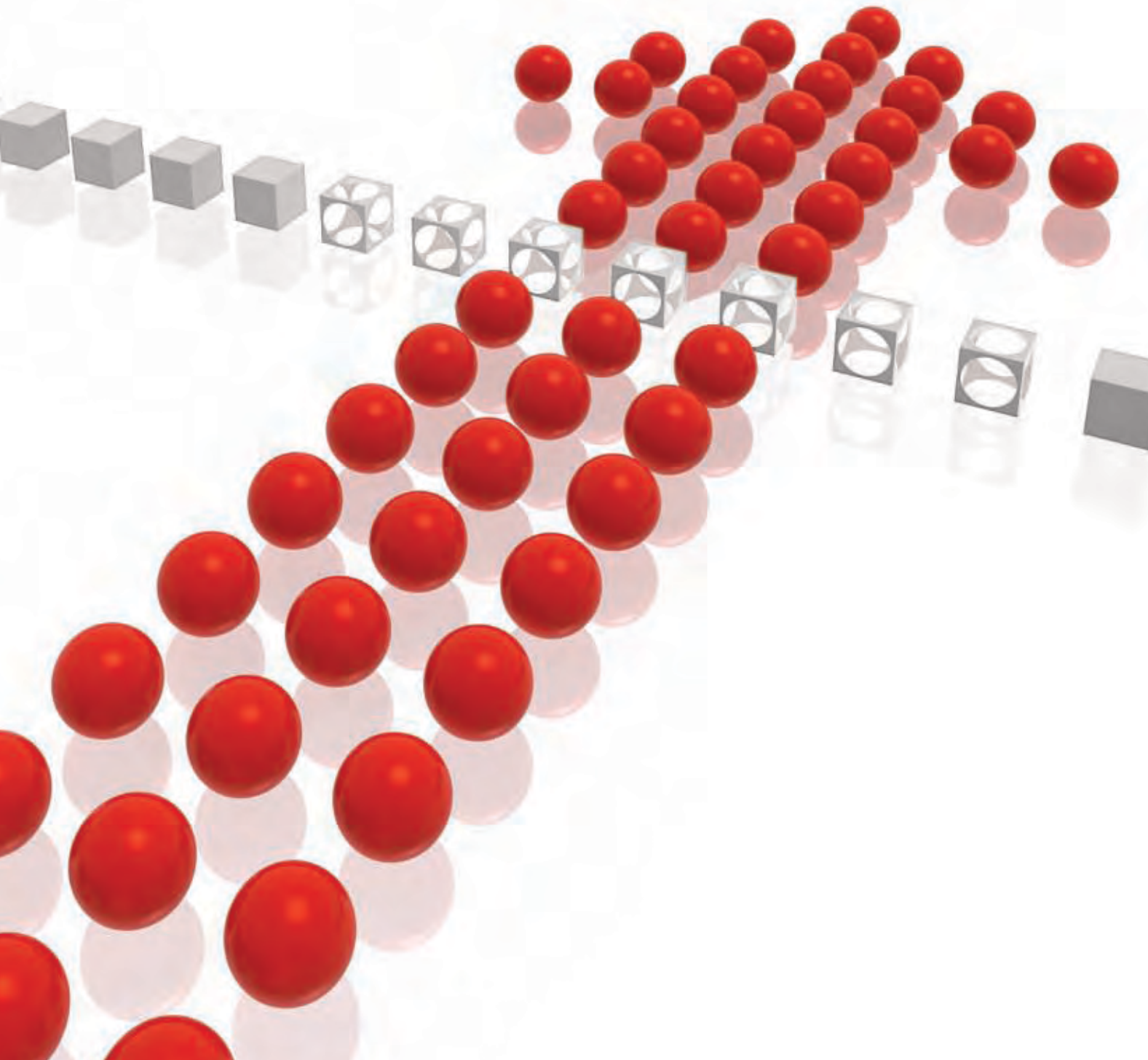




AL SALAM BANK  
البحرين Bahrain

Annual Report | 2008





**His Highness  
Shaikh 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 Highness  
Shaikh Salman Bin Hamad  
Al Khalifa**

The Crown Prince &  
Deputy Supreme Commander

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# Our Vision

# Our Mission

## OUR VISION

To become a global force in the Islamic financial services industry by providing innovative, tailor-made Shari'a compliant products and services and build a reputation as a "Trusted Bank" whilst enhancing shareholder value.

## OUR MISSION

- Become the one-stop-shop for providing differentiated Islamic financial products and services to specific target segments.
- Build a strong global presence and premier brand image as an Islamic financial shaper.
- Achieve high returns for investors and shareholders based upon their specific risk appetites.



AL SALAM BANK  
البحرين البحرين

# 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 products and 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 with a paid-up capital of BD120 million (US\$318 million), Al Salam Bank-Bahrain B.S.C. commenced commercial operations on 17 April 2006. The Bank operates under Islamic principles in accordance with regulatory requirements for Islamic banks set by the Central Bank of Bahrain.

The Bank's high-caliber management team comprises highly qualified and internationally experienced professionals with proven expertise in key areas of banking, finance and related fields. Management and staff are supported by a world-class Information Technology (IT) infrastructure and the latest 'smart' working environment.

Al Salam Bank-Bahrain is committed to adopting internationally recognized banking standards and best practices and operates with the highest levels of integrity, transparency and trust.

The Bank is equally 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.

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**Dyanamic**

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**Diversified**

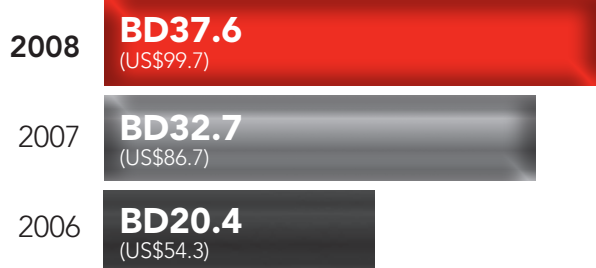
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**Defferentiated**

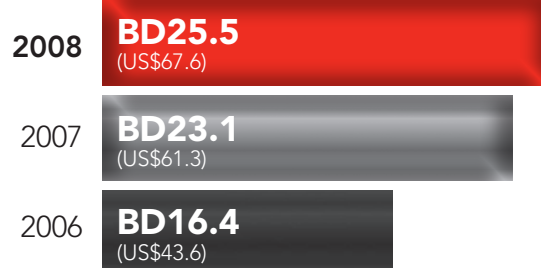
# ANNUAL HIGHLIGHTS

## KEY FINANCIAL INDICATORS

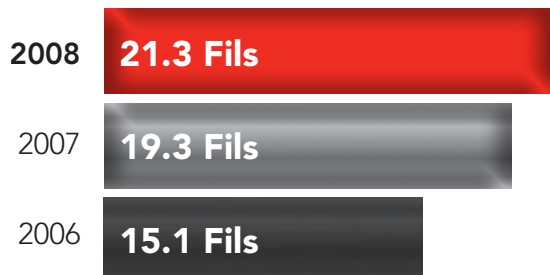
### Total Operating Income (million)



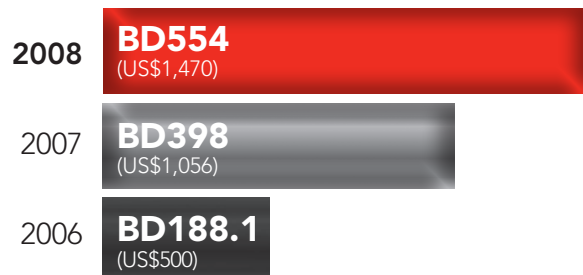
### Net Profit (million)



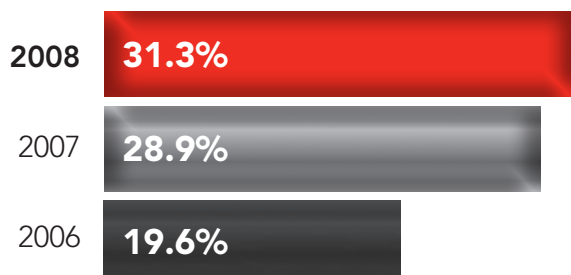
### Earnings Per Share



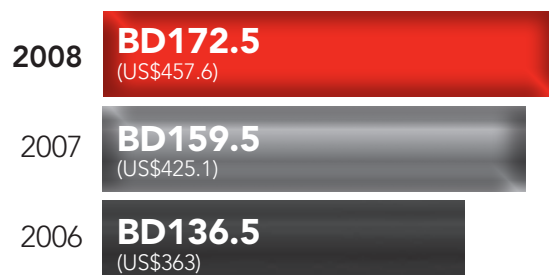
### Total Assets (million)



### Cost to Income Ratio



### Total Equity (million)





# BOARD OF DIRECTORS



In spite of extremely adverse market conditions, the Bank managed to post 40% growth in total assets compared to the level at 31 December 2007 and a 10% increase in net income for the year compared to 2007.

# BOARD OF DIRECTORS

## H. E. MOHAMED ALI RASHID ALABBAR

Chairman

Mohamed Ali Alabbar is the founding member and Chairman of Emaar Properties PJSC, the Dubai-based global property developer. Mr. Alabbar is Chairman of The Advisory Council, a high-level Dubai Government economic advisory board, and serves on the board of directors of the Investment Corporation of Dubai (ICD), the investment arm of the Government of Dubai. He is also a Board Member of

Noor Investment Group, an affiliate of Dubai Group, focused on Shari'a compliant financial services. A graduate in Finance and Business Administration from Seattle University in the United States, Mr. Alabbar works closely with regional NGOs, and is especially committed to the cause of educational reform and social housing. A keen sportsman, he is Chairman of the UAE Golf Association.



## HUSSEIN MOHAMMED AL MEEZA

Vice Chairman, Chairman of the Executive Committee



Hussein Al Meeza is one of the brightest names in the UAE's financial and banking sectors, particularly in the area of Islamic finance and insurance. Having graduated from the Beirut Arab University in 1975, Al Meeza started his professional career at the Dubai Islamic Bank (DIB). His outstanding career success was crowned in December 2006 when the International Conference of Islamic Bankers chose him as the 2006 Best Islamic Banking Personality. Al Meeza is currently CEO, Managing Director of Aman Insurance and Re-Insurance

Company, Vice Chairman of Al Salam Bank-Sudan, Vice Chairman of the Board & the Chairman of the Executive Committee of Al Salam Bank-Algeria, Chairman of Gulf Jet, Board Member of Emaar Industries & Investments, Member of the Islamic Finance Advisory Council-Dubai International Financial Centre (DIFC), Board Member of the Banking Committee and Islamic Financial Association and Chairman of the founding committee of Islamic Insurance and Re-Insurance Companies.

## Essam bin Abdulkadir Al Muhaideb

Board Member

Essam Al Muhaideb is the Group Managing Director of A.K. Al Muhaideb & 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 amongst which are Emaar Middle East, United Sugar Company, Amwal Al Khaleej, Saudi Tabreed Company, Synthomer Middle East, Nestle Co, Damas 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, Al Latifia Trading & Contracting Co. Moreover, he is a member of some charitable and non profitable organizations such as King Fahad University of Petroleum & Minerals Endowment Fund, Prince Sultan Ladies' Fund.





# BOARD OF DIRECTORS

## HABIB AHMED KASSEM

Board Member

Mr. Habib Kassem 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. Kassem 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.



## MOHAMMED BIN OMEIR YUSSEF AL MEHAIRI

Board Member



Mr. Mohammed Bin Omeir is currently the Chief Executive Officer of Bin Omeir Holding Group. He is also a Board member of Dubai Islamic Insurance and Re-Insurance Company (Aman), Al Salam Bank-Sudan and Al Salam Bank-Algeria.

## SALEH SAEED AHMED LOOTAH

Board Member

Mr. Saleh Saeed Lootah is currently the Group Executive Director of S.S. Lootah Group, Dubai. Mr. Lootah is also Executive Committee Member of Dubai Council for Economic Affairs; Vice Chairman of Awqaf & Minors' Affairs Foundation, Govt. of Dubai; Board Member and Chairman of Credit Committee at Dubai Islamic Bank; Board Member of Amlak Finance

PJSC (Dubai); Board Member of Amlak International, Riyadh (KSA) and Board Member of Dubai Insurance & Reinsurance Company. He is also the Vice Chairman of Dubai Co-operative Society (Al Islami Foods) and member of the Board of Trustees of Dubai Medical College for Girls & Dubai Pharmacy College.



# BOARD OF DIRECTORS

## SALEM RASHED SAEED AL MOHANNADI

Board Member

Mr. Salem Al Mohannadi is currently the Executive Director for Finance and Administration Department at Abu Dhabi Investment Authority, Chairman of Tunis and Emirates Bank, Vice Chairman of Abu Dhabi Holding Company. He is also Board member of Al Salam Bank – Sudan, Al Salam Bank-Algeria, Emaar Properties, Dubai Islamic Bank, Abu Dhabi Islamic Bank,

Abu Dhabi Investment company, Arab Investment Company-Riyadh, Arab Jordan investment Bank-Amman and Arab International Investment Bank-Cairo.



