

# Independent Auditors' Report

to the Shareholders of Kuwait Finance House (Bahrain) B.S.C. (c)

We have audited the accompanying consolidated financial statements of Kuwait Finance House (Bahrain) B.S.C. (c) (the "Bank") and its subsidiaries (together the "Group") which comprise the consolidated balance sheet as at 31 December 2008 and the consolidated statement of income, the consolidated statement of cash flows, the consolidated statement of changes in equity and the consolidated statement of restricted investment accounts for the year then ended and a summary of significant accounting policies and other explanatory notes.

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

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

## Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also

includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the consolidated financial statements.

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

## Opinion

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

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

## Other Regulatory Matters

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the 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 2008 which might have had a material adverse effect on the business of the Bank or on its consolidated financial position, and that the Bank has complied with the terms of its banking licence.



3 February 2009  
Manama, Kingdom of Bahrain

# Consolidated Balance Sheet

At 31 December 2008

	Notes	2008 BD 000s	2007 BD 000s
<b>ASSETS</b>			
Cash and balances with banks and Central Bank of Bahrain	7	69,791	23,640
Murabaha due from banks	8	64,421	80,685
Financing contracts with customers	9	578,482	276,061
Investments	10	204,643	141,872
Investment in associates	11	71,180	41,356
Investment properties	12	124,984	105,097
Receivables, prepayments and other assets	13	97,776	40,658
Goodwill and intangibles	14	10,599	6,927
Premises and equipment		31,409	18,995
		<b>1,253,285</b>	735,291
Assets of disposal group classified as held for sale	15	31,390	-
<b>TOTAL ASSETS</b>		<b>1,284,675</b>	735,291
<b>LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY</b>			
<b>LIABILITIES</b>			
Murabaha and due to banks		301,452	77,329
Murabaha contracts with non-banks		224,880	287,269
Customers' current accounts		53,236	107,150
Other liabilities	17	26,268	46,191
		<b>605,836</b>	517,939
Liabilities directly associated with disposal group classified as held for sale	15	19,532	-
Total liabilities excluding unrestricted investment accounts		<b>625,368</b>	517,939
Unrestricted investment accounts		310,474	53,091
<b>Total liabilities including unrestricted investment accounts</b>		<b>935,842</b>	571,030
<b>EQUITY ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT</b>			
Share capital	19	161,036	70,016
Share premium	19	71,403	15,040
Statutory reserve	20	11,807	8,238
General reserve	19	27,596	20,173
Investment revaluation reserve		32,995	22,390
Foreign currency translation reserve		(1,383)	-
Retained earnings		16,743	17,925
		<b>320,197</b>	153,782
<b>MINORITY INTEREST</b>		26,997	10,479
<b>MINORITY INTEREST IN DISPOSAL GROUP CLASSIFIED AS HELD FOR SALE</b>	15	1,639	-
		<b>348,833</b>	164,261
<b>TOTAL LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY</b>		<b>1,284,675</b>	735,291
<b>RESTRICTED INVESTMENT ACCOUNTS</b>		<b>93,269</b>	66,066
<b>COMMITMENTS AND CONTINGENT ITEMS</b>	21	<b>198,017</b>	59,372

Bader Abdul Muhsen Al-Mukhaizeem  
Chairman

Mohammed AlShaikh Ishaq  
Vice Chairman

Abdulhakeem Yaqoub Alkhayyat  
Managing Director and Chief Executive Officer

The attached notes 1 to 37 form part of these consolidated financial statements.

# Consolidated Statement of Income

For the year ended 31 December 2008

	Notes	2008 BD 000s	2007 BD 000s
Income from retail and corporate banking activities	22	38,664	26,304
Income from investment activities	23	30,428	29,467
Share of income of associates	11	21,034	14,173
Other income		8,386	2,049
		<b>98,512</b>	71,993
Less: Profit on Murabaha due to banks and non-banks		14,870	14,639
		<b>83,642</b>	57,354
Staff costs	25	10,848	8,106
Depreciation		3,519	1,871
Provisions	26	8,453	3,233
Other operating expenses	27	12,523	9,812
		<b>35,343</b>	23,022
<b>NET INCOME BEFORE PROFIT ON UNRESTRICTED INVESTMENT ACCOUNTS</b>		<b>48,299</b>	34,332
Less: Profit on unrestricted investment accounts		9,865	1,662
<b>NET INCOME FOR THE YEAR</b>		<b>38,434</b>	32,670
<b>Attributable to:</b>			
Shareholders of the Parent		35,686	31,399
Minority interest		2,748	1,271
		<b>38,434</b>	32,670

The attached notes 1 to 37 form part of these consolidated financial statements.

# Consolidated Statement of Cash Flows

For the year ended 31 December 2008

	Notes	2008 BD 000s	2007 BD 000s
<b>OPERATING ACTIVITIES</b>			
Net income for the year		38,434	32,670
Adjustments for:			
Provisions		8,453	3,233
Depreciation		3,519	1,871
Amortisation	14	58	31
(Gain) / loss on sale of investment properties	23	(2,026)	(2,736)
(Gain) / loss on sale of investments	23	302	(1,305)
Share of income of associates	11	(21,034)	(14,173)
Unrealised gain on investments	23	(9,783)	(7,147)
Unrealised gain on investment properties	23	(9,220)	(9,625)
Operating income before changes in operating assets and liabilities		8,703	2,819
Changes in operating assets and liabilities:			
Mandatory reserve with Central Bank of Bahrain		(19,909)	(6,100)
Murabaha due from banks		-	4,408
Financing contracts with customers		(305,942)	(124,089)
Receivables, prepayments and other assets		(28,760)	(24,022)
Murabahas and due to banks		224,123	(26,135)
Murabaha due to non-banks		(65,002)	169,686
Customers' current accounts		(53,914)	61,455
Other liabilities		984	7,661
Net cash flows (used in) from operating activities		(239,717)	65,683
<b>INVESTING ACTIVITIES</b>			
Acquisition of a subsidiary - net of cash and bank balances acquired	6	(8,758)	(2,236)
Additional investment in acquired subsidiary		-	(8,892)
Purchase of investments		(74,904)	(35,873)
Purchase of investments in associates	11	(13,999)	(16,315)
Purchase of subsidiary classified as held for sale		(11,602)	-
Payments for purchase of investment properties		(42,206)	(21,730)
Proceeds from sale of investments		5,607	-
Proceeds from sale of investment properties		8,315	4,037
Purchase of intangibles	14	(4,859)	(1,583)
Purchase of premises and equipment		(15,933)	(7,534)
Net cash used in investing activities		(158,339)	(90,126)
<b>FINANCING ACTIVITIES</b>			
Proceeds from issue of shares		136,881	35,280
Cash contributed by minorities in new subsidiaries		13,770	-
Increase in unrestricted investment accounts		257,383	8,716
Net movement in minority interests		-	(4,653)
Net cash flows from financing activities		408,034	39,343
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>			
Cash and cash equivalents at 1 January		92,510	77,610
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>	28	<b>102,488</b>	<b>92,510</b>

The attached notes 1 to 37 form part of these consolidated financial statements.

# Consolidated Statement of Changes in Equity

For the year ended 31 December 2008

	Attributable to the shareholders of the parent										Minority interest in investment held for sale	Total equity
	Notes	Share capital BD 000s	Share premium BD 000s	Statutory reserve BD 000s	General reserve BD 000s	Investment revaluation reserve BD 000s	Foreign currency translation reserve BD 000s	Retained earnings BD 000s	Total BD 000s	Minority interest BD 000s		
Balance at 01 January 2007		44,560	760	5,098	13,800	12,058	-	10,827	87,103	2,431	-	89,534
Income for the year		-	-	-	-	-	-	31,399	31,399	1,271	-	32,670
Transfer to investment revaluation reserve		-	-	-	-	11,717	-	(11,717)	-	-	-	-
Transfer to retained earnings on sale of investments		-	-	-	-	(1,385)	-	1,385	-	-	-	-
Net movement in minority interest		-	-	-	-	-	-	-	-	6,777	-	6,777
Transfer to general reserve		-	-	-	10,829	-	-	(10,829)	-	-	-	-
Bonus shares issued		4,456	-	-	(4,456)	-	-	-	-	-	-	-
Issue of new shares		21,000	14,280	-	-	-	-	-	35,280	-	-	35,280
Transfer to statutory reserve		-	-	3,140	-	-	-	(3,140)	-	-	-	-
<b>Balance at 31 December 2007</b>		<b>70,016</b>	<b>15,040</b>	<b>8,238</b>	<b>20,173</b>	<b>22,390</b>	<b>-</b>	<b>17,925</b>	<b>153,782</b>	<b>10,479</b>	<b>-</b>	<b>164,261</b>
Balance at 01 January 2008		70,016	15,040	8,238	20,173	22,390	-	17,925	153,782	10,479	-	164,261
Foreign currency translation		-	-	-	-	-	(1,383)	-	(1,383)	-	(618)	(2,001)
Fair value change on available for sale investments *		-	-	-	-	(4,769)	-	-	(4,769)	-	-	(4,769)
Net expense directly recognized in equity		-	-	-	-	(4,769)	(1,383)	-	(6,152)	-	(618)	(6,770)
Income for the year		-	-	-	-	-	-	35,686	35,686	2,748	-	38,434
Total recognized income and expense for the year		-	-	-	-	(4,769)	(1,383)	35,686	29,534	2,748	(618)	31,664
Transfer to investment revaluation reserve		-	-	-	-	17,119	-	(17,119)	-	-	-	-
Transfer to retained earnings on sale of investments		-	-	-	-	(1,745)	-	1,745	-	-	-	-
Increase in minority interest due to new subsidiaries		-	-	-	-	-	-	-	-	13,770	2,257	16,027
Transfer to general reserve	19	-	-	-	17,925	-	-	(17,925)	-	-	-	-
Bonus shares issued	19	10,502	-	-	(10,502)	-	-	-	-	-	-	-
Issue of new shares	19	80,518	56,363	-	-	-	-	-	136,881	-	-	136,881
Transfer to statutory reserve	20	-	-	3,569	-	-	-	(3,569)	-	-	-	-
<b>Balance at 31 December 2008</b>		<b>161,036</b>	<b>71,403</b>	<b>11,807</b>	<b>27,596</b>	<b>32,995</b>	<b>(1,383)</b>	<b>16,743</b>	<b>320,197</b>	<b>26,997</b>	<b>1,639</b>	<b>348,833</b>

Note: Included in retained earnings is a non-distributable reserve amounting to BD 906 (2007: BD 349) thousand relating to subsidiaries of the Bank.  
\* This includes share of fair value change on available for sale investments held by an associate amounting to BD 3,177 thousand (Note 11).

The attached notes 1 to 37 form part of these consolidated financial statements.

