



AL SALAM BANK  
البحرين

## Annual Report 2012

**Dynamic - Diversified - Differentiated**

[www.alsalambahrain.com](http://www.alsalambahrain.com)



**His Royal Highness  
Prince Khalifa bin Salman  
Al Khalifa**  
The Prime Minister of the  
Kingdom of Bahrain

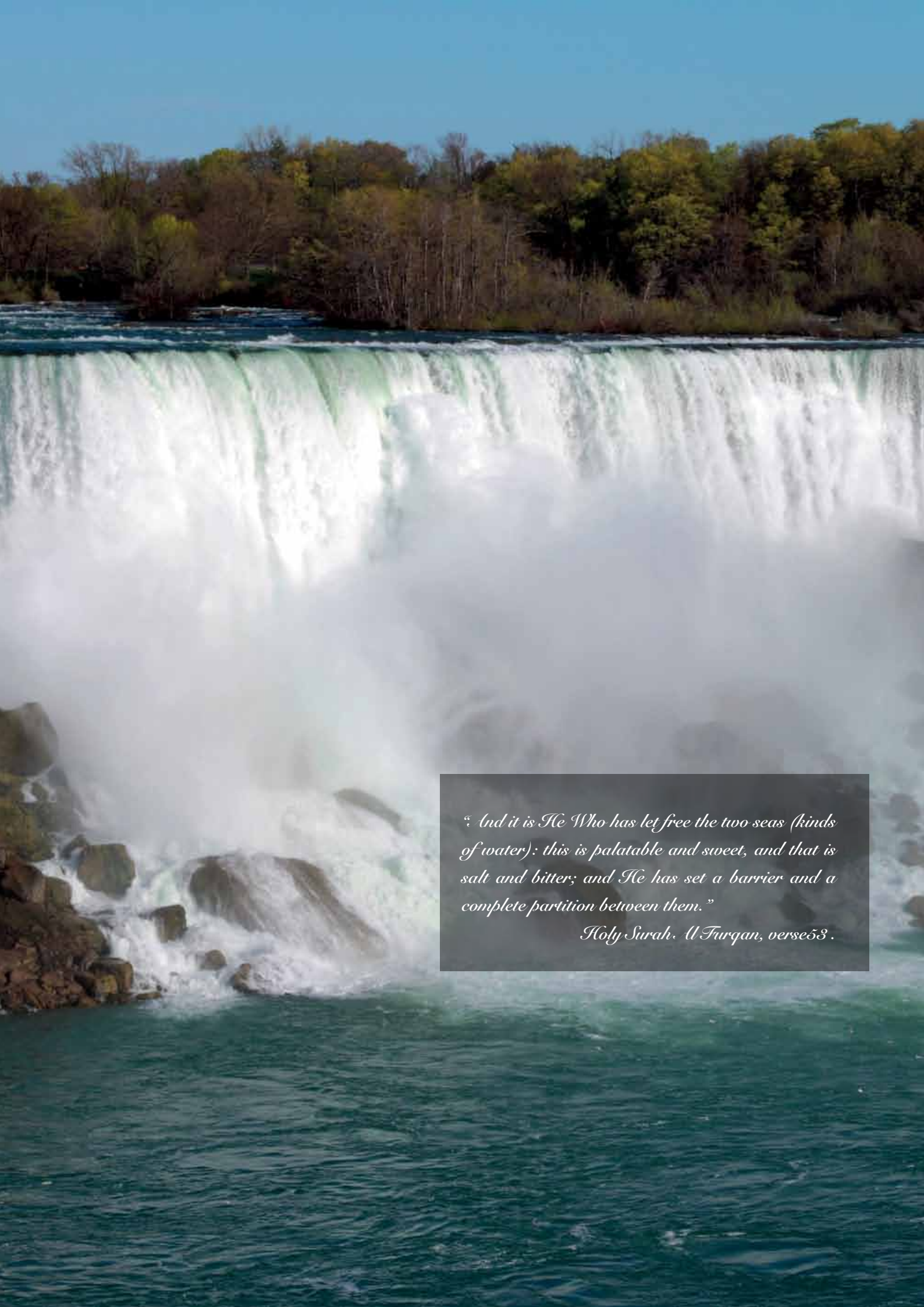


**His Majesty  
King Hamad bin Isa  
Al Khalifa**  
The King of the  
Kingdom of Bahrain



**His Royal Highness  
Prince Salman bin Hamad  
Al Khalifa**  
The Crown Prince,  
Deputy Supreme Commander  
& First Deputy Prime Minister





*“ And it is He Who has let free the two seas (kinds of water): this is palatable and sweet, and that is salt and bitter; and He has set a barrier and a complete partition between them.”*

*Holy Surah. Al Furgan, verse 53.*

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## **Our Vision**

To become a regional force in the Islamic financial services industry by providing differentiated Shari'a compliant products to focused segments.

## **Our Mission**

- Become a "one-stop-shop" for Islamic financial services.
- Create a strong onshore presence in select countries.
- Develop a premier brand image as an Islamic financial shaper.
- Achieve high returns for stakeholders commensurate with the risks undertaken

**Dynamic - Diversified - Differentiated**

## Corporate Overview

Headquartered in the Kingdom of Bahrain, Al Salam Bank-Bahrain (B.S.C.) is a dynamic, diversified and differentiated Islamic bank.

Key factors that contribute to the Bank's distinct market differentiation include:

- Strong paid-up capital base;
- Pre-eminent founding shareholders;
- High-caliber management team;
- State-of-the-Art IT infrastructure;
- Universal business model covering deposits, financing and investment services;
- Innovative, tailor-made Shari'a-compliant solutions;
- Firm commitment to corporate and social responsibility;

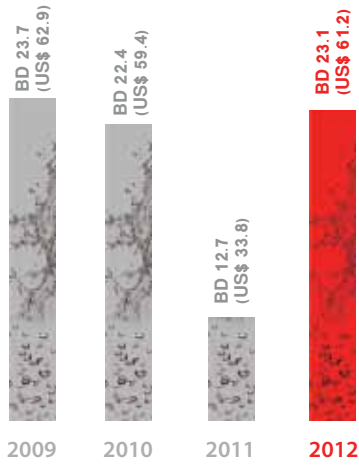
Incorporated on 19 January 2006 in the Kingdom of Bahrain and commenced commercial operations on 17 April 2006, the Bank operates under Shari'a principles in accordance with regulatory requirements for Islamic banks set by the Central Bank of Bahrain.

Al Salam Bank-Bahrain was listed on the Bahrain Bourse on 27 April 2006, and subsequently on the Dubai Financial Market on 26 March 2008. The Bank's high-caliber management team comprises highly qualified and internationally-experienced professionals with proven investment expertise in key areas of banking, finance and related fields; all supported by a world-class Information Technology (IT) infrastructure and the latest 'smart' working environment. In 2009, the Bank acquired a 90.31% stake in Bahraini Saudi Bank BSC. Established with a paid-up capital of BD120 million, the Group's total equity has crossed BD 200 million (US\$530 million) with total assets crossing the US\$2 billion mark.

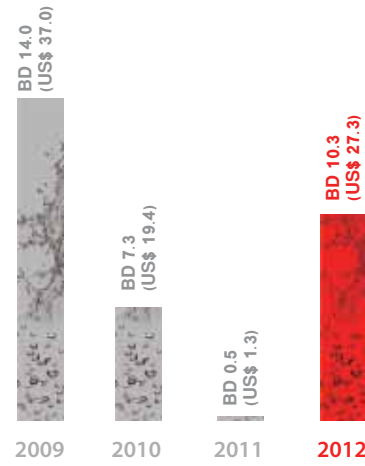
Al Salam Bank-Bahrain is committed to adopting internationally recognized standards and best practices in Corporate Governance and operates with the highest levels of integrity, transparency and trust. The Bank is committed to its role as a concerned corporate citizen, actively seeking ways to contribute and add value to the social and economic well-being of the local communities in which it invests and operates.



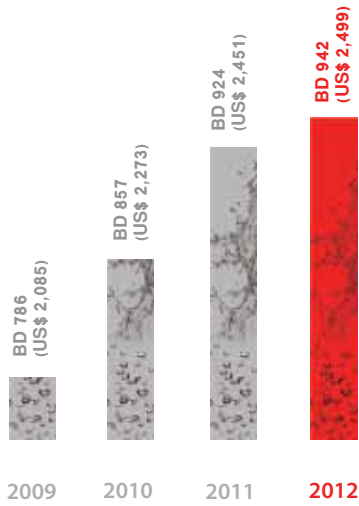
# Annual Highlights



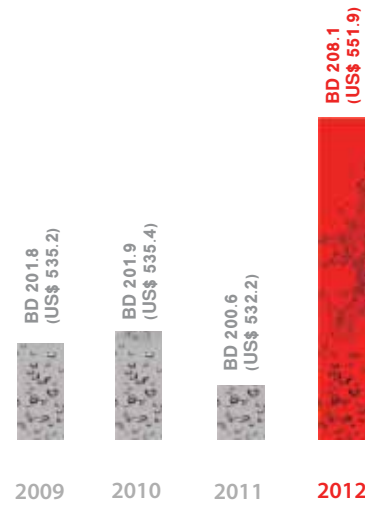
**Total Operating Income**  
(million)



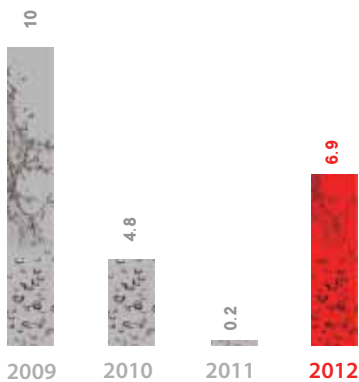
**Net Profit**  
(million)



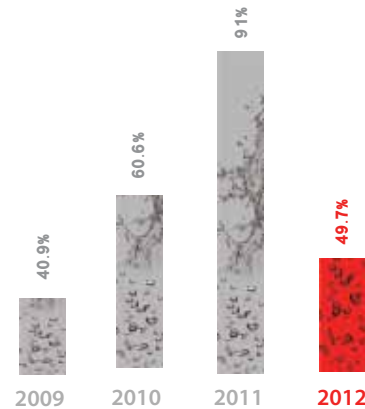
**Total Assets**  
(million)



**Total Equity**  
(million)



**Earnings Per Share**



**Cost to Income Ratio**





*Ayn Adhari is the most famous water spring of Bahrain. It is located in a village named after the waterspring Adhari, and its water channels feed many places far away from its location. Ayn Adhari used to be at the centre of the community in the Adhari region and Manama in particular. It drew visitors from across Bahrain and the Gulf region – it was a favourite picnic spot. It was famous for its swimming, canoeing and fishing. It has inspired stories and songs and is recalled with love by many Bahrainis and Citizens. At Al Salam, we emphasize the importance of family and community through the investment schemes we offer to all our clients - fresh ideas that add value to their lives.*



## Board of Directors



### **H.H. Shaikha Hessa bint Khalifa bin Hamad Al Khalifa**

#### **Chairperson Chairperson of the Corporate Governance Committee**

*Independent and non-executive  
Director since: 18 April 2009  
Term started: 20 March 2012*

An active member of the royal family of the Kingdom of Bahrain, H.H. Shaikha Hessa gained her Bachelor's degree in Management (1998), and her Master degree in Social Policy and Planning (2002) both from the London School of Economics and Political Science. Gained an MSc in Development Finance 2010 from University of London. She joined the Supreme Council for Women in 2001 as a member of the Social Committee. Since 2004 she has been a Permanent Member of the Council's Board. In 2005, she founded "INJAZ Bahrain" which is an international organization to inspire and prepare young Bahrainis to succeed in a global economy and is presently its Executive Director. With her experience and active role in enterprise education and developing skills of young women, she has been invited as speaker and panelist at various occasions including the UN, and the World Economic Forum.



### **Mr. Hamad Tarek Alhomaizi**

#### **Vice-Chairman**

*Independent and non-executive  
Term started: 18 April 2009  
Term started: 20 March 2012*

Mr. Hamad Alhomaizi has a BS in Computer Science and Business Administration from George Washington University and has a strong IT background and technical understanding of web technologies. He has varied experience in a number of areas including direct investments, hedge funds, real estate and start-up businesses. He has worked in various capacities in a number of companies and was a founding Board Member in companies including Shuwaikh Real Estate Projects Company (Kuwait), Ishraq Real Estate Company (Bahrain / UAE) and Al Shaab Holding Company (Kuwait).

## Board of Directors (Continued)



### **Mr. Hussein Mohammed Al Meeza**

**Director**  
**Chairman of the Executive Committee**

*Independent and non-executive*  
*Term started: 20 March 2012*

Mr. Hussein Mohammed Al Meeza is considered one of the renowned personalities in the Islamic banking sector and Islamic finance and Takaful. Mr. Al Meeza's outstanding career success was crowned in December 2006 when the International Conference of Islamic Bankers chose him as the 2006 Best Islamic Banking Personality. Having graduated from the Beirut Arab University in 1975, Mr. Al Meeza started his professional career at the Dubai Islamic Bank (DIB) where he spent 27 years during which he played a pioneering role in enhancing and developing the bank's services. Mr. Al Meeza is currently the CEO and Managing Director of Aman Insurance and Re-Insurance Company (AMAN), Vice Chairman of the Board and Chairman of the Executive Committee of Al Salam Bank-Sudan, Vice Chairman of the Board and Chairman of the Executive Committee of Al Salam Bank- Algeria, Board member of the General Council of Islamic Banks and Financial Institutions, Chairman of the founding committee of Islamic Insurance and Re-Insurance Companies, Chairman of Amity Health Services Company, Vice Chairman of Emirate Cooperative Society – Dubai, Vice Chairman of Leader Capital L.L.C. He is also Board Member of Emirates Society for Insurance and Chairman of Nawat Company.



### **Mr. Habib Ahmed Kassim**

**Director**  
**Chairman of Remuneration and Nomination Committee**

*Independent and non-executive*  
*Director Since: 17 April 2006*  
*Term started: 20 March 2012*

Mr. Habib Kassim is the Chairman of Almahd Investment Company, Bahrain Ferro Alloys, Bahrain Electricity Supply & Transmission Company, Capital Growth Management and Quality Wire Products Company. He is also the Chairman of Almahd Day Boarding School. Mr. Kassim was Minister of Commerce and Agriculture, Kingdom of Bahrain from 1976 to 1995, and Member of the GCC Consultative Council for the Supreme Council from 1997-2007.

## Board of Directors (Continued)



### **Mr. Salman Saleh Al Mahmeed**

**Director**  
**Chairman of the Audit Committee**

*Independent and non-executive*  
*Director since: 15 February 2010*  
*Term started: 20 March 2012*

Mr. Salman Al Mahmeed is the Deputy Chief Executive Officer of Bahrain Airport Services, the Deputy Chairman of Dar Albilad, the Managing Director and Owners' Representative of Global Hotels, Global Express and Movenpick Hotel in Bahrain. He was a Board Member of Bahraini Saudi Bank as well as being a member of its Investment, Executive and Strategic Options Committees. He was also the Investment Director of Managa Holdings. Mr. Al Mahmeed holds an MBA in Business Administration, Master in Hotel Management and BSc. degree in Administration from Cairo University.