## YOUSIF ABDULLA TAQI

Board Member, Chief Executive Officer



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), and was responsible for establishing Kuwait Finance House Malaysia. Before 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 firms. He is currently the Chairman of Manara Developments Company B.S.C. (c), Amar Holding Company B.S.C. (c) and ASB Biodiesel (Hong Kong) Limited, affiliates of ASBB, and also a board member of Al Salam Bank-Algeria and Aluminum Bahrain (ALBA)

## KHALID AHMED ABDULLA AL ASHAR

Secretary to the Board

Mr. Khalid Al Ashar enjoys a vast experience that extends to 27 years. In addition to his previous work within the public sector, Mr. Al Ashar held a number of positions in the banking sector. He previously worked in the Operations Department at the Bank of Bahrain and Kuwait and Arab Banking Corporation. He also held the position of Director of Human Resources and Administration at the Liquidity Management Centre.

He enjoys a long experience in the field of establishing Islamic banks and contributed in the establishment of the Liquidity Management Center. Mr. Al Ashar holds a BSc in Commerce and Business Administration from Beirut Arab University.



# SHARI'A SUPERVISORY BOARD

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## DR. HUSSAIN HAMID HASSAN

Chairman

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Dr Hassan holds a Ph.D. 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 Ph.D.) from the International Institute of Comparative Law, University of New York, USA. He also holds a Masters in Comparative Juries, Diplomas in Shari'a and Private Law, from the University of Cairo and an LLB 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.

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## DR. ALI MOHIUDDIN AL QURRA DAGHI

Member

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Dr. Al Qurra Daghi holds a Ph.D. 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 published several research papers tackling various types of Islamic Finance, Islamic Fiqh, Zakah and Islamic Economy.

# SHARI'A SUPERVISORY BOARD

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## SHAIKH ADNAN ABDULLA AL QATTAN

Member

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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. He is a Member of Shari'a Supervisory Boards for several Islamic banks and 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.

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## DR. MOHAMED ABDUL HAKIM ZOEIR

Member & Secretary to the Board

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Dr. Zoeir holds Ph.D. 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 at Dubai Islamic Bank.

# BOARD OF DIRECTORS' REPORT TO THE SHAREHOLDERS

The second full year of commercial operations for the year ended 31 December 2008 had been very successful with the Bank's total assets reaching BD554 million (US\$1,470 million) and net profit reaching a record of BD25.5 million (US\$67.6 million).



In the name of Allah, the Beneficent, the Merciful, Prayers and Peace Be Upon the Last Apostle and Messenger, our Prophet Mohammed.

The Directors of Al-Salam Bank-Bahrain BSC ("the Bank") have pleasure in submitting their report on the accompanying financial statements to the shareholders for the year ended 31 December 2008.

The second full year of commercial operations for the year ended 31 December 2008 had been very successful with the Bank's total assets reaching BD554 million (US\$1,470 million) and net profit reaching a record of BD25.5 million (US\$67.6 million) for 2008. This is your Bank's third profitable fiscal year since its inception in April 2006 despite global financial meltdown from the second half of 2008.

The last quarter of 2008 saw credit and liquidity crunch due to the global financial crisis and fears of a deep recession. However, in spite of extremely adverse market conditions, the Bank managed to post 40% growth in total assets compared to the level at

31 December 2007 and a 10% increase in net income for the year compared to 2007. Whilst business climate was favourable in the first half of 2008, the global financial crisis in the second half of the year prevented business growth and dampened business sentiment and lowered investor confidence.

Due to global and regional economic slowdown, the Bank had been extremely cautious in expanding the financing portfolio and has been booking assets which are less sensitive to downturn. Consistent with this philosophy, investments in ASB China Fund are very well diversified with minority stakes in food, agricultural, industrial and pharmaceutical sectors dominating the portfolio. In addition, hospitality & tourism was our focus in the region with the Bank acquiring leasehold interests in two hotel towers overlooking the El-Haram in Mecca. One of the transactions was structured and majority of the equity interest placed with investors during the last quarter of 2008 despite extremely difficult market conditions.

# BOARD OF DIRECTORS' REPORT TO THE SHAREHOLDERS

The Bank was extremely successful in growing the financial institutions relationship network and managed to draw over BD225 million in interbank lines by end of 30 June 2008. At this date, the Bank was a net lender to the Banking system to the tune of BD165 million due to sustained growth in customer deposits.

During the year, the Bank also successfully placed the majority stake in the bio-diesel private equity transaction to its investors. The project is an environmental friendly initiative and aims to produce bio-diesel from multi-feedstock, including grease trap waste, waste cooking oil and palm fatty acids. During the first half of 2008, the Bank raised over US\$250 million from investors as equity participation for the light industrial project in Hidd, Bahrain. In this regard the Bank embarked on establishing a tie-up with Emaar Industrial Company, Dubai. The project aims at developing a light industrial park and to complement it, business park, warehousing facilities, commercial and residential layouts have been planned.

In October 2008 the Bank opened a retail branch at the Bahrain City Centre, its second retail branch, in Al-Seef district in furtherance of its retail banking activities in line with the Bank's plan to establish one or two new branches per annum in Bahrain. The customer base of the Bank has expanded commensurate with the market size in Bahrain and the Bank is just a few years away from gaining the critical mass to compete in the market place. To rapidly grow retail banking activities and gain the critical mass required to achieve economies of scale, the Board is also considering non-organic growth, including acquisition of suitable retail operations or financing companies in line with its commitment to establish a large and viable commercial bank amongst Islamic banks in Bahrain.

As a demonstration of the Board's commitment to offer un-paralleled client service the Bank expanded its online delivery channel launched on a limited scale in 2007 and rolled out Al-Salam charge card with enhanced security features to protect customers against fraud. We wish to note that the management is after quality and is conscious of being at the cutting edge in its product and service deliveries rather than going after quantity.

On the treasury front, the Bank was extremely successful in growing the financial institutions relationship network and managed to draw over BD225 million in interbank lines by end of 30 June 2008. At this date, the Bank was a net lender to the Banking system to the tune of BD165 million due to sustained growth in customer deposits. When the symptoms of financial meltdown were evident, the Bank proactively managed to curtail interbank activity and build healthy liquidity reserves with Central Bank of Bahrain (CBB). This is demonstrated by huge liquid funds and investments in CBB sukuk to the tune of BD111 million or 20% of the total assets at 31 December 2008. We are proud that to date your Bank continues to be a net lender to the banking system.

# BOARD OF DIRECTORS' REPORT TO THE SHAREHOLDERS

We are confident that your Bank is poised to outperform peers in the medium to long term and establish itself as a model for an universal Islamic bank.

On the real estate sector front, anticipating strict regulations from CBB, the Bank tightened its investment in and financing to real estate sector, and limited its exposure to 30% of the total assets. Given that there is a huge shortage of dwelling units in Bahrain for the middle class, the Bank is committed to undertaking a role with the support of the Government of Bahrain in developing affordable housing solutions in the coming years. 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.

The Directors believe that 2009 would be very challenging year for the banking sector as a whole and your Bank would be no exception to these challenges. At the same time, to take advantage of the current attractive asset valuations, the Bank has established onshore investment advisory offices in London and Singapore to source opportunities for our investors. With a strong and growing deposit base and a robust

risk management framework, we are confident that your Bank is poised to outperform peers in the medium to long term and establish itself as a model for an universal Islamic bank.

In the Extraordinary General Assembly Meeting held on 10 September 2007, the shareholders resolved to seek cross listing of the Bank's stock on other stock exchanges. Following this, management implemented the resolution and listed the Bank's shares on Dubai Financial Market with effect from 26 March 2008.

# BOARD OF DIRECTORS' REPORT TO THE SHAREHOLDERS

Financially, the year 2008 had seen a reasonable growth in net profit from BD23.1 million in 2007 to BD25.5 million in 2008, representing a return on equity of 16.1% (2007: 17.1%). The gross operating income amounted to BD37.6 million (2007: BD32.7 million) and the operating expenses were BD11.8 million (2007: BD9.5 million). The cost-to-income ratio for the year was 31.3% (2007: 28.9%) with the increase attributable to expanding presence in London and Singapore. The earnings per share (EPS) for the year amounted to 21.3 fils (2007: 19.3 fils). The directors have recommended cash dividend of 10 fils per share or 10% of the paid-up capital subject to shareholders' approval in the annual general meeting.

## Retained earnings and appropriation of net income:

	<b>BD'000</b>
Balance at beginning of the year	459
Net profit for the year – 2008	25,543
Transfer to statutory reserve	(2,554)
Transfer from investment reserve	2,050
Zakah	(823)
Charitable contributions	(100)
Proposed dividends	(12,000)
<b>Balance at end of the year</b>	<b>12,575</b>



# BOARD OF DIRECTORS' REPORT TO THE SHAREHOLDERS

## Directors' and Executive Management interest:

As required by the central bank of Bahrain rulebook set out below are the interest of Directors and Senior Managers in the shares of Al Salam Bank-Bahrain B.S.C and the distribution of the sharholding as of 31 December 2008.


	31 December 2008
Directors' Shares	129,582,840
Senior Managers' Shares	9,782,879
	<u>139,365,719</u>

Directors remuneration, fees and expenses for attendance at Board meetings for 2008 amounted to BD320,000.

	2008 No. Of Shareholders	% of total outstanding Shares
<b>Percentage of shares held</b>	<b>No. Of Shares</b>	
Less than 0.5%	548,096,823	22,810
0.5% to less than 1%	168,646,473	19
1% up to less than 5%	342,290,441	14
Over 5%	140,966,263	1
Total	<u>1,200,000,000</u>	<u>22,844</u>
		100.00%

The Directors would like to express their appreciation to the leadership and ministries of the Kingdom of Bahrain, the Central bank of Bahrain, 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 2009.

22 February 2009  
Manama, Kingdom of Bahrain

  
**Mohamed Ali Rashid Alabbar**  
Chairman

# MESSAGE FROM THE CHIEF EXECUTIVE OFFICER



In these adverse market conditions, the management continues to be proactive in adopting prudent approaches in managing liquidity and booking of assets.

I'm pleased to share with you our impressive achievements for the year ended 31 December 2008, the third financial year for the Bank since inception. Despite extremely challenging economic conditions in the second half of the year, the Bank achieved a 10% annual growth in profitability amounting to BD25.5 million from BD23.1 million in 2007.

In these adverse market conditions, the management continues to be proactive in adopting prudent approaches in managing liquidity and booking of assets.

The interbank activity was significantly curtailed to mitigate credit risk while on the other hand placement and reserves with the Central Bank of Bahrain were increased. As a result, the Bank reported a liquidity ratio of 50% as of December 31, 2008 (123% in 2007).

The Balance sheet continued to strengthen with the increase in equity by BD13 million to BD172.5 million (BD159.5 million in 2007). The total assets also increased by BD156.8 million to BD554.5 million in 2008 (BD397.7 million in 2007). These results are strong evidence of the Bank's success in achieving its strategic plans.

We recognize the need to be closer to our key target markets in order to select, manage and extract value for our investors. As a result, in line with our 3 year strategy, two new regional offices were established in Singapore and London covering Asia Pacific and Europe respectively.

Our core businesses lines, Banking and Investment groups experienced a very successful year. Customer deposits increased by BD179.6 million to BD292.2 million in 2008 (BD112.6 million in 2007). While being extremely cautious in providing financing, in order to

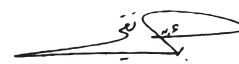
maintain high quality financing portfolio, murabaha facilities increased by BD39.9 million to BD72.5 million in 2008 (BD32.6 million in 2007).

Our Wealth Management team, through introduction of innovative investment products raised BD113 million of investor funds during the year towards several investment opportunities which were offered by the Bank. Furthermore, our Investment teams based in Singapore, Bahrain and London have identified several attractive investment opportunities which are currently being evaluated.

In recognition of the increased customer base and our objective to provide improved facilities to customers, a new retail branch "business centre" was opened in Bahrain City Centre. In the medium term, we plan to expand the number of branches within the Kingdom in order to reach and serve our valued customer base.

Our view is that 2009 will continue to bring challenges to both Islamic and conventional financial institutions as the economic crisis and its impact become evident. Therefore, management has re-visited its business plan considering the difficult operating environment. We are working tirelessly in pursuing new opportunities and putting in place new initiatives to ensure that the Bank continues to enhance shareholder value.

As a socially responsible institution and in recognition of the need to uplift the community we operate in, a total in excess of BD1 million has been allocated for Zakah, charity and other social development initiatives across the Kingdom.

  
Yousif Taqi

# MANAGEMENT REVIEW OF OPERATIONS & ACTIVITIES

The Bank's strategy is built on providing investments, products and services that drive customer satisfaction and trust with the aim to increase our growing customer base.

## Operating environment

Al Salam Bank - Bahrain completed its third fiscal period in 2008, a year that will be remembered as the most extraordinary period in the recent history during which the world economy experienced a collapse of the credit markets leading to a global recession.

In these tough market conditions, the Bank has been pursuing an extremely cautious approach to building assets by focusing its efforts in the markets that we are familiar with. Anticipating tight liquidity and credit environment, the asset liability management function of the Bank made conscious efforts to ensure that adequate liquidity is maintained at all times.