# Consolidated Statement of Restricted Investment Accounts

For the year ended 31 December 2008

	Balance at 1 January 2007 BD 000s	Deposits BD 000s	Gross Income BD 000s	Mudarib Share BD 000s	Withdrawals / distributions BD 000s	Balance at 31 December 2007 BD 000s
Murabaha receivables	5,363	59,800	1,766	(380)	(8,680)	57,869
Istisna'a	13,746	-	973	(237)	(6,285)	8,197
	<b>19,109</b>	<b>59,800</b>	<b>2,739</b>	<b>(617)</b>	<b>(14,965)</b>	<b>66,066</b>

  

	Balance at 1 January 2008 BD 000s	Deposits BD 000s	Gross Income BD 000s	Mudarib Share BD 000s	Withdrawals / distributions BD 000s	Balance at 31 December 2008 BD 000s
Murabaha receivables	57,869	50,704	4,225	(837)	(25,294)	86,667
Istisna'a / Ijarah Muntahia Bittamleek contracts *	8,197	-	614	(150)	(2,059)	6,602
	<b>66,066</b>	<b>50,704</b>	<b>4,839</b>	<b>(987)</b>	<b>(27,353)</b>	<b>93,269</b>

\* Istisna'a reported in prior year has become Ijarah Muntahia Bittamleek due to completion of construction.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 1 CORPORATE INFORMATION

Kuwait Finance House (Bahrain) B.S.C. (c) [the "Bank"] is a closed joint stock company incorporated in the Kingdom of Bahrain on 22 January 2002 under the Bahrain Commercial Companies Law No. 21/2001 and is registered with the Ministry of Industry and Commerce under commercial registration (CR) number 48128. The Bank is regulated and supervised by the Central Bank of Bahrain (the "CBB") and has a retail Islamic banking licence. The Bank operates under Islamic principles and in accordance with all the relevant regulatory guidelines for Islamic banks issued by the CBB. The address of the Bank's registered office is Bahrain World Trade Centre, West Tower, Isa Al Kabeer Avenue, Manama, 316, Kingdom of Bahrain.

The Bank offers a full range of Islamic banking services and products. The activities of the Bank include accepting Shari'a money placements/deposits, managing Shari'a profit sharing investment accounts, offering Shari'a financing contracts, dealing in Shari'a compliant financial instruments as principal/agent, managing Shari'a compliant financial instruments and other activities permitted under the CBB's Regulated Banking Services as defined in the licensing framework.

The Bank is a subsidiary of Kuwait Finance House K.S.C. (the "Parent Company"), a public company incorporated in the State of Kuwait and listed at the Kuwait Stock Exchange. The Bank's Shari'a Supervisory Board is entrusted to ensure the Group's adherence to Shari'a rules and principles in its transactions and activities.

The Bank and its subsidiaries (together the "Group") operate in the Kingdom of Bahrain and Hashemite Kingdom of Jordan. The activities of the Bank's key subsidiaries are mentioned in note 4.

The consolidated financial statements were authorized for issue in accordance with a resolution of the Board of Directors passed on 3 February 2009.

## 2 BASIS OF PREPARATION

The consolidated financial statements have been prepared under the historical cost basis, except for investments and investment properties that have been measured at fair value. The consolidated financial statements are presented in Bahraini Dinars ('BD') which is the functional currency of the Bank. All the values are rounded to the nearest BD thousand.

### Statement of Compliance

The consolidated financial statements have been prepared in accordance with Financial Accounting Standards [FAS] issued by the Accounting and Auditing Organization for Islamic Financial Institutions [AAOIFI], International Financial Reporting Standards [IFRS] and are in conformity with the Bahrain Commercial Companies Law (BCCL) and the Central Bank of Bahrain and Financial Institutions Law (CBBFIL).

### Basis of consolidation

The consolidated financial statements comprise the financial statements of the Group as at and for the year ended 31 December each year. The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies.

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

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. Control is achieved where the Group 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 or disposed of during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate.

Minority interests represent the portion of profit or loss and net assets not held by the Group and are presented separately in the consolidated statement of income and within equity in the consolidated balance sheet, separately from the equity attributable to the shareholders of the parent.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 3 ACCOUNTING POLICIES

### 3.1 Significant accounting judgments and estimates

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

#### *Classification of investments*

On initial recognition, the Group decides whether the investment should be classified as held to maturity, held for trading, designated as fair value through statement of income or available for sale.

Investments are classified as "held to maturity" where the Group has intention and ability to hold these to maturity.

The Group classifies investments as "held for trading" if they are acquired primarily for the purpose of making a short-term profit.

Investments acquired with the intention of a long-term holding period, such as in private equity or real estate are classified as "fair value" through statement of income if the following conditions are met:

- they have readily available reliable measure of fair values; and
- such investment's performance is evaluated on a fair value basis in accordance with the Group's investment strategy and information is provided internally on that basis to the Group's Senior Management.

All other investments are classified as "available for sale".

#### *Fair value of financial instruments*

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction.

Fair value is determined for each investment individually in accordance with the valuation policies set out below:

- For investments that are traded in organised financial markets, fair value is determined by reference to the quoted market price prevailing on the consolidated balance sheet date.
- For private equity investments, fair value is determined using recent buy or sell transactions with third parties that are either completed or are in progress. Where no recent significant transactions have been completed or are in progress, fair value is determined by reference to valuation models, including net present value of estimated future cash flows, and based on earnings before financing cost, tax, depreciation and amortization ("EBITDA") multiples.
- For real estate investments, fair value is determined by revaluing the underlying real estate properties based on recent transactions of properties located in adjacent areas and present valuing them for the appropriate development risk.
- Investments in funds, unit trusts, or similar investment entities are carried at the latest net asset valuation provided by the fund manager.

#### *Impairment losses on financing contracts with customers*

The Group reviews its problem financing contracts at each reporting date to assess whether a provision for impairment should be recorded in the consolidated statement of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provision required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific provisions against individually significant financing contracts, the Group also makes a collective impairment provision against exposures which, although not specifically identified as requiring a specific provision, have a greater risk of default than when originally granted. This takes into consideration factors such as any deterioration in country risk, industry, and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 3 ACCOUNTING POLICIES (continued)

### *Impairment of 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. The determination of what is 'significant' or 'prolonged' requires judgment. The Group evaluates factors, such as the share price volatility for quoted entities and future cash flows and the discount factors for unquoted entities.

### **3.2. Change in accounting policy and disclosures**

The accounting policies adopted are consistent with those of the previous financial year. However, during the year, the Group has adopted amendments to the following IFRS and FAS. Adoption of these revised standards and interpretations has the following effect on the consolidated financial statements of the Group:

IAS 39 - Financial Instruments Recognition and Measurement	Resulted in reclassification of certain investments as mentioned in note 10.3.
IFRIC 11 - IFRS 2 - Group and Treasury Share Transaction	No impact
FAS 17 - Investments	No impact

### **3.3. Summary of Significant Accounting Policies**

The significant accounting policies adopted in the preparation of the consolidated financial statements are set out below:

#### **3.3.1. Foreign currency translation**

The consolidated financial statements are presented in Bahraini Dinars, which is Group's presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

##### *(i) Transactions and balances*

Transactions in foreign currencies are initially recorded in the functional currency rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the consolidated statement of income.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial recognition. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Exchange gains / losses on non-monetary items classified as "fair value through statement of income" are taken to the consolidated statement on income and for items classified as "available for sale" such differences are taken to equity. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations and translated at closing rate.

##### *(ii) Group companies*

As at the reporting date, the assets and liabilities of subsidiaries are translated into the Group's presentation currency (the Bahraini Dinars) at the rate of exchange ruling at the balance sheet date, and their statements of income are translated at the average exchange rate for the year. Exchange differences arising on translation are taken directly to a separate component of equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the consolidated statement of income in 'Other operating expenses' or 'Other income'.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 3 ACCOUNTING POLICIES (continued)

### 3.3.2 Financial instruments - Initial recognition and subsequent measurement

Financial instruments comprise financial assets and financial liabilities.

Financial assets consist of cash, balances with banks and Central Bank of Bahrain, murabahas due from banks and financing contracts with customers, investments and other receivables. Financial liabilities consist of murabahas and due to banks, murabaha contracts with non-banks, customers' current accounts, unrestricted investment accounts and other liabilities.

#### (i) Date of recognition

Purchases and sales of financial assets are recognized on the trade date, i.e. the date the Group commits to purchase or sale the asset.

#### (ii) Initial recognition of financial instruments

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments are acquired and their characteristics. All financial instruments are measured initially at their fair value plus, in the case of financial assets and financial liabilities not at fair value through statement of income, any directly attributable incremental costs of acquisition or issue.

#### (iii) Murabaha due from banks

Murabaha due from banks are stated net of deferred profits and provision for impairment, if any.

#### (iv) Financing contracts with customers

##### (a) Murabaha receivables

Murabaha receivables consist of deferred sales transaction agreements and are stated net of deferred profits, any amounts written-off and provision for impairment, if any.

##### (b) Musharaka contracts

Musharaka contracts are partnerships in which the Group contributes capital. These are stated at the fair value of consideration given, less any amounts written-off and provision for impairment, if any.

##### (c) Ijarah Muntahia Bittamleek

Ijarah Muntahia Bittamleek is a lease whereby the legal title of the leased asset passes to the lessee at the end of the Ijarah (lease term), provided that all Ijarah installments are settled.

Ijarah assets are recorded at cost. Depreciation is provided on all Ijarah assets at rates calculated to write off the cost of each asset over the period of the lease to its residual value.

#### (v) Investments

These are classified as follows:

- Carried at fair value through statement of income
- Available for sale

##### (a) Carried at fair value through statement of income

Investments carried at fair value through statement of income include investments held for trading and investments designated upon initial recognition as carried at fair value through statement of income.

Investments are classified as "carried at fair value through statement of income" if they are designated on the date of acquisition as carried at fair value through statement of income. The Group also has venture capital ("VC") investments that fall under IAS 28, Investment in Associates or IAS 31, Interests in Joint Ventures which are classified under IAS 39 as "investments carried at fair value through statement of income" by utilising the VC exemption in IAS 28 and IAS 31. The Group's investments other than VC that fall under IAS 28 and IAS 31 are classified as associates or joint ventures respectively. Financial assets carried at fair value through statement of income are recognised at fair value, with transaction costs being recognised in statement of income.

Investments classified as 'carried at fair value through statement of income' are subsequently remeasured at fair value. The unrealised gains and losses arising from the remeasurement to fair value are included in the consolidated statement of income and transferred to the investment revaluation reserve in the consolidated statement of changes in equity. Upon realisation, these are transferred to retained earnings.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 3 ACCOUNTING POLICIES (continued)

### *(b) Available for sale*

Available for sale investments are those which are designated as such or are not classified as carried at fair value through statement of income. They include equity investments and sukuk.

