

Annual Report 2013

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Bringing Banking to Life

2013



بيت التمويل الكويتي
Kuwait Finance House

البحرين ب.س.ج. (م) Bahrain B.S.C.(c)

Licensed as an Islamic Retail Bank by the Central Bank of Bahrain





**His Royal Highness
Prince Khalifa bin Salman
Al Khalifa**
The Prime Minister



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



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

Best Investment Advisory Service for
Three-Way Banker Merger
CPI Financial Banker Middle East Product
Awards '13

KFH-Bahrain

Received Gold Award for KFHB Website for
'Best Navigation' through the Communicator
Awards program '13

KFH-Bahrain

Silver Award for KFHB Website for
'Best in Financial Services' through the
Communicator Awards program '13

KFH-Bahrain

Received Gold Award for KFHB Website for
'Bank Standard of Excellence' through the
Web Marketing Award program '13

KFH-Bahrain

Received Award for KFHB Website for
'Bahrain eContent Award 2013' for its
Responsive Website in the eBanking
category '13

KFH-Bahrain

Received Award for the 'Institutional
Excellence' Award at the 20th WIBC for
being the Lead and Transaction Advisor for
the three way bank merger in Bahrain '13

KFH-Bahrain

The Best Real Estate Investment
Islamic Business and Finance Awards '12

Diyar Homes

Best Islamic Bank in Bahrain
Islamic Finance News Awards '11

KFH-Group

Best Mobile Application
Bahrain eContent Award '11

KFH-Bahrain

Best Investment Product
Banker Middle East '11
Baytik Industrial Oasis

Best Investment Product
Banker Middle East '10

Menatelecom

Best Islamic Covered Card
Banker Middle East '10

Baytik Ijara

Best Islamic Wealth Management
Islamic Business & Finance Awards '09

Priority Banking

Best Project Finance House
Banker Middle East Industry Awards '08
Corporate Finance

Best Retail Brand
World Islamic Banking Conference Awards '08
KFH-Group

Best New Product
Islamic Business & Finance Awards '08

Priority Banking

Best New Product
Islamic Business & Finance Awards '07
Durrat Al Bahrain



Kuwait Finance House-Bahrain

Annual Report 2013



Contents

Vision & Mission	05
3 Year Highlights	06
Chairman's Statement	08
Board of Directors	12
Fatwa and Shari'a Supervisory Board	13
Management Team	14
Investment Portfolio	16
Retail Banking Group	20
Corporate Banking Group	24
Treasury & Capital Markets	25
Risk Management	26
Corporate Social Responsibility	28
Fatwa & Shari'a Supervisory Board Report	30
Independent Auditor's Report	31
Consolidated Financial Statements	32





Bringing Banking to Life

Vision

At KFH-Bahrain we believe that banking is not just about money. For us it is something that can improve people's lives. Whether we are providing commercial and investment banking services or financial products for consumers, we start by understanding our customers and their needs. With an emphasis on innovation, we aim to provide cutting edge Islamic banking solutions while staying faithful to Shari'a principles, with a view to enhancing the lives of our customers.

Mission

It is our mission to "Bring Banking to Life" by focusing on innovation, thinking outside the box and insisting on excellence in everything we do. This includes the development and provision of a wide range of integrated products and services in perfect harmony with Shari'a principles. Our mission and our commitment are backed by a robust financial position and a long and proven heritage of ingenuity, innovation and integrity.