Given the strong liquidity position, impressive profitability and financial strength together with our brand name, the Bank has positioned itself to weather the difficult current market conditions. Our financial strength, placement capability and local presence in our target markets will enable us to pursue attractive private equity assets with acceptable risk profile consistent with our commitment to offer attractive investment products to our clients.

## Performance

The Bank recorded its third consecutive profitable year since 2006 and achieved a net profit of BD25.5 million (BD23.1 million in 2007) despite extremely adverse market conditions experienced in the second half of the fiscal year. The net operating income grew by 15% to BD37.6 million (BD32.7 million in 2007).

## Capital adequacy

The Bank's capital adequacy ratio stood at a very impressive 24.7% (48.7% in 2007) as of end of the fiscal year against a regulatory requirement of 12% stipulated by CBB under the new Basel II framework that came into effect from 1 January 2008.

## Financial Position

The balance sheet as of end of the fiscal year grew by 40% to BD554.5 million (BD397.7 million in 2007). The equity increased to BD172.5 million (BD159.5 million in 2007) reflecting the strength of the balance sheet. Customer deposits increased by 159% to BD292.2 million (BD112.6 million in 2007) providing the necessary liquidity.

The Bank's liquidity ratio (cash and short term funds, less interbank liabilities, to customer liabilities) stood at a healthy 50% (123% in 2007) at end of the fiscal year.

## Assets under management

The customer base comprises a significant proportion of high net worth individuals and ultra high net worth individuals. Our wealth management team has built a strong relationship with these investors over the short history of the Bank by demonstrating our professional approach, unique and attractive investment opportunities and personalized service. The assets under management in a fiduciary capacity as of end of the fiscal year amounted to BD119.6 million (BD6.6 million in 2007) reflecting a significant growth under tough market conditions.

# MANAGEMENT REVIEW OF OPERATIONS & ACTIVITIES

## Organisation

Following careful study and independent advice, the bank decided to re-organise its investment group into 3 regional offices (MENA, Europe and Asia Pacific) each focusing on a specific region or markets. Each regional office has investment sourcing and post acquisition mandates as part of their responsibilities.

We believe that local presence is vital to exploit the private equity markets that present attractive and undervalued investment opportunities as a result from the credit crisis that is experienced worldwide.

As a result, Al Salam Asia Pacific based in Singapore and Al Salam Europe based in London were established during the year. We have attracted top talent with regional expertise in to our investment teams and coupled with our strong placement capability, we are now positioning ourselves in the target markets in order to benefit from the eventual economic recovery.

In addition to our primary listing on the Bahrain Stock Exchange, the Bank's shares were also listed on the Dubai Financial Market during the fiscal year. The dual listing enabled a large number of the Bank's shareholders who are based in the United Arab Emirates to have easy access to their holdings in the Bank.

In May 2008, the Board of Directors appointed the Chief Executive Officer Mr. Yousif Taqi as a Director of the Board in recognition of his strategic vision and valuable contribution made to the success of the bank.

## Banking Group

Since inception, the bank has been striving to provide best in class retail and commercial banking products and services to our clients. We have been selective in our approach to building

assets as we aim to create a quality portfolio, sustainable client base and a strong local and regional presence.

In addition to the traditional retail, corporate and private banking services, the banking group also offers tailored products to the wealth management market segment. Our wealth management products are offered to investors through a dedicated placement team who provide personalized services. The placement and relationship professionals meet the investors frequently and assess their appetite and risk profile prior to offering any customized solutions. During the year investors who participated in several investment products structured by the Bank across real estate, hospitality and private equity, acquired assets amounting to BD113 million (BD6.6 million in 2007).

In re-iterating our commitment to provide a one-stop-shop for our valued customers for their financial needs, the bank inaugurated its second branch at Bahrain City Centre shopping mall during the year. In addition to full commercial banking services offered to customers, the branch also provides a Business Centre, a first in the local banking community.

The Bank also successfully launched the internet banking services that provide non-stop retail banking facilities, another first among the Islamic banking community in Bahrain. This was also a major milestone of our dedication to improve customer convenience and banking experience.

During the year we also announced the launch of Platinum and Gold charge cards to our individual and corporate clients. These cards are offered in Bahraini dinars or US dollars and incorporate state of the art security features to mitigate risk of fraud and theft.

Furthermore, the bank also installed three additional automated teller machines (ATMs) at various strategic locations in the Kingdom with a view to enhancing customer convenience. We are planning to continue installing more ATM machines in various parts of the Kingdom's five governorates.

## Investments

In line with our strategy since inception, we are actively pursuing attractive investment opportunities in three regions mainly MENA, Asia Pacific and Europe. Our continuous efforts to provide unique Shari'ah compliant investment opportunities to our customers require us to follow a diligent process in selecting, acquiring and managing investments in our target markets. To this end we have put in place a robust investment process with multiple layers of controls involving several distinct and independent functions within and outside the Bank.

The primary responsibility of the investment teams is to identify high quality private equity and real estate assets through their regional experience. These teams are dedicated to source, evaluate, acquire and enhance value of these assets and seek potential exits.

All potential investment opportunities are analysed by the investment teams if they meet the basic investment guidelines set out by the Banks' Investment Committee. The opportunities that satisfy these guidelines are then subjected to an independent Middle Office review, a risk assessment, a legal review and a conceptual Shari'ah Board approval. The selected opportunities are presented for Investment Committee approval. The Investment Committee comprises of Executive Management from all business areas of the Bank.

# MANAGEMENT REVIEW OF OPERATIONS & ACTIVITIES

## Private Equity

In the current difficult economic environment, the Bank has shifted its focus on value preservation of existing private equity investments.

The investment teams are working together with the operating companies in offering advice and assistance in new initiatives to ensure the values of our investments remain intact.

During the year, two investment opportunities were acquired in the hospitality industry in Saudi Arabia. The close proximity of these investments to El-Haram in Mecca makes them highly sorted after by pilgrims who perform their annual religious rituals and present a very attractive investment opportunity for potential investors.

The opportunities comprise a 19 year sublease of two residential towers within the Burj Al Safwa development with a consolidated floor area of 29,000 square meters.

Our ability to successfully place one of these assets with our investors within a period of one month is a testimony of investor appetite for such high quality private equity assets and reflects our placement capability during these difficult economic conditions. The remaining investment was warehoused to be placed in 2009 fiscal year.

The Bank's investment in a 1999 built Boeing 777-200ER aircraft leased to Malaysian Airline Systems Berhad continues to meet investor expectations. The investment provides a cash yield of 9.5% per annum to investors paid on a quarterly basis.

The development of the ASB Biodiesel plant in the Tseung Kwan O industrial area of Hong Kong achieved the critical milestone of obtaining an environmental permit from the Government of Hong Kong. The state of the art 100,000 MT plant will use waste cooking oil, grease trap waste, non pork animal fat and palm oil fatty acid to produce environmentally friendly biodiesel, a sustainable, alternative energy for conventional diesel engines. The plant is expected to be operational in 2010.

Our US\$ 50 million capital commitment in ASB China Fund was successfully deployed across diversified asset classes in China. The underlying investment portfolio of the Fund comprises of significant minority stakes in agri business, food, pharmaceutical, logistics, galvanized steel and industrial machinery. An independent valuation of the fund shows an upside of at least 20% as of 31 December 2008.

## Real Estate

The Bank acquired a development property in Hidd industrial area closer to the Bahrain International Airport and Khalifa bin Salman Port through a JV partnership by raising BD94 million from a group of investors. The area is earmarked to set up environment-friendly light industries and Amaar Holdings Company; a joint-venture company established for this purpose will develop the infrastructure for the industrial area and create a suitable and attractive environment for local, regional and international investors.

## Corporate Governance and Risk Management

During the year, the Bank tied up with a third party award winning integrated risk solution provider to the financial services industry. We are determined to adopt best in class risk management and compliance practices and maintain a higher level of corporate Governance.

## Know Your Customer

As part of our continuous effort to provide innovative products and services to our customers, the banking group places significant emphasis on understanding customer needs. Understanding their business activities and sources of wealth is considered to be an integral part of this process of meeting and exceeding customer expectations.

The Bank complies with Financial Crimes Module of Central Bank of Bahrain's rule book. This 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 & ACTIVITIES

## Social responsibility

We recognize and value our social responsibility and understand the need to develop the society we serve and operate. We pride ourselves in taking an active role in various human resource development and charitable initiatives under the patronage of His Majesty King Hamad bin Isa Al Khalifa, the King of the Kingdom of Bahrain, His Highness the Prime Minister Shaikh Khalifa bin Salman Al Khalifa, His Highness the Crown Prince and Deputy Supreme Commander Shaikh Salman bin Hamad Al Khalifa.

We believe that providing advice and guidance to students, jobseekers and their parents through various social forums such as Career Expo 2008 is an important feature in our effort to increase the awareness of demands and skills required by the banking industry.

As in the past, the Bank continues its summer internship program where selected under graduates from the University of Bahrain are given an opportunity to learn principles of Islamic Banking. These students have the opportunity to work with our top quartile industry professionals over a period of two months to enhance their knowledge and banking skills demanded by the industry.

Establishment of Al Salam University Fund managed by the Royal Charity Organisation emphasizes our commitment to community development through which university scholarships are granted to children of needy families, orphans or handicapped in order to fulfill their aspirations and create a responsible society.

In appreciation of the University of Bahrain's contribution to the financial services industry of the Kingdom, the Bank has undertaken the construction of Al Salam Bank Centre for Financial Studies.

The Bank participated in the summer action program of the Crown Prince International Scholarship Program launched under the patronage and guidance of His Highness Shaikh Salman Bin Hamad Al Khalifa, the Crown Prince and Deputy Supreme Commander of the Kingdom of Bahrain. The program aims to provide the participants with a real life challenge where they will work with a current business scenario to research and improve performance using their ideas and experience. The program was conducted over a period of eight weeks throughout the summer.

The Board of Directors recommended BD100,000 in donations for the current fiscal year to support charitable, educational, medical, and scientific programs.

The Board also recommended BD822,525 as contribution to Zakah for the current fiscal year.

## Human capital

Since its inception, the Bank has been able to attract and retain the best industry professionals in the region. Our human resource strategy is focused on building a high performance talent pool with a diversified level of experience.

High level of employee performance is underpinning our impressive track record over a short period of time. We are proud of our 80% (87% in 2007) of Bahrainis in a total of 124 (120 in 2007) employees.

The Bank recognizes that in order to motivate and retain the best talent, it is necessary to provide competitive compensation based on individual and overall performance of the Bank. Annual performance reviews are conducted to formalize individual strengths and training requirements identified through continuous interaction. In order to provide various training opportunities to employees to acquire and maintain a high level of competency, the Bank invested BHD110,000 (BHD81,000 in 2007) in 2008. The employees across the Bank received 3,343 hours (3,120 hours in 2007) of formal training through in-house and externally arranged training programs.

The management maintains an opened dialogue with employees to encourage transparency. Regular employee events including an annual gathering to review the Bank's performance and discuss future strategy forms part of the social calendar. Workshops are organized to improve efficiency and increase productivity at workplace. These social events encourage interaction among employees and foster their relationships outside working hours.

# CORPORATE GOVERNANCE

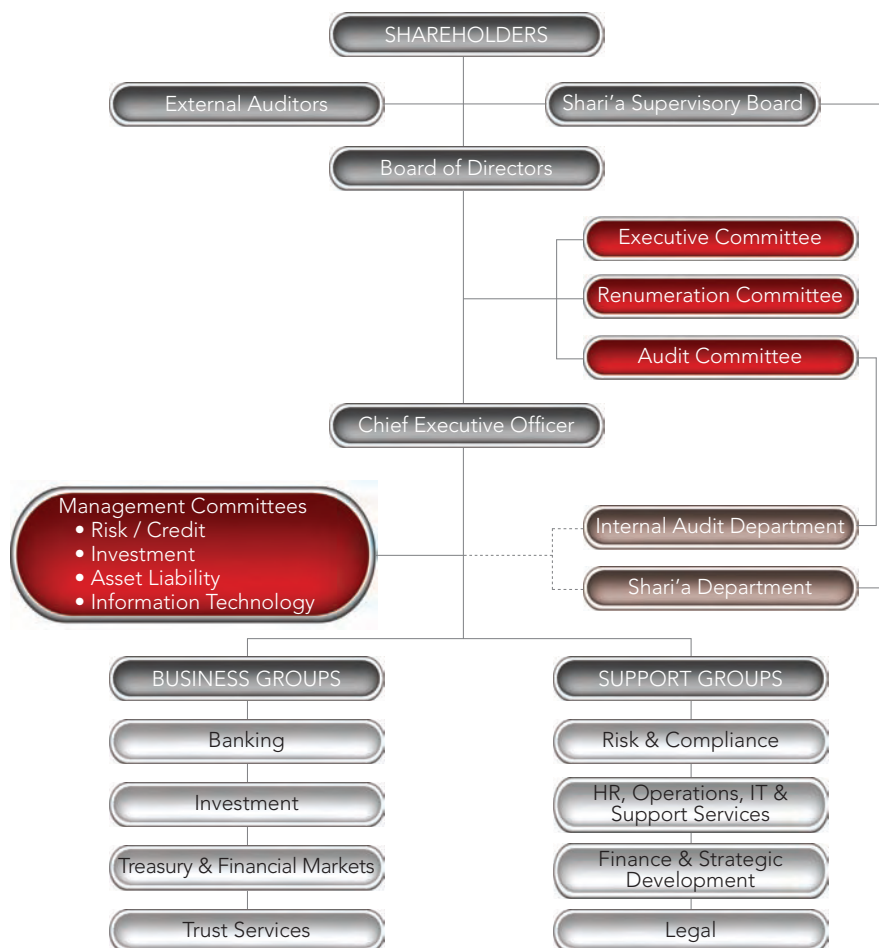
The roles and responsibilities of the Board of Directors, their independence, code of conduct and ethics are described in the Board Charter.