After initial measurement, available for sale investments are subsequently measured at fair value unless fair value cannot be measured in which case they are measured at cost less impairment. Unrealised gains and losses are recognised directly in equity in the "investment revaluation reserve". When the investment is disposed off or the asset is considered as impaired, the cumulative gain or loss in case of disposal and cumulative loss in case of impairment previously recognised in equity is recognised in the consolidated statement of income. Where the Group holds more than one investment in the same security they are deemed to be disposed off on a weighted average basis. Profit earned whilst holding available for sale investments is reported as income from investment banking activities using the effective profit rate. Dividends earned whilst holding available for sale investments are recognised in the consolidated statement of income as "Other income" when the right of the payment has been established.

### *(vi) Murabaha due to banks*

These represent funds received from banks on the principles of murabaha contracts and are stated at fair value of consideration received less amounts settled.

### *(vii) Murabaha contracts with non banks*

These are stated at fair value of consideration received less amounts settled.

### *(viii) Unrestricted investment accounts*

All unrestricted investment accounts are carried at fair value of consideration received less amounts settled.

Unrestricted investment account holders' funds are invested in short term highly liquid investments, medium term murabahas and Ijarah Muntahia Bittamleek. No priority is granted to any party for the purpose of distribution of profits. According to the terms of acceptance of the unrestricted investment accounts, 100% of the funds are invested after deductions of mandatory reserve and sufficient operational cash requirements.

The provision against Murabaha and Ijarah Muntahia Bittamleek receivables are charged to both the shareholders and the holders of the unrestricted investment accounts, considering the allocation of various assets. Any reversal in provision is charged to shareholders and the holders of the unrestricted investment accounts to the extent it was charged to them. Expenses are allocated in proportion to average unrestricted investment account to total average assets of the Bank.

## 3.3.3. Derecognition of financial assets and financial liabilities

### *(i) Financial assets*

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the right to receive cash flows from the asset has expired; or
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the Group has transferred its right to receive cash flows from the asset and either: (a) has transferred substantially all the risks and rewards of the assets, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset.

### *(ii) Financial liabilities*

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 3 ACCOUNTING POLICIES (continued)

### 3.3.4 Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) have an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in profit or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

#### (i) *Murabaha due from banks and financing contracts with customers*

For amounts due from banks and financing contracts with customers carried at amortised cost, the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of a provision account and the amount of the loss is recognised in the consolidated statement of income. Income from financing contracts with customers continue to be accrued on the reduced carrying amount based on the original effective profit rate.

Financing contracts together with the associated provisions are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the provision account. If the amount written off is later recovered, the recovery is credited to the 'Income from retail and corporate banking activities'.

The present value of the estimated future cash flows is discounted at the financial asset's original effective profit rate. If a financial asset has a variable profit rate, the discount rate for measuring any impairment loss is the current effective profit rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

#### (ii) *Available for sale investments*

For available for sale investments, the Group assesses at each balance sheet date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available for sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated statement of income – is removed from equity and recognised in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income; increases in their fair value after impairment are recognised directly in equity.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 3 ACCOUNTING POLICIES (continued)

In the case of sukuk classified as available for sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Profit continues to be accrued at the original effective profit rate on the reduced carrying amount of the asset and is recorded in the statement of income. If, in a subsequent year, the fair value of sukuk increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

### 3.3.5 Offsetting financial instruments

Financial assets and financial liabilities are only offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognized amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

### 3.3.6 Land and development costs

Land and development costs consist of cost of land being developed for sale in the ordinary course of business and costs incurred in bringing such land to its saleable condition and is stated at the lower of cost and net realisable value.

Net realisable value is based on estimated selling price less any further costs expected to be incurred on completion and sale.

### 3.3.7 Recognition of income and expense

#### (i) *Income recognition*

##### (a) *Murabaha*

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

##### (b) *Ijarah Muntahia Bittamleek*

Ijarah income is recognized on a time-apportioned basis over the lease term.

##### (c) *Musharaka*

Income on musharaka contracts is recognised when the right to receive payment is established or on distribution. Income related to accounts that are 90 days overdue is excluded from the consolidated statement of income.

##### (d) *Dividends*

Dividends from investments in equities are recognized when the right to receive the payment is established.

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

Fees and commission income is recognized when earned.

##### (f) *Sale of real estate*

Revenue on sale of land is recognised when all of the following conditions are met:

- A sale is consummated and contracts are signed;
- The buyer's investment, to the date of the financial statements, is adequate (10% and above) to demonstrate a commitment to pay for the property;
- The Group has transferred to the buyer the usual risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property.

##### (g) *Service income*

Revenue from rendering of services is recognised when the services are rendered.

##### (h) *Revenue from telecommunication services*

##### *Post paid*

Recurring post paid revenues represent billings to customers in respect of monthly rentals and usage. These are recognized when the related service is provided. Revenues arising from the previous billing date to the balance sheet date are accrued. Unearned subscription income representing billings made by the Group to its customers in advance and not earned as of the reporting date is recognised in the consolidated balance sheet as deferred revenue. Other revenue arising from sale of internet broadband equipment is recognised when such equipment is sold to the customers.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 3 ACCOUNTING POLICIES (continued)

### *Prepaid*

Prepaid cards enable the customers to forward purchase a specified amount of airtime. Sale price of the prepaid card represents the value of airtime usage available for the customers. Revenue is recognised based on airtime usage by the customer and unused airtime, that is not earned as of the reporting date, is recognised in the consolidated balance sheet as deferred revenue.

### *(i) Revenue from sale of goods*

Revenue from sales of goods is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably.

### *(ii) Expense recognition*

#### *(a) Profit on murabahas payable (Banks and non banks)*

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

#### *(b) Profit on unrestricted investment accounts*

Profit on these is based on the income generated from investment accounts after deducting mudarib share.

### **3.3.8 Investment in associates**

The Group's investments in its associates, other than those classified as fair value through statement of income under IAS 39, are accounted for under the equity method of accounting. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in the associate is carried in the balance sheet at cost plus post acquisition changes in the Group's share of net assets of the associate. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortized. After application of the equity method, the Group determines whether it is necessary to recognize any impairment loss with respect to the Group's net investment in the associate. The consolidated statement of income reflects the share of the results of operations of the associate. Where there has been a change recognized directly in the equity of the associate, the Group recognizes its share of any changes and discloses this, when applicable, in the consolidated statement of changes in equity. Profits and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

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

### **3.3.9 Investment properties**

The Group holds certain properties as investments to earn rental income, for capital appreciation or both. Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at fair value, which reflect market conditions at the balance sheet date. Gains or losses arising from changes in the fair values of investment properties are included in the consolidated statement of income in 'Income from investment activities' in the year in which they arise and transferred to the investment revaluation reserve in the consolidated statement of changes in equity. Upon realisation, these are transferred to retained earnings in accordance with the requirements of AAOIFI.

### **3.3.10 Subsidiary 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, liabilities and minority interest of the subsidiary is shown separately on the balance sheet as "Assets of disposal group classified as held for sale", "Liabilities directly associated with disposal group classified as held for sale" and "Minority interest in disposal group classified as held for sale". The subsidiary classified as "held for sale" is measured at the lower of carrying amount and fair value less costs to sell. Any resulting impairment loss reduces the carrying amount of "assets of the disposal group classified as held for sale".

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

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 3 ACCOUNTING POLICIES (continued)

### 3.3.11 Premises and equipment

Premises and equipment are stated at cost excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value.

Depreciation is calculated using the straight-line method to write down the cost of premises and equipment to their residual values over their estimated useful lives. Land is not depreciated. The estimated useful lives are as follows:

	Years
Premises:	20
Equipment:	3 - 7
Motor vehicles and office furnitures:	2 - 5

An item of premises and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in the consolidated statement of income in the year the asset is derecognised.

### 3.3.12 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 is recognised directly in the consolidated statement of income 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 Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. 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.

When subsidiaries are sold, the difference between the selling price and the net assets plus cumulative translation differences and related goodwill is recognised in the consolidated statement of income.

### 3.3.13 Intangible assets

Intangible assets include the value of license rights. Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

Intangible assets are amortised over the useful economic life. The amortisation period and the amortisation method are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense is recognised in the consolidated statement of income in the expense category consistent with the function of the intangible asset. Amortisation is calculated using the straight-line method to write down the cost of intangible assets to their residual values over their estimated useful life of 15 years.

### 3.3.14 Impairment of non financial assets

The Group assess at each reporting date or more frequently if events or changes in circumstances indicate that carrying value may be impaired, whether there is indication that a non financial asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If any such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. Impairment losses relating to goodwill cannot be reversed for subsequent increase in its recoverable amount in future periods.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 3 ACCOUNTING POLICIES (continued)

### 3.3.15 Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recorded in the consolidated financial statements at fair value in 'other liabilities' being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of guarantee.

Any increase in the liability relating to financial guarantees is taken to the consolidated statement of income in 'provisions'. The premium received is recognised in the consolidated statement of income on a straight line basis over the life of the guarantee.

### 3.3.16 Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) arising from a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of obligation.

### 3.3.17 Share based payment transactions

Eligible employees are entitled to invest in shares of the employees share purchase plan for services rendered and are classified as equity settled share based payment transaction under IFRS 2.

The costs of equity settled share based payment transactions are recognised in the statement of income over the vesting period with the corresponding increase in equity, based on the best available estimate of the number of equity instruments expected to vest.

### 3.3.18 Fiduciary assets

Assets held in a fiduciary capacity are not reported in the consolidated financial statements, as they are not the assets of the Group.

### 3.3.19 Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segment income, segment expenses and segment performance include transfers between business segments and between geographical segments.

### 3.3.20 Investment revaluation reserve

Unrealized net gains resulting from revaluation of investments classified as fair value through statement of income and investment properties, are appropriated to investment revaluation reserve and are not available for distribution to shareholders. Upon disposal of these investments, the related cumulative net gain is transferred to retained earnings and is available for distribution. Furthermore, unrealized gains and losses on revaluation of available for sale investments are directly recognized in investment revaluation reserve.

### 3.3.21 Cash and cash equivalents

Cash and cash equivalents comprise of cash and balances with banks and the Central Bank of Bahrain (excluding mandatory reserve deposits) and murabaha due from banks with original maturities of 90 days or less.

### 3.3.22 Allocation of income

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

### 3.3.23 Restricted investment accounts

Restricted investment accounts, based on Mudaraba contracts, represent assets held in trust or in a fiduciary capacity by the Group for the benefit of the investment accounts holders. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders. The mudarib share is recognized when right to receive is established and are shown as part of income from retail and corporate banking activities.