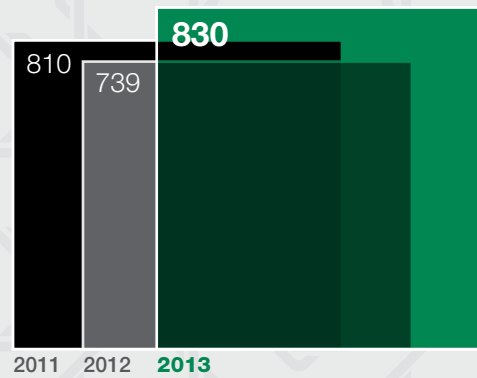
NET INCOME

BD Million



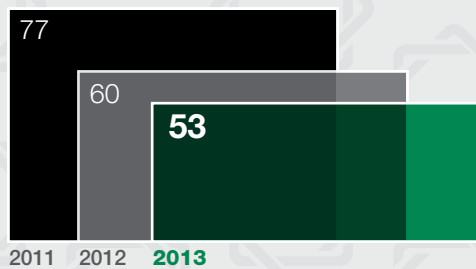
CUSTOMERS DEPOSITS

BD Million



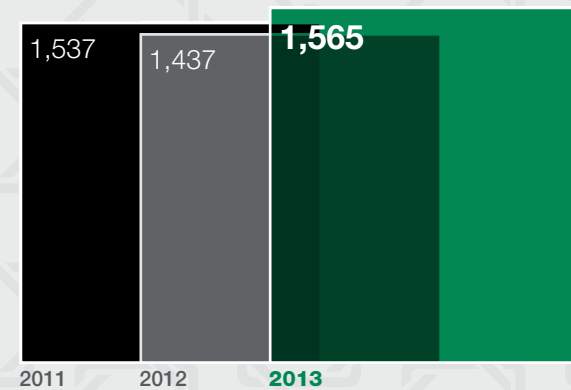
OPERATING INCOME

BD Million



TOTAL ASSETS

BD Million



3 Year Highlights

Profile

Kuwait Finance House-Bahrain ("KFH-Bahrain" or the "Bank"), is a leading provider of Islamic retail commercial and investment banking services. Established in 2002 as a wholly owned subsidiary of Kuwait Finance House-Kuwait, a global industry leader, KFH-Bahrain specialises in conceptualising the development and introduction of innovative, Shari'a compliant banking and investment products.

KFH-Bahrain enjoys a reputation as a performance-driven, results-oriented institution, combining global investment strategies with the provision of popular retail products and services. KFH-Bahrain has made major advances and experienced considerable growth in the last few years, allowing it to further develop its products and services and provide outstanding investment opportunities for its customers.

At the forefront of the investment and finance sectors, KFH-Bahrain has developed a series of successful projects and made further investments in diverse sectors of the economy.

KFH-Bahrain is continuing its strategy of innovation and change and is committed to setting new standards for Islamic banking and finance. Such a strategy will reaffirm KFH-Bahrain's status as a market leader, enhancing its continued contribution to the economic growth and social development of the Kingdom of Bahrain.



Yaqoob Yusuf Majed
Chairman

Chairman's Statement

In the name of Allah, the most Gracious, the most Merciful.

Blessings and Peace be upon the Last Prophet and Messenger Muhammad, His Companions and His Household.

It gives me great pleasure to present the annual report of KFH Bahrain for the year ended 31st December 2013.

Financial Results

Operating income for this year reached BD 53.1 million compared with BD 60.4 million in 2012. Net operating income for the year amounted to BD 31.3 million compared with BD 35.7 million last year. After distribution of BD 7.7 million for this year and BD 8.7 million for last year to unrestricted investment account holders, the net income reached to BD 7.4 million compared with BD 10.0 million in 2012. Total assets of KFH-Bahrain in this year increased by 6.2% to reach BD 1.565 billion compared with BD 1.473 billion in 2012, an increase of BD 92.0 million.

Recognition

I am pleased to report that the Bank was honored with a total of eight excellence awards during 2013. Four were awarded for KFH-Bahrain's website which is the first responsive website that was developed and launched for a commercial bank globally. Two awards were granted for the 'Best Investment Advisory Service' for advisory work on the first three-way Islamic bank merger deal led by KFH-Bahrain. The First award received was the CPI Banker Middle East Product Awards 2013 and the second was the prestigious Award for 'Institutional Excellence' at the 20th World Islamic Banking Conference.

We were also honored with an award from Islamic Business and Finance for 'Best Corporate Account' and an award from the Bahrain Ministry of Labour for 'Outstanding Institutions in the Private & Public Sectors'.

Adherence to Islamic Principles

On behalf of the Bank's Board of Directors I would like to recognize the excellent work of our Shari'a Fatwa and Supervisory Board comprising of well-respected scholars Shaikh Dr. Ajeel Jasem Al-Nashmi (Chairman), Shaikh Dr. Khalid Mathkour Al-Makhkour (Member) and Shaikh Dr. Mohammed Abdul Razaq Al-Tabtabaee (Member) who continued to work tirelessly to ensure the Bank's products and processes adhere to Islamic principles.

We increased our reach to customers throughout the Kingdom by expanding our ATM network and also by enhancing our eBanking services by offering better account management, along with more options for online utility payments. We have further enhanced our IT facilities to provide our customers with a faster more efficient service by improving the Bank's process flows.

Risk, governance and compliance

Due to further improvement of enhanced capital planning and stress testing models, and upgrades to the reporting of key risk indicators, the Bank's Board and Management teams were able to reduce and/or better mitigate various risks to which KFHB was exposed to. This improved the overall accuracy and timely assessments that relate to the Bank's daily operations. Through efficient training programs and strong monitoring of the Bank's operations, the Risk Management, Anti-Financial Crimes, the Internal Audit and Compliance departments were able to maintain and enhance the Bank's adherence to all significant applicable Central Bank and Government regulations.

Customer satisfaction - a priority

Despite a slowly recovering economy, the Bank has continued to maintain a strong balance sheet over the past years, thereby reassuring our customers of the stability of their investment accounts at the Bank. Throughout the year, we continued to improve our retail and corporate presence with the aim to further enhance the overall customer experience.