The Board is committed to establishing the highest standards in Corporate Governance. To this end, it has established various committees in line with industry best practice and has also directed the Executive Management to establish various management committees with relevant members. The Board Charter imposes the highest level of ethical conduct; doing what it proclaims to be its responsibility; reporting results with accuracy and transparency in a timely manner; and ensuring full compliance with the by-laws, and the rules and regulations that govern the Bank's business. The Board has adopted a Board Charter, which

together with the Bank's Memorandum and Articles of Association and the Charters of various Board Committees, provides the authority and practices for governance of the Bank.

The Board provides central leadership to the Bank. It has established and defined the objectives and strategies that direct the ongoing activities of the Bank to enable it to achieve its objectives. The roles and responsibilities of the Board of Directors, their independence, code of conduct and ethics are described in the Board Charter.

The Bank is organized as follows:



The Board Charter imposes the highest level of ethical conduct; doing what it proclaims to be its responsibility; reporting results with accuracy and transparency in a timely manner

## **BOARD COMMITTEES**

Consistent with the industry's best practice, the Board has established three Committees with defined roles and responsibilities. The Standing Committees of the Board are the Executive Committee, the Audit Committee, and the Remuneration Committee.

### **Executive Committee**

Has delegated authority within the overall Board authority. Provides direction to the Executive Management on all business matters and assumes the role of the Board to address matters arising between Board meetings. The Committee is responsible for business matters concerning credit and market risks, strategy review and recommendation to the Board.

### **Audit Committee**

Has responsibility to assist the Board in discharging its oversight duties relating to matters such as risk and compliance, including the integrity of the Bank's financial statements, financial reporting process and systems, internal controls and financial controls. The Committee

also, acts as a liaison between the External auditors and the Board and between the Regulators and the Board.

### **Remuneration Committee**

The role is to provide a formal and transparent procedure for developing a compensation policy for the Chief Executive Officer, Executive Management and the rest of the employees, ensures that compensation offered is competitive, in line with the market/peer group and consistent with the responsibilities assigned to employees. The Committee approves policies covering hiring, compensation and training. In addition, the Committee recommends to the Board special compensation plans, including annual performance bonus and short/long term incentives, to attract, motivate and retain key employees.



# CORPORATE GOVERNANCE

## MANAGEMENT COMMITTEES

The Chief Executive Officer is supported by a number of management committees each having a specific mandate to give focus to areas of

business, risk and strategy. The various committees and their roles and responsibilities are:

Committee	Roles and responsibilities
<b>Credit/Risk Committee</b>	Recommending the risk policy and framework to the Board. Its Primary role is the selection and implementation of risk management systems, portfolio monitoring, stress testing, risk reporting to Board, Board Committees, Regulators and Executive Management. In addition to these responsibilities, individual credit transaction approval and monitoring is an integral part of the responsibilities.
<b>Asset Liability Committee</b>	This Committee's primary responsibility is to review the trading and liquidity policy for the overall management of the balance sheet and its associated risks.
<b>Investment Committee</b>	The role of the Committee is to review and approve all transactions related to corporate and real estate investments and monitoring their performance on an ongoing basis. In addition, the Committee is responsible to oversee the performance of the fund managers and recommend exit strategies to maximize return to its investors.
<b>Technology Steering Committee</b>	TSC oversees the information technology function of the Bank. It recommends the annual IT budget and plans, drawn up in accordance with the approved strategy for the Bank, to the CEO for submission to the Board of Directors for their approval. It supervises the implementation of the approved IT annual plan within set deadlines and budgetary allocations.

# CORPORATE GOVERNANCE

The roles and responsibilities of the Board of Directors, their independence, code of conduct and ethics are described in the Board Charter.

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## **Code of Conduct**

The Bank conducts itself in accordance with the highest standards of ethical behavior. A Code of Business Conduct has been developed to govern the personal and professional conduct of all stakeholders.

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## **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 Stock Exchange, including anti-money laundering, prudential and insider trading reporting.

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## **Communications**

The Bank conducts all communications with its stakeholders in a professional, honest, transparent, understandable, accurate and timely manner. Main communications channels include annual reports, corporate brochure and website, and regular announcements in the appropriate local, regional and international media and the internet.

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# RISK MANAGEMENT AND COMPLIANCE

...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.

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 Bank against unforeseen losses, ensuring maximization of earnings potential and opportunities vis-à-vis the Bank'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 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 Bank to practice the right risk behavior consistently to ensure that there is always a balance between business profits and risk appetite.

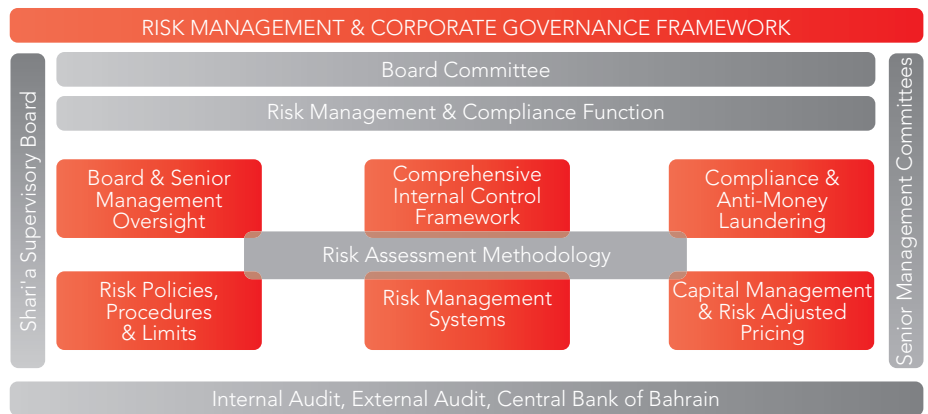
The risk management framework achieves this through the definition of the Bank's key risk management principles covering credit, market, operational, strategic and reputation risks, the role and responsibilities of the Board, Risk Management group and Executive Management towards risk management, the 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 Bank'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

The objective is creating shareholder value through protecting the Bank against unforeseen losses, ensuring maximization of earnings potential and opportunities vis-à-vis the Bank's risk appetite and ensuring earnings stability.



## 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.

business and support Heads and it is their responsibility to ensure that these risks are managed in accordance with the risk management framework.

## CORPORATE GOVERNANCE

The risk management framework is supported by an efficient Corporate Governance Framework discussed on pages 26 to 29.

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 accommodating the risks, prioritizing risk management efforts, developing risk management plans, authorizing implementation of risk management plans and tracking risk management efforts.

## RISKS OWNERSHIP

The implementation of the risk management framework bank-wide is the responsibility of the Risk Management & Compliance Departments. Ownership of the various risks across the Bank lies with the

# RISK MANAGEMENT AND COMPLIANCE

## RISK MANAGEMENT AND COMPLIANCE ORGANIZATION

Al Salam Bank- Bahrain Risk Management and Compliance Departments are under the supervision of an independent Chief Operating Officer with direct reporting line to the Chief Executive Officer.

### 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 Credit 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>• Basel 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

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.

## COMPLIANCE & ANTI-MONEY LAUNDERING UNIT

The Bank has established an independent and focused 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 Stock Exchange.

# CORPORATE SOCIAL RESPONSIBILITY

in 2008, the Bank carried out its Summer Internship Program, for the third consecutive year, with more than 20 Bahraini university students were enrolled into the Bank's training plan aimed at enhancing students' knowledge of Islamic banking Industry.

Since its inception, social responsibility formed a priority for Al Salam Bank–Bahrain. The Bank adopts a very balanced policy to contribute to the social and economic well-being of the communities in which it operates. The Bank focused on several educational initiatives such as the donations towards the Crown Prince International Scholarship Program and to the Royal Charity Organization in support of university scholarships for distinguished students, as well as funding the construction of "Al Salam Center for Financial Studies" at the University of Bahrain.

The Bank had several effective sponsorships and participations in local and international conferences and events such as the "the 7th Annual Islamic Finance Summit IFIS – Euromoney" held in London which was a great opportunity to promote the Bank's position within the Islamic finance industry and at the same time explore the abundant opportunities in other parts of the world.

The Bank also sponsored the First Women Form, The Stock Exchange Challenge held and organized by the University of Bahrain, The International conference on Business Globalization in the 21st Century organized by the University of Bahrain and the Bahrain & Singapore Asset Management Networking Event, which was a networking platform for Singapore and Bahrain-based fund managers aiming to

promote greater cooperation whereby asset managers shared their asset management experience and consider opportunities for future tie-ups or collaboration.

The Bank adopts a policy that supports training and employment. Bahrainis accounted for 80 per cent of all employees at the end of 2008. Also in 2008, the Bank carried out its Summer Internship Program, for the third consecutive year, with more than 20 Bahraini university students who were enrolled into the Bank's training plan aimed at enhancing students' knowledge of Islamic banking Industry.

During the year, the Bank has allocated part of its profit to aid various aspects of the social activities and enhance the quality of life for everyone, through its support for charitable, educational, medical, scientific, cultural, social, sporting and environmental organizations.



# FINANCIAL STATEMENTS



Al Salam Bank - Bahrain completed its third fiscal period in 2008 successfully, a year that will be remembered as the most extraordinary period in the recent history due to the collapse of the credit and liquidity markets globally.





The Bank recorded its third consecutive profitable year since 2006 and achieved a net profit of BD25.5 million (BD23.1 million in 2007) despite extremely adverse market conditions experienced in the second half of the fiscal year.



# THE SHARI'A SUPERVISORY BOARD REPORT TO THE SHAREHOLDERS

FOR THE YEAR ENDED 31 DECEMBER 2008

## Firstly:

The Board supervised the Bank's activities and transactions carried out during the year and carried out its role by guiding the various departments to comply with the principles of Islamic Shari'a and with specific Fatwas in respect to these activities and transactions. The Board has conducted various meetings with the Bank's Management and acknowledged that they have been complying with the principles of Islamic Shari'a and the Board's Fatwas.

The Board has studied the transactions submitted by the Bank during the year, approved its contracts, and responded to related questions and queries. The Board issued suitable decisions and Fatwas to the Bank for execution.

## Secondly:

The Board has reviewed the contracts and agreement templates and requested management adherence to those templates. Furthermore, the Board sees that a training plan for the employees on the new Shari'a agreements should be set for immediate implementation.

## Thirdly: The Budget

The Board has reviewed the financial statements and the related notes and disclosures. The Board believes that:

1. These financial statements fairly represent the Bank's assets and revenues. The accuracy of the information and documents is the responsibility of the Bank's Administration.
2. The Bank maintains three separate pools i.e. one each for Wakala deposits, Mudaraba deposits, and shareholders equity. The Board has advised the Bank to invest the Mudaraba deposits and the shareholders equity in one pool. It is the Board's opinion that the balance sheet and income statement as well as the distribution of profits to the depositors and shareholders are presented accordingly.

The Board sees that the Wakala contracts should stay within its framework without committing the Bank to the Wakala deposits by reverse Murabaha which has been banned by the Fiqh Council of the Muslim World League.

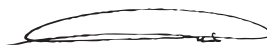
## Fourthly: Zakah

Since the amended Article no. (62) of the Memorandum of Association which states that "part of the dividends can be reserved as the Zakah of the Shareholders who entrust the Bank to deduct this Zakah. These amounts should be deposited in a fund to be called (Zakah Fund) and be disbursed by the Chief Executive Officer towards Shari'a-compliant sides that are endorsed by the bank's Supervisory Board," thus, the Shari'a Board sees that the text of the amended Article (62) of the Memorandum of Association to be submitted for amendment in order to either entrust the Bank to pay the Shareholders' Zakah explicitly or that the shareholders pay their Zakah by themselves where the Board would do the calculation and inform the shareholders of it. This is due to that the text of the amended Article 62 of the Memorandum of Association is not clear.

Based on the internal Shari'a audit reports, reviewed transactions and recommendations implemented by management, the Board confirms that the Bank's transactions executed during the year do not contradict Islamic Shari'a principles.



**Dr. Hussain Hamid Hassan**  
Chairman



**Shaikh Adnan Abdullah Al Qattan**  
Member



**Dr. Ali Mohiuddin Al Qurra Daghi**  
Member



**Dr. Mohamed Abdul Hakim Zoeir**  
Member & Board Secretary

# INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS



P.O. Box 140  
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Bahrain Commercial Complex  
Manama  
Kingdom of Bahrain

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Fax: 17 535405  
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www.ey.com/me  
C.R. No. 6700

We have audited the accompanying financial statements of Al-Salam Bank Bahrain B.S.C. ("the Bank"), which comprise the balance sheet as at 31 December 2008 and the statements of income, changes in equity and cash flows for the year ended 31 December 2008, and a summary of significant accounting policies and other explanatory notes.

