

Al Salam Bank-Bahrain B.S.C.
CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2012

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

Report on the consolidated financial statements

We have audited the accompanying consolidated statement of financial position of Al Salam Bank-Bahrain B.S.C. ["the Bank"] as of 31 December 2012, and the related consolidated statements of income, cash flows and changes in equity for the year then ended. These consolidated financial statements and the Bank'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 the Bank's Board of Directors, as well as evaluating the overall consolidated financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Bank as of 31 December 2012, the results of its operations, its cash flows and changes in equity for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

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

Other matters

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

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

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2012 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests. The Bank has also complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

A handwritten signature in black ink that reads 'Ernst & Young' in a cursive, script font.

30 January 2013
Manama, Kingdom of Bahrain

Al Salam Bank-Bahrain B.S.C.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 December 2012

	Note	31 December 2012 BD '000	31 December 2011 BD '000
ASSETS			
Cash and balances with banks and Central Bank of Bahrain	4	66,843	72,318
Central Bank of Bahrain Sukuk		117,612	125,027
Murabaha and Wakala receivables from banks	5	103,290	135,698
Corporate Sukuk	6	74,993	49,650
Murabaha financing	7	127,537	135,383
Mudaraba financing	7	99,572	57,706
Ijarah Muntahia Bittamleek	9	82,954	66,477
Musharaka		17,467	11,711
Non-trading investments	10	204,202	223,320
Investment in an associate	11	7,573	-
Investment properties		2,500	2,500
Other assets	12	36,908	43,028
Premises and equipment		767	1,089
TOTAL ASSETS		942,218	923,907
LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY			
LIABILITIES			
Murabaha and Wakala payables to banks		90,852	104,573
Wakala payables to non-banks		521,929	515,147
Customers' current accounts		83,921	66,585
Other liabilities	13	19,175	20,721
TOTAL LIABILITIES		715,877	707,026
EQUITY OF INVESTMENT ACCOUNTHOLDERS	14	18,276	16,256
OWNERS' EQUITY			
Share capital	15	149,706	149,706
Treasury stock		(492)	(465)
Reserves and retained earnings		51,366	47,228
Proposed appropriations	15	7,485	-
Total equity attributable to shareholders of the Bank		208,065	196,469
Non-controlling interest	15	-	4,156
TOTAL OWNERS' EQUITY		208,065	200,625
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY		942,218	923,907

Sh. Hessa Bint Khalifa Al Khalifa
Chairperson of the Board

Yousif A. Taqi
Director and Chief Executive Officer

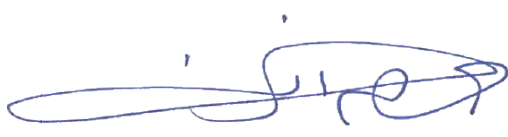
The attached notes 1 to 32 form part of these consolidated financial statements.

Al Salam Bank-Bahrain B.S.C.

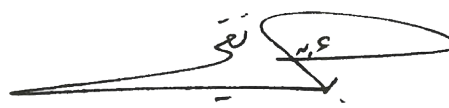
CONSOLIDATED INCOME STATEMENT

Year ended 31 December 2012

	Note	31 December 2012 BD '000	31 December 2011 BD '000
OPERATING INCOME			
Income from financing contracts	16	20,545	18,007
Income from Sukuk		8,899	6,106
Gains on sale of investments and sukuk		10,876	2,849
Income from FVTPL investments		635	601
Fair value changes on FVTPL investments		(7,021)	5,189
Net gain (loss) from available-for-sale investments		1,098	(5,325)
Fair value changes on investment properties		-	(873)
Dividend income		1,275	1,156
Foreign exchange gains		644	1,108
Fees and commission	17	823	831
Other income	17	6,281	361
		44,055	30,010
Profit on Murabaha and Wakala payables to banks		(599)	(714)
Profit on Wakala payables to non-banks		(20,228)	(16,403)
Profit relating to equity of investment accountholders	14	(166)	(153)
Total operating income		23,062	12,740
OPERATING EXPENSES			
Staff costs		6,350	6,016
Premises and equipment cost		1,179	1,168
Depreciation		394	999
Other operating expenses		3,541	3,415
Total operating expenses		11,464	11,598
PROFIT BEFORE RESULTS OF ASSOCIATE AND PROVISIONS			
		11,598	1,142
Share of profit from an associate	11	778	-
Provisions	8	(2,068)	(645)
NET PROFIT FOR THE YEAR			
		10,308	497
<i>Attributable to:</i>			
Shareholders of the Bank		10,272	312
Non-controlling interest		36	185
		10,308	497
WEIGHTED AVERAGE NUMBER OF SHARES (in '000)			
		1,491,372	1,491,779
BASIC AND DILUTED EARNINGS PER SHARE (FILS)			
		6.9	0.2



Sh. Hessa Bint Khalifa Al Khalifa
Chairperson of the Board



Yousif A. Taqi
Director and Chief Executive Officer

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

Al Salam Bank-Bahrain B.S.C.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2012

	<i>31 December 2012 BD '000</i>	<i>31 December 2011 BD '000</i>
OPERATING ACTIVITIES		
Net profit for the year	10,308	497
Adjustments:		
Depreciation	394	999
Loss on investments and investment properties	5,923	1,009
Provisions	2,068	645
Exchange differences on investment in an associate transferred to income statement	-	96
Share of profit from an associate	(778)	-
Operating income before changes in operating assets and liabilities	<u>17,915</u>	3,246
Changes in operating assets and liabilities:		
Mandatory reserve with Central Bank of Bahrain	(795)	(303)
Central Bank of Bahrain Sukuk	7,415	(56,395)
Murabaha and Wakala receivables from banks with original maturities of 90 days or more	(37)	9,990
Corporate Sukuk	(25,343)	11,309
Murabaha financing	6,100	(20,811)
Mudaraba financing	(41,866)	(38,397)
Ijarah Muntahia Bittamleek	(16,499)	(10,221)
Musharaka financing	(5,756)	(3,584)
Non-trading investments, net	7,751	(4,520)
Other assets	5,819	26,549
Murabaha and Wakala payables to banks	(13,721)	3,273
Wakala from non-banks	6,782	58,407
Customers' current accounts	17,336	9,223
Other liabilities	(5,738)	(250)
Net cash used in operating activities	<u>(40,637)</u>	(12,484)
INVESTING ACTIVITIES		
Purchase of premises and equipment	(72)	(229)
Net cash used in investing activities	<u>(72)</u>	(229)
FINANCING ACTIVITIES		
Equity of investment accountholders	2,020	(2,209)
Purchase of treasury stock	(27)	(465)
Net cash from (used in) financing activities	<u>1,993</u>	(2,674)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(38,716)	(15,387)
Cash and cash equivalents at 1 January	<u>187,729</u>	203,116
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	<u>149,013</u>	187,729
Cash and cash equivalents comprise of:		
Cash and other balances with Central Bank of Bahrain (Note 4)	35,912	45,410
Balances with other banks (Note 4)	10,866	7,638
Murabaha and Wakala receivables from banks with original maturities of less than 90 days	102,235	134,681
	<u>149,013</u>	<u>187,729</u>

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

Al Salam Bank-Bahrain B.S.C.