We increased our reach to customers throughout the Kingdom by expanding our ATM network and also by enhancing our eBanking services by offering better account management, along with more options for online utility payments. We have further enhanced our IT facilities to provide our customers with a faster more efficient service by improving the Bank's process flows. In the year ahead, we will continue to introduce more innovative products and services in order to expand our customer reach even further.

Employee Satisfaction

Throughout the year, the Bank continued to strengthen its internal culture by focusing on the development of its greatest asset, the employees. All employees attended various training courses throughout the year that were related to their job in order to gain more practical experience blended with theory. The Social Committee were very active organizing several social, educational and health related activities both for staff and their families. A high number of the Bank's employees hold university degrees and post graduate professional qualifications.

Looking towards next year, the Bank encourages all employees to further develop their professional education and inter-personal skills. Plans are already in the pipe-line to host knowledge building workshops by key personnel in the Bank to enhance the capabilities and knowledge of staff.

Community Service

During 2013, we continued to support the Islamic banking sector in Bahrain by participating in various banking conferences and seminars. We sustained our annual commitment to a range of initiatives in education, sports, health and community related activities. Our aim, as with every year, is to actively contribute to the society with a comprehensive Corporate Social Responsibility (CSR) programme.

Thanks

On behalf of the Bank's Board of Directors and Executive Management, I would like to thank His Majesty King Hamad bin Isa Al Khalifa, His Royal Highness Prince Khalifa bin Salman Al Khalifa, the Prime Minister, His Royal Highness Prince Salman bin Hamad Al Khalifa, The Crown Prince, Deputy Supreme Commander and First Deputy Prime Minister. I would also like to extend our sincere appreciation to the Government of Bahrain and the Central Bank of Bahrain for their valuable support and direction.

To conclude, I would like to thank our esteemed shareholders for their continued support, our customers and business partners for their trust and loyalty, and the management and staff for their continued dedication and high professional standards which were evident from the smooth running of the Bank.

May Allah grant everyone the best in this Life and the Hereafter
May peace, mercy and blessings of Allah be upon you

Yaqoob Yousuf Majed
Chairman



Yaqoob Yusuf Majed
Chairman



**Mohammad Naser
Abdulaziz Al Fouzan**
Vice Chairman



**Shaheen Hamad
Al Ghanem**
Board Member



**Mohammed Bin
AlShaikh Ishaq**
Board Member



**Adel Ahmed
Al Banwan**
Board Member



**Abdulhakeem Yaqoob
Alkhayat**
Managing Director & CEO

Board of Directors



**Sheikh Dr. Ajeel Jasem
Al-Nashmi**

Chairman



**Sheikh Dr. Khalid
Mathkour Al-Mathkour**

Member



**Sheikh Dr. Mohammed
Abdul Razaq Al-Tabtabaee**

Member

Fatwa and Shari'a Supervisory Board



Abdul Razak Jawahery
Executive Manager



Ahmad Saeed
Executive Manager



Khalid Al Maarafi
Executive Manager



Lilian Le Falher
Executive Manager



Paul Mercer
Executive Manager



Sattam Algosaibi
Executive Manager

Executive Management



Hisham Al-Moayyed
Senior Manager - Real Estate



Isa Al Duwaishan
Senior Manager - Shari'a



Yousif Al-Hammadi
Senior Manager - Financial Control
& Administration



Raed Ajawi
Senior Manager - Internal Audit



Amit Yashpal
Senior Manager - Risk Management



Mazar Jalal
Manager - Compliance



Alya AlShakhoory
Manager - Anti Financial Crimes

Department Senior Management



Investment Portfolio



Our Investment team strengthened the post-acquisition monitoring process and improved governance controls within our portfolio companies. These efforts have resulted in growth in the performance of our investments, which has led to successful realization of profit through sale of certain assets that we held till the markets revived.

As the markets have shown signs of improvement, we are well positioned to avail the right opportunities after having successfully spent last few years to rebalance our portfolio and streamline the underlying businesses in order to realize maximum returns on our investments. We also continued to enhance operational efficiency within our portfolio assets. Our Investment team strengthened the post-acquisition monitoring process and improved governance controls within our portfolio companies. These efforts have resulted in growth in the performance of our investments, which has led to successful realization of profit through sale of certain assets that we held till the markets revived.

Real Estate Investments

We have continued the execution of real estate projects in the Kingdom of Bahrain and the MENA region. Our support to real estate projects, whether directly undertaken by us or through strategic partnerships, enabled these projects to weather the difficult market conditions witnessed during the recent years. Our portfolio includes several distinguished projects such as Diyar Al Muharraq, Durrat Al Bahrain, Ishbiliya Village and Diyar Homes.