## **Board of Directors' Responsibility for the Financial Statements**

The Board of Directors is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and Financial Accounting Standards issued by Accounting and Auditing Organization for Islamic Financial Institutions. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In addition the Board of Directors are responsible for the Bank's undertaking to operate in accordance with Islamic Shari'a Rules and Principles.

## **Auditors' Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing and Auditing Standards for Islamic Financial Institutions. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



# INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2008 and of its financial performance and its cash flows for the year ended 31 December 2008 in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions and the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

In addition, in our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2008 and of Vits financial performance and its cash flows for the year ended in accordance with International Financial Reporting Standards.

## **Other Regulatory Matters**

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



24 January 2009

Manama, Kingdom of Bahrain

# BALANCE SHEET

31 December 2008

	Note	31 December 2008 BD	31 December 2007 BD
<b>ASSETS</b>			
Cash and balances with Central Bank of Bahrain	4	83,533,981	15,173,663
Central Bank of Bahrain Sukuk		31,095,000	20,380,000
Murabaha with banks	5	87,167,449	224,450,893
Murabaha financing		72,483,745	32,641,599
Ijarah Muntahia Bittamleek	6	41,530,784	10,435,863
Non-trading investments	7	116,929,500	62,735,696
Investment in an associate	8	8,011,913	8,193,142
Investment properties		1,177,528	1,177,528
Receivables and prepayments	9	21,032,829	10,505,046
Premises and equipment		2,583,796	2,979,252
Assets held-for-sale		88,934,033	9,024,000
<b>TOTAL ASSETS</b>		<b>554,480,558</b>	<b>397,696,682</b>
<b>LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY</b>			
<b>LIABILITIES</b>			
Murabaha from banks		32,880,685	96,983,041
Murabaha from non-banks		289,004,770	106,908,709
Customers' current accounts		3,231,303	5,688,686
Other liabilities	10	10,755,559	8,875,784
Total liabilities, excluding unrestricted investment accounts		335,872,317	218,456,220
<b>UNRESTRICTED INVESTMENT ACCOUNTS</b>	11	<b>46,124,760</b>	<b>19,769,585</b>
Total liabilities, including unrestricted investment accounts		381,997,077	238,225,805
<b>EQUITY</b>			
Share capital	12	120,000,000	120,000,000
Reserves and retained earnings	12	39,660,956	38,941,790
Proposed appropriations	12	12,822,525	529,087
<b>TOTAL LIABILITIES, UNRESTRICTED INVESTMENTS ACCOUNTS AND EQUITY</b>		<b>554,480,558</b>	<b>397,696,682</b>

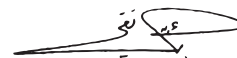
These financial statements have been authorised for issue in accordance with a resolution of the Board of Directors on 24 January 2009.



**Mohamed Ali Rashid Alabbar**  
Chairman



**Hussein Mohammed Al Meeza**  
Vice Chariman



**Yousif Taqi**  
Director & Chief Executive Officer

The attached notes 1 to 28 form part of these financial statements.

# STATEMENT OF INCOME

Year ended 31 December 2008

	31 December 2008 BD	31 December 2007 BD
Income from financing contracts	11,763,159	11,429,773
Gain on disposal of assets held-for-sale	30,266,556	11,017,492
Gains on investments designated as fair value through profit or loss	5,259,691	11,079,352
Other operating income (Note 13)	2,300,596	4,950,608
Total operating income	49,590,002	38,477,225
Less: Profit on unrestricted investment accounts	(219,939)	(245,414)
Less: Profit on Murabaha contracts	(11,768,805)	(5,519,638)
Net operating income	37,601,258	32,712,173
Staff costs	6,854,616	5,312,083
Premises and equipment cost	582,745	423,905
Depreciation	902,526	745,138
Other operating expenses	3,438,451	2,981,195
	11,778,338	9,462,321
<b>OPERATING PROFIT</b>	<b>25,822,920</b>	<b>23,249,852</b>
Share of loss from an associate (Note 8)	(280,239)	(100,858)
<b>NET PROFIT FOR THE YEAR</b>	<b>25,542,681</b>	<b>23,148,994</b>
<b>WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING (NOTE 12)</b>	<b>1,200,000,000</b>	<b>1,199,935,900</b>
<b>BASIC EARNINGS PER SHARE (FILS)</b>	<b>21.3</b>	<b>19.3</b>

The attached notes 1 to 28 form part of these financial statements.

# STATEMENT OF CASH FLOWS

Year ended 31 December 2008

	<b>31 December 2008 BD</b>	31 December 2007 BD
<b>OPERATING ACTIVITIES</b>		
Net profit for the year	<b>25,542,681</b>	23,148,994
Adjustments:		
Depreciation	<b>902,526</b>	745,138
Share of loss from an associate	<b>280,239</b>	100,858
Unrealised losses (gains) on investments designated as fair value through profit or loss	<b>2,050,309</b>	(11,079,352)
Operating income before changes in operating assets and liabilities	<b>28,775,755</b>	12,915,638
Changes in operating assets and liabilities:		
Mandatory reserve with Central Bank of Bahrain	<b>(7,241,000)</b>	(4,710,000)
Central Bank of Bahrain Sukuk	<b>(10,715,000)</b>	(20,380,000)
Murabaha and Mudaraba with Banks with original maturities of 90 days or more	<b>(1,240,065)</b>	14,439,734
Murabaha financing	<b>(39,842,146)</b>	(9,678,332)
Ijarah Muntahia Bittamleek	<b>(31,094,920)</b>	(53,434)
Non-trading investments, net	<b>(56,244,113)</b>	(10,215,813)
Receivables and prepayments	<b>(10,527,784)</b>	(1,720,592)
Customers' current accounts	<b>(2,457,383)</b>	14,874
Murabaha from banks	<b>(64,102,356)</b>	73,335,736
Murabaha from non-banks	<b>182,096,061</b>	86,796,742
Other liabilities	<b>1,250,688</b>	6,630,779
Assets held-for-sale	<b>(79,910,033)</b>	(17,845,885)
Net cash (used in) from operating activities	<b>(91,252,296)</b>	129,529,447
<b>INVESTING ACTIVITIES</b>		
Investment in an associate	-	(6,299,358)
Purchase of premises and equipment	<b>(507,070)</b>	(1,697,506)
Net cash (used in) investing activities	<b>(507,070)</b>	(7,996,864)

The attached notes 1 to 28 form part of these financial statements.

# STATEMENT OF CASH FLOWS

Year ended 31 December 2008

	<b>31 December 2008 BD</b>	31 December 2007 BD
<b>FINANCING ACTIVITIES</b>		
Proceeds from sale of treasury stock	-	20,294
Unrestricted investment accounts	<b>26,355,176</b>	19,769,585
Dividends	<b>(12,000,000)</b>	-
Net cash from financing activities	<b>14,355,176</b>	19,789,879
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>(77,404,190)</b>	141,322,462
Cash and cash equivalents at 1 January	<b>233,608,190</b>	92,285,728
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>	<b>156,204,000</b>	233,608,190
<b>Cash and cash equivalents comprise of:</b>		
Cash and other balances with Central Bank of Bahrain	<b>67,263,285</b>	1,814,814
Balances with other banks	<b>3,389,696</b>	7,718,849
Murabaha with banks with original maturities of less than 90 days	<b>85,551,019</b>	224,074,527
	<b>156,204,000</b>	233,608,190

The attached notes 1 to 28 form part of these financial statements.



# STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2008

	Share capital BD	Treasury stock BD	Statutory reserve BD	Retained earnings BD	Investment reserve BD	Foreign exchange translation reserve BD	Proposed appropriations BD	Total equity BD
Balance as of								
1 January 2008	<b>120,000,000</b>	-	<b>3,959,869</b>	<b>12,458,881</b>	<b>22,523,040</b>	-	<b>529,087</b>	<b>159,470,877</b>
Zakah on 2008 earnings	-	-	-	(822,525)	-	-	-	(822,525)
Charitable donations	-	-	-	(100,000)	-	-	-	(100,000)
Changes on investment in an associate	-	-	-	-	-	99,010	-	99,010
(Expenses) income recognised directly in equity	-	-	-	(922,525)	-	99,010	-	(823,515)
Net profit for the year	-	-	-	25,542,681	-	-	-	25,542,681
	-	-	-	<b>24,620,156</b>	-	<b>99,010</b>	-	<b>24,719,166</b>
Transfer from investment reserve	-	-	-	2,050,309	(2,050,309)	-	-	-
Transfer to statutory reserve	-	-	2,554,268	(2,554,268)	-	-	-	-
Zakah paid	-	-	-	-	-	-	(529,087)	(529,087)
Zakah contribution	-	-	-	-	-	-	822,525	822,525
Dividends paid for 2007	-	-	-	(12,000,000)	-	-	-	(12,000,000)
Proposed dividends for 2008	-	-	-	(12,000,000)	-	-	12,000,000	-
	-	-	<b>2,554,268</b>	<b>116,197</b>	<b>(2,050,309)</b>	<b>99,010</b>	<b>12,293,438</b>	<b>13,012,604</b>
<b>Balance at 31 December 2008</b>	<b>120,000,000</b>	-	<b>6,514,137</b>	<b>12,575,078</b>	<b>20,472,731</b>	<b>99,010</b>	<b>12,822,525</b>	<b>172,483,481</b>
Balance as of								
1 January 2007	<b>120,000,000</b>	(17,203)	<b>1,641,879</b>	<b>3,333,225</b>	<b>11,443,688</b>	-	-	<b>136,401,589</b>
Zakah on 2007 earnings	-	-	-	(529,087)	-	-	-	(529,087)
Charitable donations	-	-	-	(100,000)	-	-	-	(100,000)
Expenses recognised directly in equity	-	-	-	(629,087)	-	-	-	(629,087)
Net profit for the year	-	-	-	23,148,994	-	-	-	23,148,994
	-	-	-	22,519,907	-	-	-	22,519,907
Transfer to investment reserve	-	-	-	(11,079,352)	11,079,352	-	-	-
Transfer to statutory reserve	-	-	2,314,899	(2,314,899)	-	-	-	-
Zakah contribution	-	-	-	-	-	-	529,087	529,087
Sale of treasury stock	-	17,203	3,091	-	-	-	-	20,294
	-	17,203	2,317,990	9,125,656	11,079,352	-	529,087	23,069,288
<b>Balance at 31 December 2007</b>	<b>120,000,000</b>	-	<b>3,959,869</b>	<b>12,458,881</b>	<b>22,523,040</b>	-	<b>529,087</b>	<b>159,470,877</b>

The attached notes 1 to 28 form part of these financial statements.

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 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 was registered with Ministry of Industry and Commerce under Commercial Registration Number 59308 on 19 January 2006. The Bank is regulated and supervised by the Central Bank of Bahrain (CBB) and has a retail Islamic banking licence 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.

The Bank operates through its registered office, two retail branches in Al-Seef district and its investment advisory offices in London and Singapore. The Bank has a 20% stake in Al-Salam Bank Algeria, a commercial bank incorporated in Algeria with a paid up capital of US\$ 100 million equivalent in local currency.

The Bank offers a full range of Shari'a-compliant banking services and products. The activities of the Bank include accepting money placements/deposits, 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 Banking Services as defined in the licensing framework.

## 2 ACCOUNTING POLICIES

### 2.1 BASIS OF PREPARATION

The financial statements are prepared on a historical cost basis, except for investments held at fair value through profit or loss and investment properties that have been measured at fair value. These financial statements incorporate all assets, liabilities and off balance financial instruments held by the Bank, and its investment advisory offices. Investment in Al Salam Bank-Algeria is equity accounted as per IAS 28, Investment in Associates (Note 8).

These financial statements are presented in Bahraini dinars, being the functional and presentation currency of the Bank.

#### Statement of compliance

The 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) and in conformity with the Bahrain Commercial Companies Law and International Financial Reporting Standards issued by International Accounting Standards Board and the Central Bank of Bahrain and Financial Institutions Law.

#### Future changes in accounting policies

##### *IFRS 8 Operating Segments*

The application of IFRS 8 which will be effective for the year ending 31 December 2009 will result in amended and additional disclosures relating to operating segments.

##### *IAS 1 Presentation of Financial Statements (Revised)*

The application of IAS 1 (Revised) which will be effective for the year ending 31 December 2009 will result in amendments to the presentation of the financial statements.

The implementation of these standards will not have any significant impact on the Bank's financial statements.

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 2 ACCOUNTING POLICIES (continued)

### 2.2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of the 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.

Judgements are made in the classification of fair value through profit or loss, assets held for sale or held-to-maturity investments based on management's intention at acquisition of the financial asset. As fully described below, judgements are also made in determination of the objective evidence that a financial asset is impaired.

#### *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.

#### *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 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 discount factors for unquoted equities.

