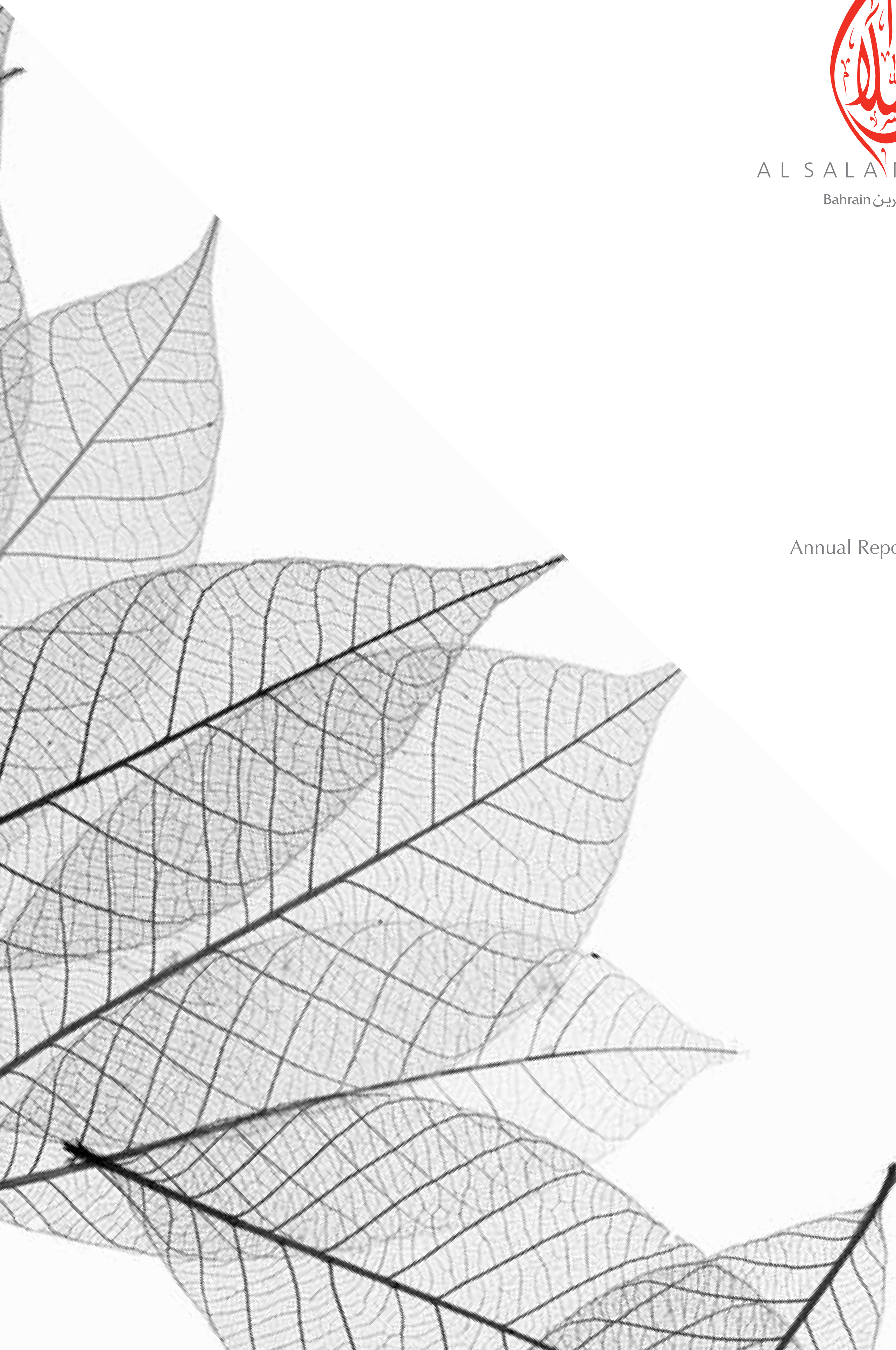
مصرف

AL SALAM BANK

Bahrain البحرين

Annual Report 2010



His Royal Highness
Prince Khalifa bin Salman
Al Khalifa

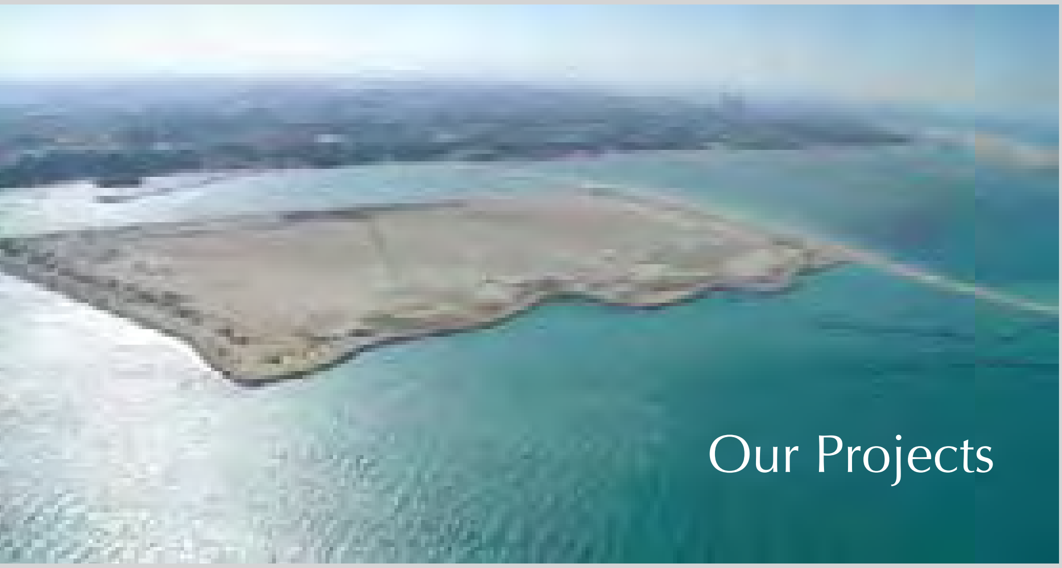
The Prime Minister of the
Kingdom of Bahrain

His Majesty
King Hamad bin Isa
Al Khalifa

The King of the
Kingdom of Bahrain

His Royal Highness
Prince Salman bin Hamad
Al Khalifa

The Crown Prince &
Deputy Supreme Commander



Our Projects

Contents

Our Vision & Mission

Our Vision

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

Our Mission

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

Dynamic - Diversified - Differentiated

Dynamic - Diversified - Differenti

Corporate Overview

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

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

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

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

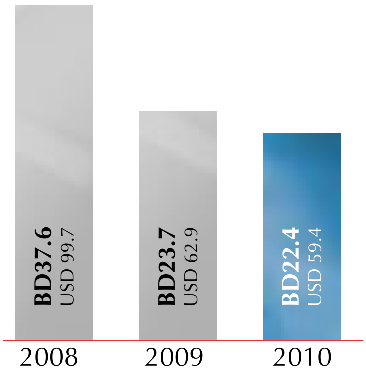
Al Salam Bank-Bahrain was listed on the Bahrain Stock Exchange on 27 April 2006, and subsequently on the Dubai Financial Market on 26 March 2008. The Bank's high-caliber management team comprises highly qualified and internationally-experienced professionals with proven investment expertise in key areas of banking, finance and related fields; all supported by a world-class Information Technology (IT) infrastructure and the latest 'smart' working environment. In 2009, the Bank acquired a 90.31% stake in Bahraini Saudi Bank BSC. Established with a paid-up capital of BD120 million, the Bank's total equity has crossed circa BD202 million (US$540 million) with total assets crossing the US$2 billion mark.

Al Salam Bank-Bahrain adopts internationally recognized standards and best practices in Corporate Governance and operates with highest levels of integrity, transparency and trust.

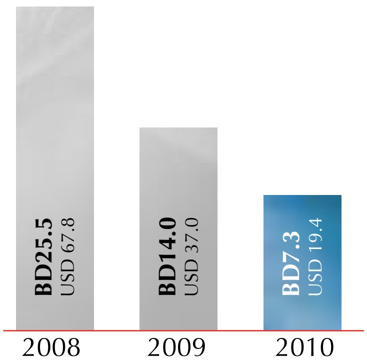
The Bank is committed to its role as a concerned corporate citizen, actively seeking ways to contribute and add value to the social and economic well-being of the local communities in which it invests and operates.

Annual Highlights

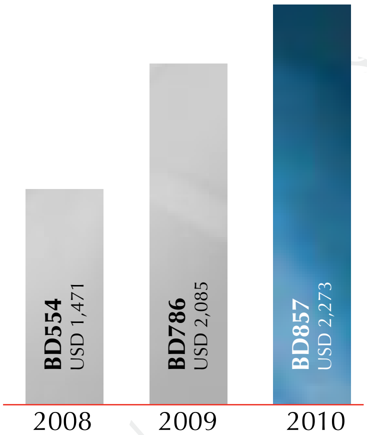
Key Financial Indicators



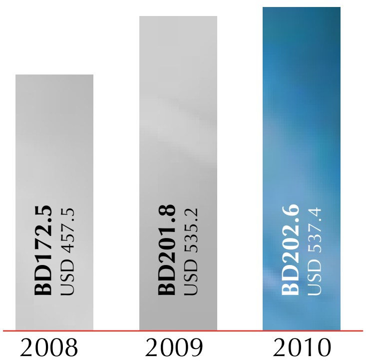
Total Operating Income (million)



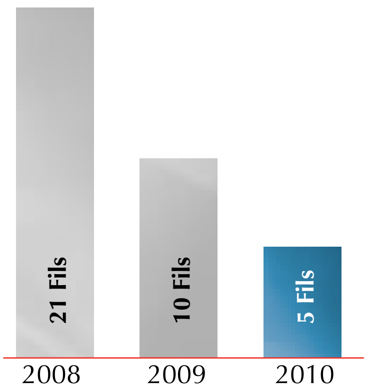
Net Profit (million)



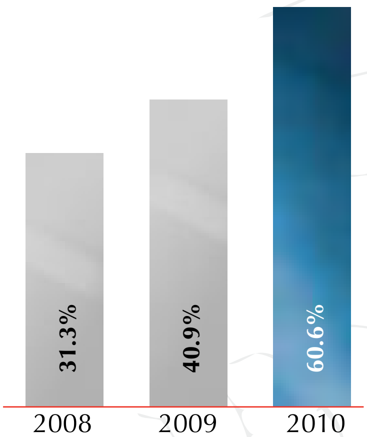
Total Assets (million)



Total Equity (million)



Earnings Per share



Cost to Income Ratio

Guiding the Vision to Success

Board of Directors

H. E. Mohamed Ali Rashid Alabbar

Salman Saleh Al Mahmeed

Shaikha Hessa bint Khalifa Al Khalifa

Terence D. Allen

Hamad Tarek Alhomaizi

Habib Ahmed Kassem

Sheikh
Abedlelah Kaki

Fahad Sami
Al Ebrahim

Yousif Abdulla
Taqi

Essam bin
Abdulkadir
Al Muhaidib

Ahmed Jamal
Jawa

Khalid Ahmed
Abdulla Al Ashar

H. E. Mohamed Ali Rashid Alabbar
Chairman

Independent and non-executive

Term started: 18 April 2009

H.E. Mohamed Alabbar is the founding member and Chairman of Emaar Properties PJSC, the Dubai-based global property developer. He 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.

Habib Ahmed Kassem
Vice Chairman

Independent and non-executive

Term started: 18 April 2009

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.

Sheikh Abedlelah Mohammed Saleh Kaki
Director

Independent and non-executive

Term started: 15 February 2010

Sheikh Abedlelah Kaki has more than 35 years experience in banking, trading & industry. He is the Chairman of Saudi International Trading & Marketing Ltd. AMK Gulf for Investments & International Agencies Co. Ltd. and United Gulf Industries Ltd in Saudi Arabia, Marsh Saudi Arabia Insurance & Reinsurance Broking, Marsh Insurance Consulting Saudi Arabia. He is also the Chairman of Noubaria Seed Production Co, Nile Company For Development & Tourism & Real Estate Investment, Tanta Flax & Oil Co, SAE and Mediterranean Agricultural Products Co (MAPCO) in Egypt. He is an active board member in several Egyptian Companies; Saudi Corporation for Arab Investment SAE, Egyptian Saudi Investment Tourism & Real Estate Co, Lacto Misr Co and Dynarabia Co Ltd, Al Jouf Cement Company in Saudi Arabia. Sheikh Kaki is a graduate in Economics from United States International University in California, United States of America.

Shaikha Hessa bint Khalifa bin Hamad Al Khalifa
Director

Independent and non-executive

Term started: 18 April 2009

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

Essam bin Abdulkadir Al Muhaidib
Director

Independent and non-executive

Term started: 18 April 2009

Mr. Essam Al Muhaidib is CEO of A.K. Al Muhaidib & Sons Group, and Board of Directors member in several organizations having interests in banking & insurance, FMCG & retail, building & construction, industrial, real estate apart from educational, charitable and benevolent organizations. Emmar 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), Al Salam Bank, 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 also a member in some of charitable and non profitable & educational organizations such as King Fahad University of Petroleum & Minerals Endowment Fund, board of directors of the educational services company at Prince Mohammad bin Fahad in Dammam as well as founder for Prince Sultan college for Prince Sultan Ladies' Fund.

Salman Saleh Al Mahmeed
Director

Independent and non-executive

Term started: 15 February 2010

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

Guiding the Vision to Success

Board of Directors (continued)

Fahad Sami Al Ebrahim
Director

Independent and non-executive

Term started: 18 April 2009

Fahad Al Ebrahim, with more than 9 years of professional experience, is currently the Vice President - Regional Client Relationship of Global Investment House (GIH). He is a Board Member of Al-Mazaya Holding Company in Kuwait and a Board Member of First Securities Brokerage Company S.A.K. Mr. Al Ebrahim has established one of the leading wealth management groups specialized in looking after the international clients who are looking for exposures towards the Middle East and North Africa region. Prior to joining GIH, Mr. Al Ebrahim worked in the Kuwait News Agency on the English News Desk. He is a graduate from the University of Oregon with an emphasis in communication studies and holds a post-graduate degree in business administration from the Maastricht School of Management.