### **Mr. Essam bin Abdulkadir Al Muhaidib**

**Director**

*Independent and non-executive*  
*Director Since: 17 April 2006*  
*Term started: 20 March 2012*

Mr. Essam Al Muhaidib is CEO of A.K. Al Muhaidib & Sons Group, and Board member in several organizations having interests in banking & insurance, FMCG & retail, building & construction, industrial & real estate apart from educational, charitable and benevolent organizations. He is also a Board member of Emmar Middle East, United Sugar Company, Amwal Al Khaleej, Saudi Tabreed Company, Synthomer Middle East, Nestle Co, Al Oula Real Estate Development Co, Dubai Contracting Company (DCC), Gulf Union Insurance Company, Al Massa International Inc-Canada, Dnata Kuwait, Saudi Fisheries Company, Aziziah Panda United Co, Savola Foods Co. and Al Latifia Trading & Contracting Co. Moreover, he is also a member in some of charitable and non-profitable & educational organizations such as King Fahad University of Petroleum & Minerals Endowment Fund, board of directors of the educational services company at Prince Mohammad bin Fahad University in Dammam as well as founder for Prince Sultan College for Prince Sultan Ladies' Fund.

## Board of Directors (Continued)



### **Mr. Fahad Sami Al Ebrahim**

#### **Director**

*Independent and non-executive*

*Director since: 18 April 2009*

*Term started: 20 March 2012*

Mr. Fahad Sami Al Ebrahim received his Bachelors of Arts degree in Journalism and Communication Studies from the University of Oregon-Eugene, Oregon, USA. He also has an MBA degree from the Maastricht School of Management and has successfully completed the 10th session of the "General Management Program" at Harvard Business School. He has over 12 years of professional experience. Mr. Al Ebrahim heads the International Wealth Management Group of Global Investment House, Kuwait as Senior Vice President, where he has played a major role in increasing assets under management and had been an active participant to establish one of the leading wealth management groups in the region.

He was mandated in early 2010 as Acting CEO of Global Investment House – Saudi for the first half of the year where he was able to downstream the operations in the Kingdom and position the company in the Saudi market. He also played a major role in increasing AUM and revenue of the Saudi operations.

Mr. Al-Ebrahim began his career with Global in the Marketing Department. Later on, he pursued Business Development positions in the Investment Funds Department focused on Alternative Investments including Hedge Funds, Real Estate Funds and Private Equity. Prior to joining Global, Mr. Al-Ebrahim worked in a semi-government institution for approximately two years. In addition, he is a member of numerous boards of directors in the financial and real estate arenas. His board memberships include Al-Mazaya Holding Company, Kuwait (Vice Chairman); First Securities Brokerage Company S.A.K., Kuwait; Investment House, Qatar and Global Investment House – Saudi, and Investment Committee member in Macro Fund.



### **Mr. Mohammed Omeir Bin Yussef Al Mehairi**

#### **Director**

*Independent and non-executive*

*Term started: 20 March 2012*

Mr. Mohammed Omeir Bin Yussef Al Mehairi holds M.Sc. from University of Cairo and B.Sc. in Political Science & Business Administration from U.A.E. University, Al Ain. He is currently the Vice Chairman & Managing Director of Omeir Bin Yussef Group, Chairman of Al Salam Bank-Sudan, Chairman of Al Salam Bank-Algeria, Chairman of Dubai Islamic Insurance and Re-Insurance Company (AMAN), the Chief Executive Officer of Bin Omeir Holding Group. He is also the CEO of United Investment Group and the CEO of Emirates National Group.



## Board of Directors (Continued)



### **Mr. Adnan Abdulla Al Bassam**

#### **Director**

*Independent and non-executive  
Term started: 20 March 2012*

Mr. Adnan Al Bassam is a Certified Public Accountant (CPA) and holds a B.S. in Business Administration with specialization in Accounting from Oregon State Board of Accountancy. His years of experience in the financial and investment sector go back to 1994. Currently he holds the positions of Vice Chairman and Managing Director of Al Bassam Investment Company W.L.L., Board member in each of Jordan Islamic Bank, Al Baraka Bank-Sudan, Esterad Investment Company B.S.C., Capinvest B.S.C.(c) and Chairman of Muharraq Mall Company W.L.L. Prior to joining the Board, Mr. Al Bassam worked for Ernst & Young and Bahrain Islamic Bank in various capacities.



### **Mr. Yousif Abdulla Taqi**

#### **Director and Chief Executive Officer**

*Director Since: 05 May 2008  
Term started: 20 March 2012*

A Certified Public Accountant (CPA), Mr. Taqi has been active in the banking and financial services industry since 1983. During his career, Mr. Taqi worked in leading positions for a number of institutions in the Kingdom of Bahrain. Prior to joining Al Salam Bank-Bahrain, he was Deputy General Manager of Kuwait Finance House (Bahrain), where he was responsible for establishing Kuwait Finance House Malaysia. Prior to this, Mr. Taqi spent 20 years with Ernst & Young, during which time he provided professional services for many regional and international financial institutions. During his career with Ernst & Young, Mr. Taqi was promoted to Partner, responsible for providing auditing and consultancy services to the Islamic financial institutions. He is currently the Chairman of Manara Developments Company B.S.C. (c), Amar Holding Company B.S.C. (c), affiliates of ASBB, and also a board member of the Housing Bank (Bahrain), Al Salam Bank-Algeria, Aluminium Bahrain (ALBA) and Tadham



## Fatwa and Shari'a Supervisory Board



### **Dr. Hussain Hamid Hassan**

#### **Chairman**

Dr Hassan holds a PhD from the Faculty of Shari'a, Al Azhar University, Cairo, Egypt; and a Masters in Comparative Jurisprudence and Diploma in Comparative Law (both of which are the equivalent of a PhD) from the International Institute of Comparative Law, University of New York, USA. He also holds a Masters in Comparative Juries, and Diplomas in Shari'a and Private Law, from the University of Cairo; and an LL B in Shari'a from Al Azhar University. He is the Chairman and member of the Shari'a Supervisory Board in many of the Islamic Financial Institutions. In addition, Dr. Hassan is Chairman of the Assembly of Muslim Jurists, Washington, USA; a member of the European Islamic Board for Research & Consultation, Dublin, Ireland; and an Expert at the Union of Islamic Banks, Jeddah, Kingdom of Saudi Arabia.



### **Dr. Ali Mohuddin Al'Qurra Daghi**

#### **Member**

Dr. Al'Qurra Daghi holds a PhD in Shari'a and Law, and a Masters in Shari'a and Comparative Fiqh, from Al Azhar University, Cairo, Egypt. He also holds a BSc. in Islamic Shari'a from Baghdad University, Iraq; a certificate of traditional Islamic Studies under the guidance of eminent scholars in Iraq; and is a graduate of the Islamic Institute in Iraq. He is currently Professor of Jurisprudence in the faculty of Shari'a law and Islamic Studies at the University of Qatar. He sits on the Boards of Shari'a Supervisory Boards for several banks and financial institutions. Dr. Al'Qurra Daghi is also a member of the Islamic Fiqh Academy, the Organisation of Islamic Conference, the European Muslim Council for Efta and Researches, the International Union of Muslim Scholars, and the Academic Advisory Committee of the Islamic Studies Centre, Oxford University, UK. He also has published several research papers tackling various types of Islamic Finance, Islamic Fiqh, Zakah and Islamic Economy.



### **Shaikh Adnan Abdulla Al Qattan**

#### **Member**

Shaikh Adnan Al-Qattan holds Masters degree in the Quran and Hadith from the University of Um Al-Qura, Makka, Kingdom of Saudi Arabia; and Bachelor's degree in Islamic Shari'a from the Islamic University, Madeena, Saudi Arabia. Shaikh Al Qattan is also a Judge in the Shari'a Supreme Court, Ministry of Justice - Kingdom of Bahrain. Shaikh Al Qattan is a Member of Shari'a Supervisory Boards for several Islamic banks and he is also Chairman of Al Sanabil Orphans Protection Society, Chairman of the Board of Trustees of the Royal Charity Establishment under the Royal Court - Kingdom of Bahrain, and President of the Kingdom of Bahrain Hajj Mission. In addition, he is a Friday sermon orator at Al-Fatih Grand Mosque. Shaikh Al Qattan contributed to drafting the Personal Status Law for the Ministry of Justice and is a regular participant in Islamic committees, courses, seminars and conferences.

## Fatwa and Shari'a Supervisory Board (Continued)



### **Dr. Mohamed Abdulhakim Zoeir**

#### **Member & Secretary to the Board**

Dr. Zoeir holds PhD in Islamic Economy; Masters degree in Islamic Shari'a (Economy); Bachelor's degree in Management Sciences; and a Higher Diploma in Islamic Studies. He is Member of the Fatwa Board in a number of Islamic financial institutions and has 18 years experience with Egypt Central Bank. Dr. Zoeir was also the Head of Shari'a compliance in Dubai Islamic Bank.



### **Dr. Mohammed Burhan Arbouna**

#### **Member**

Dr. Mohammed Burhan Arbouna holds a PhD in laws with specialization in Islamic banking and finance from International Islamic University Malaysia, and Masters in Comparative Laws. He also holds BA degree in Shari'a and Higher Diploma in Education from Islamic University, Medina. He is an expert in Islamic banking and finance since 1997. Before joining Al Salam Bank-Bahrain, Dr. Arbouna was the Shari'a Head and Shari'a Board member in the Seera Investment Bank BSC Bahrain. Prior to that, he worked as the Head of Shari'a department in the Kuwait Finance House-Bahrain. Also, Dr. Arbouna worked as Shari'a researcher and consultant for the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) - Bahrain. Dr. Arbouna lectures on Islamic banking and finance and gives consultancy on orientation and professional programs for a number of professional and educational institutions. Dr. Arbouna is a member of Islamic Money Market Framework (IMMF) steering committee initiated by Central Bank of Bahrain for management of liquidity among Islamic banks.





*The Dilmun civilization flourished on trade routes linking Mesopotamia with India- it aided the formation of particularly lustrous pearls, Bahrain's main source of income in the days before oil. At Al Salam, we have diversified our businesses honing our portfolio transforming our vision and creating avenues helping us grow -enabling us to succeed in achieving our goals.*

## Minutes of the Ordinary General Meeting Held on 20<sup>th</sup> March 2012

The Ordinary General Meeting was held in Gazal Hall, Ritz Carlton Hotel, Kingdom of Bahrain, at 11.30 a.m. on Tuesday 20<sup>th</sup> March 2012 corresponding to 27<sup>th</sup> Rabie Al Thani, 1433 Hijra under the Chairmanship of Mr. Mohamed Ali Rashid Alabbar, Chairman of the Board of Directors in the presence of the following:

1. Mr. Habib Ahmed Kassim	Board Member
2. Mr. Ahmed Jamal Jawa	Board Member
3. Shaikha Hessa bint Khalifa bin Hamad Al Khalifa	Board Member
4. Mr. Yousif Taqi	Board Member & Chief Executive
5. Mr. Khalid Ahmed Al Aashar	Board Secretary - Rapporteur
6. Shaikh Adnan Abdullah Al Qattan	Member of the Fatwa & Shari'a Supervisory Board
7. Dr. Mohammed Arbouna	Member of the Fatwa & Shari'a Supervisory Board and the Bank's Head of Shari'a Compliance
8. Mr. Mohamed Hassan	Representative of the Ministry of Industry & Commerce
9. Mr. Hussain Sharaf	Representative of the Central Bank of Bahrain
10. Mrs. Hamsa Saeed	Representative of the Central Bank of Bahrain
11. Mrs. Fatima Al Ansari	Representative of the Bahrain Stock Exchange
12. Mr. Ahmed Qassim	Representative of KPMG Fakhro, Share Registrar
13. Mr. Abdul Qader Al Afya	Representative of KPMG Fakhro, Share Registrar
14. Mr. Isa Al Jowder	Representative of Ernst & Young, External Auditor
15. Mr. Ashwani	Representative of Ernst & Young, External Auditor

The said meeting was held to discuss the following agenda, which was previously published in the local newspapers before the date of the meeting according to the legal requirements. The agenda consisted of the following items:

1. To approve the minutes of the previous AGM meeting held on 22 February 2011.
2. To discuss and approve the Board of directors' report on the Group's activities for the year ended 31 December 2011.
3. To receive the Shari'a Supervisory Board report for the year ended 31 December 2011.
4. To receive the external auditor's report for the year ended 31 December 2011.
5. To review and approve the financial statements for the year ended 31 December 2011.
6. To appropriate the net profit for the year upon the recommendations of the Board of directors as follows:
  - a. Transfer of BD139,000 to statutory reserves.
  - b. Allocation of BD100,000 for charities and donations.
7. Adoption of the report on Corporate Governance of the Bank.
8. To absolve the members of the Board from liability for their actions during the year ended 31 December 2011.
9. To appoint or re-appoint members of the Shari'a Supervisory Board for the next three years.
10. Re-appoint Ernst & Young as external auditors for the year ending 31 December 2012 and authorize the Board of Directors to determine their remuneration.
11. Elect the members of the Board of Directors for the next term of three years.

The meeting was opened by Mr. Mohamed Alabbar who thanked the members for attending the meeting. Then, he declared that the General Meeting has a quorum of 61.72% of the shareholders, which means that the meeting is validly convened according to Article 49 of the Bank's Articles of Association.



## Minutes of the Ordinary General Meeting Held on 20th March 2012 (Continued)

Then, the following topics on the agenda were discussed:

### 1. Approving the Minutes of the Previous General Meeting:

Approving the minutes of the Ordinary General Meeting held on Monday 22<sup>nd</sup> February, 2011.

- **Resolution: The General Meeting approved unanimously the minutes of the previous Meeting.**

### 2. Reviewing the Directors' Report:

Mr. Mohammed Ali Rashid Alabbar read out the Directors' report and presented to the Shareholders a synopsis about the Bank's activities and operations during 2011.

- **Resolution: The General Meeting unanimously approved the Directors' report.**

### 3. Reviewing the Fatwa & Shari'a Supervisory Board's Report:

Shaikh Adnan Abdullah Al Qattan, Representative of the Fatwa and Shari'a Supervisory Board read out the Board's Report. He explained the activities undertaken by the Board focusing on exercising the Shari'a supervision of the Bank's operations and investments. Following a discussion of the report, it was approved by the General Meeting.

- **Resolution: The General Meeting unanimously approved the Fatwa and Shari'a Supervisory Board's report.**

#### - Purifying the prohibited income earned by the Bahraini Saudi Bank as per the CBB's request:

Dr. Mohammed Arbouna, the Bank's Head of Shari'a Compliance, read the report pertaining to purifying the prohibited income earned by the Bahraini Saudi Bank.

- **Resolution: The General Meeting unanimously approved the Fatwa and Shari'a Supervisory Board's report regarding purifying the prohibited income earned by the Bahraini Saudi Bank as per the CBB's request.**

### 4. Reviewing the External Auditors' Report about the Financial Statements for the Period ended on 31st December, 2011:

Mr. Isa Al Jowder, representative of Messrs. Ernst & Young (External Auditor) read out the report and confirmed the soundness of the financial statements, which were prepared according to the International and Islamic Accounting Standards. After some deliberations and inquiries the report was approved.