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

Year ended 31 December 2012

Amounts in BD '000s

	<i>Attributable to shareholders of the Bank</i>											<i>Non-controlling interest</i>	<i>Total owners' equity</i>
	<i>Share capital</i>	<i>Treasury stock</i>	<i>Statutory reserve</i>	<i>Retained earnings</i>	<i>Investment reserve</i>	<i>Changes in fair value</i>	<i>Foreign exchange translation reserve</i>	<i>Share premium reserve</i>	<i>Total reserves</i>	<i>Proposed appropriations</i>	<i>Total</i>		
Balance as of 1 January 2012	149,706	(465)	8,662	37,823	-	(1,830)	-	2,573	47,228	-	196,469	4,156	200,625
Net profit for the year	-	-	-	10,272	-	-	-	-	10,272	-	10,272	36	10,308
Net change in fair value	-	-	-	-	-	1,922	-	-	1,922	-	1,922	-	1,922
Changes on investment in an associate	-	-	-	-	-	-	(571)	-	(571)	-	(571)	-	(571)
Treasury shares purchased	-	(27)	-	-	-	-	-	-	-	-	(27)	-	(27)
Transfer to statutory reserve	-	-	1,027	(1,027)	-	-	-	-	-	-	-	-	-
Proposed Dividends for 2012	-	-	-	(7,485)	-	-	-	-	(7,485)	7,485	-	-	-
Transfer to other liabilities (note 15.3)	-	-	-	-	-	-	-	-	-	-	-	(4,192)	(4,192)
Balance at 31 December 2012	149,706	(492)	9,689	39,583	-	92	(571)	2,573	51,366	7,485	208,065	-	208,065
Balance as of 1 January 2011	149,706	-	8,631	4,603	33,039	172	(96)	2,573	48,922	-	198,628	3,997	202,625
Changes due to adoption of FAS 25 (note 2.3.1)	-	-	-	33,039	(33,039)	(757)	-	-	(757)	-	(757)	(8)	(765)
As at 1 January 2011 (restated)	149,706	-	8,631	37,642	-	(585)	(96)	2,573	48,165	-	197,871	3,989	201,860
Net profit for the year	-	-	-	312	-	-	-	-	312	-	312	185	497
Net change in fair value	-	-	-	-	-	(1,245)	-	-	(1,245)	-	(1,245)	(18)	(1,263)
Transfer to income statement	-	-	-	-	-	-	96	-	96	-	96	-	96
Treasury shares purchased	-	(465)	-	-	-	-	-	-	-	-	(465)	-	(465)
Transfer to statutory reserve	-	-	31	(31)	-	-	-	-	-	-	-	-	-
Charitable donations	-	-	-	(100)	-	-	-	-	(100)	-	(100)	-	(100)
Balance at 31 December 2011	149,706	(465)	8,662	37,823	-	(1,830)	-	2,573	47,228	-	196,469	4,156	200,625

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

31 December 2012

1 INCORPORATION AND PRINCIPAL ACTIVITIES

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

In 2009, the Bank acquired a 90.31% stake in Bahraini Saudi Bank B.S.C. ("BSB"), a publicly listed commercial bank in the Kingdom of Bahrain engaged in retail banking. In January 2012, BSB shares were delisted from Bahrain Stock Exchange. On 26 February 2012, approval was granted by the CBB to convert BSB's license from retail conventional bank to retail Islamic bank. On 24 April 2012, the operations of BSB merged with those of the Bank as more fully explained in note 15.

The Bank operates through ten branches in the Kingdom of Bahrain and offers a full range of Shari'a-compliant banking services and products. The activities of the Bank include managing profit sharing investment accounts, offering Islamic financing contracts, dealing in Shari'a-compliant financial instruments as principal/agent, managing Shari'a-compliant financial instruments and other activities permitted for under the CBB's Regulated Islamic Banking Services as defined in the licensing framework. The Bank's ordinary shares are listed in the Bahrain Bourse and Dubai Financial Market.

These consolidated financial statements have been authorised for issue in accordance with a resolution of the Board of Directors dated 30 January 2013.

2 ACCOUNTING POLICIES

2.1 BASIS OF PREPARATION

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

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

2.1.a Statement of compliance

The consolidated financial statements of the Bank are prepared in accordance with the Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"), the Islamic Sharia' rules and principles as determined by the Sharia' Supervisory Board of the Bank and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law. Matters for which no AAOIFI standards exist, the Bank uses the relevant International Financial Reporting Standard.

The Bank presents its consolidated statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the consolidated statement of financial position date (current) and more than 12 months after the consolidated statement of financial position date (non-current) is presented in Note 24.

2 ACCOUNTING POLICIES (continued)

2.2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

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

Classification of investments

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

Estimation uncertainty

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

Collective impairment provisions on financial contracts

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

Impairment losses on financial contracts

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

Impairment of available-for-sale equity investments

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

Valuation of unquoted private equity and real estate investments

Valuation of above investments is normally based on one of the following:

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

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

2 ACCOUNTING POLICIES (continued)

2.2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Going concern

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

2.3 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated financial statements, which are consistent with those of prior year.

2.3.1 Adoption of Financial Accounting Standards FAS 25 - "Investment in Sukuk, Shares and similar instruments"

During 2010, AAOIFI amended its conceptual framework and issued new Financial Accounting Standard (FAS 25) "Investment in sukuk, shares and similar instruments", which is effective from 1 January 2011. The Bank has adopted FAS 25 issued by AAOIFI which covers the recognition, measurement, presentation and disclosure of investment in sukuk, shares and similar investments that exhibit characteristics of debt or equity instruments made by Islamic financial institutions.

The adoption of FAS 25, did have not any impact on the non-trading investments held by the Bank. The impact on the opening total owners' equity as of 1 January 2011 was a reduction of BD 765 thousands. Also, the investment reserve amounting BD 33,039 thousands as of 1 January 2011, which was previously disclosed as a separate component in the owners' equity, has been transferred to retained earnings as this reserve is no longer required to be disclosed separately under the new FAS 25.

2.3.2 Summary of significant accounting policies

a) Financial contracts

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

b) Corporate sukuk

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

c) Murabaha receivables

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

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

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

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

d) Mudaraba financing

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

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

e) Ijarah Muntahia Bittamleek

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

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

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

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

f) Musharaka

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

Musharaka is stated at amortised cost, less any impairment.

g) Non-trading investments

These are classified as available-for-sale or fair value through profit or loss.

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

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

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

g) Non-trading investments (continued)

Investments available-for-sale

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

Impairment losses on available-for-sale investments are not reversed through the consolidated statement of income and increases in their fair value after impairment are recognised directly in owners' equity.