### 3.3.24 Inventories

Inventories are held at the lower of cost and net realisable value. When inventories become old or obsolete, an estimate is made of their net realisable value. For individually significant amounts this estimation is performed on an individual basis. Amounts which are not individually significant, but which are old or obsolete, are assessed collectively and an allowance applied according to the inventory type and the degree of ageing or obsolescence, based on historical selling prices.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 3 ACCOUNTING POLICIES (continued)

### 3.4 Future changes in accounting policies

Following are the relevant FAS, IFRS and IFRIC interpretations that have been issued during the year, to be applied to financial statements for financial years commencing on or after the following dates

- FAS 23 - Consolidation, 1 January 2009
- IAS 1 - Presentation of financial statements (Revised), 1 January 2009
- IAS 23 - Borrowing costs (Revised), 1 January 2009
- IFRS 8 - Operating segments, 1 January 2009
- IAS 27 - Consolidated and separate financial statements (Revised), 1 July 2009
- IFRS 3 - Business combinations (Revised), 1 July 2009

The management expects that, except for amended IAS 27 and IFRS 3, above standards will have no material impact, apart from certain additional disclosures, on the consolidated financial statements of the Group in the period of initial application. Amended IAS 27 and IFRS 3 will introduce a number of changes in the accounting for business combination occurring from the beginning of the period of initial application. This will impact the amount of goodwill recognised, the reported results in the period the acquisition occurs and future reported results. IAS 27 revised requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as an equity transaction. Therefore, such a transaction will no longer give rise to goodwill, nor will it give rise to a gain or loss.

## 4 INVESTMENT IN SUBSIDIARIES

Key subsidiaries, all of which have 31 December as their year end, are as follows:

Subsidiary	Activities	Year of incorporation	Country of incorporation	Ownership %
<b>Mena Telecom W.L.L.</b>	The company is a licensed telecommunications company and a Satellite Access Service Provider.	2003	Kingdom of Bahrain	100%
<b>Miracle Graphics Company W.L.L.</b>	The company is engaged in the business of ordinary photography, printing and publishing.	2003	Kingdom of Bahrain	70%
<b>Baytik Investment Advisory W.L.L.</b>	The principal activity of the company is providing advisory services to the Bank and its affiliates.	2003	Kingdom of Bahrain	100%
<b>Al-Enma House for Real Estate B.S.C. (c)</b>	The company is engaged in contract works of various nature, commission trading, import, export and sale of safety items, property management of commercial, industrial and residential buildings and security services to buildings and facilities.	2003	Kingdom of Bahrain	59.3%
<b>Bayan Group for Investment Properties W.L.L.</b>	The principal activity of the company is to buy, sell and lease properties and to undertake joint ventures with other companies engaged in similar activities.	2004	Kingdom of Bahrain	100%
<b>Al Kindi Pharmaceutical Industries (Public Shareholding Company)</b>	The company is engaged in the manufacture of drugs in all their pharmaceutical dosage forms and the manufacturing of semi-pharmaceutical products specialized for skin care and cosmetics.	1997	Hashemite Kingdom of Jordan	82.2%
<b>Kuwait Finance House - Jordan and its subsidiaries</b>	The company and its subsidiaries are engaged in investment advisory, acquisition and development of private equity investments and real estate development in the Hashemite Kingdom of Jordan. KFH Jordan has established five subsidiaries during the period.	2007/2008	Hashemite Kingdom of Jordan	100%
<b>Ishbiliya Village W.L.L.</b>	The principal activity of the company is to invest in and develop real estate projects and consequently buying, selling and marketing of such properties (note 6).	2005	Kingdom of Bahrain	73.7%

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 5 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

The Group's financial instruments have been classified for the purpose of measurement under International Accounting Standard 39: Financial Instruments: Recognition and Measurement as follows:

	Financial assets at fair value through statement of income BD 000s	Financial assets as available for sale BD 000s	Financial assets at cost/ amortised cost BD 000s	Financial liabilities at cost/ amortised cost BD 000s	Total 2008 BD 000s
<b>ASSETS</b>					
Cash and balances with banks and Central Bank of Bahrain	-	-	69,791	-	69,791
Murabaha due from banks	-	-	64,421	-	64,421
Financing contracts with customers	-	-	578,482	-	578,482
Investments	160,238	44,405	-	-	204,643
Receivables	-	-	81,162	-	81,162
	160,238	44,405	793,856	-	998,499

### LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS

Murabaha and due to banks	-	-	-	301,452	301,452
Murabaha due to non-banks	-	-	-	224,880	224,880
Customers' current accounts	-	-	-	53,236	53,236
Other liabilities	-	-	-	26,268	26,268
Unrestricted Investment accounts	-	-	-	310,474	310,474
	-	-	-	916,310	916,310

	Financial assets at fair value through statement of income BD 000s	Financial assets as available for sale BD 000s	Financial assets at cost/ amortised cost BD 000s	Financial liabilities at cost/ amortised cost BD 000s	Total 2008 BD 000s
<b>ASSETS</b>					
Cash and balances with banks and Central Bank of Bahrain	-	-	23,640	-	23,640
Murabaha due from banks	-	-	80,685	-	80,685
Financing contracts with customers	-	-	276,061	-	276,061
Investments	87,794	54,078	-	-	141,872
Receivables	-	-	36,853	-	36,853
	87,794	54,078	417,239	-	559,111

### LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS

Murabaha and due to banks	-	-	-	77,329	77,329
Murabaha due to non-banks	-	-	-	287,269	287,269
Customers' current accounts	-	-	-	107,150	107,150
Other liabilities	-	-	-	46,191	46,191
Unrestricted Investment accounts	-	-	-	53,091	53,091
	-	-	-	571,030	571,030

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 6 BUSINESS COMBINATION

During the year, the Group has increased its holding in Ishbiliya Village W.L.L. ("Ishbiliya") to 73.7%. Accordingly, Ishbiliya became a subsidiary of the Group and has been consolidated. The fair value and carrying value of identifiable assets and liabilities of Ishbiliya at the date of acquisition were as follows:

	Carrying Value BD '000	Fair Value BD '000
<b>Assets</b>		
Land and development costs	20,026	25,511
	<u>20,026</u>	<u>25,511</u>
<b>Liabilities</b>		
Murabaha due to non-banks	2,612	2,612
Other liabilities	1,497	1,497
	<u>4,109</u>	<u>4,109</u>
<b>Net assets</b>	<b>15,917</b>	<b>21,402</b>
Net assets acquired by the Group		<u>21,402</u>
Less:		
Minority interest		(1,455)
Revaluation surplus arising on the Group's initial holding in Ishbiliya		(243)
Cost of acquisition		<u>19,704</u>
Cost of acquisition		19,704
Less: carrying amount included under investments		(10,946)
Net cash outflow on acquisition		<u>8,758</u>

From the date of acquisition, Ishbiliya has contributed BD 1,724 thousand to the profit of the Group.

## 7 CASH AND BALANCES WITH BANKS AND CENTRAL BANK OF BAHRAIN

	2008 BD 000s	2007 BD 000s
Cash	2,526	2,027
Balances with banks	33,389	4,525
Balances with Central Bank of Bahrain	7.1 33,876	17,088
	7.2 <u>69,791</u>	<u>23,640</u>

**7.1** This includes mandatory reserves of BD 31,724 (2007: BD 11,815) thousand, which are not available for use in the Group's day to day operation.

**7.2** This includes BD 32,173 (2007: BD 5,309) thousand financed by URIA to meet the mandatory reserve requirement of the CBB and day to day operational cash requirements of the Bank.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 8 MURABAHA DUE FROM BANKS

	2008 BD 000s	2007 BD 000s
Murabaha receivables from banks - international commodities	64,464	80,796
Deferred profits	(43)	(111)
	<b>64,421</b>	<b>80,685</b>

All the counterparties are based in the Middle East.

	Self financed*		URIA financed**		Total	
	2008 BD 000s	2007 BD 000s	2008 BD 000s	2007 BD 000s	2008 BD 000s	2007 BD 000s
Commodity murabaha	-	32,941	64,464	47,855	64,464	80,796
Deferred profits	-	(38)	(43)	(73)	(43)	(111)
	-	32,903	64,421	47,782	64,421	80,685

## 9 FINANCING CONTRACTS WITH CUSTOMERS

	Self financed*		URIA financed**		Total	
	2008 BD 000s	2007 BD 000s	2008 BD 000s	2007 BD 000s	2008 BD 000s	2007 BD 000s
Murabaha receivables	200,278	125,072	170,747	-	371,025	125,072
Deferred profits	(17,423)	(10,283)	(14,924)	-	(32,347)	(10,283)
Provisions	(941)	(336)	-	-	(941)	(336)
	181,914	114,453	155,823	-	337,737	114,453
Ijarah Muntahia Bittamleek (Note 9.1)	177,766	107,122	58,057	-	235,823	107,122
Provisions	(76)	-	-	-	(76)	-
	177,690	107,122	58,057	-	235,747	107,122
Istisna'a contracts	-	56,369	-	-	-	56,369
Musharaka contracts	17,257	7,535	-	-	17,257	7,535
	<b>376,861</b>	<b>285,479</b>	<b>213,880</b>	<b>-</b>	<b>590,741</b>	<b>285,479</b>
Collective provisions					(12,259)	(9,418)
					<b>578,482</b>	<b>276,061</b>

\* Represents financing contracts financed through funds other than URIA.

\*\* Represents financing contracts financed through the funds of URIA holders

9.1 These mainly comprises of land and building and are presented net of accumulated depreciation amounting to BD 18,479 (2007: BD 7,661) thousand.

9.2 The gross amount of financings individually determined to be impaired, before deducting any individually assessed impairment allowance is BD 1,257 (2007: BD 2,662) thousand.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 9 FINANCING CONTRACTS WITH CUSTOMERS (continued)

9.3 The composition of the financing contracts with customers, net of deferred profits for murabaha and provision, based on the status of the customer to the contract, is as follows:

	2008 BD 000s	2007 BD 000s
Commercial and business	188,271	76,524
Real estate	280,455	118,260
Private individuals	109,756	81,277
	<u>578,482</u>	<u>276,061</u>

The following is a reconciliation of the individual and collective impairment provisions for impairment losses on financing contracts with customers:

	Individual impairment 2008 BD 000s	Collective impairment 2008 BD 000s	Total 2008 BD 000s	Individual impairment 2007 BD 000s	Collective impairment 2007 BD 000s	Total 2007 BD 000s
At 1 January	336	9,418	9,754	336	6,329	6,665
Charge for the year	681	2,841	3,522	-	3,089	3,089
At 31 December	<u>1,017</u>	<u>12,259</u>	<u>13,276</u>	336	9,418	9,754

## 10 INVESTMENTS

The Group's investments are classified as follows:

		2008 BD 000s	2007 BD 000s
Investments at fair value through statement of income	10.1	160,238	87,794
Available for sale investments	10.2	44,405	54,078
		<u>204,643</u>	<u>141,872</u>

### 10.1 Investments at fair value through statement of income

Held for trading equities - quoted	-	11,830
Designated upon initial recognition as fair value through statement of income		
Equities - quoted	9,862	-
Equities - unquoted	139,270	67,809
Managed funds - at Net Asset Value	11,106	8,155
	<u>160,238</u>	<u>75,964</u>
	<u>160,238</u>	<u>87,794</u>

### 10.2 Available for sale investments

Equities - quoted *	7,757	-
Equities - unquoted	2,273	28,336
Government sukuk	16,455	12,275
Other sukuk	17,920	13,467
Other sukuk	<u>44,405</u>	<u>54,078</u>

\* These are stated net of impairment loss of BD 3,802 (2007: Nil) thousand.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 10 INVESTMENTS (continued)

The composition of the investment portfolio is as follows:

	New Zealand/ Australia BD 000s	Middle East BD 000s	Others BD 000s	Total	
				2008 BD 000s	2007 BD 000s
Commercial and technology	3,322	340	5,555	9,217	12,819
Real estate development	-	128,920	-	128,920	72,171
Banking and financial services	-	45,679	-	45,679	14,761
Others	-	20,827	-	20,827	42,121
	<b>3,322</b>	<b>195,766</b>	<b>5,555</b>	<b>204,643</b>	<b>141,872</b>

### 10.3 Reclassification of investments

Following the amendments to IAS 39 and IFRS 7, "Reclassification of Financial Assets", the Group reclassified certain of its held for trading equity investments to available for sale. The Group identified the investments, eligible under the amendments, for which at 1 July 2008, it had a clear change of intent to hold for the foreseeable future rather than to exit or trade in the short term. The change of intent was attributable to the current turmoil in the equity markets due to the credit and liquidity problems in the market. Management believes that the current market conditions qualifies for the definition of 'rare circumstances' under revised IAS 39. The reclassifications were made with effect from 1 July 2008 at fair value at that date.

