 December 2010 amounted to BD 97,882 thousand (2009: BD 43,593 thousand).

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

4 MURABAHA RECEIVABLES (continued)

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

	2010			*2009*		
	Europe BD'000	***Middle East BD'000***	***Total BD'000***	*Europe BD'000*	*Middle East BD'000*	*Total BD'000*
Commercial	**12,542**	**111,501**	**124,043**	11,205	104,619	115,824
Financial institutions	**34,376**	**195,500**	**229,876**	7,676	125,017	132,693
Others including retail	**-**	**111,970**	**111,970**	-	112,550	112,550
At 31 December	**46,918**	**418,971**	**465,889**	18,881	342,186	361,067

5 MUDARABA INVESTMENTS

	Jointly financed 2010 BD'000	*Jointly financed 2009 BD'000*
Mudaraba investments	**44,669**	56,008
Provision for impairment (note 21)	**(7,309)**	(2,638)
	37,360	53,370

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 2010 amounted to BD12,887 thousand (2009: BD 5,749 thousand).

6 MUSHARAKA INVESTMENTS

	Jointly financed 2010 BD'000	*Jointly financed 2009 BD'000*
Musharaka investment in real estate	**84,522**	80,927
Provision for impairment (note 21)	**(4,276)**	(8)
	80,246	80,919

Non-performing Musharaka investments outstanding as of 31 December 2010 amounted to BD 31,676 thousand (2009: BD 4,157 thousand).

7 INVESTMENTS

	2010			2009		
	Self financed BD'000	*Jointly financed BD'000*	*Total BD'000*	*Self financed BD'000*	*Jointly financed BD'000*	*Total BD'000*
i) Held to maturity						
Unquoted investments						
Sukuk						
At 1 January	-	93,075	93,075	-	75,492	75,492
Acquisitions	-	7,214	7,214	-	32,839	32,839
Disposals and redemptions	-	35,214	35,214	-	15,256	15,256
At 31 December	-	65,075	65,075	-	93,075	93,075
ii) Available for sale						
Quoted investments						
Equity shares						
At 1 January	37,307	-	37,307	20,074	-	20,074
Acquisitions	9,924	-	9,924	18,630	-	18,630
Disposals	26,922	-	26,922	1,397	-	1,397
At 31 December	20,309	-	20,309	37,307	-	37,307
Unquoted investments						
Equity shares						
At 1 January	14,030	-	14,030	37,451	-	37,451
Acquisitions	327	-	327	463	-	463
Disposals	37	-	37	23,884	-	23,884
At 31 December	14,320	-	14,320	14,030	-	14,030
iii) Trading securities						
Quoted investments						
Equity shares						
At 31 December	1,191	-	1,191	297	-	297
Total investment before provision for impairment at 31 December	35,820	65,075	100,895	51,634	93,075	144,709
Provision for impairment on						
Held to maturity (note 21)	-	(2,212)	(2,212)	-	(2,099)	(2,099)
Available for sale (note 21)	(4,016)	-	(4,016)	(8,415)	-	(8,415)
Total provision at 31 December	(4,016)	(2,212)	(6,228)	(8,415)	(2,099)	(10,514)
Total investments	31,804	62,863	94,667	43,219	90,976	134,195

8 INVESTMENT IN ASSOCIATES

Investments in associates comprise the following:

	Ownership %	Country of incorporation	2010 Self financed BD '000	2009 Self financed BD '000
Quoted				
Insurance				
*Takaful International Company B.S.C.**	**22.75%**	**Kingdom of Bahrain**	**1,664**	1,591
Unquoted				
Financial Institution				
Liquidity Management Centre B.S.C. (c)	**25.00%**	**Kingdom of Bahrain**	**5,114**	5,857
			6,778	7,448

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

The following table summarizes the latest associates' financial information :

	2010					
	Total assets BD '000	**Total liabilities BD '000**	**Total contingent liabilities BD '000**	**Total revenue BD '000**	**Profit / (loss) BD '000**	**Surplus in participants' fund BD '000**
Takaful International Company B.S.C.	**27,721**	**20,406**	**-**	**3,044**	**181**	387
Liquidity Management Centre B.S.C. (c)	**88,336**	**67,881**	**9,167**	**2,750**	**(3,383)**	-
	116,057	**88,287**	**9,167**	**5,794**	**(3,202)**	**387**