- **Resolution: The General Meeting unanimously approved the report of the Auditors (External Auditors) about the financial statements for the period ended on 31st December, 2011.**

### 5. Discussing the Financial Statements for the Period ended on 31st December, 2011:

The Shareholders present discussed the financial statements for the period ended on 31st December, 2011.

- **Resolution: The General Meeting unanimously approved the financial statements for the period ended on 31st December, 2011.**

### 6. Approving the Directors' recommendation for Appropriation of the net profits and Retained Earnings as follows:

- Transfer of a sum of BD31,000 to the legal reserve.
- Appropriation of a sum of BD100,000 for donations and charity.

The General Meeting took note of the Directors' recommendation with respect to appropriations and distributions.

- **Resolution: The General Meeting unanimously approved the aforesaid appropriations.**

### 7. Adoption of the report on Corporate Governance of the Bank.

The General Meeting took note of the Bank's Corporate Governance report.

- **Resolution: The General Meeting approved the Corporate Governance report.**



## Minutes of the Ordinary General Meeting Held on 20th March 2012 (Continued)

### 8. Absolving the Directors from liability for their acts during the financial year ended on 31st December, 2011.

The General Meeting approved absolving the Directors from liability for their acts during the year.

- **Resolution: The General Meeting unanimously approved absolving the Directors from liability for all their acts during the period ended on 31st December, 2011.**

### 9. To appoint or re-appoint members of the Shari'a Supervisory Board for the next three years.

The General Meeting reviewed the Corporate Governance Plan and Compliance with it.

- **Resolution: The General Meeting approved to re-appoint members of the Shari'a Supervisory Board for the next three years. It also agreed to add a new member to the Supervisory Board who is Dr. Mohammed Arbouna.**

### 10. Re-appoint Ernst & Young as external auditors for the year ending 31 December 2012 and authorize the Board of Directors to determine their remuneration:

- **Resolution: The General Meeting unanimously approved the appointment of Messrs. Ernst & Young as the External Auditors for the period ended as at 31st December, 2012, and reconsider the appointment of the auditor next year.**

### 11. Elect the members of the Board of Directors for the next term of three years:

Eleven members were elected, as the vote count was carried out under the supervision of a committee comprising representatives from the share registrars, Ministry of Industry and Commerce and a shareholders' representative.

- **Resolution: Mr. Habib Kassim read out the elections results where the General Assembly elected 11 members according to the following sequence:**

1. Mr. Yousif Abdulla Taqi
2. Shaikha Hessa bin Khalifa Al Khalifa
3. Mr. Fahad Sami Al Ebrahim
4. Mr. Salman Saleh Al Mahmeed
5. Mr. Hamad Tarek Alhomaizi
6. Mr. Habib Ahmed Kassim
7. Mr. Hussain Mohammed Al Meeza
8. Mr. Adnan Abdullah Al Bassam
9. Mr. Essam bin Abdulkadir Al Muhaidib
10. Mr. Salem Rashid Al Muhannadi
11. Mr. Mohammed Omeir Yussef

Accordingly, the standby members were:

1. Mohamed Rashid Alabbar
2. Abdul Rahman Ahmed Senan

At the end of the meeting, Mr. Habib Ahmed Kassim expressed his thanks and appreciation to the Central Bank of Bahrain, Ministry of Industry & Commerce and Bahrain Bourse and KPMG Fakhro (share registrars) for their continued support to the Bank and to H.E. Mohamed Alabbar, the Board Chairman, for managing the meeting and wished everyone further progress and success.

**Habib Ahmed Kassim**

Vice Chairman

**Khalid Ahmed Al Ashar**

Board Secretary



## BOARD OF DIRECTORS' REPORT TO THE SHAREHOLDERS

The Directors of Al Salam Bank-Bahrain BSC ("**the Bank**") have the pleasure in submitting their report to the shareholders accompanied by the consolidated financial statements for the year ended 31 December 2012. The consolidated financial statements represent the Bank's operations including those of its retail banking subsidiary, Bahraini Saudi Bank BSC (BSB). Following liquidation of BSB, its operations were integrated with those of the Bank effective 24 April 2012.

The recently ended financial year was a challenging one with global economy still limping due to sluggish growth and a higher unemployment data. The Euro zone and the United States are still reporting weaker than expected economic data with debt levels of the US and many European member countries continuing to be a major concern for financial institutions. Major Asian economies are experiencing weaker manufacturing data and factory orders indicating significant downturn due to export dependency and the effect of European and US downturn. Consequently, the GCC economies have been affected to some extent with the Kingdom of Saudi Arabia showing resilience. From a Bahrain perspective, the environment has been stable after the unrest we experienced in 2011 but the business environment is yet to get back to the pre-unrest levels as the healing and confidence restoration process takes time. As such the lending environment has been weak with modest credit growth. This has left the banking industry in Bahrain to look for alternative markets and business areas for revenue generation. The real estate sector has been holding on to 2011 levels but transactions volumes are still on a low key.

In spite of the extremely challenging environment, the Bank managed to post a modest growth in total assets from BD923.9 million (US\$2.45 billion) at 31 December 2011 to BD942.2 million (US\$ 2.5 billion) at 31 December 2012. The modest increase is the result of a conscious decision to reduce the deposit base due to limited lending opportunities within Bahrain. However, customer deposits showed an increase from BD598.0 million at end of 2011 to BD 624.1 million at end of 2012, an increase of 4.4% over the year. While continuing global economic downturn prevented exits at expected levels, the Bank managed to reduce its exposure to the real estate sector through affordable housing solutions at Al-Qalali and sale of residential sites at Al-Qadam. The prevailing economic and capital market conditions also resulted in a decrease in asset valuations causing a loss of over BD6.0 million from investment write-downs. The gross operating income witnessed a material increase from BD12.7 million in 2011 to BD23.1 million in 2012, an increase of over 80%. The encouraging feature of the 2012 operations is the surge in income from core banking activities, comprising corporate, commercial and retail banking facilities. The income from these activities increased from BD13.1 million in 2011 to BD22.4 million in 2012.

The operating results of 2012 are gratifying considering the market conditions and the 2011 performance. The net profit of BD10.3 million after taking into consideration asset provisions of BD2.1 million represents gains realised after write down of investments for negative change in fair values to the extent of BD7 million. Prudent cost management continued through 2012 with operating expenses holding on to 2011 levels, after a 14.5% reduction in 2011 over 2010.

During the year, the Bank successfully acquired equity interest in two new Boeing 777-ER300 aircraft that were leased to the Emirates Airlines for longer term and placed a majority equity interest in both the transactions with its investors. This investment provides a return of 9% cash-on-cash on a quarterly basis with a prospect of exit in 5-7 years' time at a capital gain. The Bank's investments in the leasehold interest in two hotel towers in Makkah are experiencing successful operations with positive cash flows and occupancy of the two hotels reaching over 90% throughout the year.

The Bank managed to record a growth of 21% in its financing portfolio compared to 2011 despite the challenging credit and market environment. The growth in financing portfolio demonstrates the Bank's continuous efforts in increasing its focus on retail and corporate banking initiatives. As part of its initiative to provide support to growth of private sector businesses in the Kingdom of Bahrain, the Bank entered into an agreement with Tamkeen to provide Shari'a compliant facilities to private sector business.

In line with regulatory focus on reducing real estate exposure, the Bank has tightened its investment and financing to the sector. The Board and management are conscious of the need to check the Bank's concentration to the real estate sector and hence new businesses in this sector are being undertaken on a selective basis to take advantage of market opportunities bearing in mind investor's cash yield expectations.

On the treasury front, the Bank continued to expand its financial institutions network. In 2012, the Bank continued to be a net lender to the system with a net lending position of BD79 million at 31 December 2012 in addition to holding a large portfolio of the Central Bank of Bahrain issued Sukuk which are eligible for resale. The Bank also enjoys a comfortable liquidity position as reflected by its strong liquidity ratio of 13% as of 31 December 2012. This is net of due to banks and interbank deposits and excludes Sukuk issued by Central Bank of Bahrain (CBB).

The Directors believe that the challenges facing the banking sector is expected to continue in 2013 with a competitive credit environment. The Directors and management will use key initiatives along with an existing strong risk management framework and growing customer base to achieve better results in 2013.

## BOARD OF DIRECTORS' REPORT TO THE SHAREHOLDERS (continued)

Your Bank continues to look for acquisition opportunities locally to support inorganic growth and achieve its vision of becoming one of the largest Islamic financial institutions in Bahrain as a precursor to launching the regional expansion strategy. The Board and management are ambitious in positioning the Bank as the largest Islamic bank in Bahrain in the coming years. Our Bank is ideally positioned to consummate deals of bigger size due to a strong liquidity position and capital base.

Financially, fiscal year 2012 had seen the Bank returning stronger results with a net profit of BD10.3 million, up from the nominal net profit of BD 0.3 million in 2011 attributable to shareholders of the Bank. The gross operating income amounted to BD23.1 million (2011: BD12.7 million) and the operating expenses were BD11.5 million (2011: BD11.6 million). The earnings per share (EPS) for the year amounted to 6.9 fils (2011: 0.2 fils).

### **Retained earnings and appropriation of net income:**

	BD'000
<b>Balance at beginning of the year</b>	<b>37,823</b>
Net profit for the year – 2012	10,272
Transfer to statutory reserve	(1,027)
Proposed dividends	(7,485)
<b>Balance at end of the year</b>	<b>39,583</b>

### **Directors' and senior management interest:**

As required by the Central Bank of Bahrain rule book set out below are the interests of directors and senior managers in the shares of Al Salam Bank-Bahrain B.S.C. and the distribution of the shareholdings as of 31 December 2012.

	<b>31/12/2012</b>
Directors' shares	51,237,042
Senior managers' shares	8,091,401
	<b>59,328,443</b>

Directors' remuneration for 2012 amounted to BD100,000.

Percentage of shares held	No. of shares	2012 No. of Shareholders	% of total Outstanding shares
Less than 1%	971,615,385	23,216	64.92
1% up to less than 5%	354,414,645	13	23.66
Over 5%	171,033,800	1	11.42
<b>Total</b>	<b>1,497,063,830</b>	<b>23,230</b>	<b>100.00</b>

	Nationality	Holding
<b>Shareholders holding over 5%:</b>		
Global Mena Macro Fund Company B.S.C. (c)	Bahrain	11.42%

The directors would like to express their appreciation to the leadership led by HM King Hamad bin Isa Al Khalifa, HRH the Prime Minister Prince Khalifa bin Salman Al Khalifa and HRH the Crown Prince and Deputy Supreme Commander Prince Salman bin Hamad Al Khalifa, the Ministry of Finance, the Ministry of Industry and Commerce, the Central Bank of Bahrain, the Bahrain Bourse, correspondents, customers, shareholders and employees of the Bank for their support and collective contribution since the establishment of the Bank and we look forward to their continued support in the fiscal year 2013.

30 January 2013  
Manama, Kingdom of Bahrain

Shaikha Hessa bint Khalifa bin Hamad Al-Khalifa  
Chairperson







*“ And We caused springs to gush forth from the earth. So the waters (of the heaven and the earth) met for a matter predestined.”*

*Holy Surat, Al Zamar, Verse 12.*

*Bahrain's fresh water springs are fed from aquifers that well up under ground and the sea. It is this foundation and process that we at Al Salam draw a parallel with – we have evolved to greater heights since our journey began and we continue applying methods as rigorous and intense, structuring strategies with fresh ideas and innovation ultimately benefitting our clients.*



## Message from CEO



Fiscal year 2012 has been a year of positive transformation for Al Salam Bank Bahrain (ASBB). On 25 April 2012, ASBB took over all the assets and assumed all the liabilities of Bahraini Saudi Bank (BSB) and all operations have been consolidated synergistically; formalizing ASBB as a fully-fledged commercial and retail bank licensed by the Central Bank of Bahrain.

Throughout the year we continued to remain focused on expanding our income streams, building the balance sheet and enhancing shareholder value. As a result of this dedication, I am pleased to report that we have achieved a net profit of BD 10.3 million (2011: BD 0.3 million), a remarkable improvement over the last year. The total assets grew from BD923.9million (US\$2.45billion) to BD942.2million (US\$2.5 billion) recording a 2% growth over the previous year (2011: 8 %).

This positive growth is attributed to the expansion of the loan portfolio, a substantial increase in customer deposits and the continued effort to diversify our investment portfolio. The Bank also achieved impressive cost control amid

a challenging operating environment by reducing operating expenses by 1.2%. The full impact of the considerable cost savings attributed to the consolidation of the merger we predict will be felt within the next fiscal year.

The Bank forged ahead with the strategic plan to increase the customer deposit base and expanded the commercial banking business; a strategy that continues to prove fruitful with the successful growth of customer deposits by BD26.0 million during fiscal year 2012 (2011: BD65.7 million).

As part of our focus to expand the retail banking business, the Bank expanded its ATM network, implemented across-the-board enhancements to its current financing schemes, and launched state of the art banking technologies aimed at enhancing customer offerings, banking convenience and security.

Al Salam Bahrain's customer-centric scheme included a campaign highlighting the Bank's competitive profit rates, increased personal financing limits and flexible repayment schedules on vehicle, personal, and mortgage financing, which were well received by the market.

In addition, we successfully initiated the free, secure online shopping service, "Verified by Visa", an additional privilege for Jiwan credit cardholders, which provides our customers with a safer platform to enhance their online shopping experience. Furthermore, and underscoring our commitment to the offering of pioneering banking technologies, the Bank rolled out a new mobile banking service that can be used on all mobile platforms.

Going forward, with this commercial expansion plan the Bank will continue to develop more groundbreaking and flexible financing schemes and banking tools that facilitate our customer's financial success and encourage the continued economic growth of the Kingdom.

On the real estate front, the sector remained sluggish. However, despite challenging market conditions, the Bank's real estate arm Manara Developments, has achieved substantial sales in the Wahat Al Muharraq and Kenaz Al Qadam housing development projects with projects on track to meet completion milestones.

Activity in the investment arena was enhanced as the Bank continued to diversify its income streams through investment across a wide range of industry including aviation, retail and hospitality. As a result the income for 2012 increased by 54% to BD6.86 million compared to BD4.47 million in 2011

The Bank increased its exposure to the aviation sector during the year by successfully completing the acquisition of two brand new Boeing 777-300ER aircrafts leased to Emirates Airlines on a non-cancellable lease for a period of 12 years. These investments are set to generate stable long-term cash flows for the Bank.

Aligned with this diversification strategy the Bank has undertaken a significant mezzanine financing facility in the heart of Cannes, France for a period of 5 years. The transaction facility is for a high-end commercial property comprising of eight units of luxury retailers. Our investments in Mecca also continue to generate good cash flows and provide a healthy return on investments, with sustained occupancy rates of 80-90%.

The Bank continues to maintain a conservative approach to banking practices and relied on its core competencies in lending activities. We adhered to prudent risk management practices in granting new financing facilities and acquiring investments. We continue to follow a tight policy in providing financing and investment in the real estate sector in line with the regulatory focus to control such exposures.





AL SALAM BANK  
السلام بنك البحرين

## Message from CEO (Continued)

The Bank maintains a healthy Capital Adequacy Ratio of 20.9% (2011: 24.9%) as of the end of the fiscal year against a mandatory Central Bank of Bahrain requirement of 12%. Our strong liquidity position of 13% coupled with our capital base is expected to provide us with the competitive advantage to continue on our growth trajectory and seek acquisition opportunities both locally and regionally.