The following table shows carrying values and fair values of the reclassified assets:

	1 July 2008 Carrying value BD 000s	1 July 2008 Fair value BD 000s	31 December 2008 Carrying value BD 000s	31 December 2008 Fair value BD 000s
Trading investments reclassified to available for sale	4,409	4,409	2,143	2,143

The fair value of these investments has declined by BD 2,266 thousand which is recognized in the consolidated statement of income as impairment. The above reclassification does not have any significant impact on profit for the year.

Upto 30 June 2008 fair value gain of BD 142 thousand on reclassified investments is recognized in the consolidated statement of income.

## 11 INVESTMENT IN ASSOCIATES

The Group has the following associates as at 31 December 2008:

Name of the associate	Nature of business	Country of incorporation	Percentage holding
Durrat Khaleej Al Bahrain B.S.C.(c) ("Durrat")	Engaged in developing Durrat Al Bahrain Island, a real estate project.	Bahrain	48%
Deera Investment and Real Estate Development Company ("Deera")	Engaged in real estate project development and property management.	Hashemite Kingdom of Jordan	28%
Energy Central B.S.C.(c) ("Energy")	Engaged in providing utility services including district cooling, sea water desalination, waste water treatment and related services.	Bahrain	33.5%

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 11 INVESTMENT IN ASSOCIATES (continued)

The following table illustrates the summarised financial information of the Group's investment in associates.

	2008 BD 000s	2007 BD 000s
Share of associates' balance sheet:		
Current assets	105,217	30,283
Non current assets	17,791	51,733
Current liabilities	(26,374)	(16,221)
Non current liabilities	(48,027)	(39,627)
Net assets	48,607	26,168
Share of associates' revenue and net income:		
Revenue	66,219	40,936
Net income for the year	21,034	14,173

The following is the movement of Group's investment in associates:

	2008 BD 000s	2007 BD 000s
Carrying amount at 1 January	41,356	15,385
Investment during the year	13,999	16,315
Transfers during the year	917	(3,667)
Adjustment on purchase of investment properties	811	1,822
Share of fair value changes on available for sale investments *	(3,177)	-
Share of results	21,034	14,173
Other movements	(3,760)	(2,672)
Carrying amount at 31 December	71,180	41,356

\* This amount is recognized as part of fair value change on available for sale investments in investment revaluation reserve.

## 12 INVESTMENT PROPERTIES

	2008 BD 000s	2007 BD 000s
<b>Cost</b>		
At 1 January	91,395	22,591
Additions	19,803	60,387
Relating to a subsidiary acquired during the year	-	9,718
Disposals	(8,262)	(1,301)
<b>At 31 December</b>	<b>102,936</b>	<b>91,395</b>
<b>Fair value adjustment</b>		
At 1 January	13,702	5,032
Unrealised gain on investment properties	9,220	9,625
Relating to a subsidiary acquired during the year	-	430
Relating to disposals	(874)	(1,385)
<b>At 31 December</b>	<b>22,048</b>	<b>13,702</b>
<b>Total</b>	<b>124,984</b>	<b>105,097</b>

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 12 INVESTMENT PROPERTIES (continued)

Investment properties, held in the Kingdom of Bahrain, at 31 December consist of the following:

	2008 BD 000s	2007 BD 000s
Buildings	39,790	31,199
Land	85,194	73,898
	<b>124,984</b>	<b>105,097</b>

Investment properties were revalued as of dates close to the balance sheet date, by independent consultants, who have reasonable and sufficient experience in the location and category of the properties being valued. Fair values were determined having regard to recent market transactions for similar properties in the same location as the Group's investment properties.

These include certain properties in which the Bank's share is valued at BD 353 (2007: BD 614 ) thousand which are jointly owned with third parties and are subject to normal conditions applicable to joint ownership.

## 13 RECEIVABLES, PREPAYMENTS AND OTHER ASSETS

	2008 BD 000s	2007 BD 000s
Advance for purchase of investment property	11,000	11,000
Performance and management fees receivable (Note 29)	15,545	8,101
Investment liquidation proceeds receivable	-	4,305
Project expenses receivable (Note 29)	4,864	3,915
Inventories held for consumer finance	2,058	2,669
Profit receivable	5,065	1,726
Receivable relating to investment property (Note 29)	4,522	1,675
Trade receivables of subsidiaries	29,341	1,586
Inventories and work in progress of a subsidiary	637	650
Land and development cost of subsidiaries	12,852	-
Prepaid expenses	1,067	486
Advance for purchase of investment	6,024	-
Other assets	4,801	4,545
	<b>97,776</b>	<b>40,658</b>

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 14 GOODWILL AND INTANGIBLES

	Goodwill 2008 BD 000s	Other intangible assets 2008 BD 000s	Total 2008 BD 000s	Goodwill 2007 BD 000s	Other intangible assets 2007 BD 000s	Total 2007 BD 000s
Cost:						
At 1 January	4,221	2,741	6,962	1,354	1,158	2,512
Additions	-	4,859	4,859	2,867	1,583	4,450
At 31 December	4,221	7,600	11,821	4,221	2,741	6,962
Amorisation and impairment:						
At 1 January	-	35	35	-	4	4
Amortisation charge for the year	-	58	58	-	31	31
Impairment loss for the year	1,129	-	1,129	-	-	-
At 31 December	1,129	93	1,222	-	35	35
Net book value:						
At 1 January	4,221	2,706	6,927	1,354	1,154	2,508
At 31 December	3,092	7,507	10,599	4,221	2,706	6,927

The carrying amount of goodwill is attributable to the following subsidiaries, which are treated as cash generating units:

	2008 BD 000s	2007 BD 000s
Al Kindi Pharmaceutical Industries	-	129
Miracle Graphics Company W.L.L.	1,226	1,226
Mena Telecom W.L.L.	-	1,000
Al-Enma House for Real Estate B.S.C. (c )	1,866	1,866
	3,092	4,221

### Key assumptions used in estimating recoverable amounts of cash-generating units

The recoverable amount of each cash generating unit's goodwill is based on value in use calculations using cash flow projections from financial budgets approved by senior management, extrapolated for five year using nominal GDP growth rate in the respective GCC countries in which they operate. The discount rate applied to cash flow projections represent cost of capital adjusted for appropriate risk premium for these cash generating units. The key assumptions used in estimating recoverable amounts of cash generating units were sensitised to test the resilience of value in use calculations. On this basis, management believes that reasonable changes in key assumptions used to determine the recoverable amount of the Group's cash generating units will not result in an impairment situation.

## 15 INVESTMENT HELD FOR SALE

On 19 June 2008, the Group acquired 85% stake in Motherwell Bridge Limited ("MBL"), a company incorporated in the United Kingdom. MBL specializes in the design, engineering, construction management and manpower management of engineering projects principally in the oil, gas, petrochemical and steel industries. The subsidiary has been acquired with a view to selling down majority of the equity stake within a period of one year from the date of acquisition. Accordingly, the gross amount of assets, liabilities and minority interest of MBL have been disclosed as a separate line item in these consolidated financial statements in accordance with the requirements of IFRS 5, "Non current assets held for sale and discontinued operations".

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 16 FUNDS UNDER MANAGEMENT

At 31 December 2008, clients' funds managed in a fiduciary capacity amounted to BD 113,892 (2007: BD 127,200) thousand.

## 17 OTHER LIABILITIES

	2008 BD 000s	2007 BD 000s
Payable against purchase of investment properties (Note 29)	4,542	26,945
Pay orders issued not presented	3,141	7,727
Payable on account of financing contracts	789	3,378
Staff related accruals	2,967	2,989
Profit payable on account of Murabaha due to banks and non-banks	1,599	1,115
Profit payable on Unrestricted Investment Accounts	1,995	743
Trade payables of subsidiaries	9,952	-
Others	1,283	3,294
	<b>26,268</b>	<b>46,191</b>

## 18 UNRESTRICTED INVESTMENT ACCOUNTS

The mudarib share on investment accounts ranges from 20% to 35% (2007: 20% to 35%) depending on the investment period and in case of saving accounts, where there is no restriction of cash withdrawal, the mudarib share ranges from 50% to 60% (2007: 50% to 60%). However, during the year, in addition to depositors share of profit, the Bank has distributed profit to investors from its own share of mudarib share. The rate of return paid to URIA holders for the last two financial years is as follows:

	2008 Rate of return %	2007 Rate of return %
Saving Accounts	2.00	1.25
VIP Saving Accounts	2.50	1.75
One Month TCD	5.30	4.38
Three Months TCD	5.50	4.50
Six Months TCD	5.75	4.75
1 Year TCD	6.00	5.00

## 19 SHARE CAPITAL

	2008 BD 000s	2007 BD 000s
Authorised share capital as of 31 December 2008 represents 3,500,000 thousand (2007: 3,500,000 thousand) shares of BD 0.1 (2007: BD 0.1) each.	350,000	350,000
Issued and fully paid-up share capital as of 31 December 2008 comprised as follows:		
Held by the Parent of the Bank - 1,500,863 thousand (2007: 675,654 thousand) shares of BD 0.1 (2007: BD 0.1) each.	150,086	67,565
Held under Employee Share Ownership Plan ("ESOP") - 109,505 thousand (2007: 24,506 thousand) shares of BD 0.1 (2007: BD 0.1) each.	10,950	2,451
	<b>161,036</b>	<b>70,016</b>

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 19 SHARE CAPITAL (continued)

Following a resolution passed by the shareholders of the Bank at the Annual General Meeting held on 24 March 2008, the Bank has:

- (a) transferred BD 17,925 thousand from retained earnings to general reserves
- (b) issued 105,020 thousand bonus shares amounting to BD 10,502 thousand by transfer from general reserves

Furthermore, in August 2008, the Bank increased the issued and paid up capital to BD 161,036 thousand by issuing 805,190 thousand shares at a value of BD 0.17 per share including a premium of BD 0.07 per share.