Hamad Tarek Alhomaizi
Director

Independent and non-executive

Term started: 18 April 2009

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

Ahmed Jamal Jawa
Director

Independent and non-executive

Term started: 18 April 2009

A graduate in Business Administration with an MBA from the University of San Francisco, Mr. Jawa has served on the boards of the Novapark Swiss Hotel Group; Mirapolice, and Tricon Group, US. Mr. Jawa is President, CEO and Board Member of Starling Holding Ltd, and President of Contracting and Trading Company (CTC), Saudi Arabia. Mr. Jawa is Board Member of Emaar Properties PJSC. He is also Chairman of the Nomination and Remuneration Committee, as well as a member of the Audit Committee.

He is a Board Member of Emaar the Economic City and Chairman of the Nomination and Remuneration Committee. He is a Board Member of Emaar Turkey and serves on the board of Emaar MGF India, Emaar Egypt and Emaar Cham, Syria. He is also a Board Member of RAK Petroleum. The World Economic Forum had honored Mr. Jawa as one of the Global Leaders of tomorrow in February 2006.

Terence D. Allen
Director

Independent and non-executive

Term started: 18 April 2009

Mr. Allen has more than 40 years of experience in the treasury and investment banking business. He is the founder and Managing Director of Allied Investment Partners PJSC a UAE based merchant banking company with diversified group holdings. He has spent several years in the private fund management business, where he was a Director of several asset and fund management companies. In the past he has been appointed as advisor and consultant to several regional governments and institutions. He is a Qualified Arbitrator for the GCC. He is the author of several books and frequently produces articles for newspapers and journals ranging from military history to financial and banking topics.

Yousif Abdulla Taqi
Director & Chief Executive Officer

Executive

Term started: 18 April 2009

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. Al Ashar holds a BSc in Commerce and Business Administration from Beirut Arab University. 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.

Fatwa and Shari'a Supervisory Board

Dr. Hussain Hamid Hassan
Chairman

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

Dr. Ali Mohuddin Al'Qurra Daghi
Member

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

Shaikh Adnan Abdulla Al Qattan
Member

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

Dr. Mohamed Abdulhakim Zoeir
Member & Secretary to the Board

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

“The unsung indomitable spirit, the leaf is an individual miracle - its multifaceted working systems are a wonder to mankind. This creation of Allah has come down to our day over thousands of years in the same perfect state with no alterations.”

Board of Directors' Report to the Shareholders

The Directors of Al-Salam Bank-Bahrain BSC (**"the Bank"**) have the pleasure in submitting their report to the shareholders accompanied by the consolidated financial statements for the year ended 31 December 2010. The consolidated financial statements comprise the financial statements of the Bank and its subsidiary, Bahraini Saudi Bank BSC (together known as **"the Group"**).

Fiscal year 2010 continued to be very challenging; yet the fourth full year of commercial operations has been successful.

The Group managed to post an impressive growth in total assets from BD785.9 million (US$2.1 billion) as at 31 December 2009 to BD 857.4 million (US$ 2.3 billion), an increase of BD71.5 million (US$189.7 million) or 9% over 31 December 2009. The growth is largely attributable to growth in the credit portfolio of the Group and investments. The Group managed to successfully exit one of its European real estate transactions during 2010 and concluded a new transaction with a better risk profile and expected returns. However, continuing global economic downturn prevented other planned exits in the private equity and real estate lines of businesses. Though the overall net profit for the year 2010 shows a decline over the previous year, on a normalised basis, without considering the gain that arose on acquisition of the Subsidiary in 2009, the Group has achieved a growth of 23% in the net profit. While the gross operating income increased by 40% prudent cost management continued in 2010 with a cost-to-income ratio of 61% for 2010.

Your Bank has started realising the benefits of acquisition of Bahraini Saudi Bank in 2009. In line with the directors' strategy to focus on expanding its presence in Bahrain, the Group had opened three more branches in key strategic locations during 2010, resulting in an expanded network of 11 branches and 22 ATMs. The acquisition of Bahraini Saudi Bank has assisted your Bank in further enhancing its visibility and improved the Group's service delivery capabilities. Your Bank has also been successful in converting a significant portion of conventional assets and liabilities of BSB to Shari'a compliant products. Synergies have also been established on technological and operational aspects and it is expected that this synergy will reflect in all other aspects within the group that would lead to decrease in costs over the coming years.

At the same time, your Bank continues to look for investment opportunities to achieve its vision of becoming one of the largest financial institutions in the region through acquisition and expansion in various financial services sectors.

In the small market in which it operates, the Group managed to record an impressive growth of 43% in its financing portfolio compared to 2009. This primarily includes Murabaha, Mudharaba and Ijara financing. The Bank was mandated as lead arranger for a syndicated seven year Ijara facility of BD90.5 million (US$ 240 million) to a large iconic real estate project in Bahrain and participated in this facility along with other leading banks in Bahrain. This transaction was the largest finance raising in Bahrain in 2010 amongst the private sector.

On the investments side, the Bank had successfully exited its investment in Milton Gate, a trophy asset domiciled in Central London and provided investors an impressive return of 15%. During 2010, the Bank managed to acquire a stake in Canada Square, a prime commercial real estate property in Canary Wharf, London with a better credit profile and expected returns. The transaction was concluded in August 2010 and offered to investors. The transaction offers a running cash yield of 9.46% per annum paid quarterly. This clearly indicates the Bank's commitment to bring solid transactions to its investors.

In line with regulatory focus on reducing real estate exposure, the Bank had tightened its investment and financing to real estate sector. In 2010, your Bank had launched two projects, Kenaz Al Bahrain and Tubli Gardens through its real estate development arm, Manara Developments. These projects are located at key locations in Bahrain and offer affordable housing at competitive prices. Market responses to the launches were encouraging which prove that market still exists for development offerings with a product differentiation and competitive pricing. 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 highly selective basis to take advantage of market opportunities and bearing in mind investor's cash yield expectations.

On the treasury front, the Group continues to expand its financial institutions network. In 2010, the Group continued to be a net lender to the system with a net lending position of BD127 million at 31 December 2010. The Group also enjoys a comfortable liquidity position as reflected by its strong liquidity ratio of 24% as at 31 December 2010. This is net of due to banks and interbank deposits and excludes Sukuk issued by Central Bank of Bahrain (CBB). In 2010, as part of its strategy to diversify its financing portfolio and liquidity management, the Group had invested an additional amount of BD36 million in Sukuk issued by CBB. As part of its diversification of income stream, the Bank had been an active player in the secondary market and had invested in high quality Sukuks issued by credit worthy counterparties. This had resulted in the corporate Sukuk portfolio increasing from BD17 million at end of 2009 to BD62 million at end of 2010. The yields arising from Sukuk also contributed towards improving Bank's core income.

The Directors believe that the challenges facing the banking sector could very well continue in 2011 and the Group is no exception to these challenges.

Financially, fiscal year 2010 has seen a decline in net profit from BD14 million in 2009 to BD7.3 million in 2010, representing a return on equity of 3.6% (2009:7.6%). The gross operating income amounted to BD22.4 million (2009: BD15.9 million) and the operating expenses were BD13.6 million (2009: BD9.7 million). The cost-to-income ratio for the year was 60.6% (2009:40.6 %). The earnings per share (EPS) for the year amounted to 5 fils (2009: 10 fils).

The performance of 2010 has been a result of the Bank's focus over the last few years on generation of core income, offering attractive investment opportunities to investors and prudent cost control measures. The Directors and management will use these key initiatives along with an existing strong risk management framework and growing customer base to achieve better results in 2011. This will enable your Bank to outperform its peers in the medium to long term and position itself as a universal Islamic bank.

Retained earnings and appropriation of net income:

	BD'000
Balance at beginning of the year	**5,009**
Net profit for the year - 2010	7,209
Transfer to statutory reserve	(721)
Transfer to investment reserve	(6,794)
Charitable contributions	(100)
Balance at end of the year	**4,603**

Directors' and senior management interest:

As required by the Central Bank of Bahrain rule book set out below are the interests of directors and senior managers in the shares of Al Salam Bank-Bahrain B.S.C. and the distribution of the shareholdings as of 31 December 2010.

	31/12/2010
Directors' shares	118,528,745
Senior Managers' shares	7,762,749
	126,291,494

Directors' expenses for attendance at Board meetings for 2010 amounted to BD15,989.

	No. of shares	2010 No. of Shareholders	% of total Outstanding shares
Percentage of shares held			
Less than 0.5%	712,288,319	23,155	47.6
0.5% to less than 1%	241,461,913	22	16.1
1% up to less than 5%	372,279,793	15	24.9
Over 5%	171,033,800	1	11.4
Total	1,497,063,825	23,193	100.00

Shareholders holding over 5%:

	Nationality	Holdings
Global Mena Macro Fund Company B.S.C. (c)	Bahrain	11.4%

In closing, 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 2011.

1 February 2011
Manama, Kingdom of Bahrain

Mohamed Ali Rashid Alabbar
Chairman

Message from the Chief Executive Officer

It gives me great pleasure to report to you that through hard work and dedication, the Group has continued to post profits in 2010 despite a challenging business environment. Under the prevailing business environment, the Group's focus was to strengthen the balance sheet with selective asset building. As a result, the Group achieved a 9.1% growth in total assets from BD785.9 million (US$2.1 billion) to BD857.4 million (US$2.3 billion) through the expansion of the credit portfolio and investment activities. On the funding side, customer deposits increased by BD73.0 million.

Despite the difficult business conditions, the Group reported a net profit of BD7.32 million for 2010 compared to BD13.96 million in 2009. While there was significant activity in the investment area, the income generated from such activities in the current year dropped by 44% to BD10.2 million compared to BD18.3 million in 2009. The adverse variance is due to market conditions where property transactions are far and few and real estate exits continue to be challenging. The management exercised strict expense controls measures and also adhered to prudent spending leading to a decrease in the overall operating expenses of the Group.

The Group, as the lead arranger, successfully completed a 7-year BD90.5 million syndicated Ijarah financing facility for Bahrain based Financial Center Development Company. In 2010, the Group successfully closed a transaction in the heart of the financial district of London in UK by participating in the mezzanine financing of a trophy asset in Canary Wharf. The exit from the Milton Gate investment in 2010 provided the investors with an attractive average return of 15% during a period characterised by scarcity of attractive investment opportunities.

The Group continues to apply conservative banking practices and relies on its core competencies while adhering to the principles of Shari'a. Prudent risk management practices are being followed in granting new facilities and acquiring investments. The Group has followed a tight policy in providing financing and investment in the real estate sector in line with the regulatory focus to control such exposures. The Group's Capital Adequacy Ratio reflected a healthy measure of 24.7% against the mandatory 12% fixed by the Central Bank of Bahrain (CBB). The strong liquidity position at 24% coupled with our capital base is expected to provide us a competitive advantage.

Overall, 2010 was the first full year of combined operations with Bahraini Saudi Bank (BSB), which is the retail and corporate banking arm of the Group. Various new products and services for retail banking customers are being rolled out through BSB. The integration of conventional activities of BSB into a Shari'a compliant business was challenging but the conversion of core activities was successfully completed as result of dedicating the necessary resources. The combined retail banking activity has increased the focus on reaching our customers, providing them with customized solutions and delivery channels, represented by a comprehensive network of branches and ATMs.

Aware of its social responsibilities, the Group continues to contribute, both money and in kind, to worthy causes that fulfill the societal needs of individuals or non-profit charitable organizations.

In closing, I wish to place on record my appreciation of ASBB and BSB staff members who have demonstrated their dedication, skill and professionalism in discharging their duties. I am also grateful to the Board of Directors and the Central Bank of Bahrain for their strong support and guidance. Last but certainly not least, we owe special thanks to our shareholders and clients for their continued support and confidence. As always, I note my sincere appreciation of the longstanding support to the Government of the Kingdom of Bahrain and its leadership.

Yousif Abdulla Taqi
Director & Chief Executive Officer

Management Review of Operations & Activities

Operating Environment

Contrary to our expectations of a better financial year, the market conditions in 2010 continued to be challenging with little or no visible improvement in the global as well as regional markets. The global economic crisis and the recession that followed had a significant negative impact on the banking environment in the region. Core economic sectors like real estate, construction and trading continued to be adversely affected. GCC economies have seen a higher degree of resilience to the downfall from the financial crisis as compared to its western counterparts with the exception of the real estate sector. The region achieved a 4% growth in GDP in 2010 as a result of the significant government spending that was seen in Saudi Arabia and Qatar on infrastructure projects.

Real estate development which was largely responsible for fueling the pre-crisis growth in the region remained stagnant. Execution of new developments was postponed owing to continued fall in occupancy levels and the new supply that came online. Availability of credit continues to be challenging as most regional and global financial institutions are still battling with decreasing asset values. Limited credit was available at conservative loan to value ratios which require higher development equity commitments. Most regional financial institutions are focused on restructuring their balance sheets and consolidating business units in order to save costs in this extremely challenging operating environment.

Business Environment

The business environment in the relatively smaller market we operate is yet to see a significant uplift in the demand for new credit. As a result, higher quality commercial assets have become a sought after commodity within the banking community in the Kingdom for Islamic as well as conventional financial institutions. The Group is continuing to focus on the retail sector and is seeing the benefits of acquisition of Bahraini Saudi Bank in 2009 which is providing the platform to grow the retail banking business by strengthening our presence through opening new branches in strategic locations.

Financial Performance

Total assets of the Group grew by 9.2% (2009: 41.7%) to BD 857.3 million (2009: BD 785.9 million) over the last fiscal year. Operating income of the Group marginally declined by 7% (2009: a decrease of 36%) to BD 22.3 million (2009: BD 23.9 million) with income from financing contracts growing by 63.4% over the previous year reflecting a solid expansion of the loan book. The operating expenses of the Group increased by 39.5% over the previous year, largely due to the consolidation of expenses incurred by our subsidiary, Bahraini Saudi Bank. Income from investment exits decreased by 87% over the previous year, reiterating the difficult operating environment that is experienced by most regional financial institutions. In spite of the tough market conditions, the Bank achieved a net profit of BD 7.3 million for the year fiscal year 2010 (2009: BD 13.9 million).