In 2013, we continued our financial and management support for existing large scale real estate development projects. Steady progress was made towards the pre-development phase of some of the new projects and these are being monitored closely. After the successful launch of Phase I of our affordable housing project (Diyar Homes) we have launched the second phase comprising 196 units in the end of December 2013. We have also been able to realize sale of certain real estate assets over the course of the year.

Corporate Investments

We continue to focus on the realization of non-core investments and stabilization of the investments which carry strong long term prospects. These investments are being managed and / or restructured (where required) and, through organic growth, an exit will be achieved.

We continuously evaluate new opportunities including offering investment advisory services. We are also targeting to explore new investment opportunities locally, regionally and internationally, which will contribute to increasing our returns and diversifying our portfolio geographically and sector-wise.





Retail Banking Group



New services and innovative products are constantly being introduced for the benefit of our customers. These range from technology and service enhancement that provide greater access to information and funds, both locally and internationally, to the launch of our unique, never-before-seen products.



Bahrain World Trade Centre Branch



Manama Branch



East Riffa Branch



Automall Sitra Branch



Muharraq Branch



Adliya Branch



Automall Exhibition Road Branch



West Riffa Branch



Isa Town Branch

Our Branches

Pioneering New Concepts in Islamic Consumer Banking and Financial Services

The consumer banking and finance services provided by KFH-Bahrain combine a broad range of innovative products and services with exceptional customer care. Our product and financing facilities are developed with the aim of providing for the long term needs of customers in the local market. Our growth is driven by the determination to continuously improve our service quality, while thinking innovatively and striving to deliver superior Islamic Shari'a compliant products remain at the core of all we do.

KFH-Bahrain provides a 'one-stop-shop' for our customers' banking and financing requirements through our growing network of branches and ATMs. Our ATM network has been upgraded to provide a more secure service, while network coverage has increased with new machines being installed in major residential, financial and shopping districts, including prime locations such as in Al Hajjiyat residential area in East Riffa and at the Riyadat Mall in A'ali bringing the current total to 23.

New services and innovative products are constantly being introduced for the benefit of our customers. These range from technology and service enhancement that provide greater access to information and funds, both locally and internationally, to the launch of our unique, never-before-seen products. We have demonstrated a constant pattern of growth with our electronic services throughout the years with the enhancement of the online banking service to include investment account management and real-time online utility payment for VIVA and Menatelecom

Well into its second successful year, Libshara Savings account, a Shari'a compliant scheme, is yet another market-driven and customer focused product; offering customers a great savings return while having an opportunity to win monthly cash prizes and chances to win one of 4 plots of prime land in Sarat, Diyar al Muharraq

Our Baytik Ijara card is the world's first Islamic financing card that allows cardholders to acquire durable goods on a 'lease-to-own' basis, including a special cardholder merchant discount scheme. This financing facility has been developed further to provide an exclusive student finance scheme and to purchase jewelry from approved merchants.

A unique 30 year home financing scheme is another example of our dedication for product innovation. With exclusive offers targeting villas at Durrat Al Bahrain, Ishbiliya Village, Diyar Homes and Sarat, we have set a new standard in consumer finance.

The first Islamic chipped credit card – a Shari'a compliant offering with many benefits, introduced in 2007 in association with Visa, was enthusiastically received and continues its impressive growth. Customers enjoy a revolving credit facility without incurring interest and instead pay a low annual service charge.

KFH Automall showrooms are considered to be the largest in Bahrain to date and are located in Sitra and Exhibition Road. Each showroom provides a unique automotive and marine shopping experience, while also benefitting from a fully-fledged KFH-Bahrain branch within its facility. KFH Automalls provide customers with the convenience of a 'one stop shop' service for financing, insurance, registration, auto services and others, all under one roof.

Our growth is driven by the determination to continuously improve our service quality, while thinking innovatively and striving to deliver superior Islamic Shari'a compliant products remain at the core of all we do.

Corporate Banking Group (CBG), strives to provide excellent customer services through Sharia'a compliant solutions. It is with a thorough understanding of customer requirements aligned with a comprehensive understanding of the customers' businesses and their needs, that our team of professionals is able to tailor financing facilities to aid business sustainability and growth. With expertise in various market sectors, the CBG team is able to understand business trends, specific business characteristics of each sector and requirements. Through its innovative range of Sharia'a compliant financing instruments which include Murabaha, Ijara, Istisna'a, as well as Commodity and Convertible Murabaha facilities, CBG has continued to strongly service the requirements of large corporations as well as small and medium enterprises in the Kingdom of Bahrain across all industry sectors using various facility structures which include the following:

- Real Estate Financing
- Project Financing
- Working Capital Financing
- Trade Financing

With its current platform and infrastructure, Kuwait Finance House – Bahrain, will continue to support the corporate sector of the country aligning the Bank's growth targets with the continuous development and progress of the Kingdom of Bahrain.