## 20 STATUTORY RESERVE

As required by Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the net income 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 paid up share capital. 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.

## 21 COMMITMENTS AND CONTINGENT ITEMS

The Bank has the following commitments:

	2008 BD 000s	2007 BD 000s
<b>Credit commitments on behalf of customers:</b>		
Letters of credit	19,751	20,043
Guarantees	29,011	23,278
	<b>48,762</b>	<b>43,321</b>
<b>Irrevocable commitments to extend credit:</b>		
Original term to maturity of one year or less	149,255	16,051
	<b>198,017</b>	<b>59,372</b>

### Operating lease commitments

At 31 December 2008, the Group had commitments in respect of non cancellable operating leases amounting to BD 5,967 (2007: BD 4,464) thousand relating to leasehold premises. Of the commitments in respect of operating leases BD 1,308 (2007: BD 231) thousand are due within one year and the remaining within two to five years.

### Capital commitments

At 31 December 2008, the Group had commitments of BD 1,392 (2007: BD 1,694) thousand principally relating to the office premises.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 22 INCOME FROM RETAIL AND CORPORATE BANKING ACTIVITIES

	2008 BD 000s	2007 BD 000s
Income from Murabaha receivables	14,316	7,814
Income from Ijarah Muntahia Bittamleek * and Istisna'a	17,417	11,676
Income from Musharaka contracts	735	602
Income from Murabaha with banks	2,286	4,577
<b>Financing income from retail and corporate banking activities</b>	<b>34,754</b>	<b>24,669</b>
Mudarib share on unrestricted investment accounts	997	144
Mudarib share on restricted investment accounts	837	441
Fees and commission	2,076	1,050
	<b>38,664</b>	<b>26,304</b>

\* This is presented net of depreciation on Ijarah Muntahia Bittamleek assets amounting to BD 13,337 (2007: BD 4,607) thousand.

## 23 INCOME FROM INVESTMENT ACTIVITIES

	2008 BD 000s	2007 BD 000s
Unrealised gain on investments *	9,783	7,147
(Loss) / gain on sale of investments	(302)	1,305
Unrealised gain on investment properties **	9,220	9,625
Gain on sale of investment properties	2,026	2,736
Performance and management fees (Note 29)	4,666	4,869
Other income	5,035	3,785
	<b>30,428</b>	<b>29,467</b>

\* This includes gain of BD 636 (2007: BD 4,323) thousand relating to held for trading investments.

\*\* This includes gain of BD 1,248 (2007: BD 732) thousand relating to minority shareholders of a subsidiary.

## 24 INCOME AND EXPENSE RELATING TO FINANCING CONTRACTS

	2008 BD 000s	2007 BD 000s
Financing income from retail and corporate banking activities	34,754	24,669
Profit on Murabaha due to banks and non-banks	14,870	14,639
Profit on unrestricted investment accounts	9,865	1,662
	<b>24,735</b>	<b>16,301</b>
	<b>10,019</b>	<b>8,368</b>

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 25 STAFF COSTS

	2008 BD 000s	2007 BD 000s
Salaries and benefits	9,163	6,421
Other costs	1,685	1,685
	<u>10,848</u>	<u>8,106</u>

## 26 PROVISIONS

	2008 BD 000s	2007 BD 000s
Financing contracts with customers	3,522	3,089
Investments	3,802	-
Other assets	-	144
Goodwill	1,129	-
	<u>8,453</u>	<u>3,233</u>

## 27 OTHER OPERATING EXPENSES

	2008 BD 000s	2007 BD 000s
Business development	3,399	3,201
Technology and communication	1,388	973
Premises - rentals and maintenance	891	611
Administration, selling and others	6,845	5,027
	<u>12,523</u>	<u>9,812</u>

## 28 CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the consolidated statement of cash flows comprise of the following balance sheet amounts:

	2008 BD 000s	2007 BD 000s
Cash	2,526	2,027
Balances with banks	33,389	4,525
Balances with Central Bank of Bahrain excluding mandatory reserve deposit	2,152	5,273
Murabaha due from banks	64,421	80,685
	<u>102,488</u>	<u>92,510</u>

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 29 RELATED PARTY TRANSACTIONS

Related parties represent associated companies, parent company and its major shareholders, directors and key management personnel of the Bank, and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Group's management. All the facilities to the related parties are performing facilities and are free of any provision for possible credit losses.

The following balances arise from the transactions, in addition to those relating to investment transactions, entered into with the related parties:

	Associated companies BD 000s	Parent and its major shareholders BD 000s	Directors and key management personnel BD 000s	Other related parties BD 000s	2008 BD 000s	2007 BD 000s
Murabaha due from banks	-	56,550	-	-	56,550	4,336
Financing contracts with customers	-	-	17,415	44,850	62,265	24,279
Performance and management fees receivable (Note 13)	15,545	-	-	-	15,545	8,101
Project expenses receivable (Note 13)	998	-	-	3,866	4,864	3,915
Receivable relating to investment property (Note 13)	4,522	-	-	-	4,522	-
Murabaha and due to banks	-	173,959	-	8,294	182,253	-
Murabaha due to non-banks	26,051	-	-	14,684	40,735	61,776
Customers' current accounts	10,363	-	247	3,654	14,264	71,760
Payable against purchase of investment properties (Note 17)	4,542	-	-	-	4,542	23,591
Other liabilities	151	-	-	-	151	151
Unrestricted investment accounts	5,312	-	920	21,991	28,223	7,446
Letters of credit	20	-	-	8,706	8,726	14,326
Guarantees	-	-	-	2,460	2,460	2,451
Restricted Investment Account - Funds received	22,450	-	332	1,508	24,290	255
Restricted Investment Account - Investments made	-	-	-	52,883	52,883	19,378

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 29 RELATED PARTY TRANSACTIONS (continued)

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

	Associated companies BD 000s	Parent and its major shareholders BD 000s	Directors and key management personnel BD 000s	Other related parties BD 000s	2008 BD 000s	2007 BD 000s
Income from Murabaha with banks	-	749	-	295	1,044	114
Income from financing contracts relating to customers	-	-	149	1,200	1,349	1,411
Performance and management fees (Note 23)	4,318	-	-	348	4,666	4,869
Profit on Murabaha and due to banks	-	2,257	-	223	2,480	-
Profit on Murabaha due to non-banks	1,449	-	1	331	1,781	2,749
Profit on unrestricted investment accounts	194	-	20	558	772	109
Operating expenses	-	-	-	900	900	581

Compensation of key management personnel, included in the consolidated statement of income, is as follows:

	2008 BD 000s	2007 BD 000s
Short term employee benefits	3,697	2,822
Long term employee benefits	136	5

## 30 SEGMENT INFORMATION

The primary segment reporting format is determined to be business segments as the Group's risk and rates of return are effected predominantly by differences in the products and services offered. Secondary information is reported geographically. The operating businesses are organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

For management purposes, the Group is organized into the following business segments.

Retail and Corporate Banking	Principally engaged in shari'a compliant profit sharing investment arrangements, providing shari'a compliant financing contracts and other facilities to retail, corporate and institutional customers.
Investment Banking and others	Principally engaged in investment banking activities, including private equity and real estate investments and in other activities.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 30 SEGMENT INFORMATION (continued)

### Primary segment information - business segments

The following table presents revenue, profit and certain asset and liability information regarding the Group's business segments for the year ended 31 December 2008.

	Retail and Corporate Banking BD 000s	Investment Banking and Others BD 000s	Total BD 000s
Segment revenues	38,664	59,848	98,512
Segment costs	(12,276)	(21,640)	(33,916)
Profit on unrestricted investment accounts	(9,865)	-	(9,865)
Segment results	<u>16,523</u>	<u>38,208</u>	54,731
Unallocated costs			(16,297)
<b>Net Income for the year</b>			<u>38,434</u>
<b>Assets and Liabilities</b>			
Segment assets	720,594	460,416	1,181,010
Investment in associates	-	71,180	71,180
	<u>720,594</u>	<u>531,596</u>	1,252,190
Unallocated assets			32,485
<b>Total assets</b>			<u>1,284,675</u>
Segment liabilities	410,120	212,235	622,355
Unrestricted investment accounts	310,474	-	310,474
	<u>720,594</u>	<u>212,235</u>	932,829
Unallocated liabilities			3,013
<b>Total liabilities including unrestricted investment accounts</b>			<u>935,842</u>

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 30 SEGMENT INFORMATION (continued)

The following table presents revenue, profit and certain asset and liability information regarding the Group's business segments for the year ended 31 December 2007.

	Retail and Corporate Banking BD 000s	Investment Banking and Others BD 000s	Total BD 000s
Segment revenues	26,304	45,689	71,993
Segment costs	(14,058)	(11,594)	(25,652)
Profit on unrestricted investment accounts	(1,662)	-	(1,662)
Segment results	10,584	34,095	44,679
Unallocated costs			(12,009)
<b>Net Income for the year</b>			<b>32,670</b>
<b>Assets and Liabilities</b>			
Segment assets	386,894	287,552	674,446
Investment in associates	-	41,356	41,356
	386,894	328,908	715,802
Unallocated assets			19,489
<b>Total assets</b>			<b>735,291</b>
Segment liabilities	333,803	181,047	514,850
Unrestricted investment accounts	53,091	-	53,091
	386,894	181,047	567,941
Segment liabilities - unallocated			3,089
<b>Total liabilities including unrestricted investment accounts</b>			<b>571,030</b>

### Secondary segment information - geographical segments

The Group mainly operates in the Kingdom of Bahrain therefore geographical segments are not required to be identified.

## 31 FAIR VALUE OF FINANCIAL INSTRUMENTS

At 31 December 2008, the fair value of financing contracts with customers is BD 574,463 thousands (carrying value BD 578,482 thousands) which is determined by comparing market profit rates when they were first recognized with current market profit rates offered for similar financial instruments. The fair values of other financial instruments approximate their carrying values as these are either short term or floating rate instruments.

At 31 December 2007, fair values of financial instruments approximate the carrying amount.

### Financial instruments recorded at fair value

The carrying value of financial instruments which are recorded at fair value whose fair value is based on quoted market prices and net asset value is BD 28,725 (2007: 19,985) thousands and those involving valuation techniques where all the model inputs are observable in the market is BD 175,918 (2007: BD 121,887) thousands.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 32 MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled. Group's contractual undiscounted repayment obligations are disclosed in Note 33.3 'Risk Management - Liquidity Risk and Funding Management'.