Capital Adequacy

The Group's capital adequacy continues to reflect a healthy ratio of 24.70% (2009: 28.6%) as of the end of the fiscal year against a mandatory requirement of 12% stipulated by the Central Bank of Bahrain under the new Basel II framework that came into effect in 2008.

Asset Quality

The Group continues to follow a conservative approach in selecting new assets for financing and investments. More than 90% of the financing assets are grouped under "satisfactory" category and an amount of BD 1.51 million (2009: BD Nil) has been set aside for past due but not impaired facilities although such assets are covered by adequate collateral. This provision has been made in line with the bank's conservative risk management policy.

Funds Under Management

High Net Worth Individuals in the region continued to take a conservative approach towards new investment commitments. Such an approach and our successful exit form Milton Gate investment resulted in a reduction in funds under management at the end of the fiscal year which stood at BD 48.13 million (2009: BD 60.7 million). The Group has built a strong relationship with its investors over the short history of the Bank by demonstrating our professional approach, personalized service and ability to source unique and attractive investment opportunities.

BANKING GROUP

Corporate Banking

The Group continued its efforts to grow the corporate loan book during the year. As a result of these efforts, the Group successfully secured the mandate to structure a BD 90.5 million Ijarah financing facility on behalf of Bahrain based Financial Center Development Company. The transaction was fully subscribed by local and regional financial institutions.

The Group also continued to extend support to its existing customer base to provide stability through the ongoing credit squeeze. However, credit quality remained on high priority when new facilities were granted. The Group remains committed to growth of the local economy with new assets booked to further boost the economic activity in the Kingdom. The focus in the fiscal year was to target Small and Medium Enterprises (SME) in the Kingdom. Our corporate banking team meets with customers on a regular basis to assess their financing needs and identify products which would then be tailored to suit their requirements. Through these efforts, Corporate Banking achieved improved asset quality and value.

Corporate Banking (continued)

The Group was successful in attracting new deposits during the year while retaining the existing deposits. The deposit base increased by 16% to BD 532.2 million (2009: BD 459 million).

Retail Banking

As a new business initiative, the Group continued to focus on retail banking sector. While three new branches were opened during the year, three existing branches were renovated to maintain the high standard of comfort and convenience offered to our customers. Six new ATMs were added to our current service points bringing the total number of ATM's to 22. These are installed in convenient locations throughout the Kingdom. The competition in the retail banking space continues to be extremely high. As the Kingdom continues to be overbanked, the competition among local financial institutions to attract new deposits and provide new facilities remains a challenge.

Wealth Management

The Group offered attractive products to the wealth management market segment. Wealth management products are offered to investors through a dedicated placement team which continues to provide personalized services. The placement and relationship professionals meet the investors on a regular basis and assess their appetite and risk profile prior to offering any customized solutions.

Investments

As part of our investment team's mandate, a large number of opportunities were subjected to initial review and analysis during the year. These investment opportunities typically arise from across all continents. These opportunities are subjected to rigorous internal review and analysis prior to presenting them to the Investment Committee of the Bank.

The Management follows an extremely cautious approach to investment selection. During the year, the Bank concluded several debt transactions in the global real estate market.

As a result of the financial meltdown in 2008 that continued through most of 2009, the global property markets witnessed a tightening of availability of senior financing. As the global real estate market crumbled, the risk appetite of financial institutions also diminished reducing the level of debt available for property acquisitions. The higher loan-to-value ratios that were prevalent prior to the meltdown disappeared. This environment presented a new opportunity for mezzanine financiers. The Bank took advantage of this opportunistic situation to provide £38 million mezzanine financing to restructure a prime office building in Canary Wharf in UK.

The Bank participated in the first Islamic REIT that was listed in the Singapore Stock Exchange as a cornerstone investor. The investment has enabled the Bank to deploy excess liquidity while providing superior returns and maintaining liquidity.

In order to support the Kingdom of Bahrain's initiative to distribute its wealth through public ownership of national industries, the Bank provided an underwriting commitment towards the retail tranche of the IPO of Alba that was successfully concluded toward the end of the fiscal year.

Valuation of prime commercial properties in the UK experienced a rapid improvement through the second half of 2009 and first half of 2010. In order to take advantage of the rapid growth, the Bank exited its equity investment in Milton Gate which was acquired in 2009. The exit provided our investors with an attractive return on their investment while demonstrating the Bank's ability to conclude sale transactions in tough market conditions.

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 Bank's investment across diversified asset classes in China has progressed well and had been able to achieve impressive growth in overall investment values. The underlying investment portfolio of the fund comprises of significant minority stakes in agricultural business, food, pharmaceutical, logistics, galvanized steel and industrial machinery. During the year, one of operating companies engaged in an integrated agribusiness space concluded a successful IPO that was listed on the Singapore Stock Exchange. The investment has provided a 1.7x return based on the share price as of 31 December 2010. The fund manager is targeting two IPOs in 2011 as the market for new listings in China are set to improve. The Bank's initial investment commitment was USD 40 million.

Our continuous efforts to provide unique Shari'a 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 investment teams continue to work with the operating companies in offering advice and assistance in new initiatives in order to focus on value preservation of our investments.

Information Technology

During 2010, the Group has successfully integrated the core banking platform of its subsidiary, Bahraini Saudi Bank. Both Al Salam and Bahraini Saudi Bank started working on a single Islamic banking Platform. The conversion of data from a conventional banking platform to an Islamic banking platform was a challenge and was executed as a main priority. The other priorities for the Information Technology division during the year were to enhance customers' banking experience, upgrade IT Infrastructure to offer more technology driven solutions and ensure compliance with regulatory as well as internal control requirements.

Corporate Governance and Risk Management

During the year, significant initiatives were undertaken to improve the knowledge and practice of Corporate Governance within the Bank. Compliance to Central Bank of Bahrain guidelines and other regulatory guidelines is a fundamental element of the Group's strategy. During the year a new application was rolled out for successful implementation of BASEL II requirements.

Know Your Customer

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

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

Human Capital

Human capital is considered a vital asset of the Group and also a key determinant in the success of the entity. The Bank has a comprehensive Human Resources strategy with focus on attracting talent, encouraging performance, developing skills, nurturing leadership skills, and retaining talent. Bahraini employees comprise of 84% (82% in 2009) of the total of 222 employees (233 in 2009) across Singapore and Bahrain.

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 Group. Annual performance reviews are conducted to assess individual performances where training needs are also identified and facilitated. A less formal semi-annual appraisal system has been introduced for the benefit of employees where concerns and suggestions are discussed in an informal environment. The employees across the Group received over 11,000 hours (2009: 5,380 hours) of formal training through in-house and externally arranged training programs. As part of social responsibility, 29 Bahraini students from various universities successfully completed their training program in various departments throughout the summer.

The management maintains an open dialogue with employees to encourage transparency. Regular employee events including an annual gathering to review the Group's performance and discuss future strategy forms part of the social calendar.

Workshops are organized to improve efficiency and increase productivity at the workplace. These social events encourage interaction among employees and foster their relationships outside working hours.

Corporate Social Responsibility

Since inception, the Group has taken initiatives to positively contribute towards the development of the community. Consistent efforts are made to ensure continued support of the community. The group plays an active role in assisting local communities to achieve their aspirations and goals. The Group believes in supporting business needs in a socially responsible manner where resultant benefits will encompass every individual of the community.

Our vision of a prosperous Bahrain is not restricted to providing banking service alone but to creating an environment where every member of the community has an opportunity to build a future which is safe, secure and flourishing. The following are some of the initiatives undertaken by the Group in 2010 towards achieving this vision:

- Provided financial contribution to support the National Awareness Campaign for Bahrain National Hereditary Aneamia Society. The Campaign was intended to raise awareness among school children about hereditary diseases such as Sickle cell and Thalassemia.
- Provided financial assistance to Markh Charity Fund activities to support the social activities for young children.
- Provided financial assistance to Etihad Al Reef Club to support the sports activities of the club.
- Provided financial assistance to Quran Care Society to support the community activities in the Kingdom.

"They exist silently in sunshine or in rain, wriggling in the wind – dropping to the ground when their time comes, the leaf is a busy body making carbohydrates that act as building blocks influencing more plant cells and energy source for all plant cell processes."

Policy

The Bank aspires to the highest standards of ethical conduct: doing what it says; reporting results with accuracy and transparency; and maintaining full compliance with the laws, rules and regulations that govern the Bank's business.

The Board has adopted a Board of Directors Charter which, together with the Bank's Memorandum and Articles of Association and the charters of certain Board committees, provides the authority and practices for governance of the Bank.

Board of directors

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

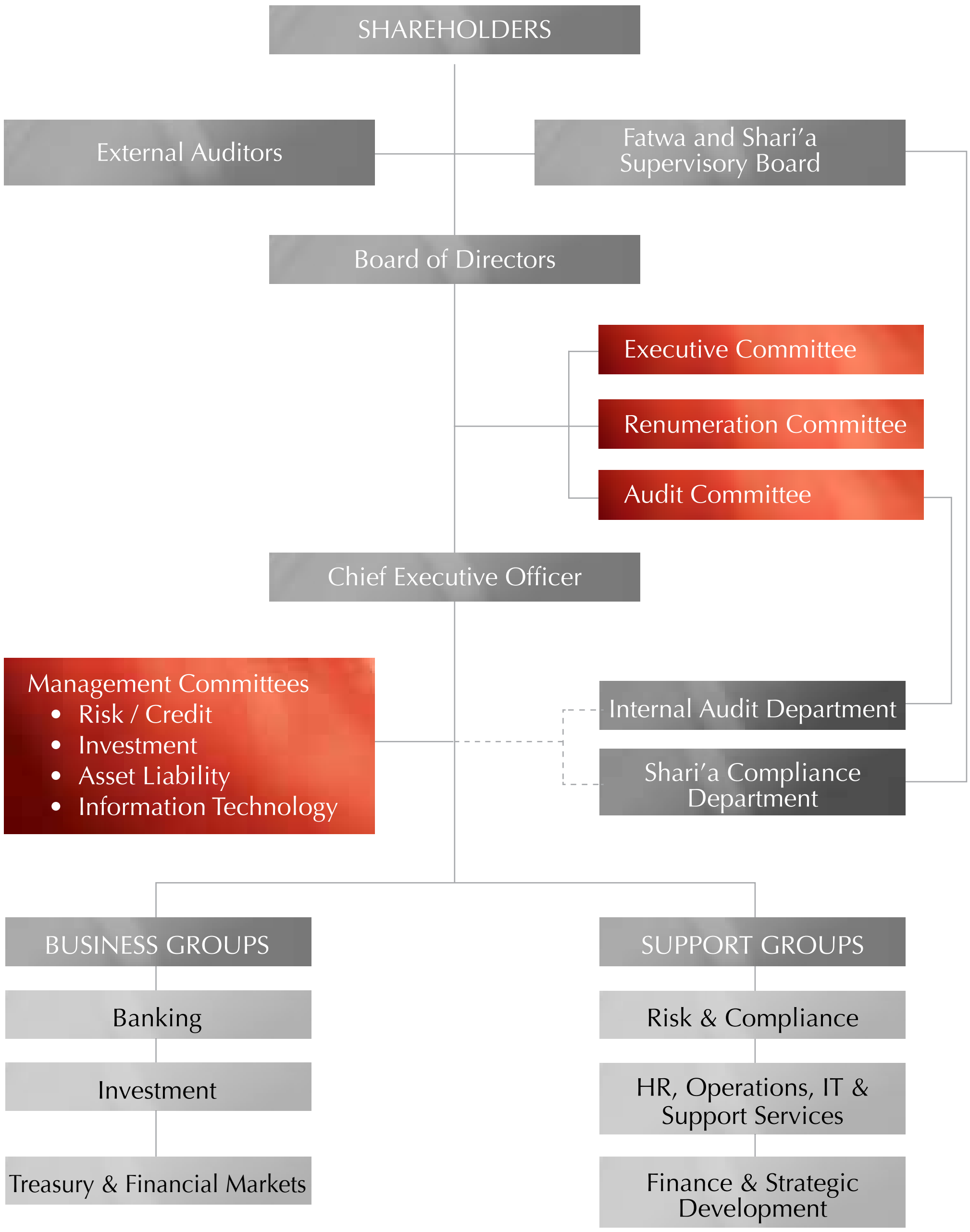
The primary responsibility of the Board is to provide effective governance over the Bank's affairs for the benefit of its shareholders, and to balance the interests of its diverse constituencies, including its customers, correspondent, employees, suppliers and local communities. In all actions taken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

Board of directors (continued)

Board of Directors

Date & Location of Board of Directors Committee Meeting	Names of Directors Present	Names of Directors Who Participated by Phone/video link	Names of Directors not present
15th February 2010 Al-Salam Bank	Habib Ahmed Kassem Shaikha Hessa bint Khalifa Al Khalifa Sheikh Abedlelah Moh'd Kaki Hamad Al Humaizi Fahad Sami Al-Ebrahim Terence D. Allen Salman Al Mahmeed Yousif Abdulla Taqi		H.E. Mohammed Al Abbar Essam Al Muhadib Ahmed Jamal Jawa
27th April 2010 Al-Salam Bank	Habib Ahmed Kassem Shaikha Hessa bint Khalifa Al Khalifa Sheikh Abedlelah Moh'd Kaki Hamad Al Humaizi Fahad Sami Al-Ebrahim Terence D. Allen Salman Al Mahmeed Yousif Abdulla Taqi Ahmed Jamal Jawa		H.E. Mohammed Al Abbar Essam Al Muhadib
8th July 2010 Al-Salam Bank *Decisions on the statements for Q2 2010 were approved by Board members through circulation*	H.E. Mohammed Al Abbar Essam Al Muhadib Habib Ahmed Kassem Shaikha Hessa bint Khalifa Al Khalifa Sheikh Abedlelah Moh'd Kaki Hamad Al Humaizi Fahad Sami Al-Ebrahim Terence D. Allen Salman Al Mahmeed Yousif Abdulla Taqi Ahmed Jamal Jawa		
18th October 2010 Al-Salam Bank	H.E. Mohammed Al Abbar Habib Ahmed Kassem Shaikha Hessa bint Khalifa Al Khalifa Salman Al Mahmeed Hamad Al Humaizi Ahmed Jamal Jawa Terence D. Allen Yousif Abdulla Taqi	Essam Al Muhadib	Sheikh Abedlelah Moh'd Kaki Fahad Sami Al-Ebrahim

The Bank is organized as follows:



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.