Investments carried at fair value through profit or loss

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

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

h) Investments in associates

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

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

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

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

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

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

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

i) Investment properties

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

Losses arising from changes in the fair values of investment properties are firstly adjusted against the fair value reserve to the extent of the available balance and then the remaining losses are included in the consolidated statement of income. In case there are unrealised losses that have been recognised in the consolidated statement of income in the previous financial period, the current year unrealised gain shall be recognised in the consolidated statement of income to the extent of crediting back such previous losses in the consolidated statement of income. When the property is disposed of, the cumulative gain previously transferred to the fair value reserve, is transferred to consolidated statement of income.

j) Premises and equipment

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

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

k) Subsidiaries acquired with a view to sell

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

l) Business combinations and goodwill

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

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

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

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

m) Impairment and uncollectability of financial assets

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

Impairment is determined as follows:

- (i) for assets carried at amortised cost, impairment is based on estimated cash flows based on the original effective profit rate;
- (ii) for assets carried at fair value, impairment is the difference between cost and fair value; and
- (iii) for assets carried at cost, impairment is based on present value of anticipated cash flows based on the current market rate of return for a similar financial asset.

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

n) Offsetting

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

o) Provisions

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

p) Employees' end of service benefits

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

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

q) Revenue recognition

Murabaha receivables

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

Corporate sukuk

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

Mudaraba

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

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

q) Revenue recognition (continued)

Dividend

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

Ijarah Muntahia Bittamleek

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

Musharaka

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

Fees and commission income

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

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

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

r) Fair value of financial assets

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

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

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

s) Foreign currencies

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

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

t) Trade and settlement date accounting

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

u) Derecognition of financial assets

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

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

v) Derecognition of financial liabilities

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

w) Fiduciary assets

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

x) Dividend on ordinary shares

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

y) Equity of investment account holders

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

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

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

z) Zakah

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

aa) Cash and cash equivalents

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

31 December 2012

2 ACCOUNTING POLICIES (continued)

2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

ab) Wakala payables

The Bank accepts deposits from banks and customers under Wakala arrangement under which a return may be payable to customers as agreed in the agreement. There is no restriction on the Bank for the use of funds received under wakala agreement.

ac) Jointly financed and self financed

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

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

ad) Investment risk reserve

This is the amount appropriated by the Bank out of the income of investment account holders, after allocating the Mudarib share, in order to compensate future losses for investment account holders.

ae) Earnings prohibited by Shari'a

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

af) Profit on Murabaha and Wakala payables to banks non-banks

Profit on these is accrued on a time-apportioned basis over the period of the contract based on the principal amounts outstanding.

2.3.3 Standards issued but not yet effective

The standards that are issued, but not yet effective, up to the date of issuance of the Bank's consolidated financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

Financial Accounting Standard 26 - Investment in real estate ("FAS 26") - Investment in real estate is property held to earn periodical income or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes or, sale in the ordinary course of business. FAS 26 is effective for financial periods beginning 1 January 2013. In accordance with FAS 26, the investment in real estate initially recognized at cost and subsequently measured based on intention whether the investment in real estate is held for use or held for sale. For held for use investments, an entity shall choose as its accounting policy either the fair value model or the cost model. Under the fair value model any unrealized gains shall be recognized directly in equity. Any unrealized losses shall be adjusted in equity to the extent of the available credit balance previously recognized. In case of any losses exceed the available balance in equity, the unrealized losses shall be recognized in the income statement. If an entity chooses cost model it shall measure all of its investment in real estate at cost less depreciation and any impairment provisions. Investment in real estate held-for-sale shall be carried at lower of its carrying value and expected fair value less costs to sell.

Al Salam Bank-Bahrain B.S.C.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

3 CLASSIFICATION OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS

<i>31 December 2012</i>				
	<i>At fair value through profit or loss</i>	<i>Available for sale</i>	<i>At amortised cost / others</i>	<i>Total</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
ASSETS				
Cash and balances with				
Central Bank of Bahrain	-	-	66,843	66,843
Central Bank of Bahrain Sukuk	-	-	117,612	117,612
Murabaha and Wakala receivables from banks	-	-	103,290	103,290
Corporate Sukuk	-	-	74,993	74,993
Murabaha and Mudaraba financing	-	-	227,109	227,109
Ijarah Muntahia Bittamleek	-	-	82,954	82,954
Musharaka financing	-	-	17,467	17,467
Non-trading investments	193,168	11,034	-	204,202
Other assets	-	3,056	27,176	30,232
	193,168	14,090	717,444	924,702
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS				
Murabaha and Wakala payables to banks	-	-	90,852	90,852
Wakala from non-banks	-	-	521,929	521,929
Customers' current accounts	-	-	83,921	83,921
Other financial liabilities	-	-	11,963	11,963
Equity of investment accountholders	-	-	18,276	18,276
	-	-	726,941	726,941

Al Salam Bank-Bahrain B.S.C.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

3 CLASSIFICATION OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS (continued)

	<i>31 December 2011</i>			
	<i>At fair value through profit or loss BD '000</i>	<i>Available for sale BD '000</i>	<i>At amortised cost / others BD '000</i>	<i>Total BD '000</i>
ASSETS				
Cash and balances with				
Central Bank of Bahrain	-	-	72,318	72,318
Central Bank of Bahrain Sukuk	-	-	125,027	125,027
Murabaha and Wakala receivables from banks	-	-	135,698	135,698
Corporate Sukuk	-	-	49,650	49,650
Murabaha and Mudaraba financing	-	-	193,089	193,089
Ijarah Muntahia Bittamleek	-	-	66,477	66,477
Musharaka financing	-	-	11,711	11,711
Non-trading investments	203,937	19,383	-	223,320
Other assets	-	4,072	38,534	42,606
	<u>203,937</u>	<u>23,455</u>	<u>692,504</u>	<u>919,896</u>
	<i>At fair value through profit or loss BD '000</i>	<i>Available for sale BD '000</i>	<i>At amortised cost / others BD '000</i>	<i>Total BD '000</i>
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS				
Murabaha and Wakala payables to banks	-	-	104,573	104,573
Wakala from non-banks	-	-	515,147	515,147
Customers' current accounts	-	-	66,585	66,585
Other financial liabilities	-	-	18,004	18,004
Equity of investment accountholders	-	-	16,256	16,256
	<u>-</u>	<u>-</u>	<u>720,565</u>	<u>720,565</u>

4 CASH AND BALANCES WITH BANKS AND CENTRAL BANK OF BAHRAIN

	<i>2012 BD '000</i>	<i>2011 BD '000</i>
Mandatory reserve with Central Bank of Bahrain	20,065	19,270
Cash and other balances with Central Bank of Bahrain	35,912	45,410
Balances with other banks	10,866	7,638
	<u>66,843</u>	<u>72,318</u>

5 MURABAHA AND WAKALA RECEIVABLES FROM BANKS

	<i>2012 BD '000</i>	<i>2011 BD '000</i>
GCC	98,012	133,813
Europe	5,278	1,885
	<u>103,290</u>	<u>135,698</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

5 MURABAHA AND WAKALA RECEIVABLES FROM BANKS (continued)

This includes certain Wakala receivables for investment in commodity Murabaha. In addition to above amounts, deferred profits on Murabaha receivables from banks amounted to BD 14 thousands (2011: BD 15 thousands).