	2009					
	Total assets BD '000	*Total liabilities BD '000*	*Total contingent liabilities BD '000*	*Total revenue BD '000*	*Profit / (loss) BD '000*	*Surplus in participants' fund BD '000*
Takaful International Company B.S.C.	27,505	20,508	-	2,323	80	163
Liquidity Management Centre B.S.C. (c)	100,611	77,186	10,000	3,945	(917)	-
	128,116	97,694	10,000	6,268	(837)	163

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.

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.

9 INVESTMENT IN IJARAH ASSETS

	2010			2009		
	Self financed			Self financed		
	Land	Buildings	Total	Land	Buildings	Total
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
Cost:						
At 1 January	**6,600**	**5,640**	**12,240**	6,600	5,640	12,240
Additions	-	-	-	-	-	-
Disposals	-	-	-	-	-	-
At 31 December	**6,600**	**5,640**	**12,240**	6,600	5,640	12,240
Depreciation:						
At 1 January	-	**2,469**	**2,469**	-	2,339	2,339
Provided during the year	-	**136**	**136**	-	130	130
At 31 December	-	**2,605**	**2,605**	-	2,469	2,469
Net book value:						
At 31 December	**6,600**	**3,035**	**9,635**	6,600	3,171	9,771

10 IJARAH MUNTAHIA BITTAMLEEK

	2010				2009			
	Jointly financed				Jointly financed			
	Land	Buildings	Aviation related assets	Total	Land	Buildings	Aviation related assets	Total
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
Cost:								
At 1 January	**53,496**	**43,486**	**25,865**	**122,847**	32,292	37,137	-	69,429
Additions	**1,937**	**26,138**	**16,257**	**44,332**	21,863	17,595	26,584	66,042
Disposals	**(19,013)**	**(11,254)**	**(23,957)**	**(54,224)**	(659)	(11,246)	(719)	(12,624)
At 31 December	**36,420**	**58,370**	**18,165**	**112,955**	53,496	43,486	25,865	122,847
Depreciation:								
At 1 January	-	**3,459**	**144**	**3,603**	-	1,469	-	1,469
Provided during the year	-	**3,110**	**1,211**	**4,321**	-	2,181	144	2,325
Relating to disposed assets	-	**(254)**	**(101)**	**(355)**	-	(191)	-	(191)
At 31 December	-	**6,315**	**1,254**	**7,569**	-	3,459	144	3,603
Net book value:								
As at 31 December	**36,420**	**52,055**	**16,911**	**105,386**	53,496	40,027	25,721	119,244

Impaired Ijarah Muntahia Bittamleek as of 31 December 2010 is BD 41,898 thousand (2009: 1,433 thousand).

11 INVESTMENT IN PROPERTIES

	2010	*2009*
	Self financed	*Self financed*
	BD'000	*BD'000*
Cost:		
At 1 January	**104,937**	98,780
Additions	**213**	6,157
Disposals	**-**	-
Cost at 31 December	**105,150**	104,937
Fair value reserve*	**42**	18,093
Fair value at 31 December	**105,192**	123,030

* During the year a net fair value adjustment of BD 18,051 thousand (2009: nil) was taken through the consolidated statement of income.

Investment in properties comprises of properties located in GCC countries.

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

12 OTHER ASSETS

	2010	*2009*
	BD'000	*BD'000*
Equipment	**4,723**	4,534
Receivables from related parties	**2,526**	2,945
Staff advances	**1,271**	1,340
Other Receivables	**756**	756
Income receivable	**311**	297
Receivables under letter of credit	**188**	188
Prepaid expenses	**160**	126
Others	**4,632**	3,125
	14,567	13,311
Provision for impairment (note 21)	**(3,249)**	(1,553)
	11,318	11,758