#### **Estimation uncertainty**

The key assumptions concerning the future and other key sources of estimating uncertainty at the balance sheet date, 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:

#### *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 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.

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 2 ACCOUNTING POLICIES (continued)

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

#### *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 contract since it was 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.

#### *Valuation of unquoted equity investments*

Valuation of unquoted equity 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;
- the expected cash flows discounted 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.

The principal accounting policies applied in the preparation of these financial statements are set out below:

#### **Financial contracts**

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

#### **Murabaha receivables**

Murabaha receivables are stated net of provision for impairment and deferred profits.

#### **Ijarah Muntahia Bittamleek**

Ijarah Muntahia Bittamleek assets comprises assets under lease, comprising aircraft, land and buildings, under terms that would transfer ownership of the assets to third parties at the end of the respective lease period.

Depreciation is provided on a straight-line 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 period of the lease.

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 2 ACCOUNTING POLICIES (continued)

### 2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### **Non-trading investments**

These are classified as held-to-maturity, 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 and loss is charged to statement of income.

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

#### ***Investments held-to-maturity***

Investments which have fixed or determinable payments and fixed maturity which are intended to be held-to-maturity, are carried at amortised cost, less provision for impairment in value.

#### ***Investments available-for-sale***

After initial recognition, investments which are classified "available-for-sale" 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 as a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as "cumulative changes in fair value" within equity, is included in the statement of income for the year.

#### ***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. In accordance with AAOIFI, such investments would classify as "available for sale investments".

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

#### **Investment in associates**

The Bank's investments in its associates are accounted for under the equity method of accounting. An associate is an entity over which the Bank has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in the associate is carried in the balance sheet 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 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 statement of changes in equity.



# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 2 ACCOUNTING POLICIES (continued)

### 2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 balance sheet 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 income statement.

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

#### **Investment properties**

Investment properties are those held to earn rentals and/or for capital appreciation. These are initially recorded at cost, including acquisition charges associated with the property.

Subsequent to initial recognition, all investment properties are remeasured at fair value and changes in fair value are recognised in the statement of income as gain or loss in investment properties. The fair value of the investment properties is determined either based on valuations made by independent valuers or using internal models with consistent assumptions.

#### **Investment reserve**

Unrealised gains resulting from revaluation of "investments carried at fair value through profit or loss" and "investment properties" recorded in the statement of income are appropriated to an investment revaluation reserve in equity and are not available for distribution to the shareholders. Upon disposal of such assets, the related cumulative gains are transferred to retained earnings and become available for distribution.

#### **Subsidiaries or associates acquired with a view to sell**

A subsidiary or an associate acquired with a view to subsequent disposal within 12 months are classified as "held-for-sale" when the sale is highly probable. Related assets and liabilities of the subsidiary are shown separately on the balance sheet 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.

Any impairment loss is recognised in the statement of income for any initial and subsequent write down of these assets to fair value, less costs to sell. A gain for any subsequent increase in the fair value, less costs to sell, is recognised to the extent that it is not in excess of the cumulative impairment loss that was recognised.

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 2 ACCOUNTING POLICIES (continued)

### 2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Premises and equipment

Premises and equipment are stated at cost less accumulated depreciation. 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 hardware and software	3 to 5 years
- Furniture and office equipments	3 to 5 years
- Motor vehicle	5 years
- Leasehold Improvements	Over the lease period

#### Impairment and uncollectability of financial assets

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

Impairment is determined as follows:

- for assets carried at amortised cost, impairment is based on estimated cash flows based on the original effective profit rate;
- for assets carried at fair value, impairment is the difference between cost and fair value; and
- 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.

In addition, a collective provision is made to cover impairment for specific banks of assets where there is a measurable decrease in estimated future cash flows.

#### Offsetting

Financial assets and financial liabilities can only be offset with the net amount being reported in the balance sheet when there is a 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.

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



# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 2 ACCOUNTING POLICIES (continued)

### 2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Revenue recognition

##### *Murabaha*

Where the income is quantifiable and contractually determined at the commencement of the contract, income is recognised on a time-apportioned basis over the period of the contract based on the principal amounts outstanding. Where the income from a contract is not quantifiable, it is recognised when realised. Accrual of income is suspended when the Bank believes that the recovery of these amounts may be doubtful or normally when the repayments are overdue by 90 days, whichever is earlier.

##### *Mudaraba*

Income on Mudaraba transactions are recognised when the right to receive is established or these are declared by the Mudarib, whichever is earlier.

##### *Dividends*

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

##### *Ijarah*

Ijarah Muntahia Bittamleek income is recognised on a time-proportionate basis over the lease term.

##### *Fees and commission income*

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

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

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

##### *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 balance sheet date.

For investments where there is no quoted market price, a reasonable estimate of fair value is determined by reference to 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 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.



# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 2 ACCOUNTING POLICIES (continued)

### 2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 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 balance sheet date are retranslated at market rates of exchange prevailing at that date. Gains and losses arising on translation are recognised in the statement of income. 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" are included in equity until the related assets are sold or derecognised at which time they are recognised in the statement of income. Translation gains on assets and liabilities classified as "fair value through profit or loss" are directly recognised in the statement of income.

#### Trade and settlement date accounting

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

#### Derecognition of financial assets

A financial asset (in whole or part) is derecognised either when the Bank has transferred substantially all the risk and rewards of ownership or when it has neither transferred nor retained substantially all the risks and rewards and when it no longer has control over the asset or a proportion of the asset.

#### 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 lender 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 statement of income.

#### Fiduciary assets

Assets held in a fiduciary capacity are not treated as assets of the Bank.

#### 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 balance sheet date are included in the equity and are disclosed as an event after the balance sheet date.

#### Unrestricted investment account holders (URIA)

All unrestricted investment accounts are carried at cost plus accrued profits less amounts repaid. Income to unrestricted investment account holders is allocated on the basis of their average daily balances in proportion to shareholders' balances.

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 2 ACCOUNTING POLICIES (continued)

### 2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Zakah

In accordance with the Articles of Association, the Bank is required to pay Zakah on all realised retained earnings and reserves on behalf of the shareholders, excluding paid-up capital and share premium which are the responsibility of the shareholders. The Bank is obligated to calculate and notify individual shareholders of their share of Zakah payable. The Bank's Shari'a Supervisory Board approves these calculations. Zakah is treated as an appropriation from the retained earnings.

#### Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with banks with maturities of less than 90 days from the date of acquisition.

## 3 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

As at 31 December 2008, financial instruments have been classified for the purpose of measurement under International Accounting Standard 39: Financial Instruments: Recognition and Measurement as follows:

	<i>Financial assets at fair value through profit or loss</i>	<i>Financial assets at cost/amortised cost</i>	<i>Financial liabilities at cost/amortised cost</i>	<i>Total</i>
	<i>BD</i>	<i>BD</i>	<i>BD</i>	<i>BD</i>
<b>ASSETS</b>				
Cash and balances with Central Bank of Bahrain	-	83,533,981	-	83,533,981
Central Bank of Bahrain Sukuk	-	31,095,000	-	31,095,000
Murabaha with banks	-	87,167,449	-	87,167,449
Murabaha financing	-	72,483,745	-	72,483,745
Ijarah Muntahia Bittamleek	-	41,530,784	-	41,530,784
Non-trading investments	116,929,500	-	-	116,929,500
Receivables	-	20,439,688	-	20,439,688
Assets held-for-sale	-	88,934,033	-	88,934,033
	<b>116,929,500</b>	<b>425,184,680</b>	<b>-</b>	<b>542,114,180</b>
<b>LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS</b>				
Murabaha from banks	-	-	32,880,685	32,880,685
Murabaha from non-banks	-	-	289,004,770	289,004,770
Customers' current accounts	-	-	3,231,303	3,231,303
UNRESTRICTED INVESTMENT ACCOUNTS	-	-	46,124,760	46,124,760
	<b>-</b>	<b>-</b>	<b>371,241,518</b>	<b>371,241,518</b>

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 3 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (continued)

As at 31 December 2007, financial instruments were classified as follows:

	<i>Financial assets at fair value through profit or loss</i>	<i>Financial assets at cost/amortised cost</i>	<i>Financial liabilities at cost/amortised cost</i>	<i>Total</i>
	<i>BD</i>	<i>BD</i>	<i>BD</i>	<i>BD</i>
<b>ASSETS</b>				
Cash and balances with Central Bank of Bahrain	-	15,173,663	-	15,173,663
Central Bank of Bahrain Sukuk	-	20,380,000	-	20,380,000
Murabaha with banks	-	224,450,893	-	224,450,893
Murabaha financing	-	32,641,599	-	32,641,599
Ijarah Muntahia Bittamleek	-	10,435,863	-	10,435,863
Non-trading investments	62,735,696	-	-	62,735,696
Receivables	-	10,156,438	-	10,156,438
Assets held-for-sale	-	9,024,000	-	9,024,000
	<b>62,735,696</b>	<b>322,262,456</b>	<b>-</b>	<b>384,998,152</b>
<b>LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS</b>				
Murabaha from banks	-	-	96,983,041	96,983,041
Murabaha from non-banks	-	-	106,908,709	106,908,709
Customers' current accounts	-	-	5,688,686	5,688,686
<b>UNRESTRICTED INVESTMENT ACCOUNTS</b>				
	-	-	19,769,585	19,769,585
	-	-	229,350,021	229,350,021

## 4 CASH AND BALANCES WITH CENTRAL BANK OF BAHRAIN

	<b>2008</b>	<b>2007</b>
	<b>BD</b>	<b>BD</b>
Mandatory reserve with Central Bank of Bahrain	<b>12,881,000</b>	5,640,000
Cash and other balances with Central Bank of Bahrain	<b>67,263,285</b>	1,814,814
Balances with other banks	<b>3,389,696</b>	7,718,849
	<b>83,533,981</b>	15,173,663

## 5 MURABAHA WITH BANKS

	<b>31 December 2008</b>		<b>Total</b>
	<b>Up to 3 months</b>	<b>3 months to 6 months</b>	<b>BD</b>
	<b>BD</b>	<b>BD</b>	<b>BD</b>
GCC	<b>82,376,388</b>	-	<b>82,376,388</b>
Europe	<b>4,791,061</b>	-	<b>4,791,061</b>
	<b>87,167,449</b>	<b>-</b>	<b>87,167,449</b>

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 5 MURABAHA WITH BANKS (continued)

	31 December 2007 Up to 3 months BD	3 months to 6 months BD	Total BD
GCC	199,822,903	376,366	200,199,269
Europe	24,251,624	-	24,251,624
	<u>224,074,527</u>	<u>376,366</u>	<u>224,450,893</u>

## 6 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 agreements stipulate that the lessor undertakes to transfer the leased assets to the lessee upon receiving the final rental payment.

	2008 BD	2007 BD
Movement in Ijarah Muntahia Bittamleek assets is as follows:		
At 1 January	<b>10,435,863</b>	10,382,429
Additions during the year	<b>33,418,897</b>	1,193,780
Ijarah assets' depreciation - net	<b>(2,323,976)</b>	(1,140,346)
At 31 December	<b>41,530,784</b>	10,435,863

	2008 BD	2007 BD
The future minimum lease receivable payments in aggregate are as follows:		
Due within one year	<b>9,915,774</b>	738,954
Due in one to five years	<b>26,505,879</b>	8,561,766
Due after five years	<b>5,109,131</b>	1,135,143
	<b>41,530,784</b>	10,435,863

	2008 BD	2007 BD
Ijarah Muntahia Bittamleek are divided into the following asset classes:		
Aviation	<b>3,836,702</b>	4,307,337
Land and buildings	<b>37,694,082</b>	6,128,526
	<b>41,530,784</b>	10,435,863

Income recognised on Ijarah assets, included under income from financing contracts, during the year amounted to BD1,605,266 (2007: BD905,497). The accumulated depreciation on assets subject to Ijarah amounted to BD3,464,322 (31 December 2007: BD1,140,346).

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 7 NON-TRADING INVESTMENTS

	2008 <i>BD</i>	2007 <i>BD</i>
Quoted	4,045,637	11,403,476
Unquoted based on valuation techniques:		
- Market observable input	97,509,445	35,027,745
- Non-market observable input	15,374,418	16,304,475
	<b>116,929,500</b>	<b>62,735,696</b>

These represent investments designated as fair value through profit or loss and are carried at fair value.

Certain of these investments are recorded at fair value using valuation techniques as current market transactions or observable market data are not available. Their fair value is determined using a valuation model that has been tested against the prices of actual market transactions and using the Bank's best estimate of the most appropriate model inputs.

## 8 INVESTMENT IN AN ASSOCIATE

During 2007 the Bank had acquired a 20% stake in Al Salam Bank Algeria (ASBA), a bank incorporated in Algeria. Al Salam Bank Algeria is not listed on any stock exchange. The following table illustrates the summarised financial information of the Bank's investment in ASBA:

	2008 <i>BD</i>	2007 <i>BD</i>
Associate's balance sheet:		
Total assets	39,514,495	41,395,705
Total liabilities	3,224,932	1,593,828
Net assets	<b>36,289,563</b>	<b>39,801,877</b>
Total revenue	9,090	-
Total expenses	1,410,287	504,290
Net loss for the year	<b>1,401,197</b>	<b>504,290</b>
Bank's share of associate's loss:	<b>280,239</b>	<b>100,858</b>

## 9 RECEIVABLES AND PREPAYMENTS

	2008 <i>BD</i>	2007 <i>BD</i>
Profit receivable on Murabaha financing	611,123	670,766
Profit receivable on Ijarah assets	278,838	205,689
Profit receivable on Sukuk	323,905	351,123
Prepayments	593,141	348,608
Other receivables	19,225,822	8,928,860
	<b>21,032,829</b>	<b>10,505,046</b>

Other receivables include subscription receivables of BD8,515,761 relating to sale of certain held-for-sale assets. At 31 December 2007, other receivables included advances of BD4,154,051 for acquisition of investments.