Management and the Board are confident that the Bank is well positioned to realize our vision of becoming a leading Islamic financial Institution in the Kingdom of Bahrain.

I would like to take this opportunity to express my appreciation of the Al Salam Bank-Bahrain team. Your hard work and dedication are key ingredients to the future success of the Bank. I am grateful to the Board of Directors and the Central Bank of Bahrain for their strong support and guidance and to our shareholders and customers for their continued confidence and support. I would also like to express my heartfelt appreciation of the continuing support of the Government of the Kingdom of Bahrain and its wise leadership.

**Yousif Taqi**  
Director & CEO



## Management Review of Operations and Activities

### Operating Environment

The global economic environment remained challenging throughout 2012 attributable to slower than anticipated growth and a higher unemployment data. The Euro zone and the United States reported economic contraction with debt levels of the US and many European member countries remaining a concern for financial institutions. Major Asian economies are experiencing weaker manufacturing data and factory orders indicating a significant downturn due to their export dependency and the effect of the European and US downturn.

The GCC economies have been affected to some extent with the Kingdom of Saudi Arabia showing some resilience. Overall the GCC GDP growth fell from 3% in 2011 to 2.7% in 2012, an effect of the lagging non-hydrocarbon sector that has been attributed to the global economy and tightening of fiscal policy.

However, the outlook for the future is looking somewhat positive for the GCC with oil sector growth, forecast to be up to 6% by 2013, offsetting the underperforming non-oil sector. Fundamentals of spending also improved during the year and together with a rise in employment rates and a fall in inflation, coupled with slowly relaxing credit conditions, may signal signs of a measured recovery.

### Business Environment

Although the political situation continues to weigh heavily on Bahrain's economy, the business environment has been fairly stable after the unrest experienced in 2011. However, the business environment is still yet to return to pre-unrest levels and the lending environment remains weak as a result of modest credit expansion. Despite these challenges, the Kingdom displayed resilience with a recovery of GDP from 2.2% in 2011 to 3.4% in 2012. Lucrative trade agreements with other GCC states, as well as generous bilateral trade agreements with the United States, are set to further boost local economic growth as the global economy improves.

Against this less than ideal backdrop, ASBB forged ahead with its retail banking focused business strategy. The Bank is now operating as a full-fledged commercial and retail bank licensed by the Central Bank of Bahrain and has successfully expanded the retail banking business, while substantially reducing operating costs through consolidation of resources.

### Financial Performance

Amid concerns that domestic instability coupled with the challenging economic environment could result in a credit squeeze in the region, ASBB has achieved modest growth in 2012. The total assets of the Bank grew by 2% (2011: 8%) to BD942.2 million (2011: BD 923.9 million) over the last fiscal year. The financing portfolio grew by BD 56.3 million (2011: BD 271.2 million) to BD 327.5 million while the investment portfolio saw a reduction of BD 11.5 million (2011: BD 223.3 million) to BD 211.8 million during the fiscal year. Customer deposits increased substantially from BD 598 million in 2011 to BD 624.1 million in 2012, reflecting a 4.4% growth (2011: 12.3%) underscoring the success of our transition to an Islamic retail bank, as well as reflecting continued customer confidence regardless of the volatile operating environment.

The operating income of the Bank also increased by an impressive 81% from BD12.7 million in 2011 to BD 23.1 million in 2012 attributable to the surge in income from core banking activities, comprising corporate, commercial and retail banking facilities.

Income from financing contracts grew by 22% (2011: 18.9%) demonstrating the Bank's continued effort to focus on retail and corporate banking initiatives. As a result of disciplined cost management measures employed during the year, the operating expenses of the Bank were maintained at 2011 levels after a decrease of 14.5% over the previous year. Additional provisions were taken against non-performing financing contracts amounting to BD 2.1 million (2011: BD 0.65 million). The Bank recorded an impressive net profit of BD 10.3 million for the fiscal year 2012 (2011: BD 0.3 million) considering the extremely challenging environment both locally and regionally.

### Capital Adequacy

Al Salam Bank-Bahrain continues to enjoy strong financial solvency and abundance of liquidity. In accordance with the Basel II capital adequacy guidelines, the Bank's capital adequacy continued to reflect a healthy ratio of 20.9% (2011: 24.9%) as of the end of the fiscal year against a mandatory Central Bank of Bahrain requirement of 12%.

### Asset Quality

The Bank maintains a conservative approach in selecting new assets for financing and investments. As a result more than 88.1% (2011: 84.3%) of the financing asset portfolio has been classified under the "satisfactory" category while an amount of BD 2.1 million (2011: BD 0.65 million) has been set aside as provisions for past due, but not impaired facilities, although such assets are covered by adequate collateral. This provision has been made in line with the bank's conservative risk management policy.

## Management Review of Operations and Activities (Continued)

### Funds Under Management

Although securing new investment commitments continue to be challenging, the Bank achieved an increase in funds under management during 2012. At the end of the fiscal year, funds under management had increased by BD 42.2 million to BD 96.9 million from BD 54.7 million in 2011. This is attributed to the strong relationships we have built with our valued investors and their continued confidence in the Bank.

### BANKING

#### Corporate Banking

Working in tandem with the Leadership and the Government of Bahrain Corporate Banking business continues to play a key role in the economic growth and investment vitality in the Kingdom. As part of its initiative to provide support to growth of private sector businesses in the Kingdom of Bahrain, the Bank entered into an agreement with Tamkeen to provide Shari'a compliant facilities to private sector business and the Bank provided substantial financing facilities for various SME's and large corporations within Bahrain and throughout the region.

Our committed Corporate Banking team has established valuable partnerships locally and internationally, and continues to expand its growing client base. The Bank is dedicated to offering our corporate clients pioneering products and services that not only meet their individual business needs but also provide total banking solutions.

#### Retail Banking

Fiscal year 2012 has been an extremely fast-paced and successful year for the Bank's retail banking business. The year signaled a new horizon for ASBB with the completion of all merger procedures with BSB according to the requirements of Bahrain Commercial Companies Law. As a result, all previous BSB branches commenced conducting business under the ASBB name. This included a prominent rebranding of all of the BSB branches with the ASBB corporate identity.

As a prelude, and to ensure a smooth transition to operating as a full-fledged Islamic Commercial Bank, the Bank implemented a number of training initiatives to develop the skills and competencies of the retail banking staff. This initiative is expected to ensure that ASBB retail customers receive the highest standard of banking and customer service possible.

In addition to enhancing capabilities and developing team synergies, the Bank's objectives continued to focus on providing better products that meet customer needs, greater accessibility, convenience and security for our customers. The retail banking team continues to enhance the level of customer service provided through our branch network as well as the ATM machines located throughout the Island.

With regard to retail product offerings, the Bank launched a campaign highlighting competitive profit rates on all financing products including vehicle, personal, and mortgage financing. The campaign highlighted ASBB's offerings as one of the lowest profit rates in the market, as well as extended financing periods, higher personal financing limits and the added benefit of reduced administration fees when financing facilities are transferred from other institutions. This initiative was well received by the market.

Together with enhanced product offerings, the year 2012 witnessed ASBB's commitment to safeguarding the interests of its customers with the launch of "Verified by Visa" secure online shopping service.

The service, in partnership with Visa International and participating merchants worldwide, is available to all Al Salam Bank-Bahrain credit card holders and allows customers total peace of mind while shopping online using their ASBB card. The service is an additional benefit for Jiwan credit cardholders who also receive a 1% cash gift on every purchase, free Takaful insurance coverage up to USD 50,000, and 5% cash back on balance transferred from other banks.

Dedicated to the implementation of the most up to date banking technologies available, the Bank also rolled out a new state of the art mobile banking service. The service is differentiated from other mobile banking services by its ability to be used on all mobile platforms including a myriad of smart phones, androids and tablets and allows greater customer accessibility of our products and services.

Details of all new products and services were communicated through the media and the bank's website.

Our ATM network was expanded during the year with new ATM machines installed in King Hamad University Hospital in Muharraq and the building of the Electricity and Water Authority increasing our ATM's across the Kingdom to 25.



## Management Review of Operations and Activities (Continued)

### Private Banking

Although investor appetite remained subdued due to market volatility, the Private Banking business performed well in 2012.

Despite the challenging market conditions, our dedicated Private Banking team continued to offer ASBB's valued local and regional customers, a diverse range of value-added Shari'a compliant investment opportunities.

The team was active in sourcing attractive investment products during the year and was unwavering in their provision of personalized Private Banking services; tailoring financial solutions that grow their wealth and protect their financial future.

### Investments

The Bank maintains a meticulous approach to new investment selection, with investment protection being a key factor in the investment strategy in order to minimize downside risk and preservation of investment valuation. All potential opportunities are subjected to rigorous internal review, independent due diligence and analysis prior to presentation to the Bank's Investment Committee.

In line with regulatory focus on reducing real estate exposure, the Bank has tightened its investment and financing to the sector. New businesses in this sector are being undertaken on a selective basis to take advantage of market opportunities bearing in mind investor's cash yield expectations.

Activity in the investment arena was improved in 2012 as the Bank continued to diversify its income streams through investment across a wide range of industry including aviation, retail and hospitality.

During the year, the Bank completed two successful transactions into the aviation sector acquiring equity interest in two new Boeing 777-ER300 aircrafts that are leased to Emirates Airlines on a long-term lease. Majority portions of these investments were placed down to the investors during the year. Boeing 777-300ER aircraft is a large twin aircraft and the most popular of the 777 models due to its excellent performance record and fuel efficiency. These investments are set to provide stable income for the Bank together with the existing Boeing 777-200ER aircraft leased to Malaysian Airline Systems on a similar basis.

On the international real estate investment front, the Bank embarked on a significant mezzanine financing facility in the heart of Cannes, France. The facility was part of the acquisition of a high-end commercial property comprising of eight units of luxury retailers, including prestigious brands such as "BURBERRY" and "Yves Saint Laurent", for a financing period of 5 years.

The Bank's investment in the hospitality sector comprising leasehold interest in Burj Al Safwa and Burj Al Jewar, residential and commercial towers in the Holy City of Mecca are experiencing successful operations with positive cash flows and sustained occupancy rates of 90% throughout the year.

### Information Technology

During 2012 the Information Technology department focused on enhancing the core-banking platform from which ASBB operates its Islamic banking activities, whilst championing the alignment of information systems; allowing for a seamless transition to serve the growth of the Bank's expanded retail banking business.

With a focus on enhancing customer experience and providing international standards of customer security, the team continuously upgraded IT Infrastructure throughout the year. Such initiatives were undertaken to support new services such as the "Verified by Visa" Service and the enhanced mobile banking platform, while ensuring compliance with regulatory, as well as internal control requirements.

### Corporate Governance and Risk Management

During the year, significant initiatives were undertaken to improve the knowledge and practice of Corporate Governance within the Bank. Compliance with the Central Bank of Bahrain guidelines and other regulatory guidelines is a fundamental element of the Bank's operating environment.

### Know Your Customer

The Bank complies with Financial Crimes Module of Central Bank of Bahrain's rulebook. The module contains Bahrain's current anti-money laundering legislation, developed under the directives of the Financial Action Task Force, which is the international organization responsible for developing global anti-money laundering policies.



## Management Review of Operations and Activities (Continued)

The Bank places significant emphasis in understanding its customers and their financial activities. The Bank has implemented world-class systems to support the monitoring activities. Proper due diligence is conducted to ensure that financial activities of its customers are performed in accordance with the guidelines issued by the regulatory authorities.

### Human Capital

Human Resources (HR) function of the Bank is a key element in maintaining positive team synergy and individual motivation..

Developing skills and competencies of Bank's employees' using focused training, knowledge management and facilitating effective communication throughout the organization has been part of human resource development program. The HR function also focuses on attracting talent of the highest professional caliber, who also share the Bank's core values.

The Annual Summer Traineeship initiative, championed by the HR department is an initiative aligned with the Bank's Corporate Social Responsibility strategy to support the Kingdom's youth. The Bank hosted 26 fresh graduates the opportunity to take part in the annual Summer Traineeship Program with the aim in producing a competent prospective workforce in the Kingdom.. The program included a number of informative workshops designed to introduce the graduates to the world of Islamic Banking, allowing them to bridge their accademic knowledge with practical on-the-job experience.

As of 31 December 2012, Bank's employees comprised of 88.1% (87.7% in 2011) Bahraini employees out of a total of 201 (212 in 2011) across Bahrain and Singapore offices.



## CORPORATE GOVERNANCE REPORT 31 December 2012

### CORPORATE GOVERNANCE PRACTICE

The Bank aspires to the highest standards of ethical conduct: doing what it says; reporting results with accuracy and transparency and maintaining full compliance with the laws, rules and regulations that govern the Bank's business. Since 2010 when the new Corporate Governance Code was introduced by the Central Bank of Bahrain, the Bank has been implementing several measures to enhance its compliance with the corporate governance rules. A separate section on the status of compliance with the corporate governance rules and High Level Controls Module is included in this report.

### SHAREHOLDERS

#### Major Shareholders as on 31 December 2012

	<b>Name</b>	<b>Country of origin</b>	<b>No. of shares</b>	<b>% Holding</b>
1	Global Mena Macro Fund Company B.S.C.(c)	BAH	171,033,800	11.42%
2	Leader Capital (L.L.C)	UAE	57,976,149	3.87%
3	Independent Enterprises & Co. Representation	UAE	44,101,670	2.95%
4	Mohamed Omeir Yuseef Ahmed Al Mehairi	UAE	40,794,981	2.72%

## CORPORATE GOVERNANCE REPORT 31 December 2012 (Continued)

### Shareholding – 31 December 2012

Category	No. of shares	No. of shareholders	% of outstanding shares
Less than 1%	971,615,385	23,216	64.92
1% to less than 5%	354,414,645	13	23.66
5% to less than 10%	-	-	-
10% to less than 20%	171,033,800	1	11.42
20% up to less than 50%	-	-	-
50% and above	-	-	-
<b>Total</b>	<b>1,497,063,830</b>	<b>23,230</b>	<b>100.00</b>

### The outstanding ordinary share ownership of the Bank is distributed as follows:

Nationality	No. of shares	Ownership percentage
Bahraini		
Government	26,599,556	1.79
Institutions	364,937,940	24.50
Individuals	200,064,412	13.43
GCC		
Government	5,179,864	0.35
Institutions	252,773,350	16.97
Individuals	536,809,972	36.04
Other		
Institutions	54,947,699	3.69
Individuals	48,045,131	3.23
<b>Outstanding</b>	<b>1,489,357,924</b>	<b>100.00</b>
ASBB treasury stock	7,705,906	
<b>Total</b>	<b>1,497,063,830</b>	



## CORPORATE GOVERNANCE REPORT 31 December 2012 (Continued)

### BOARD OF DIRECTORS

The Board of Directors shall provide central leadership to the Bank, establish its objectives and develop the strategies that direct the ongoing activities of the Bank to achieve these objectives. Directors shall determine the future of the Bank through the protection of its assets and reputation. They will consider how their decisions relate to “stakeholders” and the regulatory framework. Directors shall apply skill and care in exercising their duties to the Bank and are subject to fiduciary duties. Directors shall be accountable to the shareholders of the Bank for the Bank’s performance and can be removed from office by them.