13 OTHER LIABILITIES

	2010	*2009*
	BD'000	*BD'000*
Dividends payable	**3,477**	3,536
Payable to vendors	**2,178**	2,343
Unearned income	**1,281**	675
Managers' cheques	**1,273**	1,326
Accrued expenses	**1,215**	1,125
Provision for employees' end of service benefits and leave	**424**	333
Zakah and charity fund	**374**	345
Margin on letters of credit	**48**	201
Clearance cheques	**-**	204
Others	**2,301**	1,344
	12,571	11,432

14 UNRESTRICTED INVESTMENT ACCOUNTS

	2010 BD'000	*2009 BD'000*
Customers	**600,024**	522,379
Profit equalisation reserve (note 14.1)	**-**	-
Investment risk reserve (note 14.2)	**-**	-
Customers' investment accounts	**600,024**	522,379
Financial institutions' investment accounts	**141,358**	157,914

14.1 Movement in profit equalisation reserve

	2010 BD'000	*2009 BD'000*
Balance at 1 January	-	2,368
Transferred to income from jointly financed sales	-	(2,368)
Balance at 31 December	-	-

14.2 Movement in investment risk reserve

	2010 BD'000	*2009 BD'000*
Balance at 1 January	-	167
Amounts apportioned from income allocable to unrestricted investment account holders	-	(167)
Balance at 31 December	-	-

The profit equalisation reserve reverts to unrestricted investment accounts as per terms and conditions of the Mudaraba contract.

As unrestricted investment account holders' 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% (2009: 65%).

The following table represents the distribution of profit by type of unrestricted investment accounts:

	2010		*2009*	
Account Type	***Percentage of funds invested***	***Distributed profit rate***	*Percentage of funds invested*	*Distributed profit rate*
Defined deposits	**87%**	**2.15%**	87%	2.90%
Specific investment deposits	**95%**	**3.87%**	95%	4.40%
Investment certificates	**90%**	**4.00%**	90%	4.00%
Savings accounts	**45%**	**0.70%**	45%	0.70%
Iqra	**85%**	**3.00%**	85%	3.00%
Tejoori	**45%**	**0.70%**	45%	0.70%
Vevo	**45%**	**0.70%**	45%	0.70%

14 UNRESTRICTED INVESTMENT ACCOUNTS (continued)

14.3 Unrestricted Investment Account Balances

	2010 BD'000	2009 BD'000
Type of Unrestricted Investment Account		
Saving accounts (including Vevo)	**75,052**	66,631
Defined accounts - 1 month	**12,007**	16,834
Defined accounts - 3 months	**3,970**	4,696
Defined accounts - 6 months	**3,792**	3,984
Defined accounts - 9 months	**87**	80
Defined accounts - 1 year	**18,088**	20,048
Investment certificates	**2,317**	3,094
Iqra Deposits	**1,203**	539
Tejoori Deposit	**62,773**	38,955
Customer's deposits	**417,388**	363,806
Bank's deposits	**141,358**	157,914
Profit payable to depositors	**3,347**	3,712
	741,382	680,293

All the Bank's sources of unrestricted investment accounts funds are from the Kingdom of Bahrain.

14.4 Unrestricted Investment Account Balances by Type of Demand

Unrestricted Investment Accounts Balances by Type of Demand

	2010 BD'000	2009 BD'000
Balances on demand	**139,027**	106,125
Contractual basis*	**602,355**	574,168
	741,382	680,293

* Theses can be withdrawn subject to a monetary penalty.

15 EQUITY

	2010 BD'000	2009 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*		
728,589,400 shares (2009: 728,589,400 shares) of BD 0.100 each	**72,859**	72,859

During the year 2009 the Group has issued 66,235 thousand bonus shares at one share for every ten shares held amounting to BD 6,624 thousand.

15 EQUITY (continued)

(ii) Treasury Shares

	Number of Shares	*2010 BD'000*
At 1 January 2010	601,332	(173)
Purchase of treasury shares	699,163	(134)
At 31 December 2010	1,300,495	(307)

	2010 BD'000
Cost of treasury shares	307
Market value of treasury shares	168

The treasury shares as a percentage of total shares in issue is 0.18% only.

Own 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.