This consists of BD18,276 thousands (2011: BD 10,759 thousands) of jointly financed assets and BD 85,014 thousands (2011: BD 124,939 thousands) of self financed assets.

6 CORPORATE SUKUK

This comprises of rated and investment grade Sukuk amounting to BD59,146 thousands (2011: BD43,009 thousands), non-investment grade Sukuk of BD421 thousands (2011: nil) and unrated Sukuk amounting to BD15,426 thousands (2011: BD6,641 thousands).

7 MURABAHA AND MUDARABA FINANCING**7.a Murabaha Financing**

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
Murabaha financing - gross	130,936	137,036
Less: Provision	(3,399)	(1,653)
Murabaha financing - net	<u>127,537</u>	<u>135,383</u>

Murabaha financing are shown net of deferred profits of BD 34,477 thousands (2011: BD 23,957 thousands).

This consists of BD nil (2011: BD 5,497 thousands) of jointly financed assets and BD127,537 thousands (2011: BD 129,886 thousands) of self financed assets.

7.b Mudaraba Financing

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
Mudaraba financing - gross	99,572	57,706
Less: Provision	-	-
Mudaraba financing - net	<u>99,572</u>	<u>57,706</u>

8 MOVEMENTS IN PROVISIONS

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
Balance at beginning of the year	2,153	1,508
Charge for the year	2,202	884
Recoveries for the year	(134)	(239)
Balance at end of the year	<u>4,221</u>	<u>2,153</u>

In addition to the provisions held above, the financing portfolio acquired through BSB business combination was subject to specific write down of BD2,965 thousands and a collective impairment write down of BD3,175 thousands.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

9 IJARAH MUNTAHIA BITTAMLEEK

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

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
Movements in Ijarah Muntahia Bittamleek assets are as follows:		
At 1 January	66,477	56,756
Additions during the year	24,194	16,370
Ijarah assets depreciation Provision	(7,695)	(6,149)
	(22)	(500)
At 31 December	82,954	66,477

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
The future minimum lease receivable in aggregate are as follows:		

Due within one year	18,213	18,162
Due in one to five years	56,851	29,096
Due after five years	7,890	19,219
	82,954	66,477

Ijarah Muntahia Bittamleek is divided into the following asset classes:

Air crafts	2,310	2,735
Machinery	3,041	3,137
Land and buildings	77,603	60,605
	82,954	66,477

The accumulated depreciation on Ijarah Muntahia Bittamleek assets amounted to BD 11,812 thousands (2011:BD 6,008 thousands).

10 NON-TRADING INVESTMENTS

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

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

Fair value hierarchy

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

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

10 NON-TRADING INVESTMENTS (continued)

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

<i>31 December 2012</i>	<i>Level 1</i>	<i>Level 2</i>	<i>Level 3</i>	<i>Total</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
Financial assets at fair value through profit or loss	9,736	445	182,987	193,168
Available-for-sale financial assets	11,034	-	-	11,034
	20,770	445	182,987	204,202
<i>31 December 2011</i>				
	<i>Level 1</i>	<i>Level 2</i>	<i>Level 3</i>	<i>Total</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
Financial assets at fair value through profit or loss	4,735	460	198,742	203,937
Available-for-sale financial assets	14,105	-	5,278	19,383
	18,840	460	204,020	223,320

During the reporting year ended 31 December 2012 and 2011, there were no transfers between Level 1 and Level 2 fair value measurements.

11 INVESTMENT IN AN ASSOCIATE

The Bank has a 14.4% stake in Al Salam Bank Algeria (ASBA), an unlisted bank incorporated in Algeria. The investment was earlier classified as non-trading investment due to lack of significant influence. In the Bank's Annual General Assembly Meeting (AGM) held during 2012 some directors of ASBA were elected to the Board of the Bank. Due to common directorship ASBA is significantly influenced by the Bank. Consequently, the non-trading investment has been derecognised and an investment in an associate has been recognised with the related gains included under gain from available-for-sale investments.

The following table illustrates the summarised financial information of the Bank's investment in ASBA:

	<i>2012</i>
	<i>BD '000</i>
Associate's statement of financial position:	
Total assets	158,214
Total liabilities	101,219
Net assets	56,995
Total revenue	14,510
Total expenses	9,110
Net profit for the year	5,400
Bank's share of associate's net profit	778

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

12 OTHER ASSETS

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
Assets under conversion		
Loans and advances to customers	11,560	19,628
Non-trading-investments - Debt	3,777	4,847
Non-trading-investments - Available for sale - equity	3,056	3,275
Profit receivable on Murabaha and Mudaraba	2,454	1,590
Rental receivable on Ijarah Muntahia Bittamleek assets	438	479
Profit receivable on Sukuk	1,883	1,359
Prepayments	365	422
Repossed assets	6,425	-
Other receivables	6,950	11,428
	36,908	43,028

The above assets under conversion were previously disclosed in the consolidated statement of financial position as a separate line. Subsequent to the merger of BSB with the Bank, these non-Shari'a compliant assets were reclassified to other assets. The comparative amounts have also been reclassified to conform with current year presentation. This reclassification had no impact on previously reported net income, total assets and owners' equity.

The above available for sale equity investments are classified in Level 3 category.

During the year ended 31 December 2012, the Bank received cash and repossed certain collaterals amounting to a total of BD 6.9 million from its customers. These repossed collaterals are included in other assets. The excess amount over carrying values amounting to BD6 million (2011: nil) is included in other income.

Other receivables include BD 1,369 thousands (2011: BD 4,060 thousands) relating to sale of investments.

13 OTHER LIABILITIES

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
Profit payable	4,259	4,325
Accounts payable and accruals	7,415	5,379
Non-controlling interest (note 15.3)	4,192	-
Liabilities under conversion	-	7,633
Dividends payable	2,394	2,438
End of service benefits	474	670
Charity payable	441	276
	19,175	20,721

Charity payable includes BD 236 thousands (2011: BD 7 thousands) of Shari'a prohibited income allocated for charitable purposes.

31 December 2012

14 EQUITY OF INVESTMENT ACCOUNTHOLDERS

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

The balances consists savings accounts of BD 10,511 thousands (2011: BD 7,829 thousands) and call accounts of BD 7,765 thousands (2011: BD 8,427 thousands).

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

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
Gross return from commingled assets	301	278
Bank's share as Mudarib	(135)	(125)
	<u>166</u>	<u>153</u>
Distributions to investment account holders	<u>166</u>	<u>153</u>

The average profit rate for the holders is 0.7% (2011: 1.00%).