The primary responsibility of the Board is to provide effective governance over the Bank’s affairs for the benefit of its shareholders, and to balance the interests of its diverse constituencies including its customers, correspondents, employees, suppliers and local community. In all actions taken by the Board, the directors are expected to exercise their business judgment in what they reasonably believe to be in the best interests of the Bank. In discharging that obligation, directors may rely on the honesty and professional integrity of the Bank’s senior executives and external advisors and auditors.

### Changes during the year

Mr. Salem Rashid Al Mohanidi stepped down from the Board for personal reasons; his resignation was presented to the Board in the meeting held on 15 October 2012. The Board of directors accepted his resignation and is currently undertaking the necessary procedures to include the first substitute member - His Excellency Mr Mohamed Ali Rashid Alabbar as elected by the shareholders’ in the last Annual General Assembly meeting.

### Board Composition

The Board consists of members of high-level professional skills and expertise. Furthermore, in compliance with the corporate governance requirements, the Board Committees consist of Members with adequate professional background and experience. The Board periodically reviews its composition and the contribution of Directors and Committees.

The appointment of Directors is subject to prior screening by Remuneration and Nomination Committee and approval by the Shareholders and the Central Bank of Bahrain. The classification of “executive”, “non-executive” and “independent non-executive” directors is as per definitions Stipulated by the Central Bank of Bahrain.

### Mandate of the Board of Directors and Directors’ Roles and Responsibilities

The principal role of the Board of Directors (the Board), is to oversee the implementation of the Bank’s strategic initiatives and its functioning within the agreed framework, in accordance with relevant statutory and regulatory structures. The Board is also responsible for the consolidated financial statements of the Group. The Board ensures the adequacy of financial and operational systems and internal control, as well as the implementation of corporate ethics and the code of conduct. The Board has delegated responsibility for overall management of the Bank to the Chief Executive Officer.

The Board reserves a formal schedule of matters for its decision to ensure that the direction and control of the Bank rests with the Board. This includes strategic planning, performance reviews, material acquisition and disposal of assets, capital expenditure, authority levels, appointment of auditors and review of the financial statements, financing and borrowing activities including annual operating plan and budget, ensuring regulatory compliance and reviewing the adequacy and integrity of internal controls. All policies pertaining to the Bank’s operations and functioning are to be approved by the Board.

Each Director holds the position for three years, after which he must present himself to the Annual General Meeting of shareholders for re-appointment. The majority of ASBB Directors (including the Chairperson and/or Deputy Chairman) are required to attend the Board meetings in order to ensure a quorum.



## CORPORATE GOVERNANCE REPORT 31 December 2012 (Continued)

### Board Elections System

Article 26 of the Bank's Articles of Association provides the following:

1. The Bank shall be administered by a Board of Directors consisting of not more than fourteen members and not less than five members. The Board's term shall be three years which may be renewed.
2. Each shareholder owning 10% or more of the capital may appoint whoever represents him on the Board to the same percentage of the number of the Board members. His right to vote shall be forfeited for the percentage he has exercised to appoint his representative. If a percentage is left after exercising his right to nominate, he may use such percentage to vote.
3. Other members of the Board shall be elected by the General Assembly by secret ballot.

The Board of Directors shall elect, by secret ballot, a Chairman and one or more Vice Chairman every three years. The Vice Chairman shall act for the Chairman during his absence or if there is any barrier preventing him.

Article 29 of the Article of Association covered the "Termination of Membership in the Board of Directors". It provided the following:

A Director shall lose his office on the Board in the event that he:

- a. Fails to attend four consecutive meetings of the Board in one year without an acceptable excuse, and the Board of Directors decides to terminate his membership;
- b. Resigns his office by virtue of a written request;
- c. Forfeits any of the provisions set forth in Article 26 of the Articles of Association;
- d. Is elected or appointed contrary to the provisions of the Law; and
- e. Has abused his membership by performing acts that may constitute a competition with the Company or caused actual harm to the Company.

### Independence of Directors

An independent director is a director whom the Board has specifically determined, has no material relationship, which could affect his independence of judgment, taking into account all known facts. The Directors have disclosed their independence by signing the Directors Annual Declaration whereby they have declared that during 2012 that they have met all the conditions stipulated under Appendix A of the Corporate Governance Code. We are yet to receive declarations from a few Board members and as such the independence and non-independence of the directors is subject to review by the Board of Directors in its next Board meeting.

### Induction and Orientation for new Directors

The Bank shall provide an orientation program for new directors, which shall include presentations by senior management on the Bank's strategic plans, significant financial, accounting and risk management issues, compliance programs, operations, Code of Conduct, management structure and executive officers, and its internal and external auditors. The orientation program may also include visits to Bank's significant branches/offices to the extent practical. The Bank shall also make available continuing education programs for all members of the Board. All directors are invited to participate in the orientation and continuing education programs.

### Evaluation of Board Performance

Members of the Board of Directors have been requested to assess their self-performance, how the Board of Directors' operate, evaluate the performance of each committee in light of the purposes and responsibilities delegated to it, their attendance and their involvement in the decision making process. Below is a summary of the evaluation results:

- The directors self-assessment results were either above expectation or satisfactory in most areas, including directors' skills and experience, understanding of the Bank's business and Board operations.
- Board members have identified certain objectives moving forward such as payment of dividends to shareholders, proper utilization of excess funds, proper exits from illiquid investments in addition to the implementation of strategic plan for the Bank's growth in the next three years.
- The performance of the Chairperson, Committee chairs and the performance of different Board committee achieved above expectation and/or satisfactory results.
- Committee chairs and members have identified different objectives moving forward; including but not limited to:

#### Executive Committee

1. Actively participate in drafting the Bank's strategic plans for the next three years.
2. Monitor management functioning and implementation of Board approved plans.
3. Facilitate communication between Board and management.

#### Remuneration and Nomination Committee

1. Make proper decisions with respect to senior staff recruitment
2. Ensure right decisions are taken with respect to the remuneration of employees.

#### Audit Committee

1. Ensure that recommendations made by internal and external auditors have been implemented.
2. Institute special investigations as required.

### Remuneration of Directors

Remuneration of the Directors as provided by Article 36 of the Articles of Association states the following:

The General Assembly shall specify the remuneration of the members of the Board of Directors. However, such remunerations must not exceed in total 10% of the net profits after deducting statutory reserve and the distribution of dividends of not less than 5% of the paid capital among the shareholders. The General Assembly may decide to pay annual bonuses to the Chairman and members of the Board of Directors in the years when the Company does not make profits or in the years when it does not distribute profits to the shareholders, subject to the approval of the Minister of Industry and Commerce. The Board, based upon the recommendation of the Remuneration and Nomination Committee and subject to the laws and regulations, determines the form and amount of director compensation subject to final approval of the shareholders' at the Annual General Assembly meeting. The Remuneration and Nomination Committee shall conduct an annual review of directors' compensation.

## CORPORATE GOVERNANCE REPORT 31 December 2012 (Continued)

Per the Directors' Appointment Agreement, the structure and level for the compensation for the Board of Directors consist of the following:

1. Attendance fees payable to members attending Board meetings at BD 1,500 per meeting.
2. Attendance fees payable to members attending Committee meetings at BD 750 per meeting.
3. Annual remuneration subject to the annual financial performance of the Bank and as per the statutory limitation of the law. The total amount payable to each Board member with respect to Board and Committee meetings attendance shall be taken into consideration when determining each member's annual remuneration.

The remuneration of the Board of Directors will be approved by the shareholders at the Annual General Assembly.

In addition to the above, Directors who are employees of the Bank shall not receive any compensation for their services as directors. Directors who are not employees of the Bank may not enter into any consulting arrangements with the Bank without the prior approval of the Board. Directors who serve on the Audit Committee shall not directly or indirectly provide or receive compensation for providing accounting, consulting, legal, investment banking or financial advisory services to the Bank.

### **The Board Charter**

The Board has adopted a Charter, which provides the authority and practices for governance of the Bank. The Charter was approved by the Board in 2012 and includes general information on the composition of the Board of Directors; classification of Directors; Board related Committees, Board of Directors' roles and responsibilities, Board of Directors' code of conduct, Board remuneration and evaluation process, insider dealing, conflict of interest and other Board related information.

### **Conflict of Interest**

The Bank has a documented procedure for dealing with situations involving "conflict of interest" of Directors. In the event of Board or its Committees considering any issues involving "conflict of interest" of Directors, the decisions are taken by the full Board/Committees.

The concerned Director abstains from the discussion/ voting process. These events are recorded in Board/Committees proceedings. The Directors are required to inform the entire Board of (potential) conflicts of interest in their activities with, and commitments to, other organisations as they arise and abstain from voting on the matter. This disclosure includes all material facts in the case of a contract or transaction involving the Director.

### **Code of Conduct**

The Board has an approved Code of Conduct for ASBB Directors. The Board has also approved a Code of Ethics for the Executive Management and staff that include "whistle-blowing" procedures. The responsibility for monitoring these codes lies with the Board of Directors. The Directors' "Code of Conduct" is published on the Bank's website. The directors' adherence to this Code of Conduct is periodically reviewed.



## CORPORATE GOVERNANCE REPORT 31 December 2012 (Continued)

### Board meetings and attendances

The Board of Directors meets at the summons of its Chairperson or his Deputy (in event of his absence or disability) or if requested to do so by at least two Directors. According to the Bahrain Commercial Companies Law, the Board meets at least four times a year. A meeting of the Board of Directors shall be valid if attended by half of the members in person. During 2012, five Board meetings were held at the Bank's premises as follows:

#### Quarterly Board Meetings 2012 - Minimum Four Meetings Per Annum

##### Members

4 March 2012

1. H. E. Mohamed Ali Rashid Alabbar	✓
2. Mr. Habib Ahmed Kassim	✓
3. HH Shaikha Hessa bint Khalifa Al- Khalifa	✓
4. Mr. Fahad Sami Al-Ebrahim	✓
5. Mr. Hamad Tarek Al Homaizi	✓
6. Mr. Terence D. Allen	✓
7. Mr. Ahmed Jamal Jawa	✓
8. Mr. Yousif Abdulla Taqi	✓
9. Sheikh Abdulelah Mohahmmed Kaki	-
10. Mr. Salman Saleh Al Mahmeed	-
11. Mr. Essam Al Muhaideb	-

##### Members

4 April 2012

16 May 2012

21 June 2012

15 October  
2012

Members	4 April 2012	16 May 2012	21 June 2012	15 October 2012
1. H.H. Shaikha Hessa bint Khalifa Al Khalifa	✓	✓	✓	✓
2. Mr. Hamad Tarek Alhomaizi	✓	✓	✓	-
3. Mr. Hussein Mohammed Al Meeza	✓	✓	-	✓
4. Mr. Habib Ahmed Kassim	✓	✓	✓	✓
5. Mr. Essam bin Abdulkadir Al Muhaidib	✓	-	-	✓
6. Mr. Salman Saleh Al Mahmeed	✓	✓	✓	✓
7. Mr. Fahad Sami Al Ebrahim	✓	✓	-	-
8. Mr. Mohammed Omeir Bin Yussef	-	-	✓	-
9. Mr. Adnan Abdulla Al Bassam	✓	✓	✓	-
10. Mr. Yousif Abdulla Taqi	✓	✓	✓	✓
11. Mr. Salem Rashid Al Mohammadi (Resigned)	✓	-	✓	-



## CORPORATE GOVERNANCE REPORT 31 December 2012 (Continued)

### *Directors' and related parties' interests*

The number of shares held by Directors is as follows:

#### **Members**

H.H. Shaikha Hessa bint Khalifa Al-Khalifa	100,000
Mr. Hamad Tarek Al Homaizi	100,000
Mr. Hussain Mohammed Al Meeza	462,819
Mr. Habib Ahmed Kassim	2,102,489
Mr. Essam Bin Abdulkadir Al Muhaideb	100,000
Mr. Salman Saleh Al Mahmeed	100,000
Mr. Fahad Sami Fahad Al-Ebrahim	100,000
Mr. Mohammed Omair Yousef	40,794,981
Mr. Adnan Abdulla Al Bassam	100,000
Mr. Yousif Abdulla Taqi	100,000

During the year, a new Board was elected and newly elected directors have acquired qualification shares in accordance with the Bahrain Commercial Companies Law. There are no trading activities in the shareholdings of directors during the year except for sale of 12.75 million shares by Mr. Mohammed Omeir Yussef and 8.48 million shares by Mr. Hussein Al Meeza.

#### **Related parties**

The following shareholders are related to Mr. Habib Kassim:

- Al Mahd Investment Company owns 3,059,742 shares
- Ms. Mary Sabkar owns 2,489 shares

The following shareholder is related to Mr. Essam Al Muhaideb:

- Al Muhaideb Holding Company owns 4,314,522 shares

The following shareholder is related to Mr. Yousif Taqi:

- Capital Service House owns 7,060,133 shares

The following shareholder is related to Mr. Hussein Al Meeza:

- Top Enterprise owns 6,307,500 shares

#### **Nature and extent of transactions with related parties during 2012:**

None.

#### **Approval process for related parties' transactions:**

The Bank has a due process for dealing with transactions involving related parties. Any such transaction will require the approval of the Board of Directors.

***Material Transactions that require Board Approval***

While any transaction above BD 5 million and up to BD 10 million requires the approval of the Executive Committee of the Board of Directors, any transaction above BD 10 million requires the approval of the Board of Directors of the Bank. In addition, when acquiring 20% of a company Board approval is required regardless of the amount.

***Material contracts and financing involving Directors***

A financing facility has been provided to Mr. Mohamed Omeir Yousif Al Mehairii. The details of the facility are as follows:

- Principal amount of financing : USD 12,734,440
- Nature of facility : Lease Agreement
- Purpose of financing : Purchase a Cessna aircraft
- Profit rate : ( Libor + 2.35% p.a )
- Security : Aircraft
- Principal outstanding : USD 6,127,000

***Directorships held by Directors on other boards***

The High Level Controls Module provides that no director should hold more than three directorships in Bahrain public companies. All members of the Board of Directors meet this requirement.

***Board committees***

The Board level committees are formed, and the Board of Directors appoints their members, at the beginning of each Board term. They are considered the high level link between the Board and the Executive Management. The objective of these committees is to assist the Board in supervising the operations of the Bank. The Committee reviews issues that are submitted by the management to the Board and makes recommendations to the Board for their final review.

Below are certain issues of concern to report relating to the work of certain Board Committees during the year 2012, summary of the dates of Committee meetings held, Directors' attendance and a summary of the main responsibilities of each Committee.

The full texts for the Terms of Reference for Board Committees (Executive Committee, Audit Committee, and Remuneration and Nomination Committees) are published on the Bank's website.