(iii) 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.

(iv) 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. 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.

Investment in properties fair value reserve
This represents cumulative unrealised revaluation gains or losses on investment 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 unrealised gains or losses on available for sale investments relating to self financed investments.

(v) Appropriations

	2010 BD'000	*2009 BD'000*
Zakah	167	747
	167	747

15 EQUITY (continued)

(v) Appropriations (continued)
The proposed appropriations for the year ended 2009 was approved at the Annual General Meeting held on 17 March 2010 and was effected in 2010 following that approval.

(vi) Additional information on shareholding pattern
i) 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;

		2010		*2009*	
Names	***Nationality***	***Number of shares***	***% holding***	*Number of shares*	*% holding*
Investment Dar	Kuwait	**290,591,510**	**39.88%**	290,591,510	39.88%
Islamic Development Bank	Saudi	**94,745,420**	**13.00%**	94,745,420	13.00%
General Council of Kuwaiti Awaqaf	Kuwait	**67,946,033**	**9.33%**	67,946,033	9.33%
Kuwait Investment Company S.A.K	Kuwait	**63,407,126**	**8.70%**	63,407,126	8.70%

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

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

	Number of shares	***Number of shareholders***	***2010 % of total outstanding shares***	*Number of shares*	*Number of shareholders*	*2009 % of total outstanding shares*
Less than 1%	**126,602,716**	**3,418**	**17.38%**	126,602,716	3,423	17.38%
1% up to less than 5%	**85,296,595**	**5**	**11.71%**	85,296,595	5	11.71%
5% up to less than 10%	**131,353,159**	**2**	**18.02%**	131,353,159	2	18.02%
10% up to less than 50%	**385,336,930**	**2**	**52.89%**	385,336,930	2	52.89%
	728,589,400	**3,427**	**100.00%**	728,589,400	3,432	100.00%

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

Categories:

	2010		*2009*	
	No. of shares	***No. of directors***	*No. of shares*	*No. of directors*
Less than 1%	**3,307,383**	**9**	3,454,753	11

The following is the number of shares, and percentage of shareholding of Directors and Senior management (Assistant General Managers and above);

	2010		*2009*	
	No. of shares	***Percentage Shareholdi***	*No. of shares*	*Percentage Shareholding*
Directors	**3,307,383**	**0.45%**	3,454,753	0.47%
Senior management	**65,872**	**0.01%**	75,872	0.01%
	3,373,255	**0.46%**	3,530,625	0.48%

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:

	2010	*2009*
	BD'000	*BD'000*
Core capital - Tier 1:		
Issued and fully paid ordinary shares	**72,552**	72,686
General reserves	**1,000**	1,000
Legal / statutory reserves	**10,268**	9,840
Share premium	**43,936**	43,936
Retained earnings / losses (excluding current year net income/loss)	**(4,798)**	11,380
Less:		
Net losses for the year	**(21,661)**	(18,634)
Unrealized gross losses arising from fair valuing equity securities	**(2,412)**	(2,636)
Tier 1 Capital before deductions	**98,885**	117,572
Supplementary capital - Tier 2:		
Current year net income	**-**	-
Asset revaluation reserve (45% only)	**19**	6,302
Unrealized gains arising from fair valuing equities (45% only)	**348**	156
Tier 2 Capital before deductions	**367**	6,458
Total available capital	**99,252**	124,030
Deductions		
Significant minority interest in banking, securities and financial entities	**(5,114)**	(5,480)
Excess amount over materiality threshold	**-**	(7,452)
Investment in insurance entity greater than or equal to 20%	**(1,664)**	(1,593)
Excess amount over maximum permitted large exposure limit	**(16,138)**	(35,072)
Total eligible capital	**76,336**	74,433

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:

16 CAPITAL ADEQUACY (continued)

	2010 *BD'000*	*2009* *BD'000*
Total Credit Risk Weighted Assets	**465,798**	463,217
Total Market Risk Weighted Assets	**22,656**	24,255
Total Operational Risk Weighted Assets	**52,968**	54,095
Total Regulatory Risk Weighted Assets	**541,422**	541,567
Capital Adequacy Ratio	**14.10%**	13.74%
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:

	2010 *BD'000*	*2009* *BD'000*
Letters of credit and acceptances	**4,971**	9,096
Guarantees	**7,735**	9,255
Operating lease commitments *	**524**	414
	13,230	18,765

* The Group has entered into commercial leases for certain branches. These leases have an average life of between 3 months and 7 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:

	2010 *BD'000*	*2009* *BD'000*
Within one year	**238**	170
After one year but not more than five years	**286**	230
More than five years	**-**	14
	524	414

Credit Lines Commitment

The Group during 2009 has provided credit line to its associate of BD 9,425 thousand for liquidity purposes which was fully utilised during 2009.

18 INCOME FROM JOINTLY FINANCED SALES AND INVESTMENTS

	2010 BD'000	2009 BD'000
Income from Islamic finances:		
Income from Murabaha receivables	**16,088**	16,645
Income from Mudaraba investments	**368**	872
Income from Musharaka investments	**4,660**	5,315
Income from Ijarah Muntahia Bittamleek - net *	**6,957**	7,468
	28,073	30,300

	2010 BD'000	2009 BD'000
Income from sukuk and commodities:		
Income from Murabaha commodities	**946**	1,422
Income from investments in sukuk	**4,064**	3,972
	5,010	5,394

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

	2010 BD'000	2009 BD'000
Income from Ijarah Muntahia Bittamleek – gross	**11,278**	9,793
Depreciation during the year (note 10)	**(4,321)**	(2,325)
	6,957	7,468

19 NET INCOME FROM INVESTMENTS

	2010 BD'000	2009 BD'000
Dividend income	**868**	1,640
Gain on sale of investment in properties	**-**	1,176
Unrealised loss on trading securities	**(97)**	(40)
Other investment income	**130**	388
	901	3,164

20 OTHER EXPENSES

	2010 BD'000	2009 BD'000
Marketing and advertisement expenses	**1,791**	1,047
Information technology related expenses	**1,128**	911
Communication expenses	**790**	776
Expenses on Ijarah assets	**662**	450
Professional services and consultancy fees	**395**	518
Stationery expenses	**409**	279
Travelling and transportation expenses	**159**	183
Brokerage fees and commission	**204**	290
Shari'a committee remuneration and board expenses	**216**	200
Premises Expenses	**607**	497
Other miscellaneous expenses	**1,112**	599
	7,473	5,750

21 PROVISIONS

2010	***Murabaha receivables BD'000***	***Mudaraba investments BD'000***	***Musharaka investments BD'000***	***Investments BD'000***	***Other assets BD'000***	***Total BD'000***
Provisions at 1 January	**28,548**	**2,638**	**8**	**10,514**	**1,553**	**43,261**
Written (off) back	**(3,691)**	**(475)**	**1,963**	**(7,056)**	**940**	**(8,319)**
	24,857	**2,163**	**1,971**	**3,458**	**2,493**	**34,942**
Provided	**9,340**	**5,146**	**2,305**	**2,770**	**756**	**20,317**
Provisions at 31 December	**34,197**	**7,309**	**4,276**	**6,228**	**3,249**	**55,259**
Notes	4	5	6	7	12	

2009	*Murabaha receivables BD'000*	*Mudaraba investments BD'000*	*Musharaka investments BD'000*	*Investments BD'000*	*Other assets BD'000*	*Total BD'000*
Provisions at 1 January	8,867	3,421	50	5,824	-	18,162
Written off during the year	(111)	(305)	(42)	(850)	-	(1,308)
	8,756	3,116	8	4,974	-	16,854
Provided (written back) during the year	19,792	(478)	-	5,540	1,553	26,407
Provisions at 31 December	28,548	2,638	8	10,514	1,553	43,261
Notes	4	5	6	7	12	

The fair value of collateral that the Group holds relating to non performing facilities at 31 December 2010 amounts to BD 171,069 thousand (31 December 2009: BD 9,828 thousand). The collateral consists of cash, securities and properties.

The Bank has taken all the provision allocated to the non performing assets to their own capital. Hence the Unrestricted Investment Account holders were not charged for any of the impairment.