15 OWNERS' EQUITY

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
15.1 Share capital		
Authorised:		
2,000,000,000 ordinary shares of BD 0.100 each	<u>200,000</u>	<u>200,000</u>
Issued and fully paid at BD 0.100 per share:		
Balance at beginning and end - 1,497,063,825 shares	<u>149,706</u>	<u>149,706</u>

15.2 Proposed appropriations

The Board of Directors in its meeting on 30 January 2013 has resolved to recommend a cash dividend of 5 fils per share or 5% of the paid-up capital (2011: nil) subject to approval at the forthcoming annual general meeting.

15.3 Non-controlling interest

The shareholders of BSB in an Extraordinary General Assembly Meeting held on 22 December 2011 resolved to merge BSB's operations with those of the Bank. Consequently, on 24 April 2012, the Commercial Registration of BSB was cancelled by MOIC. Following this, the Bank acquired all the assets, and assumed all the liabilities of BSB, with effect from 25 April 2012 and integrated BSB's operations with those of the Bank.

The Bank's financial obligations to the non-controlling interest of BSB have been transferred to other liabilities in the consolidated statement of financial position, pending completion of legal formalities and settlement.

15.4 Statutory reserve

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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16 INCOME FROM FINANCING CONTRACTS

	<i>2012</i> <i>BD '000</i>	<i>2011</i> <i>BD '000</i>
Murabaha and Wakala receivables from banks	552	585
Murabaha and Mudaraba financing	15,269	12,336
Musharaka	488	773
Ijarah Muntahia Bittamleek*	4,236	4,313
	<u>20,545</u>	<u>18,007</u>

* Depreciation on Ijarah Muntahia Bitamleek amounts to BD 7,695 thousands (2011: BD 6,149 thousands).

17 FEES AND COMMISSION AND OTHER INCOME

	<i>2012</i> <i>BD '000</i>	<i>2011</i> <i>BD '000</i>
17.1 Fees and commission		
Financing and transaction related fees and commissions	299	314
Fiduciary and other fees	524	517
	<u>823</u>	<u>831</u>
	<i>2012</i> <i>BD '000</i>	<i>2011</i> <i>BD '000</i>
17.2 Other income	<u>6,281</u>	<u>361</u>

During the year ended 31 December 2012, the Bank received cash and repossessed certain collaterals amounting to a total of BD 6.9 million from its customers. These repossessed collaterals are included in other assets. The excess amount over carrying values amounting to BD6 million (2011: nil) is included in other income.

18 TOTAL COMPREHENSIVE INCOME

	<i>2012</i> <i>BD '000</i>	<i>2011</i> <i>BD '000</i>
NET PROFIT FOR THE YEAR	<u>10,308</u>	<u>497</u>
Other comprehensive income:		
Net changes in fair value	1,922	(1,263)
Exchange differences on investment in an associate	(571)	-
Exchange differences on investment in an associate transferred to income statement	-	96
Other comprehensive income (loss) for the year	<u>1,351</u>	<u>(1,167)</u>
TOTAL COMPREHENSIVE INCOME (LOSS) FOR THE YEAR	<u>11,659</u>	<u>(670)</u>
<i>Attributable to:</i>		
Owners of the Bank	11,623	(837)
Non-controlling interest	36	167
	<u>11,659</u>	<u>(670)</u>

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19 RELATED PARTY TRANSACTIONS

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

The significant balances with related parties at 31 December 2012 were as follows:

	<i>2012</i>			
	<i>Associates and joint ventures BD '000</i>	<i>Directors and related entities BD '000</i>	<i>Senior management BD '000</i>	<i>Total BD '000</i>
Assets:				
Murabaha financing	30,198	13	70	30,281
Mudaraba financing	14,214	100	-	14,314
Ijarah Muntahia Bittamleek	-	2,310	-	2,310
Musharaka financing	2,061	-	-	2,061
Other assets	822	4	-	826
Liabilities and equity of investment accountholders:				
Wakala payables to non-banks	2,459	926	230	3,615
Customers' current accounts	5,145	154	10	5,309
Equity of investment accountholders	1,866	110	10	1,986
Commitments	9,425	-	-	9,425
Contingent liabilities	4,273	-	-	4,273

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

	<i>2012</i>			
	<i>Associates and joint ventures BD '000</i>	<i>Directors and related entities BD '000</i>	<i>Senior management BD '000</i>	<i>Total BD '000</i>
Income:				
Income from financing contracts	2,311	7	8	2,326
Expenses:				
Profit on Wakala payables to non-banks	66	33	5	104
Share of profits on equity of investment account holders	2	1	-	3

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19 RELATED PARTY TRANSACTIONS (continued)

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

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

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

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

As of 31 December 2012, Ijarah Muntahia Bittamleek included BD2,310 thousand (2011: nil) of facilities provided to directors and their related entities which are past due and on which profit is not being recognised.

Directors' remuneration for 2012 amounted to BD100,000.

Compensation of key management personnel, consisting solely of short-term benefits, for the year was BD 1,161 thousands (2011: BD 1,438 thousands).

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20 CONTINGENT LIABILITIES AND COMMITMENTS

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
Contingent liabilities on behalf of customers		
Guarantees	9,744	5,270
Letters of credit	814	1,301
Acceptances	275	406
	10,833	6,977
Irrevocable unutilised commitments		
Unutilised financing commitments	20,396	25,591
Unutilised non-funded commitments	6,219	8,283
Unutilised capital commitments	1,391	1,398
	28,006	35,272
	38,839	42,249

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

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

Operating lease commitment - Bank as lessee

The Bank has entered into various operating lease agreements for its premises. Future minimal rentals payable under the non-cancellable leases are as follows:

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
Within 1 year	714	646
After one year but not more than five years	915	1,133
	1,629	1,779

21 RISK MANAGEMENT**21.1 Introduction**

Risk is inherent in the Bank'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 Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to early settlement risk and operational risks.

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

Risk management structure

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

Board of Directors

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

21 RISK MANAGEMENT (continued)

21.1 Introduction (continued)

Executive Committee

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

Shari'a Supervisory Board

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

Credit/ Risk Committee

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

Asset and Liability Committee

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

Board Audit Committee

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

Internal Audit

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

Risk measurement and reporting systems

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

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

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

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21 RISK MANAGEMENT (continued)**21.1 Introduction (continued)*****Risk measurement and reporting systems (continued)***

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

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

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

21.2 Credit risk

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

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

Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure (excluding sovereign exposure) to credit risk for the components of the consolidated statement of financial position. The maximum exposure is shown net of provision, before the effect of mitigation through the use of master netting and collateral agreements.