## CORPORATE GOVERNANCE REPORT 31 December 2012 (Continued)

### Executive Committee

**Quarterly Committee meetings 2012 -Minimum four meetings per annum.**

**Four Committee meetings were held during 2012 as follows:**

<b>Members</b>	<b>29 February 2012</b>		
Mr. Habib Ahmed Kassim			✓
Mr. Ahmed Jamal Jawa			✓
Mr. Essam Al Muhaideb			✓
Mr. Yousif Abdulla Taqi (Non-Voting Member)			✓

<b>Members</b>	<b>14 May 2012</b>	<b>14 June 2012</b>	<b>1 October 2012</b>
Mr. Hussein Mohammed Al Meeza (Chairman)	✓	✓	✓
Mr. Hamad Tarek Alhomaizi	✓	✓	-
Mr. Essam bin Abdulkadir Al Muhaidib	✓	✓	✓
Mr. Adnan Abdulla Al Bassam	✓	✓	✓
Mr. Yousif Abdulla Taqi (Non-Voting Member)	✓	✓	✓

**Summary of responsibilities:** Deputizing the Board on matters pending decisions between Board meetings, considering and reviewing management's operational reports and regulatory and strategic developments, reviewing and approving credit and market risk proposals in excess of the authority limits of the relevant committees, reviewing management's recovery procedures for problem loans and requirements for provisioning.

**CORPORATE GOVERNANCE REPORT**  
**31 December 2012 (Continued)*****Audit Committee***

**Quarterly Committee meetings in 2012 - Minimum four meetings per annum.**

**Four Committee meetings were held during 2012 as follows:**

<b>Members</b>	<b>29 February 2012</b>
Mr. Terence D. Allen	✓
Mr. John Hawkins	✓
Mr. Hamad Al Homaizi	-

<b>Members</b>	<b>10 June 2012</b>	<b>9 September 2012</b>	<b>12 December 2012</b>
Mr. Salman Saleh Al Mahmeed (Chairman)	✓	✓	✓
Mr. Fahad Sami Fahad Al-Ebrahim	✓	✓	✓
Mr Salem Rashid Al Mohannidi (Resigned)	✓	-	-
Mr. AbdulRahman Al Sayed (Committee Expert – Non-Voting)	✓	✓	✓

**Summary of responsibilities:** Reviews the internal audit program and internal control system, considers major findings of internal audit review, investigations and management's response, ensures coordination among internal and External Auditors, monitors trading activities of key persons and ensures prohibition of the abuse of inside information and disclosure requirements.

Note: Mr Al Mohannadi no longer serves on the committee as he resigned from the Board of Directors. Members of the Board are in the process of appointing a new Audit Committee member during 2013.



## CORPORATE GOVERNANCE REPORT 31 December 2012 (Continued)

### Remuneration and Nomination Committee

**Quarterly Committee meetings in 2012 - Minimum two meetings per annum.**

**Four meetings were convened during 2012**

<b>Members</b>	<b>29 February 2012</b>		
HH Shaikha Hessa bint Khalifa Al- Khalifa			✓
Mr. Habib Ahmed Kassim			✓
Mr. Fahad Sami Al-Ebrahim			-

<b>Members</b>	<b>15 May 2012</b>	<b>10 June 2012</b>	<b>6 December 2012</b>
Mr. Habib Ahmed Kassim (Chairman)	✓	✓	✓
Mr. Fahad Sami Al-Ebrahim	✓	✓	✓
Mr Salem Rashid Al Mohanidi (Resigned)	✓	-	-

**Summary of responsibilities:** Make specific recommendations to the Board of Directors' on both remuneration policy and individual remuneration packages for the Chief Executive Officer and other senior managers. Evaluate senior management's performance in light of the Bank's corporate goals. Make recommendations to the Board from time to time as to the changes the committee believes to be desirable to the size of the Board or any committee of the Board.

Note: Mr Al Mohannadi no longer serves on the Committee as he resigned from the Board of Directors. In the last Board meeting held on 30 January 2013, members of the Board appointed Mr Adnan Al Bassam as a new member in the Committee.

### **Executive Management Compensation**

The performance bonus of the Chief Executive Officer is recommended by the Remuneration and Nomination Committee and approved by the Board. The performance bonus of senior management is recommended by the Chief Executive Officer for review and endorsement by the Remuneration and Nomination Committee subject to Board approval.

### **COMPLIANCE**

The Bank has in place comprehensive policies and procedures to ensure full compliance with the relevant rules and regulations of the Central Bank of Bahrain and the Bahrain Bourse, the Dubai Financial Market, the Emirates Securities & Commodities Authority, including anti-money laundering, prudential and insider trading reporting. The Bank is in compliance with High Level Control Module issued by the Central Bank of Bahrain.

### **KEY PERSONS POLICY**

The Bank has established a Key Persons' Policy to ensure that Key Persons are aware of the legal and administrative requirements regarding holding and trading of the Bank's shares, with the primary objective of preventing abuse of inside information. Key Persons are defined to include the Directors, Executive Management, designated employees and any person or firm connected to the identified Key Persons. The ownership of the Key Persons' Policy is entrusted to the Board's Audit Committee.

The Key Persons' Policy is posted on the Bank's website.



### **COMMUNICATION POLICY**

The Bank recognizes that active communication with different stakeholders and the general public is an integral part of good business and administration. In order to reach its overall goals for communication, the Bank follows a set of guiding principles such as efficiency, transparency, clarity and cultural awareness.

The Bank uses modern communication technologies in a timely manner to convey messages to its target groups. The Bank shall reply without unnecessary delay, to information requests by the media and the public. The Bank strives in its communication to be as transparent and open as possible while taking into account bank confidentiality. This contributes to maintaining a high level of accountability. The Bank also proactively develops contacts with its target groups and identifies topics of possible mutual interest. The Bank reinforces clarity by adhering to a well-defined visual identity in its external communications.

The Bank's formal communication material is provided in both Arabic and English languages. The Bank maintains a Legal Policy published on its website: [www.alsalambahrain.com](http://www.alsalambahrain.com) that includes terms and conditions on the use of information published on the site.

The annual reports and quarterly financial statements, Board Charter and v are published on the Bank's website. Shareholders have easy access to various types of forms including proxies used for the Annual General Meeting. In addition, forms are also available online to file complaints or make inquiries which are duly dealt with. The Bank regularly communicates with its staff through internal communications to provide updates of the Bank's various activities.

### **WHISTLE BLOWING POLICY**

The Bank has a whistle blowing policy with designated officials to whom the employee can approach. The policy provides adequate protection to employees for any reports in good faith. The Board's Audit Committee oversees the implementation of this policy.

The directors have adopted the following code of conduct in respect of their behavior:

- To act with honesty, integrity and in good faith, with due diligence and care, in the best interest of the Bank and its stakeholders;
- To act only within the scope of their responsibilities;
- To have a proper understanding of the affairs of the Bank and to devote sufficient time to their responsibilities;
- To keep confidential Board discussions and deliberations;
- Not to make improper use of information gained through the position as a director;
- Not to take undue advantage of the position of director;
- To ensure his/her personal financial affairs will never cause reputational loss to the Bank;
- To maintain sufficient/detailed knowledge of the Bank's business and performance to make informed decisions;
- To be independent in judgment and actions and to take all reasonable steps to be satisfied as to the soundness of all decisions of the Board;
- Not to agree to the Bank incurring an obligation unless he/she believes at the time, on reasonable grounds, that the Bank will be able to discharge the obligations when it is required to do so;
- Not to agree to the business of the Bank being carried out, or cause or allow the business to be carried out, in a manner likely to create a substantial risk of serious loss to the Bank's creditors;
- To treat fairly and with respect all of the Bank's employees and customers with whom they interact;
- Not enter into competition with the Bank;
- Not demand or accept substantial gifts from the Bank for himself/herself or his/her associates;



## CORPORATE GOVERNANCE REPORT 31 December 2012 (Continued)

- Not take advantage of business opportunities to which the Bank is entitled for himself/herself or his/her associates;
- Report to the Board any potential conflict of interest, and
- Absent themselves from any discussions or decision-making that involves a subject in which they are incapable of providing objective advice or which involves a subject of proposed conflict of interest.

### **STATUS OF COMPLIANCE WITH THE NEW CBB RULES AND CORPORATE GOVERNANCE CODE**

The Corporate Governance Committee was constituted immediately following the holding of the ordinary general assembly meeting in March 2012. One member of the Committee resigned in the middle of 2012 and hence the Committee could not be convened due to lack of quorum. This situation has been rectified following year-end and the Committee is scheduled to meet following regulatory approval of the re-constituted Committee. With exception of this the Bank is in compliance with all the CBB rules and corporate governance code of the Kingdom.

- Not demand or accept substantial gifts from the Bank for himself/herself or his/her associates;
- Not take advantage of business opportunities to which the Bank is entitled for himself/herself or his/her associates;
- Report to the Board any potential conflict of interest, and
- Absent themselves from any discussions or decision-making that involves a subject in which they are incapable of providing objective advice or which involves a subject of proposed conflict of interest.

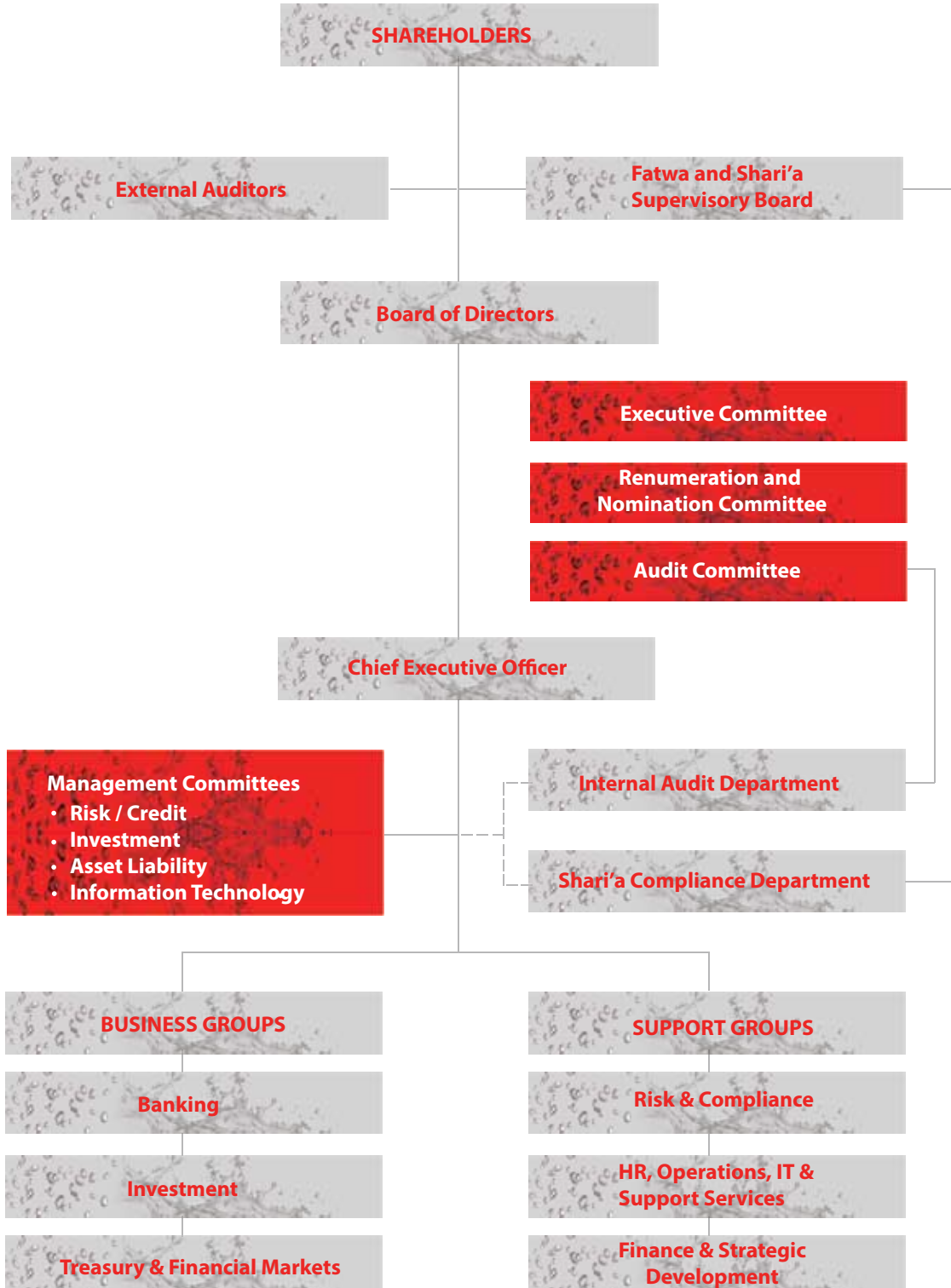
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# CORPORATE GOVERNANCE REPORT 31 December 2012 (Continued)

## ORGANIZATION STRUCTURE



The changes made to the management structure during the year is reflected in the executive management team section of this annual report.

## Risk Management and Compliance

### Executive Management Compensation

At Al Salam Bank-Bahrain we appreciate the fact that we are in the business of taking risks and our success is largely dependent on how efficiently we identify, measure, control and manage these risks. Hence, we view risk management as a core competency from a strategic point of view and the Basel II Accord as a catalyst to the successful implementation of the pillars of risk management.

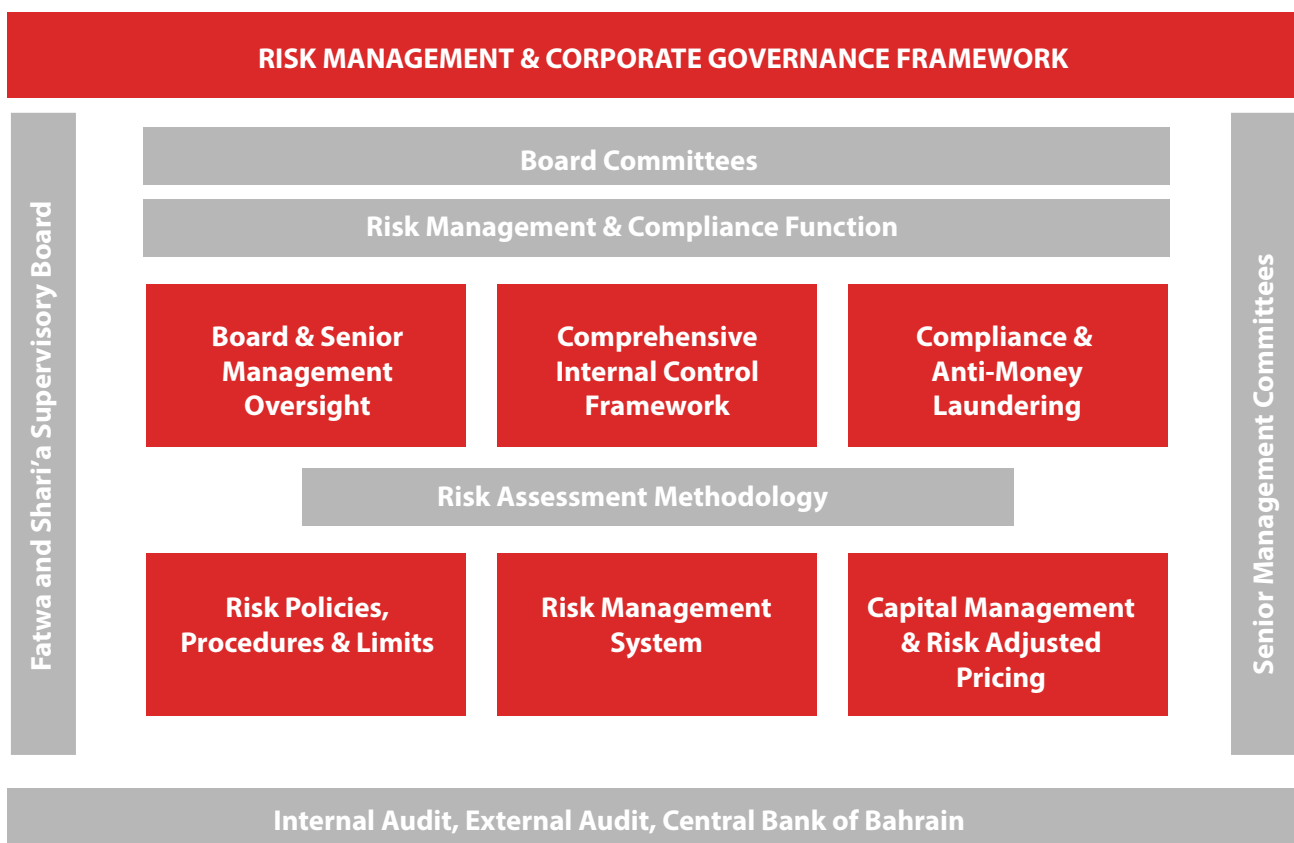
The fundamental principle underlying our risk management framework is ensuring that accepted risks are within Board approved risk appetite and the returns are commensurate with the risks taken. The objective is creating shareholder value through protecting the Group against unforeseen losses, ensuring maximization of earnings potential and opportunities vis-à-vis the Group's risk appetite and ensuring earnings stability.