Corporate Banking Group

KFH-Bahrain's Treasury & Capital Markets Department is active in the institutional banking and wholesale markets through its Treasury, Capital Markets, and Product Structuring functions.

The Department aims at offering institutional banking services to financial institutions, sovereign and quasi-sovereign entities, as well as large corporates.

Treasury

The primary function of the Treasury is to efficiently manage liquidity and capital across KFH-Bahrain. In this capacity, the Department is responsible for handling interbank activities (assets & liabilities) and foreign exchange.

Capital Markets

The Department's mission comprises Sukuk issuance and syndicated financing service offering (with institutions and entities accessing financial markets). It is mandated with managing KFH-Bahrain's Sukuk portfolio and participating in regional syndication activity.

Product Structuring

In addition to its Treasury, Sukuk and financing activities, the Department's scope includes, as an objective, the development of services in fields such as liquidity management, investment funds and financial instruments (intended for different types of investors or parties).

Treasury & Capital Markets

KFH-Bahrain's Approach to Risk Management

At KFH-Bahrain, we believe that a robust and well implemented risk management framework is essential in protecting the interests of our stakeholders and translating our banking processes into tangible results. To achieve this, we developed a framework and culture which is proactive in the management of risk throughout the full life cycle of a financial transaction and our operating circumstances.

The board of directors (the board) is responsible for managing risk in the Bank. It does this through setting the risk appetite in the form of a comprehensive limit structure and aligning business and risk strategies to achieve the targeted risk adjusted returns. The board level Audit, Risk, Governance and Compliance Committee (ARGCC) meets regularly to oversee the Bank-wide implementation of the board approved strategies, policies and the risk appetite. The senior management through the Risk Management Committee develops and implements appropriate risk and business processes to monitor and manage risk within the parameters set by the board.

The Risk Management department helps the Asset and Liability Committee (ALCO), the ARGCC and the board in taking sound business and operating decisions. In the last few years, the Bank has put tremendous effort into improving, monitoring and gathering quality data into systems and formats which give a timely and accurate picture of the risk profile of the Bank. Sophisticated and prudent models are developed and refined periodically to allow measurement of risk taken and project the likely impact of various risk factors in the Bank's business and operating goals. The models such as internal scoring systems, stress test programs and the Internal Capital Adequacy and Assessment Program (ICAAP) have become valuable decision tools in the Bank. The bank has also developed models for Funds Transfer Pricing (FTP) and risk adjusted performance measurements (RAROC) which are being embedded in the risk management framework of the Bank.

KFH-Bahrain recognizes that good policies are not enough and it is only through the creation of a sound risk culture that risk can be contained and managed. To achieve this, all staff members are educated in basic risk management principles. Further, departmental procedures are integrated with the Bank's risk management processes. The Bank has put in place a Risk and Control Self-Assessment (RCSA) framework which ensures

Risk Management

that risk taking activities are owned, understood and properly mitigated continuously by the risk takers. Several layers of checks and balances are implemented in the Bank's processes. Business units are the first line of defense against risk in their activities whereas the Risk Management department provides necessary tools and framework. Further, Internal Audit provides audit assurance on the efficacy of the risk management framework in the Bank.

In 2013, the Bank was identified by the Central Bank of Bahrain (CBB) as a Domestic Systematically Important Bank (D-SIB). To fulfill the requirement of D-SIB and also to enhance the control framework and resilience of the bank, the Bank has developed an appropriate recovery and resolution plan (RRP).

As a concerned corporate citizen and a leading Bahrain-based Islamic financial institution, we are committed to contributing towards the social well-being of the Bahraini local community. We are also dedicated to supporting the business and economic development of the Kingdom, in-line with the principles of Shari'a and ethical approach to business.

Throughout 2013, KFH-Bahrain continued to implement a comprehensive Corporate Social Responsibility (CSR) programme comprising of financial and practical support for a range of charitable, educational, medical, cultural, sporting and social organizations and other deserving causes. We also participated in and sponsored a number of major initiatives and events aimed at supporting Islamic banking and finance with a view to contributing towards the further development of business and the economy. Some examples of our CSR activities during the year are as follows:

Developing Tomorrow's Sporting Champions

- Sponsored the H.H. Shaikh Khalid Bin Hamad Al Khalifa's Endurance Cup
- Sponsored the Al Ahli Club participation in the 33rd Handball GCC Cup
- Sponsored the Bahrain Football Association's Futsal League and Cup
- Sponsored the Busaiteen Sports and Cultural Club
- Sponsored the Al Najma Club's Bankers Futsal Tournament
- Sponsored the TFA Social Tournament