	<i>Gross maximum exposure 2012 BD '000</i>	<i>Gross maximum exposure 2011 BD '000</i>
ASSETS		
Balances with other banks	10,866	7,638
Murabaha receivables from banks	103,290	135,698
Corporate Sukuk	74,993	49,650
Murabaha and Mudaraba financing	171,308	148,243
Ijarah Muntahia Bittamleek	79,913	63,277
Musharaka financing	17,467	11,711
Other assets	5,561	22,725
Total	463,398	438,942
Contingent liabilities and commitments	40,468	34,848
Total credit risk exposure	503,866	473,790

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

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21 RISK MANAGEMENT (continued)**21.2 Credit risk (continued)***Type of credit risk*

Various contracts entered into by the Bank comprise Murabaha financing, Mudaraba financing, Musharaka financing, Sukuk and Ijarah Muntahia Bittamleek contracts. Murabaha financing contracts cover land, buildings, commodities, motor vehicles and others. Mudaraba financing consist of financing transactions entered through other Islamic banks and financial institutions. Mudaraba is a partnership agreement in which the Islamic bank acts as the provider of funds (the Rabamal) while the recipient of the funds (the Mudarib or the manager) provides the professional, managerial and technical know-how towards carrying out the venture, trade or service with an aim of earning profit. The various financial instruments are:

Murabaha financing

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

Ijarah Muntahia Bittamleek

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

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

	31 December 2012				
	Neither past due nor impaired			Past due or individually impaired	Total
	'A' Rated BD '000	'B' Rated BD '000	Unrated BD '000	BD '000	BD '000
Balances with banks	6,486	144	4,236		10,866
Murabaha and Wakala receivables from banks	30,670	33,135	39,485		103,290
	37,156	33,279	43,721	-	114,156
	31 December 2011				
	Neither past due nor impaired			Past due or individually impaired	Total
	'A' Rated BD '000	'B' Rated BD '000	Unrated BD '000	BD '000	BD '000
Balances with banks	7,460	54	123	-	7,637
Murabaha and Wakala receivables from banks	65,804	29,706	40,188	-	135,698
	73,264	29,760	40,311	-	143,335

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

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21 RISK MANAGEMENT (continued)**21.2 Credit risk (continued)**

b) The credit quality of Corporate sukuk and financing facilities that are subject to credit risk, based on internal credit ratings, is as follows:

	31 December 2012					
	Neither past due nor impaired			Past due		Total BD '000
	Satisfactory	Watch List	Substandard	Not impaired	Impaired	
BD '000	BD '000	BD '000	BD '000	BD '000		
Corporate Sukuk	74,993	-	-	-	-	74,993
Murabaha and Mudaraba financing	151,926	1,284	1,801	8,517	7,780	171,308
Ijarah Muntahia Bittamleek	63,266	655	1,041	13,819	1,132	79,913
Musharaka financing	17,273	-	-	100	94	17,467
Other assets	148	-	3,910	1	1,502	5,561
	307,606	1,939	6,752	22,437	10,508	349,242

	31 December 2011					
	Neither past due nor impaired			Past due		Total BD '000
	Satisfactory	Watch List	Substandard	Not impaired	Impaired	
BD '000	BD '000	BD '000	BD '000	BD '000		
Corporate sukuk	49,650	-	-	-	-	49,650
Murabaha and Mudaraba financing	120,382	-	9,019	15,250	3,592	148,243
Ijarah Muntahia Bittamleek	45,081	6,499	3,336	7,979	382	63,277
Musharaka financing	11,492	159	-	60	-	11,711
Other assets	22,633	48	44	-	-	22,725
	249,238	6,706	12,399	23,289	3,974	295,606

In addition to the above, the financing facilities provided to the Government of Bahrain and its related entities amount to BD64,841 thousands (2011: BD44,949 thousands).

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

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21 RISK MANAGEMENT (continued)**21.2 Credit risk (continued)**

c) Past due but not impaired financing facilities are analysed as follows:

	<i>31 December 2012</i>			
	<i>0-30 days</i>	<i>31-90 days</i>	<i>> 90 days</i>	<i>Total</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
Murabaha and Mudaraba financing	1,298	1,196	6,023	8,517
Ijarah Muntahia Bittamleek	272	1,819	11,728	13,819
Musharaka financing	-	-	100	100
Other assets	-	1	-	1
	1,570	3,016	17,851	22,437
	<i>31 December 2011</i>			
	<i>0-30 days</i>	<i>31-90 days</i>	<i>> 90 days</i>	<i>Total</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
Murabaha and Mudaraba financing	4,815	58	10,377	15,250
Ijarah Muntahia Bittamleek	1,639	149	6,191	7,979
Musharaka financing	-	-	60	60
	6,454	207	16,628	23,289

All the past due but not impaired financing facilities are covered by collateral of BD36,579 thousands (2011: BD 27,310 thousands). The utilisation of the collateral will be on customer by customer basis and is limited to the customers' total exposure.

The maximum credit risk, without taking into account the fair value of any collateral and Shari'a-compliant netting agreements, is limited to the amounts on the consolidated statement of financial position plus commitments to customers disclosed in Note 20 except capital commitments.

During the year BD 23,725 thousands (2011: BD 30,039 thousands) of financing facilities were renegotiated. All renegotiated facilities are performing and are fully secured.

At 31 December 2012, the amount of credit exposure in excess of 15% of the Bank's regulatory capital to individual counterparties was BD5,453 thousands (2011: nil).

The Bank has pledged certain Sukuk with a financial institution having a carrying value of BD 11,668 thousands as at 31 December 2012 (2011: BD11,502 thousands) against which the financing as at 31 December 2012 amount to BD 9,321 thousands (2011: BD 8,465 thousands). These financing are included in Murabaha and Wakala payables to banks.

21.3 Legal risk and claims

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

As at 31 December 2012, legal suits amounting to BD 1,978 thousands (2011: BD 2,030 thousands) were pending against the Bank. Based on the opinion of the Bank's legal counsel, the total estimated liability arising from these cases is not considered to be material to the Bank's consolidated financial position as the Bank also has filed counter cases against these parties.

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22 CONCENTRATIONS

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

The distribution of assets, liabilities and equity of investment account holders by geographic region and industry sector was as follows. For quoted investments this is analysed with reference to the indices in with the investments are listed. For unquoted investments, this is analysed by changing the key inputs used in the valuation assumptions.

	<i>Liabilities, equity of investment account holders and</i>			<i>Assets</i>	<i>Liabilities, equity of investment account holders and</i>		
	<i>owners' equity</i>	<i>Contingent liabilities and Commitments</i>	<i>Assets</i>		<i>owners' equity</i>	<i>Contingent liabilities and Commitments</i>	
	<i>2012</i>	<i>2012</i>	<i>2012</i>	<i>2011</i>	<i>2011</i>	<i>2011</i>	
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	
Geographic region							
GCC	829,357	713,695	25,379	820,079	703,561	42,607	
Arab World	7,610	124	-	5,282	3,774	-	
Europe	38,135	14,242	-	32,563	13,257	-	
Asia	63,134	6,083	15,089	54,459	2,429	1,421	
North America	3,556	9	-	10,159	261	-	
Others	426	-	-	1,365	-	-	
	942,218	734,153	40,468	923,907	723,282	44,028	
Owners' equity	-	208,065	-	-	200,625	-	
	942,218	942,218	40,468	923,907	923,907	44,028	
Industry sector							
Trading and manufacturing	58,398	44,242	17,255	11,008	76,298	9,828	
Banks and financial institutions	182,737	114,831	-	206,540	128,681	263	
Real estate	257,335	86,932	8,679	256,175	77,670	11,190	
Aviation	13,125	-	-	12,573	29	-	
Individuals	72,813	361,700	1,829	53,179	336,464	1,853	
Government and public sector	265,716	51,778	-	258,711	71,429	9,180	
Others	92,094	74,670	12,705	125,721	32,711	11,714	
	942,218	734,153	40,468	923,907	723,282	44,028	
Owners' equity	-	208,065	-	-	200,625	-	
	942,218	942,218	40,468	923,907	923,907	44,028	