Members:

1. Habib Ahmed Kasim
2. Ahmed Jamal Jawa
3. Fahad Sami Al Ebrahim
4. Essam Al Muhaideb

Executive Committee

Date & Location of Executive Committee Meeting	Names of Directors Present	Names of Directors Who Participated by Phone/video link	Names of Directors not present
2nd February 2010 Al-Salam Bank	Habib Ahmed Kassem Essam Al Muhaideb Fahad Al Ebrahim		Ahmed Jamal Jawa
20th April 2010 Al-Salam Bank	Habib Ahmed Kassem Essam Al Muhaideb Fahad Al Ebrahim		Ahmed Jamal Jawa
13th October 2010 Al-Salam Bank	Habib Ahmed Kassem Essam Al Muhaideb Fahad Al Ebrahim		Ahmed Jamal Jawa

BOARD COMMITTEES (continued)

Audit Committee

Has a 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.

Members:

1. Terence D. Allen
2. Hamad Al Humaizi
3. John Hawkins - independent financial adviser

Audit Committee

Date & Location of Audit Committee Meeting	Names of Directors Present	Names of Directors Who Participated by Phone/video link	Names of Directors not present
14th February 2010 Al-Salam Bank	Terence Allen Hamad Al Homaizi		
26th April 2010 Al-Salam Bank	Terence Allen Hamad Al Homaizi John Hawkins		
7th July 2010 Al-Salam Bank	Terence Allen Hamad Al Homaizi John Hawkins		
13th October 2010 Al-Salam Bank	Terence Allen Hamad Al Homaizi John Hawkins		

BOARD COMMITTEES (continued)

Remuneration Committee

The role is to provide a formal and transparent procedure for developing a compensation policy for the Chief Executive Officer, the senior 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.

Members:

1. Shaikha Hessa bint Khalifa Al Khalifa
2. Habib Ahmed Kassem
3. Fahad Sami Al Ebrahim

Remuneration Committee

Date & Location of Remuneration Committee Meeting	Names of Directors Present	Names of Directors Who Participated by Phone/video link	Names of Directors not present
14th January 2010 Al-Salam Bank	Shaikha Hessa bint Khalifa Al Khalifa Habib Ahmed Kassem Fahad Sami Al-Ebrahim		

MANAGEMENT COMMITTEES

The Board delegates the authority for management of the Bank to the Chief Executive Officer. The CEO and Executive Management are responsible for implementation of decisions and strategies approved by the Board of Directors and the Fatwa and Shari'a Supervisory Board.

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
Credit/Risk Committee	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 up to delegate limit and monitoring is an integral part of the responsibilities. Members: 1. Yousif Abdulla Taqi 2. Mukundan Raghavachari 3. Nabeel Al Tattan 4. Ahmed Abdi Sheikh 5. Dr. Anwar Al Sadah
Asset Liability Committee	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. Members: 1. Yousif Abdulla Taqi 2. Dr. Anwar Al Sadah 3. Mukundan Raghavachari 4. Nabeel Al Tattan 5. Ahmed Abdi Sheikh

MANAGEMENT COMMITTEES (continued)

Committee	Roles and responsibilities
Investment Committee	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. Members: 1. Yousif Abdulla Taqi 2. Dr. Anwar Al Sadah 3. Mukundan Raghavachari 4. Nabeel Al Tattan 5. Byron Askin
Information Technology Steering Committee	ITSC 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. Members: 1. Mukundan Raghavachari 2. Ahmed Abdi Sheikh 3. Karim Turki 4. Essa Bohijji 5. T. R. Venkatesh 6. Anwar Murad 7. Rachad El Khawand

Code of Conduct

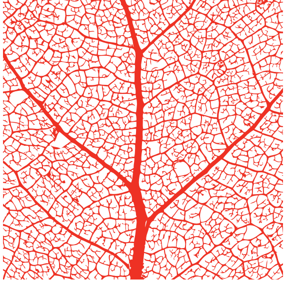
The Bank conducts itself in accordance with the highest standards of ethical behavior. A Code of Business Conduct has been developed to govern the personal and professional conduct of all stakeholders.

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, the Dubai Financial Market, the Emirates Securities & Commodities Authority including anti-money laundering, prudential and insider trading reporting.

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.



Risk Management and Compliance

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 the Central Bank of Bahrain and the Basel II Accord.

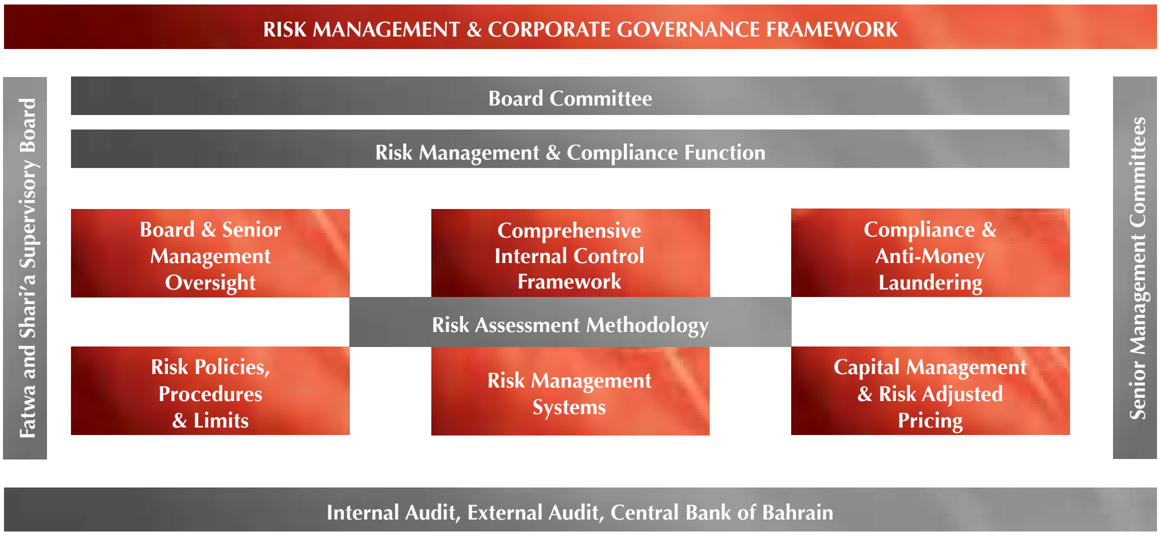
RISK MANAGEMENT FRAMEWORK

The risk management framework defines the risk culture of Al Salam Bank – Bahrain and sets the tone throughout the 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 Senior Management towards risk management, the risk assessment methodology based on likelihood and consequences, the major risk policies, procedures and risk limits, the risk management information systems and reports, the internal control framework and the 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



CAPITAL MANAGEMENT

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

CORPORATE GOVERNANCE

The risk management framework is supported by an efficient Corporate Governance Framework discussed on pages 34 to 41.

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

Risk Management assists business and support heads in identifying concerns and risks, identifying risk owners, evaluating risks as to likelihood and consequences, assessing options for mitigating the risks, prioritizing risk management efforts, developing risk management plans, authorizing implementation of risk management plans and tracking risk management efforts.

RISK MANAGEMENT AND COMPLIANCE ORGANIZATION

Al Salam Bank- Bahrain's Risk Management and Compliance Departments are under the supervision of an independent Chief Operating Officer with a 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
• Exposures and limits Monitoring	• Positioning and Limits Monitoring	• Control Self Assessments	• Basel II Compliance	• Compliance Monitoring
• Portfolio Management	• Risk Measurement Methodology	• Key Risk Indicators Monitoring	• Risk Adjusted Pricing	• Anti-money Laundering control
• Timely Reporting to Risk Committee	• Timely reporting to ALCO	• Risk & Loss Events Database	• Reporting to Board Executive Committee	• Training and Awareness
• Internal rating Methodology		• IT Security Managements	• Scenario Analysis	• AML System Controls
• Periodic Stress Testing and Scenario Analysis		• Business Continuity Planning		
		• Outsourcing Risk Management		

COMPLIANCE & ANTI-MONEY LAUNDERING UNIT

The Bank has established an independent and dedicated unit to coordinate the implementation of compliance and Anti-Money Laundering and Anti-Terrorist Financing program. The program covers policies and procedures for managing compliance with regulations, anti-money laundering, disclosure standards on material and sensitive information and insider trading.

In line with its commitment to combat money laundering and terrorist financing, Al Salam Bank - Bahrain through it's 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

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 "Al Salam Center for Financial Studies" at the University of Bahrain.

The human side has never been neglected by the Bank for it believes in human capital value and development and sharpening the capabilities through the provision of equal employment opportunities. To this end, Al Salam Bank-Bahrain in cooperation with Disabled Services Centre recruited a number of citizens of special needs, in a sign of the importance of integrating people with special needs in the workplace leading them to contribute to the country's development and prosperity.

The Bank also spent BD122,000 as sponsorships and donations for the treatment of a number of patients, and for assisting a number of needy Bahraini families.

Al Salam Bank adopts a policy that supports training and employment. Bahrainis accounted for 84% of all employees at the end of 2010. Also in 2010, the Bank carried out its Summer Internship Program, for the fourth 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.

In addition, the Directors have recommended the allocation of BD 100,000 in charitable donation to aid various aspects of the social activities to enhance the quality of life for everyone, through its support for charitable, educational, medical, scientific, cultural, social, sporting and environmental organizations. Such organizations included the Bahrain National Hereditary Aneamia Society, the Bahraini Blind Friendship Society, the Quran Care Society, the Markh Charity Fund and the Etihad Al-Reef Club.

*"The veins in the leaf may look alike
but each vein is different in nature
programmed to perform complex functions
that constantly adds value and energy to
the tree and the surroundings."*

Fatwa & Shari'a Supervisory Board Report to the Shareholders

for the Financial Year Ended 31 December 2010

The Shari'a Supervisory Board ("**the Board**") has reviewed the transactions entered into by the Bank during the year. The Board reviewed the balance sheet, the income statement, the statement of cash flows and the statement of changes in equity. The Board met and discussed the financial statements with the management of the Bank and presented its annual report as follows:

First:

1. The Board has supervised the Bank's activities and transactions during the year. The Board had played its role in guiding various departments to adherence to the Principles of Shari'a and the pronouncements of the Board in respect of these activities and transactions. The Board held, for this purpose, several meetings with the Bank's management. The Board is hereby emphasizing the Bank's management utmost keenness to observe the Rules and Principles of Shari'a and Pronouncements of the Board.

2. The Board has examined the transactions that were presented to it during the year, and approved contracts and documents relating to these transactions. The Board has responded to questions and queries raised in respect of these transactions, and issued appropriate Fatwas and Pronouncements. These decisions have been circulated to the departments concerned for execution.

Second:

The Board has reviewed samples of contracts and agreements that were presented to it and requested management to abide by these sample contracts and agreements.

Third: Financial Statements:

The Board has reviewed the consolidated financial statements of the Group (the Bank and its subsidiary) and the notes thereto and clarifications complementary to them, on which the Board made the following observations and recommendations:

1. Based on information made available by the Banks' management, the consolidated financial statements reviewed by the Board presents fairly the Banks' assets, its liabilities, URIA, equity, revenues and operating expenses. The accuracy of the information and data provided are the responsibility of the Bank's management.

2. The Banks' management represents that majority of the deposits are based on Wakala contracts; the clients are informed of the profit to expect and the Bank holds one general pool for these deposits. The management represents that the Bank receives limited amounts of saving accounts deposits for investment on the basis of Mudaraba which are comingled with the funds of shareholders in a common pool. The Board has advised that the Bank expands its activities of receiving deposits to include accepting fixed-term deposits on Mudaraba basis in line with the practice in other Islamic Banks.

The Board believes that the consolidated balance sheet, income statement and the distribution of profits between depositors and shareholders had been prepared on this basis.

Fourth: Zakah:

Since the Articles of Association of the Bank does not require the Bank to pay Zakah on behalf of the shareholders, the Board has calculated the Zakah payable by shareholders. This has been disclosed in the notes to financial statements for shareholders information.

Fifth: Conversion of Bahraini Saudi Bank:

The Bank has acquired a 90.31% stake in Bahraini Saudi Bank with the objective of converting it to an Islamic Bank. The conversion is underway and the Board has advised that 30 June 2011 is the last day of conversion, so that the bank may start all its activities on 01 July 2011 in accordance with Shari'a principles and Rules only.

Sixth: Shari'a Prohibited Income:

Pursuant to the Board's directive, the prohibited income earned by the Subsidiary should be purified by the Group from the date of conversion. Since the Subsidiary's operations are not fully compliant with Shari'a rules and Principles, the prohibited income and expenses have been calculated and disclosed in the notes to the financial statements. The shareholders should purify the amount of prohibited income attributable to each share by donating the relevant amounts of such prohibited income to charity.

The prohibited income to be donated by each shareholder for 2010 has been determined by the Shari'a Supervisory Board as 2.06 fils per share.

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

Dr. Hussein Hamed Hassan
Chairman

Dr. Ali Al Qura Daghi
Board Member

Dr. Mohammed Zoeir
Member & Secretary to the Board

Shaikh Adnan Al Qattan
Board Member

ERNST & YOUNG

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C.R. No. 6700

Independent Auditors' Report to the Shareholders of Al Salam Bank-Bahrain B.S.C.