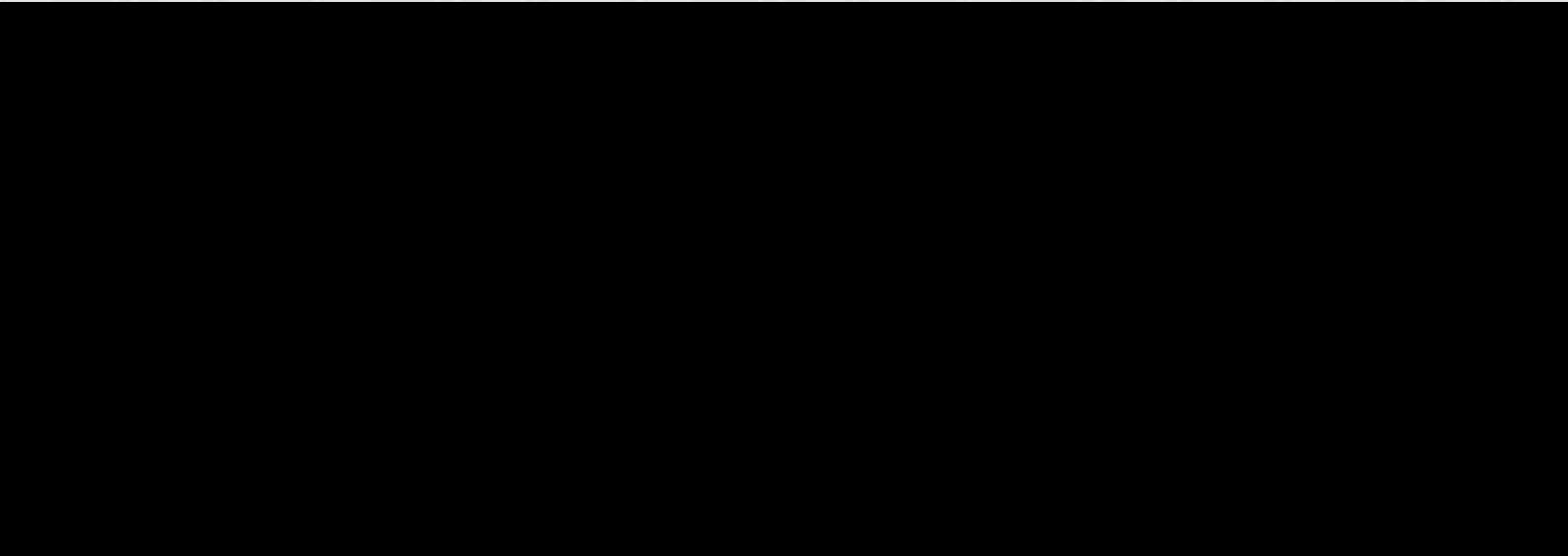
Supporting Islamic Banking and Finance

- Sponsored the IFSB Summit Malaysia
- Silver Sponsor of the Annual Conference of the Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI) in Bahrain
- Gold Strategic Partners of The World Islamic Banking Conference

Promoting Health, Education and Leadership

- Sponsored the International Diabetes Symposium
- Sponsored the University of Bahrain's 2nd Gulf Universities Forum
- Sponsored the Southern Governorate Anti-Drug Campaign
- Sponsored the World Quran Recital Competition
- Sponsored the Bahrain Down Syndrome Society

Corporate Social Responsibility



Fatwa & Shari'a Supervisory Board Report

In the Name of Allah Most Gracious Most Merciful

Praise be to Allah, Almighty, and Prayers and Peace be upon Prophet Mohammed, his family and Companions

To: The Shareholders of Kuwait Finance House-Bahrain

Al Salam Alaikum Wa Rahmatu Allah Wa Barakatuh

In compliance with the letter of appointment, we are required to submit the following report:

We have supervised the products and contracts relating the transactions and applications introduced by Kuwait Finance House – Bahrain (the Bank) during the period ended 31st Dec 2013. We have performed our supervision to form an opinion as to whether the Bank has complied with the provisions and principles of Islamic Shari'a, as well as Fatwas, rules and guidelines issued by us.

Responsibility of Management

The Bank management is responsible for ensuring that the Bank conducts its business in accordance with the provisions and principles of Islamic Shari'a. It is our responsibility to form an independent opinion based on our review of the operations of the Bank and preparing a report for you.