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23 MARKET RISK

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

23.1 Equity price risk

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

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

	<i>2012</i>			
	<i>10% increase</i>		<i>10% decrease</i>	
	<i>Effect on</i>	<i>Effect on</i>	<i>Effect on</i>	<i>Effect on</i>
	<i>net profit</i>	<i>equity</i>	<i>net profit</i>	<i>equity</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
Quoted:				
Bahrain	-	248	(248)	-
Saudi	376	-	(376)	-
Singapore	142	856	(142)	(856)
Frankfurt	456	-	(456)	-
Unquoted	18,343	306	(18,343)	(306)
	<i>2011</i>			
	<i>10% increase</i>		<i>10% decrease</i>	
	<i>Effect on</i>	<i>Effect on</i>	<i>Effect on</i>	<i>Effect on</i>
	<i>net profit</i>	<i>equity</i>	<i>net profit</i>	<i>equity</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
Quoted:				
Bahrain	-	375	(375)	-
Saudi	318	-	(318)	-
Singapore	156	1,036	(156)	(1,036)
Unquoted	20,448	327	(20,448)	(327)

23.2 Profit return risk

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

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

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23 MARKET RISK (continued)**23.2 Profit return risk (continued)**

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

	<i>2012</i>			
	<i>Change in rate %</i>	<i>Effect on net profit BD '000</i>	<i>Change in rate %</i>	<i>Effect on net profit BD '000</i>
US dollars	0.25	497	(0.25)	(497)
Bahraini dinars	0.25	357	(0.25)	(357)
Sterling pounds	0.25	35	(0.25)	(35)

	<i>2011</i>			
	<i>Change in rate %</i>	<i>Effect on net profit BD '000</i>	<i>Change in rate %</i>	<i>Effect on net profit BD '000</i>
US dollars	0.25	202	(0.25)	(202)
Bahraini dinars	0.25	409	(0.25)	(409)
Sterling pounds	0.25	27	(0.25)	(27)

In addition to profit generating Islamic financing and investment products considered in arriving at the effect on net profits, the other assets include assets-under-conversion amounting to BD 15,336 thousands (2011: BD 24,475 thousands) which are interest bearing. The Bank is in the process of converting these into Shari'a compliant contracts. If all the interest bearing assets abilities were converted into Shari'a complaint contracts on 1 January 2013, the change in profit rate by 0.25% would result in a profit or loss of BD 38 thousands (2011: BD 42 thousands).

The Bank has entered into profit rate swaps for a notional amount of BD 15,080 thousands (2011: Nil) with a counterparty to minimise the impact of the fluctuations in the profit rates. The Bank pays a fixed rate and receives floating rates with reference to an index. The maturity of the contract is 1 to 5 years. The fair value adjustment is included in other assets and is classified as level 2 in fair value hierarchies.

23.3 Currency risk

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

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

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
US dollars	-	48,825
Saudi riyals	39,918	43,125

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23 MARKET RISK (continued)**23.3 Currency risk (continued)**

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

	<i>2012</i>			
	<i>Change in rate %</i>	<i>Effect on net profit BD '000</i>	<i>Change in rate %</i>	<i>Effect on net profit BD '000</i>
US dollars to Bahraini dinars	1	-	(1)	-
Saudi riyals to Bahraini dinars	1	399	(1)	(399)
	<i>2011</i>			
	<i>Change in rate %</i>	<i>Effect on net profit BD '000</i>	<i>Change in rate %</i>	<i>Effect on net profit BD '000</i>
US dollars to Bahraini dinars	1	488	(1)	(488)
Saudi riyals to Bahraini dinars	1	431	(1)	(431)

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24 LIQUIDITY RISK

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

The table below summarises the expected maturity profile of the Bank's assets and liabilities as at 31 December 2012 and 2011:

	<i>31 December 2012</i>				
	<i>Up to 3 months</i>	<i>3 months to 1 year</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
ASSETS					
Cash and balances with banks and					
Central Bank of Bahrain	57,733	4,255	4,855	-	66,843
Central Bank of Bahrain Sukuk	8,897	6,143	80,715	21,857	117,612
Murabaha and					
Wakala receivables from banks	103,290	-	-	-	103,290
Corporate Sukuk	-	3,770	57,813	13,410	74,993
Murabaha and Mudaraba financing	54,767	47,397	89,922	35,023	227,109
Ijarah Muntahia Bittamleek	10,471	7,742	56,851	7,890	82,954
Musharaka financing	5,374	4,759	6,960	374	17,467
Non-trading investments	-	11,034	193,168	-	204,202
Investment in an associate	-	-	7,573	-	7,573
Investment properties	-	-	-	2,500	2,500
Other assets	12,169	8,371	8,684	7,684	36,908
Premises and equipment	-	-	767	-	767
	252,701	93,471	507,308	88,738	942,218
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS					
Murabaha and Wakala payables					
to banks	-	9,085	81,767	-	90,852
Wakala payables to non-banks	-	175,126	346,803	-	521,929
Customers' current accounts	83,921	-	-	-	83,921
Other liabilities	7,306	11,226	197	446	19,175
Equity of investment accountholders	5,483	3,655	9,138	-	18,276
	96,710	199,092	437,905	446	734,153

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24 LIQUIDITY RISK (continued)

	<i>31 December 2011</i>				<i>Total BD '000</i>
	<i>Up to 3 months BD '000</i>	<i>3 months to 1 year BD '000</i>	<i>1 to 5 years BD '000</i>	<i>Over 5 years BD '000</i>	
ASSETS					
Cash and balances with banks and					
Central Bank of Bahrain	68,218	-	4,100	-	72,318
Central Bank of Bahrain Sukuk	12,070	24,600	77,039	11,318	125,027
Murabaha and					
Wakala receivables from banks	135,698	-	-	-	135,698
Corporate Sukuk	-	-	49,650	-	49,650
Murabaha and Mudaraba financing	33,175	58,707	81,932	19,275	193,089
Ijarah Muntahia Bittamleek	9,309	8,853	29,096	19,219	66,477
Musharaka financing	5,781	407	5,329	194	11,711
Non-trading investments	-	14,105	201,263	7,952	223,320
Investment in an associate	-	-	-	-	-
Investment properties	-	-	-	2,500	2,500
Other assets	20,928	6,640	12,000	3,460	43,028
Premises and equipment	-	-	1,089	-	1,089
	<u>285,179</u>	<u>113,312</u>	<u>461,498</u>	<u>63,918</u>	<u>923,907</u>
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS					
Murabaha and Wakala payables					
to banks	-	10,457	94,116	-	104,573
Wakala payables to non-banks	-	284,748	230,399	-	515,147
Customers' current accounts	66,585	-	-	-	66,585
Other liabilities	18,481	2,101	139	-	20,721
Equity of investment accountholders	-	-	16,256	-	16,256
	<u>85,066</u>	<u>297,306</u>	<u>340,910</u>	<u>-</u>	<u>723,282</u>