With this in mind, the Bank's establishment plan gave priority to the development of an effective and practical risk management framework and independent risk management and compliance function in line with best risk management practice locally and internationally, the requirements of the Central Bank of Bahrain and the Basel II Accord.

### Risk Management Framework

The risk management framework defines the risk culture of Al Salam Bank-Bahrain and sets the tone throughout the Group to practice the right risk behavior consistently to ensure that there is always a balance between business profits and risk appetite.

The risk management framework achieves this through the definition of the Group's key risk management principles covering credit, market, operational, strategic and reputation risks, the role and responsibilities of the Board, Risk Management group and Senior Management towards risk management, the risk assessment methodology based on likelihood and consequences, the major risk policies, procedures and risk limits, the risk management information systems and reports, the internal control framework and the Group's approach to capital management. The effectiveness of the risk management framework is independently assessed and reviewed through internal audits, external audits and Central Bank of Bahrain supervision. In addition, business and support groups carry out periodic control risk self assessments. As a result, the risk management framework creates an alignment between business and risk management objectives.







## Risk Management and Compliance (Continued)

### Capital Management

The cornerstone of risk management framework is the optimization of risk-reward relationship against the capital available through a focused and well monitored capital management process involving Risk Management, Finance and Business groups.

### Corporate Governance

The risk management framework is supported by an efficient Corporate Governance Framework discussed on pages 36 to 50.

### Risks Ownership

The implementation of the risk management framework Group-wide is the responsibility of the Risk Management & Compliance Departments. Ownership of the various risks across the Group lies with the business and support Heads and it is their responsibility to ensure that these risks are managed in accordance with the risk management framework. Risk Management assists business and support heads in identifying concerns and risks, identifying risk owners, evaluating risks as to likelihood and consequences, assessing options for mitigating the risks, prioritizing risk management efforts, developing risk management plans, authorizing implementation of risk management plans and tracking risk management efforts.

### Board Approved Policies, Procedures and Limits

Credit Risk Management	Market Risk Management	Operational Risk Management	Capital Management	Compliance & Anti-Money Laundering
<ul style="list-style-type: none"> <li>Exposures and limits Monitoring</li> <li>Portfolio Management</li> <li>Timely Reporting to Risk Committee</li> <li>Internal Rating Methodology</li> <li>Periodic Stress Testing and Scenario Analysis</li> </ul>	<ul style="list-style-type: none"> <li>Positioning and Limits Monitoring</li> <li>Risk Measurement Methodology</li> <li>Timely Reporting to ALCO</li> </ul>	<ul style="list-style-type: none"> <li>Control Self Assessments</li> <li>Key Risk Indicators Monitoring</li> <li>Risk &amp; Loss Events Database</li> <li>IT Security Managements</li> <li>Business Continuity Planning</li> <li>Outsourcing Risk Management</li> </ul>	<ul style="list-style-type: none"> <li>Base II Compliance</li> <li>Risk Adjusted Pricing</li> <li>Reporting to Board Executive Committee</li> <li>Scenario Analysis</li> </ul>	<ul style="list-style-type: none"> <li>Compliance Monitoring</li> <li>Anti-Money Laundering Control</li> <li>Training and Awareness</li> <li>AML System Controls</li> </ul>



## Risk Management and Compliance (Continued)

### Compliance & Anti-Money Laundering Unit

The Bank has established an independent and dedicated unit to coordinate the implementation of compliance and Anti-Money Laundering and Anti-Terrorist Financing program. The program covers policies and procedures for managing compliance with regulations, anti-money laundering, disclosure standards on material and sensitive information and insider trading. In line with its commitment to combat money laundering and terrorist financing, Al Salam Bank - Bahrain through its Anti-Money Laundering policies ensures that adequate preventive and detective internal controls and systems operate effectively. The policies govern the guidelines and procedures for client acceptance, maintenance and monitoring in line with the Central Bank of Bahrain and International standards such as FATF 40 + 9 recommendations and Basel Committee papers.

All inward and outward electronic transfers are screened against identified sanction lists issued by certain regulatory bodies including the UN Security Council Sanctions Committees and US Department of the Treasury - OFAC, in addition to those designated by the Central Bank of Bahrain. The compliance program also ensures that all applicable Central Bank of Bahrain regulations are complied with and/ or non-compliance is detected and addressed in a timely manner. The program includes compliance with regulations set by Ministry of Industry & Commerce and Bahrain Bourse.

## Corporate Social Responsibility

The Bank is committed to fulfilling its obligations as a good corporate citizen in the communities in which it operates. We endeavor to support the Bahrain Government in its efforts to enhance the quality of life of the people of the Kingdom of Bahrain.

ASBB underscore this commitment to our community by supporting initiatives that add value to the Island's housing, education and health infrastructure, as well as encouraging future economic growth and prosperity through supporting entrepreneurship and the development of our youth.

During the year, charitable donations were made to medical facilities and other charities that care for the less fortunate and supported cultural initiatives in order to preserve the traditions of the Kingdom for generations.

## The Shari'a and Supervisory Board Report for Al Salam Bank- Bahrain presented to the AGM for the financial year 2012

The Shari'a Fatwa and Supervisory Board ("the Board") has reviewed the Bank's transactions during the year, as well as the Financial Position, Income, Cash Flows and Changes in Equity statements. The Board met with the Bank's management and submitted its annual report as follows:

### First:

- 1- The Board has supervised the Banks' activities and transactions during the year, and carried out its role by advising the various departments to adhere to the Shari'a principles and the Board's legal opinions in respect to those activities and transactions. The Board held, for this purpose, several meetings with the Banks' management. The Board hereby confirms the Bank's management keenness to adhere to the Shari'a principles and the Board's legal opinions.
- 2- The Board has studied the transactions presented to it during the year, and approved the contracts and documents relating to those transactions. The Board responded to questions and queries and issued appropriate decisions and legal opinions relevant to the transactions. The decisions and legal opinions were circulated to the pertinent departments for execution.

### Second:

The Board has reviewed samples of contracts and agreements that were presented and requested the Management to adhere to them.

### Third: Financial Statements:

The Board has reviewed the financial statements and notes and made its observations on them.

In line with the available information and disclosures that are presented by the banks' management, the financial statement reviewed by the Board represents the Banks' assets, liabilities, revenues, equity, customers' accounts and operational expenses. The accuracy of the information and data provided are the responsibility of the Banks' management.

The Board believes that the consolidated balance sheet, profit and loss account and the distribution of profits to depositors and shareholders had been prepared in conformity with the Islamic Shari'a.

### Fourth: Zakah:

Since the articles of association of the Bank did not require the Bank to pay Zakah on behalf of the Shareholders, the Board has calculated the Zakah due on shareholders in order to inform them, and which should be disclosed in the notes to the financial statements.

### Fifth: Prohibited Income:

The Shari'a Board has set aside the Shari'a non-compliant income and directed it to the Charity Account.

**The Board hereby emphasizes that management has the primary responsibility to comply with the Rules and Principles of Shari'a in all activities and transactions of the Bank. The Board confirms that the executed transactions that are submitted by management of the Bank for the Board's review during the year were generally in compliance with Rules and Principles of Shari'a. The management has shown utmost interest and willingness to fully comply with the recommendations of the Board**

### Board Members



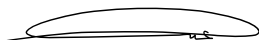
Dr. Ali Al Qura Daghi  
Member



Dr. Hussein Hamed Hassan  
Chairman



Shaikh Adnan Al Qattan  
Member



Dr. Mohammed Zoair  
Member & Secretary to the Board

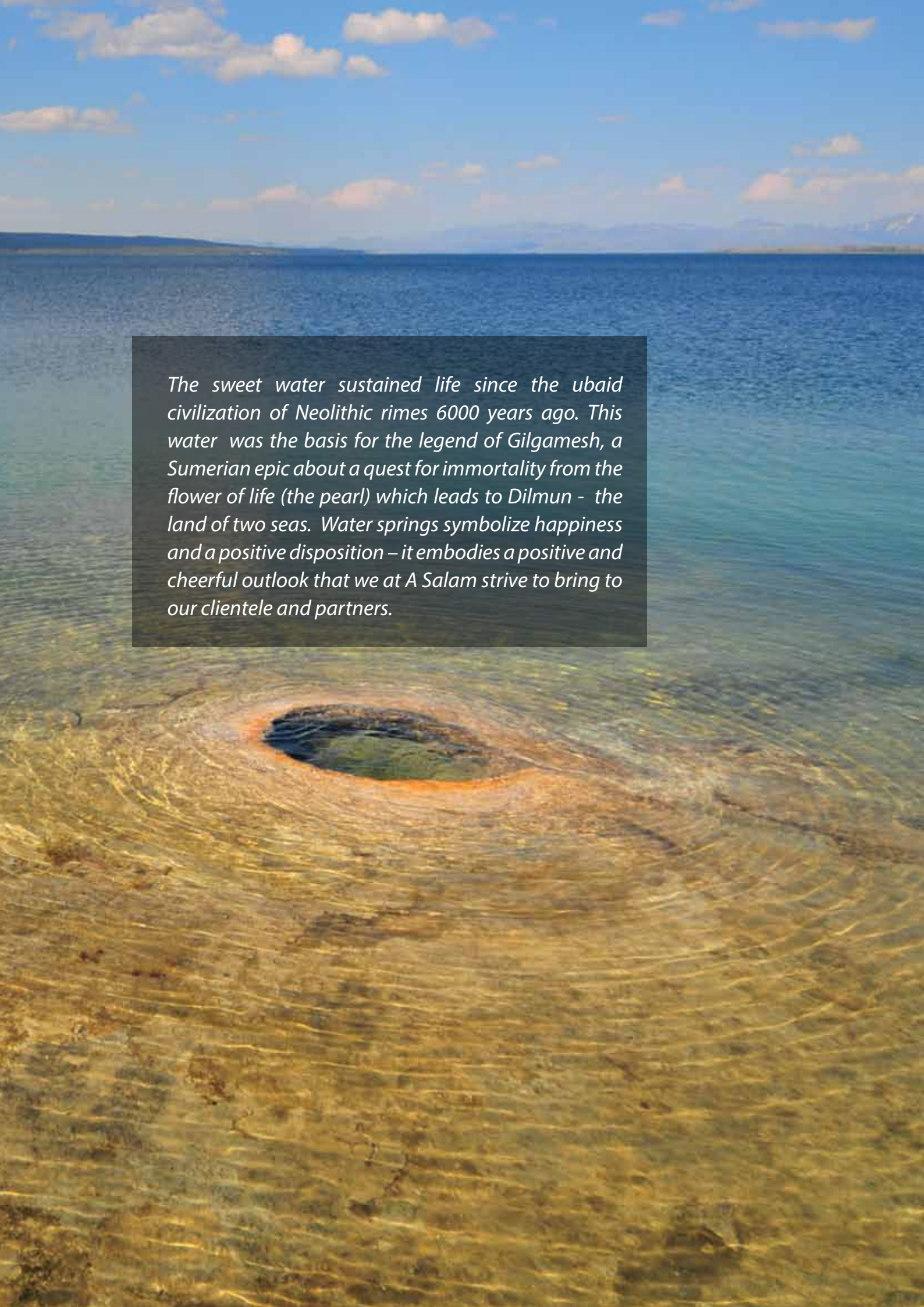


Dr. Mohammed Arbouna  
Member









*The sweet water sustained life since the Ubaid civilization of Neolithic times 6000 years ago. This water was the basis for the legend of Gilgamesh, a Sumerian epic about a quest for immortality from the flower of life (the pearl) which leads to Dilmun - the land of two seas. Water springs symbolize happiness and a positive disposition – it embodies a positive and cheerful outlook that we at A Salam strive to bring to our clientele and partners.*

## 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 stylized, handwritten signature of 'Ernst & Young' in black ink.

30 January 2013  
Manama, Kingdom of Bahrain





## CONSOLIDATED STATEMENT OF FINANCIAL POSITION 31 December 2012

		31 December 2012	31 December 2011
	Note	BD'000	BD'000
<b>ASSETS</b>			
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
<b>TOTAL ASSETS</b>		<b>942,218</b>	<b>923,907</b>
<b>LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY</b>			
<b>LIABILITIES</b>			
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
<b>TOTAL LIABILITIES</b>		<b>715,877</b>	<b>707,026</b>
<b>EQUITY OF INVESTMENT ACCOUNTHOLDERS OWNERS' EQUITY</b>			
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
<b>TOTAL OWNERS' EQUITY</b>		<b>208,065</b>	<b>200,625</b>
<b>TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY</b>		<b>942,218</b>	<b>923,907</b>

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

Shaikha Hessa bint Khalifa Al Khalifa  
Chairperson of the Board

Yousif Taqi  
Director & CEO

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

## CONSOLIDATED INCOME STATEMENT

Year ended 31 December 2012

		31 December 2012	31 December 2011
	Note	BD '000	BD '000
<b>OPERATING INCOME</b>			
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
		<b>44,055</b>	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		<b>23,062</b>	12,740
<b>OPERATING EXPENSES</b>			
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		<b>11,464</b>	11,598
<b>PROFIT BEFORE RESULTS OF ASSOCIATE AND PROVISIONS</b>			
		<b>11,598</b>	1,142
Share of profit from an associate	11	778	-
Provisions	8	(2,068)	(645)
<b>NET PROFIT FOR THE YEAR</b>		<b>10,308</b>	497
<i>Attributable to:</i>			
Shareholders of the Bank		10,272	312
Non-controlling interest		36	185
		<b>10,308</b>	497
<b>WEIGHTED AVERAGE NUMBER OF SHARES (in '000)</b>			
		<b>1,491,372</b>	1,491,779
<b>BASIC AND DILUTED EARNINGS PER SHARE (FILS)</b>			
		<b>6.9</b>	0.2

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





## CONSOLIDATED STATEMENT OF CASH FLOWS

### Year ended 31 December 2012

	Year ended 31 December 2012	Year ended 31 December 2011
	BD'000	BD'000
<b>OPERATING ACTIVITIES</b>		
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	17,915	3,246
<b>Changes in operating assets and liabilities:</b>		
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	(40,637)	(12,484)
<b>INVESTING ACTIVITIES</b>		
Purchase of premises and equipment	(72)	(229)
Net cash used in investing activities	(72)	(229)
<b>FINANCING ACTIVITIES</b>		
Equity of investment accountholders	2,020	(2,209)
Purchase of treasury stock	(27)	(465)
Net cash from (used in) financing activities	1,993	(2,674)
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	(38,716)	(15,387)
Cash and cash equivalents at 1 January	187,729	203,116
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>	149,013	187,729
<b>Cash and cash equivalents comprise of:</b>		
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
	149,013	187,729

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

## CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY Year ended 31 December 2012

**Attributable to Shareholders of the Bank** Amounts in BD'000

	Share capital	Treasury stock	Statutory reserve	Retained earnings	Investment reserve	Changes in fair value	Foreign exchange translation reserve	Share premium reserve	Total reserves	Proposed appropriations	Total	Non-controlling interest	Total owners' equity
<b>Balance as of 1 January 2012</b>	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)
<b>Balance at 31 December 2012</b>	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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 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 Shari'a rules and principles as determined by the Shari'a 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.