Scope of work of the Fatwa and Shari'a Supervisory Board

Through the periodic reports provided by the head of Shari'a Department, The Fatwa and Shari'a Supervisory Board (The Board) confirmed that the Bank did not violate the provisions, rules and principles of Islamic Shari'a. The reports contained the results of reviewed and approved contracts and agreements and the results of the Bank operations reviewed on a random sample selection in accordance to the annual audit plan for the Shari'a Department which was approved by The Board including the field visits and supervision of the workflow from Shari'a viewpoint and implementation of Fatwa and decisions issued by us.

We planned and performed our supervision to obtain all the information and explanations which we considered necessary to provide us with sufficient evidence to give reasonable assurance that the Bank did not violate the provisions and principles of Islamic Shari'a.

In our opinion

1. The contracts, transactions, and dealings entered into by the Bank during the year ended 31st December 2013 that we have reviewed are in compliance with the provisions and principles of Islamic Shari'a.
2. The allocation of profits and charging of losses relating to investment accounts conform to the basis that had been approved by us in accordance with the provisions and principles of Islamic Shari'a.
3. All earnings that have been realized from sources or by means of prohibited by the provisions and principles of Islamic Shari'a have been set aside in an independent account and disposed of to charitable causes; and
4. The calculation of Zakat is in compliance with the provisions and principles of Islamic Shari'a.

The Fatwa and Shari'a Supervisory Board approved the report based on the periodic reports provided by the Shari'a Department.

The Board thanks the senior management, the departments and the staff of Kuwait Finance House - Bahrain for their cooperation and commitment to our decisions and guidelines and asks Allah Almighty to bring them success and rashad.

We pray to Allah Almighty to guide us to the righteous path.



Sh. Dr. Ajeel Al Nashmi
Chairman
Fatwa and Shari'a Supervisory Board



Sh. Dr. Khalid AlMadhkoor
Member
Fatwa and Shari'a Supervisory Board



Sh. Dr. Mohammed Tabatabai
Member
Fatwa and Shari'a Supervisory Board

Independent Auditors' Report

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

We have audited the accompanying consolidated statement of financial position of Kuwait Finance House (Bahrain) B.S.C. (c) [the "Bank"] and its subsidiaries [together the "Group"] as of 31 December 2013, and the related consolidated statements of income, cash flows, changes in owners' equity, and changes in off-balance sheet equity of investment account holders for the year then ended and a summary of significant accounting policies and other explanatory information. These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a Rules and Principles are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

Opinion

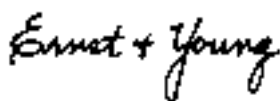
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2013, the results of its operations, its cash flows, changes in equity and changes in off-balance sheet equity of investment account holders for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

Other Matters

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

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

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



17 February 2014
Manama, Kingdom of Bahrain



Consolidated Financial Statements

Consolidated Statement of Financial Position

31 December 2013

	Note	2013 BD 000	2012 BD 000
ASSETS			
Cash and balances with banks and Central Bank of Bahrain	6	54,733	41,525
Murabaha and due from banks	7	117,902	100,672
Financing contracts with customers	8	600,544	551,717
Investments	9	268,276	258,475
Investment in joint ventures and associates	10	168,669	167,749
Investment in real estate	11	147,785	153,498
Receivables, prepayments and other assets	12	115,196	124,525
Goodwill and intangibles	13	383	28,497
Premises and equipment		10,342	46,824
		1,483,830	1,473,482
Assets of disposal group classified as held for sale	14	81,317	-
TOTAL ASSETS		1,565,147	1,473,482
LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS, AND OWNERS' EQUITY			
LIABILITIES			
Customers' current accounts		77,293	51,561
Murabaha and due to banks	15	216,363	213,078
Murabaha due to non-banks		300,490	235,861
Other liabilities	17	33,715	40,109
Subordinated murabaha payable	18	98,790	99,197
		726,651	639,806
Liabilities associated with disposal group classified as held for sale	14	18,210	-
		744,861	639,806
EQUITY OF INVESTMENT ACCOUNT HOLDERS	19	452,504	451,870
OWNERS' EQUITY			
Equity attributable to shareholders of the Parent			
Share capital	20	177,140	177,140
Share premium		71,403	71,403
Treasury shares	20	(21,923)	-
Statutory reserve		16,053	15,314
General reserve		28,237	28,237
Fair value through equity reserve		977	61
Property fair value reserve		35,540	37,719
Foreign currency translation reserve		(1,448)	(1,455)
Retained earnings		40,454	31,622
		346,433	360,041
Non-controlling stakeholders		17,900	21,765
Non-controlling stakeholders of disposal group classified as held for sale		3,449	-
		367,782	381,806
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNERS' EQUITY		1,565,147	1,473,482
OFF-BALANCE SHEET:			
EQUITY OF INVESTMENT ACCOUNT HOLDERS		99,176	95,200
CONTINGENT LIABILITIES AND COMMITMENTS	22	57,952	44,918

Yaqoob Yusuf Majed
Chairman of the
Board of Directors

Abdulhakeem Yaqoob Alkhayyat
Managing Director and
Chief Executive Officer

The attached notes 1 to 40 form part of these consolidated financial statements.