We have audited the accompanying consolidated statement of financial position of Al Salam Bank-Bahrain B.S.C. ["**the Bank**"] and its subsidiary [together "**the Group**"] as of 31 December 2010, and the related consolidated statements of income, comprehensive income, cash flows and changes in equity for the year then ended. These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a Rules and Principles are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

Auditors' Responsibility

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ["**AAOIFI**"]. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Board of Directors, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of 31 December 2010, the results of its operations, its cash flows and changes in equity for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

Other Matters

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements, and the contents of the Report of the Board of Directors relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank, have occurred during the year ended 31 December 2010 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position and that the Bank has complied with the terms of its banking license and has also complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

Ernst + Young

1 February 2011
Manama, Kingdom of Bahrain

Consolidated Statement of Financial Position

31 December 2010

	Note	31 December 2010 BD '000	31 December 2009 BD '000
ASSETS			
Cash and balances with banks and Central Bank of Bahrain	5	**95,791**	126,739
Central Bank of Bahrain Sukuk		**68,632**	32,908
Murabaha receivables from banks	6	**137,299**	149,304
Corporate Sukuk		**61,724**	16,950
Murabaha and Mudaraba financing	7	**120,812**	87,274
Ijarah Muntahia Bittamleek	8	**69,825**	46,315
Musharaka financing		**8,127**	5,384
Assets under conversion	9	**57,432**	98,305
Non-trading investments	10	**212,432**	184,680
Investment in an associate	11	**7,578**	7,659
Investment properties		**3,373**	1,177
Receivables and prepayments	12	**12,479**	26,902
Premises and equipment		**1,859**	2,337
TOTAL ASSETS		**857,363**	785,934
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY			
LIABILITIES			
Murabaha and Wakala payables to banks		**101,300**	89,398
Wakala from non-banks		**456,447**	317,370
Customers' current accounts		**57,362**	32,700
Liabilities under conversion	9	**5,171**	120,402
Other liabilities	13	**15,993**	14,877
TOTAL LIABILITIES		**636,273**	574,747
UNRESTRICTED INVESTMENT ACCOUNTS	14	**18,465**	9,409

The attached notes 1 to 30 form part of these consolidated financial statements.

Consolidated Statement of Financial Position (continued)

Year ended 31 December 2010

	Note	*31 December 2010 BD '000*	*31 December 2009 BD '000*
EQUITY			
Share capital	15	**149,706**	142,577
Reserves and retained earnings	15	**48,922**	41,356
Proposed appropriations	15	**-**	14,258
Total equity attributable to shareholders of the bank		**198,628**	198,191
Non-controlling interest		**3,997**	3,587
TOTAL EQUITY		**202,625**	201,778
TOTAL LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY		**857,363**	785,934

These consolidated financial statements have been authorised for issue in accordance with a resolution of the Board of Directors dated 1 February 2011.

Mohamed Ali Rashid Alabbar	**Yousif Taqi**
Chairman	Director & Chief Executive Officer

The attached notes 1 to 30 form part of these consolidated financial statements.

Consolidated Income Statement

Year ended 31 December 2010

	Note	*31 December 2010 BD '000*	*31 December 2009 BD '000*
OPERATING INCOME			
Income from financing contracts		**26,135**	15,998
Income from investments designated as fair value through profit or loss		**1,089**	713
Gains on disposal of investments		**1,531**	11,782
Gains on investments designated as fair value through profit or loss		**7,608**	5,772
Fees and commissions	16	**2,145**	556
Foreign exchange gains		**839**	337
Other income		**2,954**	18
		42,301	35,176
Profit on Murabaha and Wakala payables to banks		**(617)**	(1,119)
Profit on Wakala from non-banks		**(14,674)**	(13,928)
Profit on unrestricted investment accounts		**(216)**	(155)
Depreciation on Ijarah Muntahia Bittamleek	8	**(4,430)**	(4,038)
TOTAL OPERATING INCOME		**22,364**	15,936
OPERATING EXPENSES			
Staff costs		**7,023**	5,131
Premises and equipment cost		**1,144**	723
Depreciation		**1,133**	1,010
Other operating expenses		**4,255**	2,853
TOTAL OPERATING EXPENSES		**13,555**	9,717
PROFIT BEFORE RESULTS OF ASSOCIATE / SUBSIDIARY		**8,809**	6,219
Gain arising on acquisition of a subsidiary		**-**	7,996
Share of gain (loss) from an associate	11	**15**	(255)
Post acquisition profit from the subsidiary		**-**	21
Shari'a prohibited income contributed to charity		**-**	(19)
NET PROFIT BEFORE PROVISIONS		**8,824**	13,962
Provision for impairment	7	**(1,508)**	-
NET PROFIT FOR THE YEAR		**7,316**	13,962
Attributable to:			
Equity holders of the Bank		**7,209**	13,960
Non-controlling interest		**107**	2
		7,316	13,962
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING		**1,497,063,825**	1,360,825,581
BASIC AND DILUTED EARNINGS PER SHARE (FILS)		**5**	10

The attached notes 1 to 30 form part of these consolidated financial statements.

Consolidated Statement of Comprehensive Income

Year ended 31 December 2010

	31 December 2010 BD '000	*31 December 2009 BD '000*
NET PROFIT FOR THE YEAR	**7,316**	13,962
Other comprehensive income:		
Net change in fair value	**856**	(367)
Exchange differences on investment in an associate	**(96)**	(99)
Other comprehensive income (loss) for the year	**760**	(466)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**8,076**	13,496
Attributable to:		
Equity holders of the Bank	**7,666**	13,480
Non-controlling interest	**410**	16
	8,076	13,496

The attached notes 1 to 30 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

Year ended 31 December 2010

	31 December 2010 BD '000	*31 December 2009 BD '000*
OPERATING ACTIVITIES		
Net profit for the year	**7,316**	13,962
Adjustments:		
Depreciation	**1,133**	1,010
Gains on investments designated as fair value through profit or loss	**(7,608)**	(5,772)
Provision for impairment	**1,508**	-
Share of (gain)/loss from an associate	**(15)**	255
Operating income before changes in operating assets and liabilities	**2,334**	9,455
Changes in operating assets and liabilities:		
Mandatory reserve with Central Bank of Bahrain	**(1,600)**	(4,486)
Central Bank of Bahrain Sukuk	**(35,724)**	(1,813)
Murabaha receivables from banks with original maturities of 90 days or more	**(10,888)**	1,497
Corporate Sukuk	**(43,579)**	(17,457)
Murabaha and Mudaraba financing	**(35,046)**	(14,790)
Ijarah Muntahia Bittamleek	**(23,510)**	(4,784)
Musharaka financing	**(2,743)**	(5,384)
Assets under conversion	**41,304**	9,030
Non-trading investments, net	**(20,914)**	(1,208)
Receivables and prepayments	**14,423**	(12,473)
Assets held-for-sale	**-**	28,164
Murabaha and Wakala payables to banks	**11,902**	56,517
Wakala from non-banks	**119,130**	28,365
Customers' current accounts	**24,662**	(10,286)
Liabilities under conversion	**(95,284)**	(6,262)
Other liabilities	**1,016**	(460)
Net cash (used in) from operating activities	**(54,517)**	53,625

The attached notes 1 to 30 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows (continued)

Year ended 31 December 2010

	31 December 2010 BD '000	31 December 2009 BD '000
INVESTING ACTIVITIES		
Cash flow arising on acquisition of a subsidiary	-	58,092
Purchase of premises and equipment	(655)	(265)
Purchase of investment property	(2,196)	-
Net cash (used in) from investing activities	(2,851)	57,827
FINANCING ACTIVITIES		
Unrestricted investment accounts	9,056	3,039
Share issue expenses	-	(136)
Dividends	(7,129)	(12,000)
Net movement in non-controlling interests	-	(2)
Net cash from (used in) financing activities	1,927	(9,099)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(55,441)	102,353
Cash and cash equivalents at 1 January	258,557	156,204
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	203,116	258,557
Cash and cash equivalents comprise of:		
Cash and other balances with Central Bank of Bahrain	73,945	104,616
Balances with other banks (Note 5)	2,879	4,756
Murabaha receivables from banks with original maturities of less than 90 days	126,292	149,185
	203,116	258,557

The attached notes 1 to 30 form part of these consolidated financial statements.

Consolidated Statement of Changes In Equity

Year ended 31 December 2010

Amounts in BD '000

	Attributable to equity holders of the Bank											
	Share capital	*Statutory reserve*	*Retained earnings*	*Investment reserve*	*Changes in fair value*	*Foreign exchange translation reserve*	*Share premium reserve*	*Total reserves*	*Proposed propriations*	*Total*	*Non-controlling interest*	*Total equity*
Balance as of 1 January 2009	120,000	6,514	12,575	20,473	-	99	-	39,661	12,823	172,484	-	172,484
Non-controlling interest arising on acquisition of a subsidiary (Note 3)	-	-	-	-	-	-	-	-	-	-	3,571	3,571
Total comprehensive income:												
Net profit for the year	-	-	13,960	-	-	-	-	13,960	-	13,960	2	13,962
Other Comprehensive income (loss):												
Net change in fair value	-	-	-	-	(381)	-	-	(381)	-	(381)	14	(367)
Changes on investment in an associate	-	-	-	-	-	(99)	-	(99)	-	(99)	-	(99)
Total comprehensive income (loss)	-	-	13,960	-	(381)	(99)	-	13,480	-	13,480	16	13,496
	120,000	6,514	26,535	20,473	(381)	-	-	53,141	12,823	185,964	3,587	189,551
Transfer to investment reserve	-	-	(5,772)	5,772	-	-	-	-	-	-	-	-
Transfer to statutory reserve	-	1,396	(1,396)	-	-	-	-	-	-	-	-	-
Zakah paid	-	-	-	-	-	-	-	-	(823)	(823)	-	(823)
Charitable donations	-	-	(100)	-	-	-	-	(100)	-	(100)	-	(100)
Dividends paid for 2008	-	-	-	-	-	-	-	-	(12,000)	(12,000)	-	(12,000)
Proposed dividends for 2009	-	-	(14,258)	-	-	-	-	(14,258)	14,258	-	-	-
Shares issued (Notes 3 and 15.1)	22,577	-	-	-	-	-	2,709	2,709	-	25,286	-	25,286
Share issue expenses	-	-	-	-	-	-	(136)	(136)	-	(136)	-	(136)
Balance at 31 December 2009	142,577	7,910	5,009	26,245	(381)	-	2,573	41,356	14,258	198,191	3,587	201,778
Total comprehensive income:												
Net profit for the year	-	-	7,209	-	-	-	-	7,209	-	7,209	107	7,316
Other Comprehensive income (loss):												
Net change in fair value	-	-	-	-	553	-	-	553	-	553	303	856
Changes on investment in an associate	-	-	-	-	-	(96)	-	(96)	-	(96)	-	(96)
Total comprehensive income (loss)	-	-	7,209	-	553	(96)	-	7,666	-	7,666	410	8,076
	142,577	7,910	12,218	26,245	172	(96)	2,573	49,022	14,258	205,857	3,997	209,854
Transfer to investment reserve	-	-	(6,794)	6,794	-	-	-	-	-	-	-	-
Bonus shares issued	7,129	-	-	-	-	-	-	-	(7,129)	-	-	-
Transfer to statutory reserve	-	721	(721)	-	-	-	-	-	-	-	-	-
Charitable donations	-	-	(100)	-	-	-	-	(100)	-	(100)	-	(100)
Dividends paid for 2009	-	-	-	-	-	-	-	-	(7,129)	(7,129)	-	(7,129)
Balance at 31 December 2010	**149,706**	**8,631**	**4,603**	**33,039**	**172**	**(96)**	**2,573**	**48,922**	**-**	**198,628**	**3,997**	**202,625**

The attached notes 1 to 30 form part of these consolidated financial statements.

1 INCORPORATION AND PRINCIPAL ACTIVITIES

The parent company, 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 ("the CBB") and has an Islamic retail banking license and is operating under Islamic principles, and in accordance with all the relevant regulatory guidelines for Islamic banks issued by the CBB. The Bank's registered office is P.O. Box 18282, Building 22, Avenue 58, Block 436, Al Seef District, Kingdom of Bahrain.

In 2009, the Bank acquired a 90.31% stake in Bahraini Saudi Bank B.S.C. (BSB), a publicly listed commercial bank in the Kingdom of Bahrain. BSB operates under a retail banking license issued by the Central Bank of Bahrain. BSB has applied for an Islamic retail banking license with the CBB and is awaiting approval. Subsequent to acquisition by the Bank, BSB has discontinued new conventional activities and the conversion into fully compliant Islamic operations is in progress.

The Bank and its subsidiary BSB (together known as "the Group") operate through eleven retail branches in the Kingdom of Bahrain. The Bank offers a full range of Shari'a-compliant banking services and products. The activities of the Bank include managing profit sharing investment accounts, offering Islamic financing contracts, dealing in Shari'a-compliant financial instruments as principal/agent, managing Shari'a-compliant financial instruments and other activities permitted for under the CBB's Regulated Banking Services as defined in the licensing framework. The Bank's ordinary shares are listed in the Bahrain Stock Exchange.

2 SIGNIFICANT ACCOUNTING POLICIES

2.1 BASIS OF PREPARATION

The consolidated financial statements are prepared on a historical cost basis, except for investments held at fair value through profit or loss, available-for-sale investments and investment properties which are held at fair value. These consolidated financial statements incorporate all assets, liabilities and off balance sheet financial instruments held by the Group. Investment in an associate, Al Salam Bank-Algeria is equity accounted as per Financial Accounting Standard (FAS) 24, Investment in Associates (Note 11).

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

Statement of compliance
The consolidated financial statements of the Group 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 the Central Bank of Bahrain and Financial Institutions Law. For matters for which no AAOIFI standards exist, the Group uses the relevant International Financial Reporting Standard.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 BASIS OF PREPARATION (continued)

The Group presents its consolidated statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the consolidated statement of financial position date (current) and more than 12 months after the consolidated statement of financial position date (non-current) is presented in Note 22.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary for the year ended 31 December 2010. The financial statements of the Bank's subsidiary is prepared for the same reporting year as the Bank, using consistent accounting policies. Non-Shari'a compliant assets and liabilities of the subsidiary are consolidated as set out in Note 9.

Subsidiaries are fully consolidated from the date on which control is transferred to the Bank. Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired during the year are included in the consolidated income statement from the date of gaining control over the subsidiary.

Non-controlling interests represent the portion of profit or loss and net assets not owned, directly or indirectly, by the Group and are presented separately in the consolidated income statement and within equity in the consolidated statement of financial position, separately from parent shareholders' equity.

2.2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

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

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.

Estimation uncertainty

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

Impairment losses on financial contracts

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

2 ACCOUNTING POLICIES (continued)

2.2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Impairment of available-for-sale equity investments
The Group 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 Group evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

Collective impairment provisions on financial contracts
In addition to specific provisions against individually significant financial contracts, the Group 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 Group, of the financial contracts since they were granted (acquired). The amount of the provision is based on the historical loss pattern for other contracts within each grade and is adjusted to reflect current economic changes.