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24 LIQUIDITY RISK (continued)

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December, 2012 and 2011 based on contractual undiscounted payment obligation:

	<i>31 December 2012</i>					<i>Total BD '000</i>
	<i>On demand BD '000</i>	<i>Up to 3 months BD '000</i>	<i>3 months to 1 year BD '000</i>	<i>1 to 5 years BD '000</i>	<i>Over 5 years BD '000</i>	
	LIABILITIES, EQUITY OF INVESTMENT ACCOUNT					
HOLDERS' COMMITMENTS AND CONTINGENT LIABILITIES						
Murabaha and Wakala payables						
to banks	-	90,852	-	-	-	90,852
Wakala payables to non-banks		275,126	232,463	14,340	-	521,929
Customers' current accounts	83,921	-	-	-	-	83,921
Equity of investment accountholders	-	18,276	-	-	-	18,276
Unutilised commitments	14,238	4,026	4,596	3,218	537	26,615
Unutilised capital commitments	-	-	-	1,391	-	1,391
Contingent liabilities	9,923	649	-	261	-	10,833
Other financial liabilities	-	5,180	6,587	196	-	11,963
Profit due on financing contracts	-	1,331	4,608	953	-	6,892
	108,082	395,440	248,254	20,359	537	772,672

	<i>31 December 2011</i>					<i>Total BD '000</i>
	<i>On demand BD '000</i>	<i>Up to 3 months BD '000</i>	<i>3 months to 1 year BD '000</i>	<i>1 to 5 years BD '000</i>	<i>Over 5 years BD '000</i>	
	LIABILITIES, EQUITY OF INVESTMENT ACCOUNT					
HOLDERS' COMMITMENTS AND CONTINGENT LIABILITIES						
Murabaha and Wakala payables						
to banks	-	101,120	3,453	-	-	104,573
Wakala payables to non-banks	-	284,748	219,476	10,923	-	515,147
Customers' current accounts	66,585	-	-	-	-	66,585
Equity of investment accountholders	-	16,256	-	-	-	16,256
Unutilised commitments	14,576	901	5,361	3,578	9,458	33,874
Unutilised capital commitments	-	-	-	1,398	-	1,398
Contingent liabilities	6,145	342	490	-	-	6,977
Other financial liabilities	-	16,416	1,449	139	-	18,004
Profit due on financing contracts	-	2,071	6,864	811	-	9,746
	87,306	421,854	237,093	16,849	9,458	772,560

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25 SEGMENT INFORMATION**Primary segment information**

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

- Banking** - principally managing Shari'a compliant profit sharing investment accounts, and offering Shari'a compliant financing contracts and other Shari'a-compliant products. This segment comprises corporate banking, retail banking and private banking and wealth management.
- Treasury** - principally handling Shari'a-compliant money market, trading and treasury services including short-term commodity Murabaha.
- Investments** - principally the Banks' proprietary portfolio and serving clients with a range of investment products, funds and alternative investments.
- Capital** - manages the undeployed capital of the Bank by investing it in high quality financial instruments, incurs all expenses in managing such investments and accounts for the capital governance related expenses.

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

Segment information is disclosed as follows:

	<i>31 December 2012</i>				
	<i>Banking</i>	<i>Treasury</i>	<i>Investments</i>	<i>Capital</i>	<i>Total</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
Operating income	7,035	11,437	(2,418)	7,008	23,062
Segment result	826	10,627	(3,852)	2,707	10,308
Other information					
Segment assets	348,043	361,628	171,287	61,260	942,218
Segment liabilities, and equity	629,981	90,966	2,547	218,724	942,218
	<i>31 December 2011</i>				
	<i>Banking</i>	<i>Treasury</i>	<i>Investments</i>	<i>Capital</i>	<i>Total</i>
	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>	<i>BD '000</i>
Operating income	7,974	5,196	(2,850)	2,420	12,740
Segment result	3,019	4,253	(4,786)	(1,989)	497
Other information					
Segment assets	291,269	385,475	194,313	52,850	923,907
Segment liabilities, and equity	585,102	118,818	8,494	211,493	923,907

Secondary segment information

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

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26 FIDUCIARY ASSETS

Funds under management at the year-end amounted to BD 96,973 thousands (2011: BD 54,759 thousands). These assets are held in a fiduciary capacity and are not included in the consolidated statement of financial position.

27 SHARI'A SUPERVISORY BOARD

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

28 FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Bank's financial instruments are not significantly different from their carrying values as at 31 December 2012 and 2011.

29 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

During the year, the Bank received Sharia' prohibited income totalling BD 236 thousands (2011: BD 7 thousands). These include, income earned from the conventional financing and investments, penalty charges from customers and income on current account balances held with correspondent banks. These funds were allocated to charitable contributions.

30 SOCIAL RESPONSIBILITY

The Bank discharges its social responsibility through charity fund expenditures and donations to the good faith qard fund which is used for charitable purposes. During the year the Bank paid an amount of BD 77 thousands (2011: BD 60 thousands) on account of charitable donations.

31 ZAKAH

Pursuant to a resolution of the shareholders in an EGM held on 12 November 2009, it was resolved to amend the articles of association of the Bank to inform the shareholders of their obligation to pay Zakah on income and net worth. Consequently, Zakah is not recognized in the consolidated income statement as an expense. The total Zakah payable by the shareholders for 2012 has been determined by the Shari'a supervisory board as 3.6 fils (2011: 3.4 fils) per share.

32 CAPITAL ADEQUACY

The adequacy of the Bank's capital is monitored using, primarily, the rules and ratios established by the Basel Committee on Banking Supervision and adopted by the Central Bank of Bahrain. The primary objective of the Bank's capital management is to ensure that it complies with externally imposed capital requirements. The Bank complied in full with all externally imposed capital requirements during the years ended 31 December 2012 and 31 December 2011.

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32 CAPITAL ADEQUACY (continued)

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

	<i>2012</i>	<i>2011</i>
	<i>BD '000</i>	<i>BD '000</i>
Capital base (Tier 1)	145,974	172,872
Credit risk weighted exposures	662,977	653,391
Market risk weighted exposures	1,213	3,416
Operational risk weighted exposures	34,881	36,767
Total risk weighted exposure	699,071	693,574
Capital adequacy	20.9%	24.9%
Minimum requirement	12.0%	12.0%