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 10 OTHER LIABILITIES

	2008 BD	2007 BD
Profit payable	2,614,170	1,176,903
Accounts payable and accruals	8,024,884	7,561,307
End of service benefits	116,505	137,574
	<b>10,755,559</b>	<b>8,875,784</b>

## 11 UNRESTRICTED INVESTMENT ACCOUNTS

Unrestricted investment account holders' funds are commingled with the Bank's funds and invested in short-term highly liquid Commodity Murabaha financing with banks. According to the terms of acceptance of the unrestricted investment accounts, 100% of the funds are invested after deducting a mandatory reserve. Unrestricted investment accounts have no restriction on cash withdrawal. The Mudarib fee ranges between 40% and 50%.

## 12 EQUITY

	2008 BD	2007 BD
<b>12.1 SHARE CAPITAL</b>		
Authorised:		
1,200,000,000 ordinary shares of BD0.100 each	<b>120,000,000</b>	120,000,000
Issued and fully paid:		
1,200,000,000 ordinary shares of BD0.100 each, issued against cash	<b>120,000,000</b>	120,000,000

### 12.2 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.

### 12.3 INVESTMENT RESERVE

During the year BD2,050,309 was transferred from the investment reserve to retained earnings (2007: gains of BD11,079,352 were transferred from retained earnings to the investment reserve). The reserve represents unrealised gains and losses from revaluation of investments and investment properties carried at fair value through profit or loss, and is not available for distribution under the Bank's Shari'a policies until transferred back to retained earnings upon disposal of the assets and realisation of the gains.

### 12.4 PROPOSED APPROPRIATIONS

The Board of Directors in its meeting on 24 January 2009 has resolved to recommend a dividend of 10 fils per share or 10% of the paid-up capital. For Zakah appropriations, see Note 26.

## 13 OTHER OPERATING INCOME

	2008 BD	2007 BD
Financing related fees and commissions	843,708	530,937
Transaction related fees	367,334	3,853,532
Fiduciary and other fees	840,504	311,875
Foreign exchange gains	249,050	254,264
	<b>2,300,596</b>	<b>4,950,608</b>

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 14 RELATED PARTY TRANSACTIONS

Related parties comprise major shareholders, directors of the Bank, 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 2008 were as follows:

	2008			
	<i>Associates and joint ventures</i>	<i>Directors and related entities</i>	<i>Senior management</i>	<i>Total</i>
	<i>BD</i>	<i>BD</i>	<i>BD</i>	<i>BD</i>
<b>Assets:</b>				
Murabaha financing	7,040,472	3,693,308	60,985	10,794,765
Ijarah Muntahia Bittamleek	12,556,290	6,301,531	179,595	19,037,416
Receivables and prepayments	8,669,913	91,225	14,583	8,775,721
<b>Liabilities:</b>				
Murabaha from non-banks	26,966,966	141,577	1,031,541	28,140,084
Customer current accounts	-	180,255	49,004	229,259
Unrestricted investment accounts	3,242,180	100,680	44,142	3,387,002

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

<b>Income:</b>				
Income from other Islamic financing contracts	605,768	419,558	15,731	1,041,057
Fees and commission income (Note 13)	40,905	-	-	40,905
<b>Expenses:</b>				
Profit paid on Murabaha from non-banks	966,272	3,828	29,269	999,369
Share of profits on unrestricted investment accounts	-	192	4,879	5,071

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 14 RELATED PARTY TRANSACTIONS (continued)

	2007			
	Associates and joint ventures BD	Directors and related entities BD	Senior management BD	Total BD
<b>Assets:</b>				
Murabaha financing	-	4,603,987	45,896	4,649,883
Ijarah Muntahia Bittamleek	-	6,807,337	253,129	7,060,466
Receivables and prepayments	600	196,325	1,275	198,200
<b>Liabilities</b>				
Murabaha from non-banks	1,453,500	568,410	576,490	2,598,400
Customer current accounts	-	164,027	21,767	185,794
Unrestricted investment accounts	-	50,315	608,454	658,769

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

<b>Income:</b>				
Income from other Islamic financing contracts	-	929,514	10,305	939,819
Fees and commission income (Note 13)	-	19,250	938	20,188
<b>Expenses:</b>				
Profit paid on Murabaha from non-banks	165,372	42,062	26,002	233,436
Share of profits on unrestricted investment accounts	-	39	1,082	1,121

As of 31 December 2008, Murabaha financing and Ijarah Muntahia Bittamleek included BD3,693,309 (2007: 4,603,987) of facilities provided to directors and their associates which are past due and on which profit is not being accrued. No provisions have been made against these facilities since sufficient collaterals, including cash collateral, are held.

Directors are compensated in the form of fees for attending board and committee meetings. Directors' remuneration, allowances and expenses for attending board and committee meetings for the year ended 31 December 2008 amounted to BD350,000 (31 December 2007: BD370,000).

Compensation of key management personnel, consisting solely of short-term benefits, paid during the year was BD2,753,000 (2007: BD2,329,980).

## 15 COMMITMENTS

### Undrawn financing commitments

The Bank has a contracted commitment to the extent of BD2,434,840 (2007: BD6,409,746) which remained undrawn as at the year end. In addition, the Bank had an undrawn capital commitment of BD5,027,488 (2007: BD32,601,265) as at the year end on account of investments. Commitments generally have fixed expiration dates, or other termination clauses. Since commitment may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.



# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 15 COMMITMENTS (continued)

### Operating lease commitment - Bank as lessee

The Bank has entered into a five-year operating lease for its headquarters premises. Future minimal rentals payable under the non-cancellable lease as at 31 December 2008 are as follows:

	2008 BD	2007 BD
Within 1 year	451,095	366,373
After one year but not more than five years	448,371	821,980
<b>TOTAL</b>	<b>899,466</b>	<b>1,188,353</b>

## 16 RISK MANAGEMENT

### 16.1 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 prepayment 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 Board, Board Committees, Regulators and Executive Management. In addition to these responsibilities, individual credit transaction approval and monitoring is an integral part of the responsibilities.

#### *Asset and Liability Committee*

The Asset and Liability Committee establishes policy and objectives for the asset and liability management of the Bank's balance sheet 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 balance sheet 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.

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 16 RISK MANAGEMENT (continued)

### 16.1 Introduction (continued)

#### *Board Audit Committee*

The Audit Committee is appointed by the Board of Directors and consists of three members who are Directors, including one non-Executive Director. 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 Audit Committee.

#### *Risk measurement and reporting systems*

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

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

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Board of Directors, the 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. Executive 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.

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 General Manager and all other relevant members of the Bank on the utilisation of market limits, proprietary investments and liquidity, plus any other risk developments.

#### **Excessive risk concentration**

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 FINANCIAL STATEMENTS

31 December 2008

## 16 RISK MANAGEMENT (continued)

### 16.2 CREDIT RISK (continued)

#### Risk management

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 controls 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 to credit risk for the components of the balance sheet. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

		<b>Gross maximum exposure 2008</b>	<b>Net maximum exposure 2008</b>	<b>Gross maximum exposure 2007</b>	<b>Net maximum exposure 2007</b>
	Note	<b>BD</b>	<b>BD</b>	<b>BD</b>	<b>BD</b>
<b>ASSETS</b>					
Cash and balances with banks		<b>3,389,696</b>	<b>3,389,696</b>	7,718,849	7,718,849
Murabaha with banks	5	<b>87,167,449</b>	<b>87,167,449</b>	224,450,893	224,450,893
Murabaha financing		<b>52,058,745</b>	<b>32,542,273</b>	31,141,599	6,913,987
Ijarah Muntahia Bittamleek	6	<b>37,688,214</b>	<b>14,163,658</b>	10,435,863	-
Non-trading investments	7	<b>116,929,500</b>	<b>95,261,108</b>	62,735,696	62,735,696
Receivables	9	<b>20,115,783</b>	<b>20,115,783</b>	9,865,191	9,865,191
Assets held-for-sale		<b>88,934,033</b>	<b>39,715,428</b>	9,024,000	9,024,000
<b>Total</b>		<b>406,283,420</b>	<b>292,355,395</b>	355,372,091	320,708,616
<b>Commitments</b>		<b>7,462,328</b>	<b>6,401,007</b>	11,437,234	6,777,488
<b>Total credit risk exposure</b>		<b>413,745,748</b>	<b>298,756,402</b>	366,809,325	327,486,104

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.

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 16 RISK MANAGEMENT (continued)

### 16.2 CREDIT RISK (continued)

#### Type of credit risk

Various contracts entered into by the Bank comprise Murabaha receivables, Mudaraba investments and Ijarah Muntahia Bittamleek contracts. Murabaha receivables contracts cover land, buildings, commodities, motor vehicles and others. Mudaraba investments consist of financing transactions entered through other Islamic banks and financial institutions. The various financial instruments are:

#### Murabaha receivables

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 repaid in installments over the agreed period.

#### Ijarah Muntahia Bittamleek

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

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

	31 December 2008				
	Neither past due nor impaired			Past due or individually impaired	Total
	'A' Rated	'B' Rated	Unrated		
	BD	BD	BD	BD	BD
Murabaha with banks	60,638,666	7,540,000	18,988,783	-	87,167,449
	60,638,666	7,540,000	18,988,783	-	87,167,449
	31 December 2007				
	Neither past due nor impaired			Past due or individually impaired	Total
	'A' Rated	'B' Rated	Unrated		
	BD	BD	BD	BD	BD
Murabaha with banks	135,572,893	51,822,000	37,056,000	-	224,450,893
	135,572,893	51,822,000	37,056,000	-	224,450,893

The ratings referred to in the above tables are by one or more of the 4 international rating agencies (Standards & Pools, Moody's, Fitch and Capital Intelligence).

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 16 RISK MANAGEMENT (continued)

### 16.2 CREDIT RISK (continued)

b) The credit quality of Murabaha financing and Ijarah Muntahia Bittamleek subject to credit risk, based on internal credit ratings, is as follows:

	31 December 2008				
	Neither past due nor impaired				
	Satisfactory BD	Watch list BD	Substandard	Past due BD	Total BD
			but not impaired BD		
Murabaha financing	66,756,279	-	-	5,727,466	72,483,745
Ijarah Muntahia Bittamleek	41,507,924	-	-	22,860	41,530,784
	<b>108,264,203</b>	-	-	<b>5,750,326</b>	<b>114,014,529</b>

	31 December 2007				
	Neither past due nor impaired				
	Satisfactory BD	Watch list BD	Substandard	Past due BD	Total BD
			but not impaired BD		
Murabaha financing	27,040,226	-	-	5,601,373	32,641,599
Ijarah Muntahia Bittamleek	10,429,788	-	-	6,075	10,435,863
	<b>37,470,014</b>	-	-	<b>5,607,448</b>	<b>43,077,462</b>

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.

c) Past due but not impaired Murabaha financing, and Ijarah Muntahia Bittamleek are analysed as follows:

	31 December 2008			
	0-30 days	30-90 days	> 90 days	Total
	BD	BD	BD	BD
Murabaha financing	-	2,034,158	3,693,308	5,727,466
Ijarah Muntahia Bittamleek	22,860	-	-	22,860
	<b>22,860</b>	<b>2,034,158</b>	<b>3,693,308</b>	<b>5,750,326</b>

	31 December 2007			
	0-30 days	30-90 days	> 90 days	Total
	BD	BD	BD	BD
Murabaha financing	997,380	3,480,396	1,123,597	5,601,373
Ijarah Muntahia Bittamleek	252	-	5,823	6,075
	<b>997,632</b>	<b>3,480,396</b>	<b>1,129,420</b>	<b>5,607,448</b>

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 16 RISK MANAGEMENT (continued)

### 16.2 CREDIT RISK (continued)

All the past due but not impaired Murabaha and Ijarah financing are covered by collateral of BD8,901,056 (2007: BD1,717,930), including cash collateral of BD3,292,000. In addition, the Bank is holding sovereign guarantee of BD1,877,944 in respect of one of the facilities.

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 balance sheet plus commitments to customers disclosed in note 15 except capital commitments.

During the year BD2,350,000 of financing facilities to individuals were renegotiated. All renegotiated facilities are performing and are fully secured.

At 31 December 2008, the amount of credit exposure in excess of 10% of the equity to individual counterparties was nil (2007: nil).