Valuation of unquoted private equity and real estate investments
Valuation of above investments is normally based on one of the following:

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

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

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated financial statements, which are consistent with those of prior year [except for items disclosed in note 2.3 (ad)] are set out below:

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

2 ACCOUNTING POLICIES (continued)

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

b) Corporate sukuk
These are quoted securities and classified as available-for-sale. These are initially recorded at fair value, being the consideration given and subsequently remeasured at fair value. Changes in fair value are recognized in the other comprehensive income until the investment is derecognised or the investment is determined to be impaired, upon which the cumulative fair value is transferred to consolidated income statement.

c) Murabaha financing
These mainly consist of deferred sales transactions and stated net of deferred profits, provision for impairment, if any, and amounts settled.

d) Mudaraba financing
These are stated at fair value of consideration given net of provision for impairment, if any, and amounts settled.

e) 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 term.

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 shorter of either period of the lease or economic life of the asset.

f) Musharaka
These are initially stated at the fair value of the consideration given and subsequently remeasured at amortised cost less provision for impairment in value, if any.

g) Assets and liabilities under conversion
"These represent assets and liabilities of BSB which are under conversion to Shari'a compliant products. These are initially measured at fair value at the date of acquisition and the subsequent measurement is as follows:

Assets under conversion:
Due from Banks and Loans and advances to customers:
At amortised cost less any amounts written off and provision for impairment, if any.

Investments:
These are classified as available-for-sale investments and are fair valued based on criteria set out in Note 2.3 h. Any changes in fair values subsequent to acquisition date are recognized in other comprehensive income.

Liabilities under conversion:
These are remeasured at amortised cost.

h) 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 or loss is charged to consolidated income statement.

2 ACCOUNTING POLICIES (continued)

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Non-trading investments (continued)
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 in other comprehensive income until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as "changes in fair value" within equity, is included in the consolidated income statement.

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 Group's risk management policy and its investment strategy. These include all private equity investments including those in joint ventures and associates.

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

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

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

2 ACCOUNTING POLICIES (continued)

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

i) Investment in an associate (continued)

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

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

After application of the equity method, the Group determines whether it is necessary to recognise an additional impairment loss on its investment in associates. The Group 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 Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount in the consolidated income statement.

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

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

k) 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 consolidated 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.

l) Premises and equipment

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

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

2 ACCOUNTING POLICIES (continued)

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

m) Subsidiaries acquired with a view to sell

A subsidiary acquired with a view to subsequent disposal within 12 months is classified as "held-for-sale" when the sale is highly probable. Related assets and liabilities of the subsidiary are shown separately on the consolidated statement of financial position as "Assets held-for-sale" and "Liabilities relating to assets held-for-sale". Assets that are classified as held-for-sale are measured at the lower of carrying amount and fair value less costs to sell. Any resulting impairment loss reduces the carrying amount of the assets. Assets that are classified as held-for-sale are not depreciated.

n) Business Combinations and goodwill

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

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

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

o) Impairment and uncollectability of financial assets

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

2 ACCOUNTING POLICIES *(continued)*

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

n) Impairment and uncollectability of financial assets (continued)

Impairment is determined as follows:

(i) for assets carried at amortised cost, impairment is based on estimated cash flows based on the original effective profit rate;

(ii) for assets carried at fair value, impairment is the difference between cost and fair value; and

(iii) for assets carried at cost, impairment is based on present value of anticipated cash flows based on the current market rate of return for a similar financial asset.

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

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

p) Offsetting

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

q) Provisions

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

r) Employees' end of service benefits

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

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

s) Revenue recognition

Murabaha

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

Corporate sukuk

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

2 ACCOUNTING POLICIES (continued)

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

s) Revenue recognition (continued)

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

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

Musharaka
Income on Musharaka is recognized when the right to receive payment is established or on distributions.

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

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

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

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

For investments where there is no quoted market price, a reasonable estimate of fair value is determined by reference to valuation by independent external valuers or based on recent arm's length market transactions.

2 ACCOUNTING POLICIES (continued)

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

s) Revenue recognition (continued)

Alternatively, the estimate would also be based on current market value of another instrument, which is substantially the same, or is based on the assessment of future cash flows. The cash equivalent values are determined by the Group 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 Group using current profit rates for investments with similar terms and risk characteristics.

t) Foreign currencies

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

u) Trade and settlement date accounting

Purchases and sales of financial assets and liabilities are recognised on the trade date, i.e. the date that the Group purchases or sells the asset or liability.

v) Derecognition of financial assets

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

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

w) Derecognition of financial liabilities

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

x) Fiduciary assets

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

2 ACCOUNTING POLICIES (continued)

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

z) Unrestricted investment accounts (URIA)
All unrestricted investment accounts are carried at capital received plus profit earned less amounts paid. Income to unrestricted investment account holders is allocated, net of Mudarib fees, on the basis of their average daily balances in proportion to shareholders' daily average balances.

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

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

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

ad) Adoption of new and amended standards
Financial Accounting Standard No. 23 - Consolidation
FAS 23 sets out the principles for determining entities that are subject to be included in the consolidated financial statements of a parent and prescribes the accounting for investment in subsidiaries by parent.

Financial Accounting Standard No. 24 - Associates
FAS 24 sets out the accounting principles for recognising, measuring, presenting and disclosing the investments in associate.

The requirements of FAS 23 and FAS 24 are largely in line with the current policies followed by the Group for accounting of subsidiaries and associates and the adoption of these standards does not have any material impact on the consolidated financial statements.

ae) Wakala
The Group accepts deposits from customers under Wakala arrangement under which a return may be payable to customers. There is no restriction on the Group for the use of funds received under wakala agreement.

3 BUSINESS COMBINATION

During 2009, the Bank made an offer to acquire up to 100% of the issued and paid up shares of Bahraini Saudi Bank B.S.C. (BSB), a publicly listed commercial bank incorporated in the Kingdom of Bahrain, at an exchange ratio of one new share of the Bank for every two shares of BSB. The acquisition through share exchange was approved by the shareholders of the Bank in their Extraordinary General Assembly Meeting held on 4 May 2009. The Bank acquired 90.31% stake in BSB and issued 225,775,075 new shares of the Bank (Note 15.1). On 28 October 2009, the Board of BSB was reconstituted with three out of the five Board members of BSB representing the Bank gaining effective control over BSB.

4 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

As at 31 December 2010, financial instruments have been classified as follows:

	Financial assets at fair value through profit or loss BD '000	*Available for sale BD '000*	*Financial assets at cost / amortised cost BD '000*	*Total BD '000*
ASSETS				
Cash and balances with Central Bank of Bahrain	-	-	**95,791**	**95,791**
Central Bank of Bahrain Sukuk	-	-	**68,632**	**68,632**
Murabaha receivables from banks	-	-	**137,299**	**137,299**
Corporate Sukuk	-	**61,724**	-	**61,724**
Murabaha and Mudaraba receivables	-	-	**120,812**	**120,812**
Ijarah Muntahia Bittamleek	-	-	**69,825**	**69,825**
Musharaka financing	-	-	**8,127**	**8,127**
Assets under conversion	-	**8,803**	**48,629**	**57,432**
Non-trading investments	**199,335**	**13,097**	-	**212,432**
Receivables	-	-	**11,762**	**11,762**
	199,335	**83,624**	**560,877**	**843,836**

4 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (continued)

(Table continued)

	Financial liabilities at fair value through profit or loss BD '000	***Available for sale BD '000***	***Financial liabilities at amortised cost BD '000***	***Total BD '000***
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS				
Murabaha and Wakala payables to banks	**-**	**-**	**101,300**	**101,300**
Wakala from non-banks	**-**	**-**	**456,447**	**456,447**
Customers' current accounts	**-**	**-**	**57,362**	**57,362**
Liabilities under conversion	**-**	**-**	**5,171**	**5,171**
Other Financial liabilities	**-**	**-**	**12,697**	**12,697**
Unrestricted investment accounts	**-**	**-**	**18,465**	**18,465**
	-	**-**	**651,442**	**651,442**

As at 31 December 2009, financial instruments have been classified as follows:

	Financial assets at fair value through profit or loss BD '000	*Available for sale BD '000*	*Financial assets at cost / amortised cost BD '000*	*Total BD '000*
ASSETS				
Cash and balances with Central Bank of Bahrain	-	-	126,739	126,739
Central Bank of Bahrain Sukuk	-	-	32,908	32,908
Murabaha receivables from banks	-	-	149,304	149,304
Corporate Sukuk	-	16,950	-	16,950
Murabaha and Mudaraba financing	-	-	87,274	87,274
Ijarah Muntahia Bittamleek	-	-	46,315	46,315
Musharaka financing	-	-	5,384	5,384
Assets under conversion	-	27,696	70,609	98,305
Non-trading investments	184,680	-	-	184,680
Receivables	-	-	26,214	26,214
	184,680	44,646	544,747	774,073

4 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (continued)

(Table continued)

	Financial assets at fair value through profit or loss BD '000	Available for sale BD '000	Financial assets at cost / amortised cost BD '000	Total BD '000
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS				
Murabaha and Wakala payables to banks	-	-	89,398	89,398
Wakala from non-banks	-	-	317,370	317,370
Customers' current accounts	-	-	32,700	32,700
Liabilities under conversion	-	-	120,402	120,402
Other financial liabilities	-	-	9,824	9,824
Unrestricted Investment Accounts	-	-	9,409	9,409
	-	-	579,103	579,103

5 CASH AND BALANCES WITH CENTRAL BANK OF BAHRAIN

	2010 BD '000	2009 BD '000
Mandatory reserve with Central Bank of Bahrain	**18,967**	17,367
Cash and other balances with Central Bank of Bahrain	**73,945**	104,616
Balances with other banks	**2,879**	4,756
	95,791	126,739

6 MURABAHA RECEIVABLES FROM BANKS

	Up to 3 months 2010 BD '000	Up to 3 months 2009 BD '000
GCC	**137,299**	149,304
	137,299	149,304

This includes certain Wakala receivables for investment in commodity Murabaha. Deferred profits on Murabaha receivables from banks amounted to BD 107,000 (2009: BD 58,000).

7 MURABAHA AND MUDARABA FINANCING

	2010 BD '000	*2009 BD '000*
Murabaha financing - gross	**116,080**	87,274
Less: Provision for impairment	**(1,508)**	-
Murabaha financing - net	**114,572**	87,274
Mudaraba financing	**6,240**	-
Total Murabaha and Mudaraba financing	**120,812**	87,274

Murabaha financing are shown net of deferred profits of BD 23,480,000 (2009: BD 9,665,000).

8 IJARAH MUNTAHIA BITTAMLEEK

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

	2010 BD '000	*2009 BD '000*
Movements in Ijarah Muntahia Bittamleek assets are as follows:		
At 1 January	**46,315**	41,531
Additions during the year - net	**27,940**	8,822
Ijarah assets depreciation - net	**(4,430)**	(4,038)
At 31 December	**69,825**	46,315

	2010 BD '000	*2009 BD '000*
The future minimum lease receivable in aggregate are as follows:		
Due within one year	**18,860**	17,184
Due in one to five years	**36,409**	22,179
Due after five years	**14,556**	6,952
	69,825	46,315

8 IJARAH MUNTAHIA BITTAMLEEK (continued)

	2010 BD '000	2009 BD '000
Ijarah Muntahia Bittamleek are divided into the following asset classes:		
Aviation	**3,114**	3,596
Machinery	**3,555**	3,973
Land and buildings	**63,156**	38,746
	69,825	46,315

The accumulated depreciation on assets subject to Ijarah Muntahia Bittamleek amounted to BD4,402,000 (2009:BD4,863,000).

9 ASSETS AND LIABILITIES UNDER CONVERSION

These represent interest bearing assets and liabilities of BSB, a majority owned subsidiary of the Bank. At the consolidated statement of financial position date, the conversion of the subsidiary into a fully Islamic compliant operations is in progress, accordingly these assets and liabilities have been reported as separate line items on the face of the consolidated statement of financial position. The details of these assets and liabilities under conversion are as follows:

	2010 BD '000	2009 BD '000
Assets		
Due from banks and financial institutions	**757**	6,839
Loans and advances to customers	**47,872**	63,770
Non-trading investments	**8,803**	27,696
	57,432	98,305
Liabilities		
Due to banks and financial institutions	**5,171**	20,912
Customers' deposits	**-**	99,490
	5,171	120,402

Loans and advances, included under assets under conversion above, are stated net of write down of BD 3,983,000 made by the Group against assets held by the Subsidiary at the time of acquisition. This write down comprise of BD 2,133,000 of specific adjustments against identified facilities and a general write down of BD 1,850,000 as fair value adjustments as required by IFRS 3, Business Combinations. The Subsidiary carries these assets at amortized cost, less impairment, as per its accounting policy for Loans and Receivables Originated by an enterprise. Included in the non-trading investments are certain investments against which the Group has taken a fair value write down amounting to BD330,000.

9 ASSETS AND LIABILITIES UNDER CONVERSION *(continued)*

Income from financing contracts includes BD 4,963,000 arising from assets under conversion. Profit on Wakala from non-banks includes BD 1,557,000 arising from liabilities under conversion.

In addition to the above assets under conversion, the subsidiary has a conventional deposit of BD 14,655,000 with the Central Bank of Bahrain.

10 NON-TRADING INVESTMENTS

	2010 BD '000	*2009 BD '000*
Quoted		
- Available for sale	**13,097**	-
- Fair value through profit or loss	**3,212**	4,342
Unquoted based on valuation techniques:		
- Fair value through profit or loss		
Market observable input	**149,683**	133,402
Non-market observable input	**46,440**	46,936
	212,432	184,680

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 Group's best estimate of the most appropriate model inputs.