22 ZAKAH

The total Zakah payable as of 31 December 2010 amounted to BD 1,601 thousand (2009: BD 2,692 thousand) of which BD 167 thousand (2009: BD 747 thousand) represent the Zakah on the statutory reserve, general reserve and retained earning as at 1 January 2010, is payable by the Bank. The remaining Zakah balance amounting to BD1,433 thousand or 2.0 fils per share (2009: BD 1,945 thousand or 2.7 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:

	2010	*2009*
Net loss for the year in BD'000'	**(39,712)**	(19,397)
Weighted average number of shares	**727,289**	727,289
Basic and diluted earnings per share (fils)	**(54.60)**	(26.67)

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:

		Income (expense)		*Balance at 31 December*	
Related party	*Transaction*	***2010***	*2009*	***2010***	*2009*
		BD'000	*BD'000*	***BD'000***	*BD'000*
Shareholders*	Sukuk	-	-	**4,197**	4,197
Shareholders**	Tawarooq	**455**	902	**20,359**	19,665
Shareholders	Investment in properties	-	-	**15,693**	18,850
Shareholders*	Receivable	-	1,553	**2,526**	2,945
Associate	Sukuk	-	82	-	-
Associate	Mudaraba	**155**	138	**3,691**	13,136
Board of Directors	Ijarah Muntahia Bittamleek	-	9	-	-
Board of Directors	Musharaka	-	20	-	-
Board of Directors	Tawarooq	**113**	82	**1,115**	1,259
Board of Directors	Expenses	**(162)**	(124)	-	-
Shari'a Supervisory Board	Expenses	**(54)**	(76)	-	-
Shari'a Supervisory Board	Murabaha	**82**	59	**1,081**	809
Shari'a Supervisory Board	Musharaka	**17**	17	**192**	231
Shari'a Supervisory Board	Tawarooq	**5**	1	-	137
Key management personnel	Staff advances	-	-	**366**	454
		611	2,663	**49,220**	61,683

* An amount of BD5,750 thousand (2009: BD 5,750 thousand) is considered as impaired for which provision of BD3,652 thousand (2009: BD 3,652 thousand) has been made.

** An amount of BD7,817 thousand (2009: BD 7,817 thousand) is considered as impaired for which provision of BD1,634 thousand (2009: Nil) 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.

	2010	*2009*
	BD'000	*BD'000*
Short term employee benefits	**1,102**	1,046
Other long term benefits	**128**	133
	1,230	1,179

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 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 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, Managing Director, 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.

25 RISK MANAGEMENT (continued)

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).

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 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 installments 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.

25 RISK MANAGEMENT (continued)

a) Credit Risk (continued)

Credit Risk Mitigation (continued)
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.

(i) Gross maximum exposure to credit risk

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

	2010 ***BD'000***	*2009* *BD'000*
Balances with banks and other financial institutions	**8,206**	5,712
Murabaha receivables	**465,889**	361,067
Mudaraba investments	**44,669**	56,008
Musharaka investments	**84,522**	80,927
Investment in Sukuk	**65,075**	93,075
Ijarah muntahia bittamleek	**105,386**	119,244
Ijarah rental receivables	**7,569**	3,603
Other assets	**5,052**	5,526
	786,368	725,162
Letters of credit, guarantees and acceptances	**12,706**	18,351

25 RISK MANAGEMENT (continued)

a) Credit Risk (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 of the Group's assets, liabilities, unrestricted investment accounts, commitments and contingent liabilities by geographic region and industry sector is as follows:

	Assets		*Liabilities and unrestricted investment accounts*		*Commitments and contingent liabilities*	
	31 December 2010 BD'000	*31 December 2009 BD'000*	***31 December 2010 BD'000***	*31 December 2009 BD'000*	***31 December 2010 BD'000***	*31 December 2009 BD'000*
Geographical region						
North America	**4,682**	4,776	**-**	-	**-**	-
Europe	**55,171**	26,121	**5,009**	7,026	**-**	-
Middle East	**873,768**	877,874	**830,600**	764,419	**13,230**	18,765
Rest of Asia	**2,053**	3,179	**4**	4	**-**	-
	935,674	911,950	**835,613**	771,449	**13,230**	18,765
Industry sector						
Trading and manufacturing	**82,011**	88,644	**47,455**	67,192	**6,821**	8,993
Aviation	**24,801**	27,950	**103,568**	11,924	**-**	-
Real Estate	**243,945**	304,355	**14,657**	27,767	**3,410**	1,498
Banks and financial institutions	**314,860**	226,822	**195,795**	247,677	**2,475**	7,860
Others	**270,057**	264,179	**474,138**	416,889	**524**	414
	935,674	911,950	**835,613**	771,449	**13,230**	18,765

25 RISK MANAGEMENT (continued)

a) Credit Risk (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 2010					
	Neither past due nor impaired					
	High grade BD'000	***Standard grade BD'000***	***Restructured* BD'000***	***Past due but not impaired BD'000***	***Individually impaired BD'000***	***Total BD'000***
Murabaha receivables	**9,160**	**330,349**	**11,049**	**17,449**	**97,882**	**465,889**
Musharaka investments	**4,098**	**31,507**	**6,899**	**10,342**	**31,676**	**84,522**
Ijarah muntahia bittamleek	-	**59,023**	-	**4,465**	**41,898**	**105,386**
Ijarah rental receivables	-	**7,569**	-	-	-	**7,569**
	13,258	**428,448**	**17,948**	**32,256**	**171,456**	**663,366**

	31 December 2009					
	Neither past due nor impaired					
	High grade BD'000	*Standard grade BD'000*	*Restructured* BD'000*	*Past due but not impaired BD'000*	*Individually impaired BD'000*	*Total BD'000*
Murabaha receivables	8,167	248,336	58,201	2,770	43,593	361,067
Musharaka investments	-	46,099	30,541	130	4,157	80,927
Ijarah muntahia bittamleek	-	111,342	-	6,469	1,433	119,244
Ijarah rental receivables	-	3,603	-	-	-	3,603
	8,167	409,380	88,742	9,369	49,183	564,841

* Restructured facilities represent the facilities which were restructured during the year. Moreover any restructured facilities which become non-performing is classified as individually impaired.

25 RISK MANAGEMENT (continued)

a) Credit Risk (continued)

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

2010	*Less than 30 days* BD'000	*31 to 60 days* BD'000	*61 to 90 days* BD'000	*Total* BD'000
Murabaha receivable	**8,583**	**2,642**	**6,224**	**17,449**
Musharaka investments	**4,408**	**3,013**	**2,921**	**10,342**
Ijarah muntahia bittamleek	**3,551**	**451**	**463**	**4,465**
	16,542	**6,106**	**9,608**	**32,256**

2009	*Less than 30 days* BD'000	*31 to 60 days* BD'000	*61 to 90 days* BD'000	*Total* BD'000
Murabaha receivable	462	2,264	44	2,770
Musharaka investments	108	22	-	130
Ijarah muntahia bittamleek	4,777	1,486	206	6,469
	5,347	3,772	250	9,369

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.

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 unrestricted investment accounts.

The maturity profile of assets, liabilities, unrestricted investment accounts and equity at 31 December 2010 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 CBB and other banks	18,961	-	-	-	-	-	26,870	45,831
Murabaha receivables	194,333	35,254	18,236	23,395	24,683	135,791	-	431,692
Mudaraba investments	4,274	-	747	-	-	32,339	-	37,360
Musharaka investments	3,336	4,579	5,264	402	3,224	63,441	-	80,246
Investments	4,836	18,672	12,721	645	14,477	30,184	13,132	94,667
Investment in associates	-	-	-	-	-	-	6,778	6,778
Investment in Ijarah assets	-	-	-	-	-	-	9,635	9,635
Ijarah Muntahia Bittamleek	1,125	108	135	25	11,639	92,354	-	105,386
Investment in properties	-	-	-	-	-	-	105,192	105,192
Ijarah rental receivables	-	-	7,569	-	-	-	-	7,569
Other assets	-	-	6,597	-	-	-	4,721	11,318
Total assets	226,865	58,613	51,269	24,467	54,023	354,109	166,328	935,674
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY								
Customers' current accounts	81,660	-	-	-	-	-	-	81,660
Other liabilities	12,571	-	-	-	-	-	-	12,571
Unrestricted investment accounts	243,682	228,086	68,063	191,433	8,799	-	1,319	741,382
Equity	-	-	-	-	-	-	100,061	100,061
Total liabilities, unrestricted investment accounts and equity	337,913	228,086	68,063	191,433	8,799	-	101,380	935,674
Liquidity gap	(111,048)	(169,473)	(16,794)	(166,966)	45,224	354,109	64,948	-
Cumulative liquidity gap	(111,048)	(280,521)	(297,315)	(464,281)	(419,057)	(64,948)	-	-