	Up to one year			Over one year			Subtotal Over 1 year 2008 BD 000s	Total 2008 BD 000s
	Up to	3 months to	Subtotal	1 to 5	5 to 10	Over 10		
	3 months	12 months	up to	years	years	years		
	2008	2008	12 months	2008	2008	2008		
	BD 000s	BD 000s	BD 000s	BD 000s	BD 000s	BD 000s	BD 000s	
<b>Assets</b>								
Cash and balances with banks and Central Bank of Bahrain	38,067	-	38,067	-	-	31,724	31,724	69,791
Murabaha due from banks	64,421	-	64,421	-	-	-	-	64,421
Financing contracts with customers	63,481	208,230	271,711	261,417	38,377	6,977	306,771	578,482
Investments	5,000	19,889	24,889	179,754	-	-	179,754	204,643
Investment in associates	-	-	-	-	-	71,180	71,180	71,180
Investment properties	-	-	-	124,984	-	-	124,984	124,984
Receivables, prepayments and other assets	51,632	35,144	86,776	11,000	-	-	11,000	97,776
Goodwill and intangibles	-	-	-	-	-	10,599	10,599	10,599
Premises and equipment	-	-	-	-	-	31,409	31,409	31,409
Assets of disposal group classified as held for sale	-	31,390	31,390	-	-	-	-	31,390
<b>Total</b>	<b>222,601</b>	<b>294,653</b>	<b>517,254</b>	<b>577,155</b>	<b>38,377</b>	<b>151,889</b>	<b>767,421</b>	<b>1,284,675</b>
<b>Liabilities and unrestricted investment accounts</b>								
Murabaha and due to banks	301,452	-	301,452	-	-	-	-	301,452
Murabaha contracts with non-banks	38,159	4,530	42,689	182,191	-	-	182,191	224,880
Customers' current accounts	26,618	10,647	37,265	15,971	-	-	15,971	53,236
Other liabilities	13,306	12,806	26,112	156	-	-	156	26,268
Liabilities directly associated with disposal group classified as held for sale	-	19,532	19,532	-	-	-	-	19,532
Unrestricted investment accounts	43,180	10,409	53,589	256,885	-	-	256,885	310,474
<b>Total</b>	<b>422,715</b>	<b>57,924</b>	<b>480,639</b>	<b>455,203</b>	<b>-</b>	<b>-</b>	<b>455,203</b>	<b>935,842</b>
<b>Net</b>	<b>(200,114)</b>	<b>236,729</b>	<b>36,615</b>	<b>121,952</b>	<b>38,377</b>	<b>151,889</b>	<b>312,218</b>	<b>348,833</b>

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 32 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

	Up to one year			Over one year			Subtotal Over 1 year 2007 BD 000s	Total 2007 BD 000s
	Up to 3 months 2007 BD 000s	3 months to 12 months 2007 BD 000s	Subtotal up to 12 months 2007 BD 000s	1 to 5 years 2007 BD 000s	5 to 10 years 2007 BD 000s	Over 10 years 2007 BD 000s		
<b>Assets</b>								
Cash and balances with banks and Central Bank of Bahrain	11,825	-	11,825	-	-	11,815	11,815	23,640
Murabaha due from banks	80,685	-	80,685	-	-	-	-	80,685
Financing contracts with customers	19,805	64,539	84,344	119,468	43,795	28,454	191,717	276,061
Investments	11,830	6,620	18,450	29,915	80,314	13,193	123,422	141,872
Investment in associates	-	-	-	-	-	41,356	41,356	41,356
Investment properties	-	-	-	105,097	-	-	105,097	105,097
Receivables, prepayments and other assets	15,026	14,236	29,262	11,396	-	-	11,396	40,658
Goodwill and intangibles	-	-	-	-	-	6,927	6,927	6,927
Premises and equipment	-	-	-	-	-	18,995	18,995	18,995
<b>Total</b>	<b>139,171</b>	<b>85,395</b>	<b>224,566</b>	<b>265,876</b>	<b>124,109</b>	<b>120,740</b>	<b>510,725</b>	<b>735,291</b>
<b>Liabilities and unrestricted investment accounts</b>								
Murabaha and due to banks	73,559	3,770	77,329	-	-	-	-	77,329
Murabaha contracts with non-banks	254,182	33,087	287,269	-	-	-	-	287,269
Customers' current accounts	53,575	21,430	75,005	32,145	-	-	32,145	107,150
Other liabilities	15,486	29,142	44,628	47	-	1,516	1,563	46,191
Unrestricted investment accounts	26,921	15,294	42,215	10,876	-	-	10,876	53,091
<b>Total</b>	<b>423,723</b>	<b>102,723</b>	<b>526,446</b>	<b>43,068</b>	<b>-</b>	<b>1,516</b>	<b>44,584</b>	<b>571,030</b>
<b>Net</b>	<b>(284,552)</b>	<b>(17,328)</b>	<b>(301,880)</b>	<b>222,808</b>	<b>124,109</b>	<b>119,224</b>	<b>466,141</b>	<b>164,261</b>

# Notes to the Consolidated Financial Statements

At 31 December 2008

## **33 RISK MANAGEMENT**

### **33.1 Introduction**

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring of material risks. The Group manages its exposure to risks within the approved risk limits. The process of risk management is critical to the Group's continuing profitability and each business unit within the Group is accountable for the risk exposures relating to its responsibilities. The Group is mainly exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. The Group is also subject to prepayment risk and operating risk.

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, policies and risk appetite.

#### ***Audit Committee***

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

#### ***Risk and Governance Committee***

The Risk and Governance Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

#### ***Asset and Liability Committee***

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

#### ***Shari'a Supervisory Board***

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

#### ***Risk Management Group***

The Risk Management Group is responsible for implementing and maintaining risk related procedures to ensure an independent control process and also monitoring compliance with risk principles, policies and limits, across the Bank. The group is also responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This group also ensures the complete capture of the risks in risk measurement and reporting systems.

#### ***Bank Treasury***

Bank Treasury is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

#### ***Internal Audit***

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

# Notes to the Consolidated Financial Statements

At 31 December 2008

## **33 RISK MANAGEMENT (continued)**

### ***Risk measurement and reporting systems***

The Group identifies, measures, controls and monitors its material risks on a periodic basis. The Bank has established relevant risk limit structures to quantify its risk appetite. The Bank conducts stress testing under various scenarios for its material portfolios using statistical methods to assess the impact of such scenarios on its portfolio and regulatory capital.

Established risk limits reflect the business strategy and market environment in which the Bank operates as well as the level of risk that the Bank is willing to accept. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposures across its material risk types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Board of Directors, the Risk & Governance Committee and senior management. The report includes aggregate credit exposures, concentration limits, investment limits, foreign exchange exposures, hold limit exceptions, liquidity gaps and ratios and changes in Group's risk profile. On a periodic basis, a detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the collective provision for credit losses on a quarterly basis. The Board of Directors receives Risk & Governance Committee's report once in a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Group.

As part of the Risk Management's reporting framework, 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 periodic briefing is given to the Chief Executive Officer and all other relevant members of the Bank on the utilisation of market limits, proprietary investments and liquidity, plus any other risk developments.

### ***Excessive risk concentration***

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

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

## **33.2 Credit Risk**

Credit risk is the risk that the Group will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls its credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions for corporate portfolio. Counterparty limits are established with the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings for corporates are subject to revision at the time of renewal of the corporate facility. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

### ***Credit-related commitments risks***

The Bank makes available to its customers guarantees which may require that the Bank makes payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to risks similar to financing contracts and these are mitigated by the same control processes and policies.

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

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

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 33 RISK MANAGEMENT (continued)

### 33.2 Credit Risk (continued)

	Gross maximum exposure 2008 BD 000's	Gross maximum exposure 2007 BD 000's
Balances with banks and Central Bank of Bahrain	67,265	21,613
Murabaha due from banks	64,421	80,685
Financing contracts with customers	578,482	276,061
Investments - sukuks	34,375	25,742
Receivables	81,162	40,172
<b>Total</b>	<b>825,705</b>	<b>444,273</b>
Commitments and contingent items	198,017	59,372
<b>Total credit risk exposure</b>	<b>1,023,722</b>	<b>503,645</b>

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.

#### *Risk concentrations of the maximum exposure to credit risk*

Concentration of risk is managed by client/counterparty, by geographical region and by industry sector. The maximum credit exposure to any client or counterparty as of 31 December 2008 was BD 52,923 (2007: BD 54,718) thousand before taking account of collateral. This facility is fully secured by authenticated mortgage over title deeds of land and building in the favour of the Bank.

The Group financial assets having credit risk, before taking into account any collateral held can be analysed by the following geographical regions:

	2008 BD 000s	2007 BD 000s
Middle East	1,018,707	471,456
North America	416	13,394
Europe	805	500
New Zealand / Australia	1,282	10,875
Other	2,512	7,420
<b>Total</b>	<b>1,023,722</b>	<b>503,645</b>

An industry sector analysis of the Group financial assets having credit risk, before and after taking into account collateral held or other credit enhancements, is as follows:

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 33 RISK MANAGEMENT (continued)

### 33.2 Credit Risk (continued)

	Gross maximum exposure 2008 BD 000's	Gross maximum exposure 2007 BD 000's
Trading and Manufacturing	176,085	106,324
Banking and financial institutions	236,642	121,941
Construction and real estate	485,917	160,967
Other	125,078	114,413
<b>Total</b>	<b>1,023,722</b>	<b>503,645</b>

The Group holds collateral against its financial assets relating to customers.

#### **Collateral and other credit enhancements**

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. The Bank has guidelines regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For commercial financing, lien over investment accounts, charges over real estate properties, inventory and trade receivables; and
- For retail and consumer financing, lien over investment accounts, mortgages over the related assets.

The Bank also obtains personal guarantees from the owners for financings to their companies, but the benefits are not included in the above table. Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained periodically and during its review of the facility.

#### **Credit quality per class of financial assets**

The credit quality of financial assets is managed by the Bank using internal credit gradings. These internal credit gradings are assigned to each individual borrower. They are defined as follows:

##### *Good*

Credit exposures in this category are normal credit risks which show no sign of actual or potential default and it is unlikely that the Bank will sustain a loss.

##### *Special mention*

Credit exposures in this category show no sign of actual or potential default. However certain minor unsatisfactory aspects to the exposure justify more than normal attention.

##### *Sub-standard*

In this category normal repayment is in jeopardy and there exists well defined weaknesses in support of the same. The asset is inadequately protected by the current net worth and paying capacity of the obligor or pledged collateral.

##### *Doubtful*

Full repayment is questionable in this grade. Serious problems exist to the point where a partial loss of principal is likely. Weaknesses are so pronounced that on the basis of current information, conditions and values, collection in full is highly improbable.

##### *Loss - Individually impaired*

Total loss is expected, however in management's opinion recovery is a possibility, and hence write off is deferred.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 33 RISK MANAGEMENT (continued)

### 33.2 Credit Risk (continued)

#### Credit quality per class of financial assets

	Neither past due nor impaired			Past due or	Total 2008 BD 000's
	Good 2008 BD 000's	Special mention 2008 BD 000's	Substandard and Doubtful 2008 BD 000's	individually impaired 2008 BD 000's	
Murabaha due from banks	64,421	-	-	-	64,421
Financing contracts with customers	560,052	18,696	-	13,010	591,758
Investments - sukuks	34,375	-	-	-	34,375
<b>Total</b>	<b>658,848</b>	<b>18,696</b>	<b>-</b>	<b>13,010</b>	<b>690,554</b>

	Neither past due nor impaired			Past due or	Total 2007 BD 000's
	Good 2007 BD 000's	Special mention 2007 BD 000's	Substandard and Doubtful 2007 BD 000's	individually impaired 2007 BD 000's	
Murabaha due from banks	80,685	-	-	-	80,685
Financing contracts with customers	261,929	9,058	-	14,828	285,815
Investments - sukuks	25,742	-	-	-	25,742
<b>Total</b>	<b>368,356</b>	<b>9,058</b>	<b>-</b>	<b>14,828</b>	<b>392,242</b>

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographical regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. 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 for corporate customers.