11 INVESTMENT IN AN ASSOCIATE

The Group has investment in an associate, Al Salam Bank Algeria (ASBA), an unlisted bank incorporated in Algeria. The following table illustrates the summarised financial information of the Group's investment in ASBA:

	2010 BD '000	*2009 BD '000*
Associate's statement of financial position:		
Total assets	**86,405**	69,692
Total liabilities	**38,792**	20,318
Net assets	**47,613**	49,374
Total revenue	**1,787**	1,077
Total expenses	**1,685**	2,842
Net gain/(loss) for the year	**102**	(1,765)
Group's share of associate's gain/(loss)	**15**	(255)

12 RECEIVABLES AND PREPAYMENTS

	2010 BD '000	2009 BD '000
Profit receivable on Murabaha and Mudaraba	**1,807**	1,251
Rental receivable on Ijarah Muntahia Bittamleek assets	**683**	1,314
Profit receivable on Sukuk	**650**	263
Prepayments	**716**	688
Other receivables	**8,623**	23,386
	12,479	26,902

At 31 December 2009, the other receivables included BD 17,892,000 relating to sale of investments and majority of which was received during 2010.

13 OTHER LIABILITIES

	2010 BD '000	2009 BD '000
Profit payable	**4,626**	3,198
Accounts payable and accruals	**7,029**	7,083
Dividends payable	**3,440**	3,805
End of service benefits	**669**	599
Charity payable	**229**	192
	15,993	14,877

Charity payable includes BD 8,000 (2009: BD 75,000) of Shari'a prohibited income allocated for charitable purposes.

14 UNRESTRICTED INVESTMENT ACCOUNTS

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

14 UNRESTRICTED INVESTMENT ACCOUNTS (continued)

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

	2010 BD '000	2009 BD '000
Gross return from commingled assets	**393**	307
Group's share as Mudarib	**(177)**	(152)
Distributions to unrestricted investment account holders	**216**	155

The average profit rate for the URIA holders is 1.00% (2009: 1.25%).

15 EQUITY

	2010 BD '000	2009 BD '000
15.1 SHARE CAPITAL		
Authorised:		
2,000,000,000 ordinary shares of BD 0.100 each	**200,000**	200,000
Issued and fully paid (at BD 0.100 per share):		
Balance at beginning - 1,425,775,075 (2009:1,200,000,000) shares	**142,577**	120,000
Issued during the year - 71,288,750 (2009: 225,775,075) shares	**7,129**	22,577
	149,706	142,577

Pursuant to a shareholders' resolution, during the year the Bank issued one bonus share for every twenty shares held. This amounted to 5% of the paid up capital resulting in an utilization of BD 7,129,000 from the retained earnings to this effect. During 2009, pursuant to a shareholders' resolution, the Bank raised its authorised capital from BD 120 million to BD 200 million and issued 225,775,075 ordinary shares of the Bank to those shareholders of BSB who accepted the offer (note 3). At the offer closing date, the market price of the Bank's shares was BD 0.112 each. This resulted in proceeds of BD 25,287,000 from the new issue, including a share premium of BD 0.012 per share aggregating to BD 2,709,000.

15.2 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.

15 EQUITY (continued)

15.3 INVESTMENT RESERVE

During the year the net unrealized gain of BD 6,794,000 (2009: BD 5,772,000) was transferred from retained earnings to investment reserve. The reserve represents unrealised gains and losses from revaluation of investments and investment properties carried at fair value though 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.

16 FEES AND COMMISSIONS

	2010 BD '000	*2009 BD '000*
Financing and transaction related fees and commissions	**1,269**	284
Fiduciary and other fees	**876**	272
	2,145	556

17 RELATED PARTY TRANSACTIONS

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

The significant balances with related parties at 31 December 2010 were as follows:

	2010			
	Associates and joint ventures BD '000	***Directors and related entities BD '000***	***Senior management BD '000***	***Total BD '000***
Assets:				
Murabaha and Mudaraba financing	**21,653**	**54**	**37**	**21,744**
Ijarah Muntahia Bittamleek	**15,068**	**3,114**	**175**	**18,357**
Musharaka financing	**7,830**	**-**	**89**	**7,919**
Assets under conversion	**-**	**-**	**21**	**21**
Receivables and prepayments	**3,260**	**8**	**6**	**3,274**
Liabilities and URIA:				
Wakala from non-banks	**3,451**	**1,297**	**125**	**4,873**
Customers' current accounts	**7,428**	**161**	**333**	**7,922**
Unrestricted investment accounts	**35**	**91**	**1,292**	**1,418**
Commitments	**4,310**	**-**	**-**	**4,310**
Contingent liabilities	**1,549**	**63**	**-**	**1,612**

17 RELATED PARTY TRANSACTIONS (continued)

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

	2010			
	Associates and joint ventures ***BD '000***	***Directors and related entities*** ***BD '000***	***Senior management*** ***BD '000***	***Total*** ***BD '000***
Income:				
Income from Islamic financing contracts	**2,945**	**150**	**17**	**3,112**
Expenses:				
Profit paid on Wakala from non-banks	**118**	**54**	**43**	**215**
Share of profits on unrestricted investment accounts	**3**	**1**	**1**	**5**

	2009			
	Associates and joint ventures *BD '000*	*Directors and related entities* *BD '000*	*Senior management* *BD '000*	*Total* *BD '000*
Assets:				
Murabaha and Mudaraba financing	9,540	28	67	9,635
Ijarah Muntahia Bittamleek	14,098	3,596	178	17,872
Musharaka financing	5,234	-	99	5,333
Assets under conversion	-	-	27	27
Receivables and prepayments	2,734	9	15	2,758
Liabilities and URIA:				
Wakala from non-banks	15,593	511	312	16,416
Customers' current accounts	7,012	257	35	7,304
Liabilities under conversion	-	-	1,017	1,017
Unrestricted investment accounts	116	65	62	243
Commitments	4,624	-	-	4,624
Contingent liabilities	11,402	56	-	11,458

17 RELATED PARTY TRANSACTIONS (continued)

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

	2009			
	Associates and joint ventures BD '000	*Directors and related entities BD '000*	*Senior management BD '000*	*Total BD '000*
Income:				
Income from other Islamic financing contracts	2,242	93	10	2,345
Expenses:				
Profit paid on Wakala from non-banks	281	34	14	329
Share of profits on unrestricted investment accounts	-	1	1	2

As of 31 December 2010, Murabaha and Mudaraba financing and Ijarah Muntahia Bittamleek included BD3,114,000 (2009: BD3,596,000) of facilities provided to directors and their associates which are past due and on which profit is not being recognised.

Directors are compensated in the form of fees for attending board and committee meetings. Directors' remuneration for the year ended 31 December 2010 amounted to nil (31 December 2009: BD 250,000).

Compensation of key management personnel, consisting solely of short-term benefits, for the year was BD1,695,000 (2009: BD2,182,000).

18 CONTINGENT LIABILITIES AND COMMITMENTS

The Group has the following commitments:

	2010 BD '000	*2009 BD '000*
Contingent liabilities on behalf of customers		
Guarantees	**6,773**	19,077
Letters of credit	**1,645**	1,675
Acceptances	**432**	409
	8,850	21,161
Irrevocable Unutilised commitments		
Unutilised financing commitments	**27,970**	13,473
Unutilised non-funded commitments	**7,583**	7,424
Unutilised capital commitments	**1,502**	5,681
	37,055	26,578
	45,905	47,739

18 CONTINGENT LIABILITIES AND COMMITMENTS (continued)

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

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

Operating lease commitment - Group as lessee

The Group has entered into a five-year operating lease for its premises. Future minimal rentals payable under the non-cancellable lease are as follows:

	2010 BD '000	*2009 BD '000*
Within 1 year	**429**	665
After one year but not more than five years	**85**	86
	514	751

19 RISK MANAGEMENT

19.1 Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to early settlement risk and operational risks.

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

19 RISK MANAGEMENT (continued)

19.1 Introduction *(continued)*

Executive Committee

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

Shari'a Supervisory Board

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

Credit/ Risk Committee

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

Asset and Liability Committee

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

Board Audit Committee

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

Internal Audit

Risk management processes throughout the Group are audited by the internal audit function, that examines both the adequacy of the procedures and the Group'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 Group'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 Group also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

19 RISK MANAGEMENT *(continued)*

19.1 Introduction *(continued)*

Risk measurement and reporting systems (continued)

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

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

For all levels throughout the Group, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information. A daily briefing is given to the Chief Financial Officer and all other relevant members of the Group 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 Group's performance to developments affecting a particular industry or geographical location.

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

19 RISK MANAGEMENT (continued)

19.2 Credit risk

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

In addition to monitoring credit limits, the Group 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 consolidated statement of financial position. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Gross maximum exposure 2010 BD '000	*Gross maximum exposure 2009 BD '000*
ASSETS		
Balances with other banks	**2,879**	4,756
Murabaha receivables from banks	**137,299**	149,304
Corporate sukuk	**61,724**	16,950
Murabaha and Mudaraba financing	**100,642**	58,352
Ijarah Muntahia Bittamleek	**65,777**	42,342
Musharaka financing	**8,127**	5,384
Assets under conversion	**48,629**	77,972
Receivables	**9,399**	26,012
Total	**434,476**	381,072
Contingent liabilities and commitments	**33,652**	48,490
Total credit risk exposure	**468,128**	429,562

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.

19 RISK MANAGEMENT (continued)

19.2 Credit risk (continued)

Type of credit risk

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

Murabaha financing

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

Ijarah Muntahia Bittamleek

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

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

	31 December 2010				
	Neither past due nor impaired			***Past due or individually impaired***	
	'A' Rated BD '000	***'B' Rated BD '000***	***Unrated BD '000***	***BD '000***	***Total BD '000***
Balances with banks	**2,604**	**36**	**239**	**-**	**2,879**
Murabaha receivables from banks	**84,853**	**15,084**	**37,362**	**-**	**137,299**
	87,457	**15,120**	**37,601**	**-**	**140,178**

	31 December 2009				
	Neither past due nor impaired			*Past due or individually impaired*	
	'A' Rated BD '000	*'B' Rated BD '000*	*Unrated BD '000*	*BD '000*	*Total BD '000*
Balances with banks	4,403	106	247	-	4,756
Murabaha receivables from banks	93,228	11,466	44,610	-	149,304
	97,631	11,572	44,857	-	154,060

19 RISK MANAGEMENT (continued)

19.2 Credit risk (continued)

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

b) The credit quality of Corporate sukuk, Murabaha and Mudaraba financing, Ijarah Muntahia Bittamleek, Musharaka financing, Assets under conversion and financing that are subject to credit risk, based on internal credit ratings, is as follows:

	31 December 2010					
	Neither past due nor impaired					
	Satisfactory BD '000	***Watch List BD '000***	***Substandard but not impaired BD '000***	***Past due but not impaired BD '000***	***Impaired BD '000***	***Total BD '000***
Corporate sukuk	**61,724**	**-**	**-**	**-**	**-**	**61,724**
Murabaha and Mudaraba financing	**86,476**	**1,958**	**-**	**9,260**	**2,948**	**100,642**
Ijarah Muntahia Bittamleek	**53,408**	**-**	**195**	**12,174**	**-**	**65,777**
Musharaka financing	**8,127**	**-**	**-**	**-**	**-**	**8,127**
Assets under conversion	**48,629**	**-**	**-**	**-**	**-**	**48,629**
Receivables	**11,276**	**41**	**-**	**-**	**-**	**11,317**
	269,640	**1,999**	**195**	**21,434**	**2,948**	**296,216**

	31 December 2009					
	Neither past due nor impaired					
	Satisfactory BD '000	Watch List BD '000	Substandard but not impaired BD '000	Past due but not impaired BD '000	Impaired BD '000	Total BD '000
Corporate sukuk	16,950	-	-	-	-	16,950
Murabaha and Mudaraba financing	37,512	7,539	-	13,301	-	58,352
Ijarah Muntahia Bittamleek	31,647	-	3,960	6,735	-	42,342
Musharaka financing	5,384	-	-	-	-	5,384
Assets under conversion	77,972	-	-	-	-	77,972
Receivables	26,012	-	-	-	-	26,012
	195,477	7,539	3,960	20,036	-	227,012

19 RISK MANAGEMENT (continued)

19.2 Credit risk (continued)

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

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

	31 December 2010			
	0-30 days BD '000	**31-90 days BD '000**	**> 90 days BD '000**	**Total BD '000**
Murabaha and Mudaraba financing	**-**	**7,726**	**1,534**	**9,260**
Ijarah Muntahia Bittamleek	**-**	**61**	**12,113**	**12,174**
	-	**7,787**	**13,647**	**21,434**

	31 December 2009			
	0-30 days BD '000	31-90 days BD '000	> 90 days BD '000	Total BD '000
Murabaha and Mudaraba financing	1,741	4,610	6,951	13,302
Ijarah Muntahia Bittamleek	1,724	692	4,318	6,734
	3,465	5,302	11,269	20,036

All the past due but not impaired Murabaha and Mudaraba financing and Ijarah financing are covered by collateral of BD 29,933,000 (2009: BD 42,035,000). A provision of BD 1,508,000 has been taken against the past due but not impaired 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 statement of financial position plus commitments to customers disclosed in Note 18 except capital commitments.

During the year BD 22,148,000 (2009: BD 9,520,000) of financing facilities to individuals were renegotiated. All renegotiated facilities are performing and are fully secured.

At 31 December 2010, the amount of credit exposure in excess of 15% of the Group's regulatory capital to individual counterparties was nil (2009: nil).

19 RISK MANAGEMENT (continued)

19.3 Legal risk and claims

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

As at 31 December 2010, legal suits amounting to BD 1,686,000 (2009: BD 1,681,000) were pending against the Group. Based on the opinion of the Group's legal counsel, the total estimated liability arising from these cases is not considered to be material to the Group's consolidated financial position as the Group also has filed counter cases against these parties.