25 RISK MANAGEMENT (continued)

b) Liquidity risk (continued)

The maturity profile of assets, liabilities, unrestricted investment accounts and equity at 31 December 2009 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	12,683	-	-	-	-	-	23,410	36,093
Murabaha receivables	145,302	24,434	30,468	36,492	38,698	57,125	-	332,519
Mudaraba investments	13,690	-	1,610	-	-	38,070	-	53,370
Musharaka investments	20,310	5,722	6,704	4,091	10,010	34,082	-	80,919
Investments	5,671	36,549	-	5,414	43,744	29,804	13,013	134,195
Investment in associates	-	-	-	-	-	-	7,448	7,448
Investment in Ijarah assets	-	-	-	-	-	-	9,771	9,771
Ijarah Muntahia Bittamleek	6,860	1,315	36,097	198	6,357	68,417	-	119,244
Investment in properties	-	-	-	-	-	-	123,030	123,030
Ijarah rental receivables	-	-	3,603	-	-	-	-	3,603
Other assets	-	-	7,224	-	-	-	4,534	11,758
Total assets	204,516	68,020	85,706	46,195	98,809	227,498	181,206	911,950
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY								
Customers' current accounts	79,724	-	-	-	-	-	-	79,724
Other liabilities	11,432	-	-	-	-	-	-	11,432
Unrestricted investment accounts	302,351	133,560	79,318	160,177	4,077	-	810	680,293
Equity	-	-	-	-	-	-	140,501	140,501
Total liabilities, unrestricted investment accounts and equity	393,507	133,560	79,318	160,177	4,077	-	141,311	911,950
Liquidity gap	(188,991)	(65,540)	6,388	(113,982)	94,732	227,498	39,895	-
Cumulative liquidity gap	(188,991)	(254,531)	(248,143)	(362,125)	(267,393)	(39,895)	-	-

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 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 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;

2010	***Increase in equity price*** %	***Sensitivity of profit or loss*** BD'000	***Sensitivity of equity*** BD'000
Bahrain Stock Exchange	+10	**49**	**969**
Saudi Stock Exchange (TADAWUL)	+10	**38**	**-**
Qatar Stock Exchange	+10	**10**	**438**
Abu Dhabi Stock Exchange	+10	**8**	**-**
Oman Stock Exchange	+10	**14**	**342**

2009	*Increase in equity price* %	*Sensitivity of profit or loss* BD'000	*Sensitivity of equity* BD'000
Bahrain Stock Exchange	+10	16	2,054
Saudi Stock Exchange (TADAWUL)	+10	-	957
Dubai International Financial Exchange	+10	-	36
Qatar Stock Exchange	+10	-	368
Abu Dhabi Stock Exchange	+10	9	-
Kuwait Stock Exchange	+10	5	-

As at consolidated statement of financial position date, the Group has unquoted (equities and sukuk) of BD 76 million (31 December 2009: BD 107 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)	*Equivalent Long (short)*
	2010	*2009*
	BD '000	*BD '000*
Currency		
Pound Sterling	**(9,714)**	(5,157)
Euro	**14,109**	23,880
Kuwaiti Dinars	**8,533**	(12,391)

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.

26 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.

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 unquoted available for sale investments amounting to BD 13,132 (2009: BD 13,014) 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 equity.