#### Aging analysis of past due but not impaired receivables per class of financial assets

An analysis of past due financing contracts, by age, is provided below. The majority of the past due financing contracts are not considered to be impaired.

	Less than 30 days 2008 BD 000's	31 to 60 days 2008 BD 000's	61 to 90 days 2008 BD 000's	More than 90 days 2008 BD 000's	Total 2008 BD 000's
	Financing contracts with customers	10,518	232	251	752

	Less than 30 days 2007 BD 000's	31 to 60 days 2007 BD 000's	61 to 90 days 2007 BD 000's	More than 90 days 2007 BD 000's	Total 2007 BD 000's
	Financing contracts with customers	4,430	533	4,402	887

# Notes to the Consolidated Financial Statements

At 31 December 2008

## **33 RISK MANAGEMENT (continued)**

### **33.2 Credit Risk (continued)**

#### **Impairment assessment**

The main considerations for the impairment assessment include whether any payments of principal or profit are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Group addresses impairment assessment in two areas: individually assessed provisions and collectively assessed provisions.

#### **Individually assessed provisions**

The Group determines the provisions appropriate for each individually significant financing contract on an individual basis. Items considered when determining provision amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

#### **Collectively assessed provisions**

Provisions are assessed collectively for losses on financing contracts that are not individually significant and for individually significant financing contract where there is not yet objective evidence of individual impairment. Provisions are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment provision, and expected receipts and recoveries once impaired. Management is responsible for deciding the length of this period which can extend for as long as one year. The impairment provision is then reviewed by credit management to ensure alignment with the Group's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for financing contracts.

### **33.3 Liquidity risk and funding management**

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Group maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Group also has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains a statutory deposit with the Central Bank of Bahrain equal to 7% of customer deposits, denominated in Bahrain Dinars, excluding deposits from resident subsidiaries. The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank. The most important of these is to maintain limits on the ratio of liquid assets to customer liabilities. Liquid assets consists of cash and balances with banks and Central Bank of Bahrain, Murabaha due from banks and Central Bank of Bahrain sukuk. The ratios during the year were as follows:

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 33 RISK MANAGEMENT (continued)

### 33.3 Liquidity risk and funding management (continued)

	2008 %	2007 %
31 December	25.60	19.47
During the year:		
Average	28.19	25.92
Highest	35.86	39.11
Lowest	20.89	19.47

#### Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2008 and 2007 based on contractual undiscounted repayment obligations. Maturity analysis of assets and liabilities for the expected maturities of these liabilities is disclosed in Note 32. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

Financial liabilities	On demand BD 000's	Less than 3 months BD 000's	3 to 12 months BD 000's	1 to 5 years BD 000's	Over 5 years BD 000's	Total BD 000's
<b>At 31 December 2008</b>						
Murabaha and due to banks	22,975	278,720	-	-	-	301,695
Murabaha due to non-banks	-	191,830	34,378	-	-	226,208
Customers' current accounts	53,236	-	-	-	-	53,236
Other liabilities	-	8,655	17,613	-	-	26,268
Unrestricted investment accounts	36,092	27,429	256,191	-	-	319,712
<b>Total undiscounted financial liabilities 2008</b>	<b>112,303</b>	<b>506,634</b>	<b>308,182</b>	<b>-</b>	<b>-</b>	<b>927,119</b>
<b>At 31 December 2007</b>						
Murabaha and due to banks	4,427	69,670	3,980	-	-	78,077
Murabaha due to non-banks	-	255,286	33,231	-	-	288,517
Customers' current accounts	107,150	-	-	-	-	107,150
Other liabilities	-	15,486	29,142	47	1,516	46,191
Unrestricted investment accounts	36,255	8,922	8,159	-	-	53,336
<b>Total undiscounted financial liabilities 2007</b>	<b>147,832</b>	<b>349,364</b>	<b>74,512</b>	<b>47</b>	<b>1,516</b>	<b>573,271</b>

#### Credit commitments and contingent items

These include commitments to enter into contracts which are designed to meet the requirements of the Group's customers. Commitments represent contractual commitments under Murabaha, Musharaka and Ijarah Muntahia Bittamleek contracts. Commitments generally have fixed expiration dates, or other termination clauses. Since commitments may expire without being exercised, the total contract amounts do not necessarily represent future cash flow requirements.

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

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 33 RISK MANAGEMENT (continued)

### 33.3 Liquidity risk and funding management (continued)

The table below shows the contractual expiry by maturity of the Group's credit commitments and contingent items.

	Less than 3 months BD 000's	3 to 12 months BD 000's	1 to 5 years BD 000's	Total BD 000's
<b>At 31 December 2008</b>				
Commitments on behalf of customers:				
Letters of credits	4,829	5,141	9,781	19,751
Guarantees	-	-	29,011	29,011
Irrevocable commitments to extend credit	8,960	140,295	-	149,255
<b>Total</b>	<b>13,789</b>	<b>145,436</b>	<b>38,792</b>	<b>198,017</b>
<b>At 31 December 2007</b>				
Commitments on behalf of customers:				
Letters of credits	9,708	10,335	-	20,043
Guarantees	-	14,580	8,698	23,278
Irrevocable commitments to extend credit	964	15,087	-	16,051
<b>Total</b>	<b>10,672</b>	<b>40,002</b>	<b>8,698</b>	<b>59,372</b>

The Group does not expect any material loss in respect of the above.

### 33.4 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as profit rates, foreign exchange rates, and equity prices. The Group manages and monitors the positions using sensitivity analyses.

#### Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments.

The following table demonstrates the sensitivity to reasonably possible change in profit rates, with all other variables held constant of the Group's consolidated statement of income. The sensitivity of the consolidated statement of income is the effect of the assumed changes in profit rates on the net income for the year, based on the non-trading financial assets and financial liabilities held at 31 December 2008. As all the profit bearing financial instruments classified as available for sale are floating rate instruments there is minimal impact of profit rate risk on the Bank's equity.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 33 RISK MANAGEMENT (continued)

### 33.4 Market risk (continued)

The effect of decreases in basis points is expected to be equal and opposite to the effect of the increases shown.

	2008 BD 000s	Change in basis points	Effect on net income for the year BD 000s
<b>ASSETS</b>			
Murabaha due from banks	64,421	+25	161
Financing contracts with customers	253,081	+25	633
Investments - sukuk	34,375	+25	86
<b>LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS</b>			
Murabaha and due to banks	301,452	+25	(754)
Murabaha due to non-banks	224,880	+25	(562)
Unrestricted investment accounts	310,474	+25	(776)
<b>Total</b>			<b>(1,212)</b>

	2007 BD 000s	Change in basis points	Effect on net income for the year BD 000s
<b>ASSETS</b>			
Murabaha due from banks	80,685	+25	202
Financing contracts with customers	171,026	+25	428
Investments - sukuk	25,742	+25	64
<b>LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS</b>			
Murabaha and due to banks	77,329	+25	(193)
Murabaha due to non-banks	287,269	+25	(718)
Unrestricted investment accounts	53,091	+25	(133)
<b>Total</b>			<b>(350)</b>

### Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank has established Value at Risk limit for foreign currency exposures, this limit is monitored on a regular basis by the Risk Management Group.

The tables below indicate the currencies to which the Group had significant exposure at 31 December 2008 on all its monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Bahraini Dinar, with all other variables held constant, on the consolidated statement of income.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 33 RISK MANAGEMENT (continued)

### 33.4 Market risk (continued)

The effect of decreases in currency rate is expected to be equal and opposite to the effect of the increases shown.

	Change in currency rate %	Effect on profit 2008 BD 000's	Effect on equity 2008 BD 000's	Effect on profit 2007 BD 000's	Effect on equity 2007 BD 000's
NZD	+20	520	164	3,164	928
KWD	+20	(1,288)	-	1,580	-
JOR	+20	7,521	-	-	968
GBP	+20	470	-	876	-
<b>Total</b>		<b>7,223</b>	<b>164</b>	<b>5,620</b>	<b>1,896</b>

#### Equity price risk

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio.

The effect on income and equity (as a result of a change in the fair value of equity instruments at 31 December 2008) due to a possible change (i.e. +15%) in the value of individual investments, with all other variables held constant, is BD 24,036 thousands and BD 1,505 thousands, respectively (2007: BD 13,169 thousands and BD 4,250 thousands, respectively). The effect of decrease in the value of individual investment is expected to be equal and opposite to the effect of the increase shown.

#### 33.5 Prepayment risk

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier than expected. The Group is not exposed to any significant prepayment risk.

#### 33.6 Investment property price risk

Investment property price risk is the risk that the fair values of investment properties decrease as the result of downfall in the real estate market. The investment property price risk exposure arises from Group's holding of investment properties (lands and buildings).

The effect on income and equity due to a reasonably possible change (i.e. +15%) in the value of individual investment properties, with all other variables held constant, is BD 18,748 (2007: 15,765) thousands. The effect of decrease in the value of individual investment is expected to be equal and opposite to the effect of the increase shown.

#### 33.7 Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

# Notes to the Consolidated Financial Statements

At 31 December 2008

## 34 CAPITAL MANAGEMENT

The Group maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") and adopted by the Central Bank of Bahrain in supervising the Group.

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains healthy capital ratios in order to support its business and to maximise shareholders' value.

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Regulatory capital	2008 BD 000s	2007 BD 000s
As per the return submitted to CBB, the regulatory capital of the Bank is as follows:		
Tier 1 capital	185,402	116,584
Tier 2 capital	-	40,215
Total capital	185,402	156,799
Risk weighted assets	1,024,840	705,943
Total capital ratio	18.1%	22.2%
Minimum requirement	12.5%	12.5%

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, retained earnings, foreign currency translation and minority interests less goodwill. The other component of regulatory capital is Tier 2 capital, which includes collective provision, current year's profit and revaluation reserves. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the Central Bank of Bahrain.

## 35 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

The Group did not receive any significant income or incurred significant expenses which were prohibited by the Shari'a.

## 36 SOCIAL RESPONSIBILITY

The Bank discharges its social responsibilities through donations to charitable causes and organisations approved by Shari'a Supervisory Board.

## 37 ZAKAH

In accordance with the instructions of the Shari'a Supervisory Board of the Bank, payment of Zakah is the responsibility of the shareholders of the Bank. Accordingly, no Zakah has been charged to these consolidated financial statements.