20 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 Group's performance to developments affecting a particular industry or geographic location. The Group 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:

	Assets	***Liabilities, unrestricted investment accounts and equity***	***Contingent liabilities and Commitments***	*Assets*	*Liabilities, unrestricted investment accounts and equity*	*Commitments*
	2010	***2010***	***2010***	*2009*	*2009*	*2009*
	BD '000	***BD '000***	***BD '000***	*BD '000*	*BD '000*	*BD '000*
Geographic region						
GCC	**778,449**	**644,613**	**43,494**	718,881	560,809	32,550
Arab World	**7,584**	**3,855**	**64**	9,566	2,791	-
Europe	**12,088**	**3,265**	**-**	23,087	11,642	48
Asia	**49,907**	**2,737**	**2,861**	27,106	8,734	12,347
America	**6,990**	**268**	**-**	2,274	180	-
Others	**2,345**	**-**	**-**	5,020	-	3,545
	857,363	**654,738**	**46,419**	785,934	584,156	48,490
Equity	**-**	**202,625**	**-**	-	201,778	-
	857,363	**857,363**	**46,419**	785,934	785,934	48,490
Industry sector						
Trading and manufacturing	**12,158**	**22,726**	**5,436**	10,419	15,798	16,627
Banks and financial institutions	**208,260**	**142,136**	**211**	257,170	143,697	344
Real estate	**221,884**	**102,717**	**11,732**	188,082	60,406	23,332
Aviation	**12,872**	**29**	**-**	10,373	9	-
Individuals	**49,611**	**232,667**	**2,499**	45,769	206,898	1,726
Government and public sector	**228,176**	**86,357**	**24,071**	127,925	87,211	-
Others	**124,402**	**68,106**	**2,470**	146,196	70,137	6,461
	857,363	**654,738**	**46,419**	785,934	584,156	48,490
Equity	**-**	**202,625**	**-**	-	201,778	-
	857,363	**857,363**	**46,419**	785,934	785,934	48,490

21 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 Group'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 Group.

21.1 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 Group'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:

	2010			
	10% increase		**10% decrease**	
	Effect on net profit BD '000	**Effect on Comprehensive income BD '000**	**Effect on net profit BD '000**	**Effect on Comprehensive income BD '000**
Quoted:				
GCC	**321**	**667**	**(321)**	**(667)**
Asia	**-**	**805**	**-**	**(805)**
Unquoted	**19,612**	**173**	**(19,612)**	**(173)**

	2009			
	10% increase		*10% decrease*	
	Effect on net profit BD '000	*Effect on Comprehensive income BD '000*	*Effect on net profit BD '000*	*Effect on Comprehensive income BD '000*
Quoted:				
GCC	434	173	(434)	(173)
Unquoted	18,034	1,515	(18,034)	(1,515)

Assets under conversion (Note 9) include quoted equities of BD 1,632,000 (2009: BD 1,727,000) and unquoted equities of BD 1,733,000 (2009: BD 15,146,000). In determining the effect of price volatility on above, equity positions included in assets under conversion have been considered.

21 MARKET RISK (continued)

21.2 PROFIT RETURN RISK

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

The Group 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:

	2010			
	Change in rate %	***Effect on net profit BD '000***	***Change in rate %***	***Effect on net profit BD '000***
US dollars	**0.25**	**246**	**(0.25)**	**(246)**
Bahraini dinars	**0.25**	**483**	**(0.25)**	**(483)**
Sterling pounds	**0.25**	**25**	**(0.25)**	**(25)**

	2009			
	Change in rate %	*Effect on net profit BD*	*Change in rate %*	*Effect on net profit BD*
US dollars	0.25	180	(0.25)	(180)
Bahraini dinars	0.25	344	(0.25)	(344)

In addition to profit rate bearing financing contracts considered in arriving at the effect on net profits, the assets under conversion includes BD52,150,000 (2009: BD81,088,000) financial assets and BD5,171,000 (2009: BD120,001,000) of financial liabilities which are interest bearing. The Group is in the process of converting these into Shari'a compliant contracts. If all the interest bearing assets and liabilities were converted into Shari'a complaint contracts on 1 January 2011, the change in profit rate by 0.25% would result in a profit or loss of BD117,000.

21 MARKET RISK (continued)

21.3 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 Group's Asset Liability Committee to ensure positions are maintained within established limits.

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

	2010 ***BD '000***	*2009* *BD '000*
US dollars	**24,268**	10,402
Saudi riyals	**48,003**	55,802
Singapore dollars	**8,123**	28

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

	2010			
	Change in rate %	***Effect on net profit BD '000***	***Change in rate %***	***Effect on net profit BD '000***
US dollars to Bahraini dinars	**1**	**243**	**(1)**	**(243)**
Saudi riyals to Bahraini dinars	**1**	**480**	**(1)**	**(480)**
Singapore dollars to Bahraini dinars	**1**	**81**	**(1)**	**(81)**

	2009			
	Change in rate %	*Effect on net profit BD*	*Change in rate %*	*Effect on net profit BD*
US dollars to Bahraini dinars	1	104	(1)	(104)
Saudi riyals to Bahraini dinars	1	558	(1)	(558)
Singapore dollars to Bahraini dinars	1	-	(1)	-

22 LIQUIDITY RISK

Liquidity risk is the risk that the Group 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 Group's Asset Liability Committee.

The table below summarises the expected maturity profile of the Group's assets and liabilities as at 31 December 2010 and 2009:

	31 December 2010				
	Up to 3 months BD '000	*3 months to 1 year BD '000*	*1 to 5 years BD '000*	*Over 5 years BD '000*	*Total BD '000*
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	**76,824**	**-**	**18,967**	**-**	**95,791**
Central Bank of Bahrain Sukuk	**20,230**	**14,510**	**33,892**	**-**	**68,632**
Murabaha receivables from banks	**137,299**	**-**	**-**	**-**	**137,299**
Corporate Sukuk	**-**	**-**	**61,724**	**-**	**61,724**
Murabaha and Mudaraba financing	**25,016**	**35,513**	**50,901**	**9,382**	**120,812**
Ijarah Muntahia Bittamleek	**8,330**	**10,530**	**36,409**	**14,556**	**69,825**
Musharaka financing	**5,853**	**2,044**	**190**	**40**	**8,127**
Assets under conversion	**14,047**	**43,385**	**-**	**-**	**57,432**
Non-trading investments	**-**	**13,097**	**199,335**	**-**	**212,432**
Investment in an associate	**-**	**-**	**7,578**	**-**	**7,578**
Investment properties	**-**	**-**	**-**	**3,373**	**3,373**
Receivables and prepayments	**11,394**	**1,085**	**-**	**-**	**12,479**
Premises and equipment	**-**	**-**	**1,859**	**-**	**1,859**
	298,993	**120,164**	**410,855**	**27,351**	**857,363**
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS					
Murabaha and Wakala payables to banks	**-**	**-**	**101,300**	**-**	**101,300**
Wakala from non-banks	**-**	**296,807**	**159,640**	**-**	**456,447**
Customers' current accounts	**57,362**	**-**	**-**	**-**	**57,362**
Liabilities under conversion	**5,171**	**-**	**-**	**-**	**5,171**
Other liabilities	**13,411**	**1,838**	**744**	**-**	**15,993**
Unrestricted investment accounts	**-**	**-**	**18,465**	**-**	**18,465**
	75,944	**298,645**	**280,149**	**-**	**654,738**

22 LIQUIDITY RISK (continued)

	31 December 2009				
	Up to 3 months BD '000	3 months to 1 year BD '000	1 to 5 years BD '000	Over 5 years BD '000	Total BD '000
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	109,372	-	17,367	-	126,739
Central Bank of Bahrain Sukuk	-	32,908	-	-	32,908
Murabaha receivables from banks	149,304	-	-	-	149,304
Corporate Sukuk	-	-	16,950	-	16,950
Murabaha and Mudaraba financing	20,097	14,665	52,512	-	87,274
Ijarah Muntahia Bittamleek	7,063	10,121	22,179	6,952	46,315
Musharaka financing	5	16	5,363	-	5,384
Assets under conversion	30,901	17,156	50,248	-	98,305
Non-trading investments	-	-	184,680	-	184,680
Investment in an associate	-	-	7,659	-	7,659
Investment properties	-	-	-	1,177	1,177
Receivables and prepayments	25,233	1,130	539	-	26,902
Premises and equipment	-	-	2,337	-	2,337
	341,975	75,996	359,834	8,129	785,934
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS					
Murabaha and Wakala payables to banks	-	-	89,398	-	89,398
Wakala from non-banks	-	47,882	269,488	-	317,370
Customers' current accounts	32,700	-	-	-	32,700
Liabilities under conversion	87,810	14,120	18,472	-	120,402
Other liabilities	13,512	1,097	268	-	14,877
Unrestricted investment accounts	-	-	9,409	-	9,409
	134,022	63,099	387,035	-	584,156

22 LIQUIDITY RISK (continued)

The table below summarizes the maturity profile of the Group's financial liabilities at 31 December, 2010 and 2009 based on contractual undiscounted payment obligation:

	31 December 2010					
	On demand BD '000	Up to 3 months BD '000	3 months to 1 year BD '000	1 to 5 years BD '000	Over 5 years BD '000	Total BD '000
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS COMMITMENTS AND CONTINGENT LIABILITIES						
Murabaha and Wakala payables to banks	-	**100,810**	**490**	-	-	**101,300**
Wakala from non-banks	-	**296,807**	**140,251**	**19,389**	-	**456,447**
Customers' current accounts	**57,362**	-	-	-	-	**57,362**
Liabilities under conversion	-	**5,171**	-	-	-	**5,171**
Unrestricted investment accounts	-	**18,465**	-	-	-	**18,465**
Unutilised financing commitments	**12,560**	**2,513**	**1,641**	**5,749**	**13,090**	**35,553**
Unutilised capital commitments	-	-	-	**1,502**	-	**1,502**
Contingent liabilities	**1,191**	**2,277**	**4,888**	**494**	-	**8,850**
Other financial liabilities	-	**11,583**	**1,114**	-	-	**12,697**
Profit due on financing contracts	-	**1,743**	**3,442**	**2,288**	-	**7,473**
	71,113	**439,369**	**151,826**	**29,422**	**13,090**	**704,820**

	31 December 2009					
	On demand BD '000	Up to 3 months BD '000	3 months to 1 year BD '000	1 to 5 years BD '000	Over 5 years BD '000	Total BD '000
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS COMMITMENTS AND CONTINGENT LIABILITIES						
Murabaha and Wakala payables to banks	-	89,398	-	-	-	89,398
Wakala from non-banks	-	250,850	47,882	18,638	-	317,370
Customers' current accounts	32,700	-	-	-	-	32,700
Liabilities under conversion	-	87,810	14,120	18,472	-	120,402
Unrestricted investment accounts	-	9,409	-	-	-	9,409
Unutilised financing commitments	13,749	-	3,052	4,097	-	20,898
Unutilised capital commitments	-	-	3,545	2,136	-	5,681
Contingent liabilities	19,119	538	1,504	-	-	21,161
Other financial liabilities	-	9,592	436	599	-	10,627
Profit due on financing contracts	-	986	2,168	2,882	-	6,036
	65,568	448,583	72,707	46,824	-	633,682

23 SEGMENT INFORMATION

Primary segment information

For management purposes, the Group 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 Group 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 2010 was as follows:

	31 December 2010				
	Banking BD '000	***Treasury BD '000***	***Investments BD '000***	***Capital BD '000***	***Total BD '000***
Operating income	**11,854**	**2,890**	**5,108**	**2,527**	**22,379**
Segment result	**3,855**	**1,866**	**2,070**	**(475)**	**7,316**
Other information					
Segment assets	**195,713**	**325,087**	**249,994**	**86,569**	**857,363**
Segment liabilities, and equity	**517,737**	**120,985**	**8,318**	**210,323**	**857,363**

	31 December 2009				
	Banking BD '000	*Treasury BD '000*	*Investments BD '000*	*Capital BD '000*	*Total BD '000*
Operating income	7,887	2,500	5,583	7,709	23,679
Segment result	4,101	1,493	2,709	5,659	13,962
Other information					
Segment assets	208,248	336,171	171,962	69,553	785,934
Segment liabilities, and equity	471,409	103,403	984	210,138	785,934

23 SEGMENT INFORMATION (continued)

Secondary segment information

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

24 FIDUCIARY ASSETS

Funds under management at the year-end amounted to BD 48,137,000 (2009: BD 60,706,000). These assets are held in a fiduciary capacity and are not included in the consolidated statement of financial position.

25 SHARI'A SUPERVISORY BOARD

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

26 FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Group's financial instruments are not significantly different from their carrying values as at 31 December 2010 and 2009.

27 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

During the year, the Bank received income totaling BD 8,000 (2009: BD 56,000) from conventional financial institutions on current account balances during the year. These funds were held as payable to charity as they are in the nature of Shari'a prohibited income.

28 SOCIAL RESPONSIBILITY

The Group discharges its social responsibility through charity fund expenditures and donations to the good faith qard fund which is used for charitable purposes. During the year the Group paid an amount of BD213,000 (2009: BD915,000) on account of charitable donations.

29 ZAKAH

Pursuant to a resolution of the shareholders in an EGM held on 12 November 2009, it was resolved to amend the articles of association of the Bank to inform the shareholders of their obligation to pay Zakah on income and net worth. Consequently, Zakah is not recognized in the consolidated income statement as an expense. The total Zakah payable by the shareholders for 2010 has been determined by the Shari'a supervisory board as 3.5 fils (2009: 3.8 fils) per share.

Pursuant to the Shari'a Supervisory Board's directive, the prohibited income earned from the subsidiary's operations should be purified by the Group from the date of conversion. Since the Subsidiary's operations are not fully compliant with Shari'a Rules and Principles, the prohibited income has been calculated and disclosed (Note 9). The Shareholders should purify the amount of prohibited income attributable to each share by donating the relevant amounts of such prohibited income to charity. The prohibited income to be donated by each shareholder for 2010 has been determined by the Shari'a Supervisory Board as 2.06 fils per share.

30 CAPITAL ADEQUACY

The adequacy of the Group's capital is monitored using, primarily, the rules and ratios established by the Basel Committee on Grouping Supervision and adopted by the Central Bank of Bahrain. The primary objective of the Group's capital management is to ensure that it complies with externally imposed capital requirements. The Group complied in full with all externally imposed capital requirements during the years ended 31 December 2010 and 31 December 2009.

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

	2010 ***BD '000***	*2009* *BD '000*
Capital base (Tier 1)	**172,773**	179,564
Credit risk weighted exposures	**631,566**	555,389
Market risk weighted exposures	**9,700**	2,950
Operational risk weighted exposures	**58,372**	68,803
Total risk weighted exposure	**699,638**	627,142
Capital adequacy	**24.7%**	28.6%
Minimum requirement	**12.0%**	12.0%

"Each leaf is a holistic functional unit influencing and manufacturing the plant's nutrition independently. The plant's survival relies on the right balance of these functioning leaves who come together as a whole to help it survive."