#### 2.2 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 2 ACCOUNTING POLICIES (continued)

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

##### *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.

##### **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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 2 ACCOUNTING POLICIES (continued)

#### 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.

###### 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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 2 ACCOUNTING POLICIES (continued)

#### 2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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:

###### *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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 2 ACCOUNTING POLICIES (continued)

#### 2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

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

###### *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.

###### **g) Non-trading investments (continued)**

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) Investment in an associate**

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.

###### **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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 2 ACCOUNTING POLICIES (continued)

#### 2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 2 ACCOUNTING POLICIES (continued)

#### 2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

##### 2.3.2 Summary of 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.

##### *Dividends*

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 2 ACCOUNTING POLICIES (continued)

#### 2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

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

##### *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.

##### *Fees and commission income (continued)*

**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.

#### **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.



**2 ACCOUNTING POLICIES (continued)**  
**2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)**  
**2.3.2 Summary of significant accounting policies (continued)**

**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) Dividends on ordinary shares**

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

**y) Equity of investment account holders**

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

Share of income for equity of investment accountholder is calculated based on the income generated by the assets funded by such investment accounts after deducting Mudarib share (as Mudarib and Rabalmaal). 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 accountholders' share of income is total investment income less shareholders' income. Portion of the income generated from equity of investment accountholders is transferred to profit equalization reserve, mudarib share and investment risk reserve and the remaining is distributed to the equity of investment accountholders.

**z) Zakah**

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

**aa) Cash and cash equivalents**

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

**ab) Wakala payables**

The 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 2 ACCOUNTING POLICIES (continued)

#### 2.3 SIGNIFICANT ACCOUNTING POLICIES (continued)

##### 2.3.3 Standards issued but not yet effective (continued)

###### **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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 3 CLASSIFICATION OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS

31 December 2012				
	<i>At fair value through profit or loss</i>	<i>Available for sale</i>	<i>At amortised cost /others</i>	<i>Total</i>
	<b>BD'000</b>	<b>BD'000</b>	<b>BD'000</b>	<b>BD'000</b>
<b>ASSETS</b>				
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
	<b>193,168</b>	<b>14,090</b>	<b>717,444</b>	<b>924,702</b>
<b>LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS</b>				
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
	-	-	<b>726,941</b>	<b>726,941</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

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

31 December 2011				
	<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>
<b>ASSETS</b>				
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</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>
<b>LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS</b>				
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

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**31 December 2012 (Continued)****5 MURABAHA AND WAKALA RECEIVABLES FROM BANKS**

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

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**

	2012	2011
	BD'000	BD'000
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**

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



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 8 MOVEMENTS IN PROVISIONS

	2012	2011
	BD'000	BD'000
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.

### 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.

	2012	2011
	BD'000	BD'000
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	(7,695)	(6,149)
Provision	(22)	(500)
At 31 December	<u>82,954</u>	<u>66,477</u>

	2012	2011
	BD'000	BD'000
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
	<u>82,954</u>	<u>66,477</u>

	2012	2011
	BD'000	BD'000
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
	<u>82,954</u>	<u>66,477</u>

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



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 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 financials 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.

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

	Level 1	Level 2	Level 3	Total
	BD'000	BD'000	BD'000	BD'000
<b>31 December 2012</b>				
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
	<u>20,770</u>	<u>445</u>	<u>182,987</u>	<u>204,202</u>
<b>31 December 2011</b>				
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
	<u>18,840</u>	<u>460</u>	<u>204,020</u>	<u>223,320</u>

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 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:

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

### 12 OTHER ASSETS

	2012	2011
	<i>BD'000</i>	<i>BD'000</i>
<b>Assets under conversion</b>		
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	<u>6,950</u>	<u>11,428</u>
	<u>36,908</u>	<u>43,028</u>

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 reposessed certain collaterals amounting to a total of BD 6.9 million from its customers. These reposessed 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.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**31 December 2012 (Continued)****13 OTHER LIABILITIES**

	2012	2011
	BD'000	BD'000
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
	<u>19,175</u>	<u>20,721</u>

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

**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:

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

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

**15 OWNERS' EQUITY**

	2012	2011
	BD'000	BD'000
<b>15.1 Share capital</b>		
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>

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 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.

## 16 INCOME FROM FINANCING CONTRACTS

	2012	2011
	<i>BD'000</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

	2011	2010
	<i>BD'000</i>	<i>BD'000</i>
<b>17.1 Fees and commission</b>		
Financing and transaction related fees and commissions	299	314
Fiduciary and other fees	524	517
	<u>823</u>	<u>831</u>
<b>17.2 Other income</b>		
	<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.





## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 18 TOTAL COMPREHENSIVE INCOME

	2012	2011
	BD'000	BD'000
<b>NET PROFIT FOR THE YEAR</b>	<b>10,308</b>	<b>497</b>
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
<b>Other comprehensive income (loss) for the year</b>	<b>1,351</b>	<b>(1,167)</b>
<b>TOTAL COMPREHENSIVE INCOME (LOSS) FOR THE YEAR</b>	<b>11,659</b>	<b>(670)</b>
<b>Attributable to:</b>		
Owners of the Bank	11,623	(837)
Non-controlling interest	36	167
	<b>11,659</b>	<b>(670)</b>

### 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:

	2012			
	<i>Associates and joint ventures</i>	<i>Directors and related entities</i>	<i>Senior management</i>	<i>Total</i>
	BD'000	BD'000	BD'000	BD'000
<b>Assets:</b>				
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
<b>Liabilities and Equity of Investment accountholders:</b>				
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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 19 RELATED PARTY TRANSACTIONS (continued)

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

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

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

	2011			
	<i>Associates and joint ventures</i>	<i>Directors and related entities</i>	<i>Senior management</i>	<i>Total</i>
	<i>BD'000</i>	<i>BD'000</i>	<i>BD'000</i>	<i>BD'000</i>
<b>Assets:</b>				
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
<b>Liabilities and equity of investment account holders:</b>				
Wakala from non-banks	3,289	1,090	453	4,832
Customers' current accounts	4,029	355	189	4,573
Equity of investment account holders	-	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:

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**31 December 2012 (Continued)****19 RELATED PARTY TRANSACTIONS (continued)**

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).

**20 CONTINGENT LIABILITIES AND COMMITMENTS**

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

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:

	2012	2011
	<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
	<u>1,629</u>	<u>1,779</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 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.

#### **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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 21 RISK MANAGEMENT (continued)

#### 21.1 Introduction (continued)

##### ***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.

##### ***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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 21 RISK MANAGEMENT (continued)

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

#### 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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 21 RISK MANAGEMENT (continued)

#### 21.2 Credit risk (continued)

##### *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
	<b>37,156</b>	<b>33,279</b>	<b>43,721</b>	-	<b>114,156</b>

	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
	<b>73,264</b>	<b>29,760</b>	<b>40,311</b>	-	<b>143,335</b>

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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 31 December 2012 (Continued)

#### 21 RISK MANAGEMENT (continued)

##### 21.2 Credit risk (continued)

###### *Type of 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		
	Satisfactory BD'000	Watch List BD'000	Substandard BD'000	Not impaired BD'000	Impaired BD'000	Total 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
	<u>307,606</u>	<u>1,939</u>	<u>6,752</u>	<u>22,437</u>	<u>10,508</u>	<u>349,242</u>

	31 December 2011					
	Neither past due nor impaired			Past due		
	Satisfactory BD'000	Watch List BD'000	Substandard BD'000	Not impaired BD'000	Impaired BD'000	Total 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
	<u>249,238</u>	<u>6,706</u>	<u>12,399</u>	<u>23,289</u>	<u>3,974</u>	<u>295,606</u>

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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 21 RISK MANAGEMENT (continued)

#### 21.2 Credit risk (continued)

##### Type of credit risk (continued)

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

	31 December 2012			
	0-30 days	31-90 days	> 90 days	Total
	BD'000	BD'000	BD'000	BD'000
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
	<b>1,570</b>	<b>3,016</b>	<b>17,851</b>	<b>22,437</b>

	31 December 2011			
	0-30 days	31-90 days	> 90 days	Total
	BD'000	BD'000	BD'000	BD'000
Murabaha and Mudaraba financing	4,815	58	10,377	15,250
Ijarah Muntahia Bittamleek	1,639	149	6,191	7,979
Musharaka financing	-	-	60	60
	<b>6,454</b>	<b>207</b>	<b>16,628</b>	<b>23,289</b>

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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 31 December 2012 (Continued)

#### 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.

	<b>Assets 2012</b>	<b>Liabilities, equity of investment account holders and owners' equity 2012</b>	<b>Contingent liabilities and Commitments 2012</b>	<b>Assets 2011</b>	<b>Liabilities, equity of investment account holders and owners' equity 2011</b>	<b>Commitments 2011</b>
	<b>BD'000</b>	<b>BD'000</b>	<b>BD'000</b>	<b>BD'000</b>	<b>BD'000</b>	<b>BD'000</b>
<b>Geographic region</b>						
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	-	-
	<b>942,218</b>	<b>734,153</b>	<b>40,468</b>	<b>923,907</b>	<b>723,282</b>	<b>44,028</b>
Owners' equity	-	<b>208,065</b>	-	-	<b>200,625</b>	-
	<b>942,218</b>	<b>942,218</b>	<b>40,468</b>	<b>923,907</b>	<b>923,907</b>	<b>44,028</b>
<b>Industry sector</b>						
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
	<b>942,218</b>	<b>734,153</b>	<b>40,468</b>	<b>923,907</b>	<b>723,282</b>	<b>44,028</b>
Owners' Equity	-	<b>208,065</b>	-	-	<b>200,625</b>	-
	<b>942,218</b>	<b>942,218</b>	<b>40,468</b>	<b>923,907</b>	<b>923,907</b>	<b>44,028</b>





## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 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:

	2012			
	10% increase		10% decrease	
	<i>Effect on net profit</i>	<i>Effect on equity</i>	<i>Effect on net profit</i>	<i>Effect on 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)

	2011			
	10% increase		10% decrease	
	<i>Effect on net profit</i>	<i>Effect on equity</i>	<i>Effect on net profit</i>	<i>Effect on 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 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:

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

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

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 were converted into Shari'a compliant 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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 23 MARKET RISK (continued)

#### 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 :

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

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

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

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 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:

	<b>31 December 2012</b>				
	<b>Up to 3 months</b>	<b>3 months to 1 year</b>	<b>1 to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
	<b>BD'000</b>	<b>BD'000</b>	<b>BD'000</b>	<b>BD'000</b>	<b>BD'000</b>
<b>ASSETS</b>					
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
	<b>252,701</b>	<b>93,471</b>	<b>507,308</b>	<b>88,738</b>	<b>942,218</b>
<b>LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS</b>					
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
	<b>96,710</b>	<b>199,092</b>	<b>437,905</b>	<b>446</b>	<b>734,153</b>



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 24 LIQUIDITY RISK (continued)

	31 December 2011				
	Up to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
	BD'000	BD'000	BD'000	BD'000	BD'000
<b>ASSETS</b>					
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>
<b>LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS</b>					
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>



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 31 December 2012 (Continued)

#### 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:

	31 December 2012					
	On demand	Up to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
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
	<b>108,082</b>	<b>395,440</b>	<b>248,254</b>	<b>20,359</b>	<b>537</b>	<b>772,672</b>

	31 December 2011					
	On demand	Up to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000
LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS' COMMITMENTS AND CONTINGENT LIABILITIES						
Murabaha and Wakala payables to banks	-	101,120	3,453	-	-	104,573
Wakala payables to non-banks	-	284,748	219,476	10,923	-	515,147
Customers' current accounts	66,585	-	-	-	-	66,585
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
	<b>87,306</b>	<b>421,854</b>	<b>237,093</b>	<b>16,849</b>	<b>9,458</b>	<b>772,560</b>



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 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:

	31 December 2012				
	Banking	Treasury	Investments	Capital	Total
	BD'000	BD'000	BD'000	BD'000	BD'000
Operating income	7,035	11,437	(2,418)	7,008	23,062
Segment result	<u>826</u>	<u>10,627</u>	<u>(3,852)</u>	<u>2,707</u>	<u>10,308</u>
<b>Other information</b>					
Segment assets	<u>348,043</u>	<u>361,628</u>	<u>171,287</u>	<u>61,260</u>	<u>942,218</u>
Segment liabilities, and equity	<u>629,981</u>	<u>90,966</u>	<u>2,547</u>	<u>218,724</u>	<u>942,218</u>

	31 December 2011				
	Banking	Treasury	Investments	Capital	Total
	BD'000	BD'000	BD'000	BD'000	BD'000
Operating income	7,974	5,196	(2,850)	2,420	12,740
Segment result	<u>3,019</u>	<u>4,253</u>	<u>(4,786)</u>	<u>(1,989)</u>	<u>497</u>
<b>Other information</b>					
Segment assets	<u>291,269</u>	<u>385,475</u>	<u>194,313</u>	<u>52,850</u>	<u>923,907</u>
Segment liabilities, and equity	<u>585,102</u>	<u>118,818</u>	<u>8,494</u>	<u>211,493</u>	<u>923,907</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 25 SEGMENT INFORMATION (continued)

#### 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.

### 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 Shari'a prohibited income totaling 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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 31 December 2012 (Continued)

### 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.

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

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



*Some of the other famous water springs were Ayn Al Hunaineya, Ayn Qassari, Ayn Umm Lesh um, Ayn Elssayeh, Al Raha, Ayn Elikir, Ayn Arad, Ayn Buri, Ayn ad Dar, Ayn Hartah and Ayn Zaidan. These watersprings brought life, drinking water and food security through their agricultural products. The Al Salam portfolio comprises a vast array of products which aim to bring security and financial stability to our clients.*