## 17 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 unrestricted investment accounts by geographic region and industry sector was as follows:

	<i>Liabilities, unrestricted investment accounts and equity</i>			<i>Liabilities, unrestricted investment accounts and equity</i>		
	<i>Assets</i>	<i>Commitments</i>	<i>Assets</i>	<i>Commitments</i>	<i>Assets</i>	<i>Commitments</i>
	<i>2008</i>	<i>2008</i>	<i>2007</i>	<i>2007</i>	<i>2007</i>	<i>2007</i>
	<i>BD</i>	<i>BD</i>	<i>BD</i>	<i>BD</i>	<i>BD</i>	<i>BD</i>
<b>Geographic region</b>						
GCC	502,539,276	357,555,010	2,465,607	355,982,172	223,511,805	6,409,746
Arab World	9,917,696	4,978,221	-	10,122,930	4,199,469	-
Europe	6,106,964	6,856,091	-	27,161,365	9,930,884	-
Asia/Pacific	32,222,098	12,600,551	2,278,578	3,570,847	576,258	26,344,625
America	1,709,064	7,204	-	779,299	7,389	-
Others	1,985,460	-	2,718,143	80,069	-	6,256,640
	<b>554,480,558</b>	<b>381,997,077</b>	<b>7,462,328</b>	<b>397,696,682</b>	<b>238,225,805</b>	<b>39,011,011</b>
Equity	-	172,483,481	-	-	159,470,877	-
	<b>554,480,558</b>	<b>554,480,558</b>	<b>7,462,328</b>	<b>397,696,682</b>	<b>397,696,682</b>	<b>39,011,011</b>

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## 17 CONCENTRATIONS (continued)

	<i>Liabilities, unrestricted investment accounts and equity</i>			<i>Liabilities, unrestricted investment accounts and equity</i>		
	<i>Assets</i>	<i>Commitments</i>	<i>Assets</i>	<i>Commitments</i>	<i>Commitments</i>	
	<i>2008</i>	<i>2008</i>	<i>2007</i>	<i>2007</i>	<i>2007</i>	
<i>BD</i>	<i>BD</i>	<i>BD</i>	<i>BD</i>	<i>BD</i>	<i>BD</i>	
<b>Industry sector</b>						
Trading and manufacturing	12,752,030	423,602	48,789	5,217,109	71,317	1,750,000
Banks and financial institutions	109,199,534	72,547,160	-	274,555,235	164,538,487	-
Real estate	167,869,248	68,098,462	4,242,721	56,991,542	6,152,146	8,537,265
Aviation	5,090,915	1,025,554	-	7,159,208	-	-
Individuals	23,199,665	106,905,733	1,167,200	10,846,341	49,883,876	4,659,746
Government and public sector	35,204,195	97,537,011	1,218,851	29,957,802	8,463,880	-
Others	101,164,971	35,459,555	784,767	12,969,445	9,116,099	24,064,000
	<b>554,480,558</b>	<b>381,997,077</b>	<b>7,462,328</b>	<b>397,696,682</b>	<b>238,225,805</b>	<b>39,011,011</b>
Equity	-	172,483,481	-	-	159,470,877	-
	<b>554,480,558</b>	<b>554,480,558</b>	<b>7,462,328</b>	<b>397,696,682</b>	<b>397,696,682</b>	<b>39,011,011</b>

## 18 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.

### 18.1 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 assets held for sale) solely due to reasonably possible changes in equity prices, is as follows:

	2008			
	<i>Change in price</i>	<i>Effect on net profit</i>	<i>Change in price</i>	<i>Effect on net profit</i>
	<i>%</i>	<i>BD</i>	<i>%</i>	<i>BD</i>
Quoted:				
GCC	10	404,564	(10)	(404,564)
Unquoted	10	11,288,386	(10)	(11,288,386)
	2007			
	<i>Change in price</i>	<i>Effect on net profit</i>	<i>Change in price</i>	<i>Effect on net profit</i>
	<i>%</i>	<i>BD</i>	<i>%</i>	<i>BD</i>
Quoted:				
GCC	10	1,026,589	(10)	(1,026,589)
Unquoted	10	5,133,222	(10)	(5,133,222)

# NOTES TO THE FINANCIAL STATEMENTS

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## 18 MARKET RISK (continued)

### 18.2 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.

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:

	2008			
	Change in rate %	Effect on net profit BD	Change in rate %	Effect on net profit BD
US dollars	0.25	506,153	(0.25)	(506,153)
Bahraini dinars	0.25	1,656,026	(0.25)	(1,656,026)

	2007			
	Change in rate %	Effect on net profit BD	Change in rate %	Effect on net profit BD
US dollars	1	233,879	(1)	(233,879)
Bahraini dinars	1	361,379	(1)	(361,379)

### 18.3 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 :

	2008 BD	2007 BD
US Dollars	17,090,387	12,150,234
Saudi Riyals	57,553,210	10,889,630

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

	2008			
	Change in rate %	Effect on net profit BD	Change in rate %	Effect on net profit BD
US dollars to Bahraini dinar	1	170,904	(1)	(170,904)

	2007			
	Change in rate %	Effect on net profit BD	Change in rate %	Effect on net profit BD
US dollars to Bahraini dinar	1	121,502	(1)	(121,502)



# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 19 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 at 31 December 2008 and 2007:

	<i>Up to 3 months BD</i>	<i>3 months to 1 year BD</i>	<i>1 to 5 years BD</i>	<i>Over 5 years BD</i>	<i>Total BD</i>
<b>ASSETS</b>					
Cash and balances with Central Bank of Bahrain	83,533,981	-	-	-	83,533,981
Central Bank of Bahrain Sukuk	-	6,620,000	24,475,000	-	31,095,000
Murabaha with banks	87,167,449	-	-	-	87,167,449
Murabaha financing	29,807,777	16,005,000	26,555,359	115,609	72,483,745
Ijarah Muntahia Bittamleek	6,022,862	3,892,912	26,505,879	5,109,131	41,530,784
Non-trading investments	-	-	116,929,500	-	116,929,500
Investment in an associate	-	-	-	8,011,913	8,011,913
Investment properties	-	-	-	1,177,528	1,177,528
Receivables and prepayments	20,055,603	256,556	720,670	-	21,032,829
Premises and equipment	-	-	2,583,796	-	2,583,796
Assets held-for-sale	-	19,715,428	69,218,605	-	88,934,033
	<b>226,587,672</b>	<b>46,489,896</b>	<b>266,988,809</b>	<b>14,414,181</b>	<b>554,480,558</b>
<b>LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS</b>					
Murabaha from banks	-	-	32,880,685	-	32,880,685
Murabaha from non-banks	-	97,980,280	191,024,490	-	289,004,770
Customers' current accounts	-	-	3,231,303	-	3,231,303
Other liabilities	10,182,013	573,360	186	-	10,755,559
Unrestricted investment accounts	-	-	46,124,760	-	46,124,760
	<b>10,182,013</b>	<b>98,553,640</b>	<b>273,261,424</b>	<b>-</b>	<b>381,997,077</b>

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 19 LIQUIDITY RISK (continued)

	31 December 2007				
	Up to 3 months BD	3 months to 1 year BD	1 to 5 years BD	Over 5 years BD	Total BD
<b>ASSETS</b>					
Cash and balances with Central Bank of Bahrain	15,173,663	-	-	-	15,173,663
Central Bank of Bahrain Sukuk	1,560,000	-	18,820,000	-	20,380,000
Murabaha with banks	224,074,527	376,366	-	-	224,450,893
Murabaha financing	13,862,210	5,524,705	13,134,684	120,000	32,641,599
Ijarah Muntahia Bittamleek	107,861	631,093	8,561,767	1,135,142	10,435,863
Non-trading investments	-	-	62,735,696	-	62,735,696
Investment in an associate	-	-	-	8,171,142	8,171,142
Investment properties	-	1,177,528	-	-	1,177,528
Receivables and prepayments	9,632,557	56,096	810,216	6,177	10,505,046
Premises and equipment	-	-	2,979,252	-	2,979,252
Assets held-for-sale	-	9,024,000	-	-	9,024,000
	264,410,818	16,789,788	107,041,615	9,432,461	397,674,682
<b>LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS</b>					
Murabaha from banks	-	64,102,356	32,880,685	-	96,983,041
Murabaha from non-banks	-	-	106,908,709	-	106,908,709
Customers' current accounts	-	5,688,686	-	-	5,688,686
Other liabilities	8,625,257	51,683	176,844	-	8,853,784
Unrestricted investment accounts	-	-	19,769,585	-	19,769,585
	8,625,257	69,842,725	159,735,823	-	238,203,805

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 19 LIQUIDITY RISK (continued)

The table below summarizes the maturity profile of the Bank's financial liabilities at 31 December, 2008 and 2007 based on contractual undiscounted repayment obligation:

	31 December 2008				Total BD
	Up to 3 months BD	3 months to 1 year BD	1 to 5 years BD	Over 5 years BD	
<b>LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND COMMITMENTS</b>					
Murabaha from banks	32,880,685	-	-	-	32,880,685
Murabaha from non-banks	218,957,897	68,928,893	1,117,980	-	289,004,770
Customers' current accounts	3,231,303	-	-	-	3,231,303
Unrestricted investment accounts	46,124,760	-	-	-	46,124,760
Undrawn financing commitments	-	2,434,840	-	-	2,434,840
Undrawn investment commitments	-	777,766	4,249,722	-	5,027,488
Profit due on financing contracts	-	1,213,866	-	-	1,213,866
	<b>301,194,645</b>	<b>73,355,365</b>	<b>5,367,702</b>	<b>-</b>	<b>379,917,712</b>
	31 December 2007				Total BD
	Up to 3 months BD	3 months to 1 year BD	1 to 5 years BD	Over 5 years BD	
<b>LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND COMMITMENTS</b>					
Murabaha from banks	96,983,041	-	-	-	96,983,041
Murabaha from non-banks	101,975,729	4,932,980	-	-	106,908,709
Customers' current accounts	5,688,686	-	-	-	5,688,686
Unrestricted investment accounts	-	19,769,585	-	-	19,769,585
Undrawn financing commitments	-	6,409,746	-	-	6,409,746
Undrawn investment commitments	-	25,510,000	7,091,265	-	32,601,265
Profit due on financing contracts	-	1,227,578	-	-	1,227,578
	<b>204,647,456</b>	<b>57,849,889</b>	<b>7,091,265</b>	<b>-</b>	<b>269,588,610</b>

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 20 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 for the **year ended 31 December 2008** was as follows:

	31 December 2008				
	Banking BD	Treasury BD	Investments BD	Capital BD	Total BD
Operating income	12,358,078	1,363,925	11,360,600	12,518,655	37,601,258
Segment result	8,053,899	131,570	8,111,172	9,246,040	25,542,681
<b>Other information</b>					
Segment assets	111,419,675	206,307,380	164,730,985	72,022,518	554,480,558
Segment liabilities, and equity	332,442,317	41,505,053	1,000,000	179,533,188	554,480,558
	31 December 2007				
	Banking BD	Treasury BD	Investments BD	Capital BD	Total BD
Operating income	11,832,171	866,524	11,184,478	8,829,000	32,712,173
Segment result	8,000,973	51,399	8,335,463	6,761,159	23,148,994
<b>Other information</b>					
Segment assets	42,574,473	175,158,216	84,587,099	95,376,894	397,696,682
Segment liabilities, and equity	126,635,534	104,044,820	23,241,303	143,775,025	397,696,682

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 20 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.

## 21 FIDUCIARY ASSETS

Funds under management at the year-end amounted to [BD25,000,000] (2007: BD26,202,212). These assets are held in a fiduciary capacity and are not included in the balance sheet.

## 22 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. 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.

## 23 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 2008 and 2007.

## 24 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

During the year 2008, the Bank received income totaling BD2,767 (2007: BD151) from conventional financial institution on current accounts balances. These funds were held as payable to charity as they are prohibited by Shari'a law.

## 25 SOCIAL RESPONSIBILITY

The Bank discharges its social responsibility through Zakah, charity fund expenditures and donations to the good faith qard fund which is used for charitable purposes. During the period the Bank incurred an amount of BD536,084 (2007: BD35,100) on account of charitable donations.

## 26 ZAKAH

The total Zakah payable as of 31 December 2008 amounted to BD1,437,774 of which BD822,525, representing the Zakah on the statutory reserve, general reserve and retained earnings balances for the year 2008, is payable by the Bank. The remaining Zakah balance amounting to BD615,249 (2007: 3,522,047) or 0.51 fils (2007: 2.94 fils) per share is due and payable by the shareholders.

# NOTES TO THE FINANCIAL STATEMENTS

31 December 2008

## 27 CAPITAL

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 2008 and 31 December 2007.

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

	2008 BD	2007 BD
Capital base (Tier 1)	<b>107,989,000</b>	126,809,000
Credit risk weighted exposures	<b>393,251,000</b>	208,682,000
Market risk weighted exposures	<b>3,213,000</b>	775,000
Operational risk weighted exposures	<b>40,410,000</b>	50,888,000
Total risk weighted exposure	<b>436,874,000</b>	260,345,000
Capital adequacy	<b>24.7%</b>	48.7%
Minimum requirement	<b>12.0%</b>	12.0%

## 28 COMPARATIVE FIGURES

Certain of the prior year's figures have been reclassified to conform to the presentation adopted in the current period. Such reclassifications have not resulted in any change to the previously reported net income or shareholders' equity.