Consolidated Statement of Income

31 December 2013

	Note	2013 BD 000	2012 BD 000
Continuing operations			
Income from retail and corporate banking activities	23	42,945	42,946
Income from investment activities	24	8,746	13,700
Share of income of joint ventures and associates	10	1,943	654
Other (loss) income	26	(542)	3,072
Operating income		53,092	60,372
Return on equity of investment account holders, net of mudarib share	19	(7,745)	(8,713)
Profit on murabaha and due to banks, murabaha due to non-banks and subordinated murabaha payable	29	(14,094)	(15,964)
Net operating income		31,253	35,695
Staff costs		12,982	12,446
Depreciation		1,637	2,082
(Reversals) Provisions - net	27	(1,217)	417
Other expenses	28	11,977	12,050
Total operating expenses		25,379	26,995
Net income for the year from continuing operations		5,874	8,700
Discontinued operations			
Net (loss) income for the year from assets classified as held for sale	14	(129)	950
NET INCOME FOR THE GROUP BEFORE ADJUSTMENT FOR NON-CONTROLLING STAKEHOLDERS		5,745	9,650
Adjustment attributable to non-controlling stakeholders		2,214	775
Adjustment attributable to non-controlling stakeholders of assets held for sale		(567)	(382)
NET INCOME ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT		7,392	10,043

Yaqoob Yusuf Majed
Chairman of the
Board of Directors

Abdulhakeem Yaqoob Alkhayyat
Managing Director and
Chief Executive Officer

The attached notes 1 to 40 form part of these consolidated financial statements.

Consolidated Statement of Changes in Owners' Equity

31 December 2013

	Attributable to shareholders of the parent										Non-controlling stakeholders of disposal group classified as held for sale	Total owners' equity
	Share capital BD 000	Share premium BD 000	Treasury shares BD 000	Statutory reserve BD 000	General reserve BD 000	Fair value through equity reserve BD 000	Property fair value reserve BD 000	Foreign currency translation reserve BD 000	Retained earnings BD 000	Total BD 000	Non-controlling stakeholders BD 000	
Balance at 1 January 2013	177,140	71,403	-	15,314	28,237	61	37,719	(1,455)	31,622	360,041	21,765	- 381,806
Net income (loss) for the year	-	-	-	-	-	-	-	-	7,392	7,392	(2,214)	567 5,745
Other comprehensive income for the year (note 21)	-	-	-	-	-	916	-	7	-	923	-	- 923
Total comprehensive income (loss) for the year	-	-	-	-	-	916	-	7	7,392	8,315	(2,214)	567 6,668
Repurchase of shares	-	-	(21,923)	-	-	-	-	-	-	(21,923)	-	- (21,923)
Net transfer from property fair value reserve	-	-	-	-	-	-	(2,179)	-	2,179	-	-	- -
Transfer to statutory reserve	-	-	-	739	-	-	-	-	(739)	-	-	- -
Net movement in share of non-controlling stakeholders	-	-	-	-	-	-	-	-	-	-	(1,651)	2,882 1,231
Balance at 31 December 2013	177,140	71,403	(21,923)	16,053	28,237	977	35,540	(1,448)	40,454	346,433	17,900	3,449 367,782
Balance at 1 January 2012	177,140	71,403	-	14,310	28,237	332	43,662	(1,439)	16,640	350,285	22,639	- 372,924
Net income (loss) for the year	-	-	-	-	-	-	-	-	10,043	10,043	(393)	- 9,650
Other comprehensive loss for the year (note 21)	-	-	-	-	-	(271)	-	(16)	-	(287)	-	- (287)
Total comprehensive (loss) income for the year	-	-	-	-	-	(271)	-	(16)	10,043	9,756	(393)	- 9,363
Net transfer from property fair value reserve	-	-	-	-	-	-	(5,943)	-	5,943	-	-	- -
Transfer to statutory reserve	-	-	-	1,004	-	-	-	-	(1,004)	-	-	- -
Net movement in share of non-controlling stakeholders	-	-	-	-	-	-	-	-	-	-	(481)	- (481)
Balance at 31 December 2012	177,140	71,403	-	15,314	28,237	61	37,719	(1,455)	31,622	360,041	21,765	- 381,806

The attached notes 1 to 40 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

31 December 2013

	Note	2013 BD 000	2012 BD 000
OPERATING ACTIVITIES			
Net income for the year from continuing operations		5,874	8,700
Net (loss) income for the year from assets classified as held for sale		(129)	950
Net income for the Group before adjustments for non-controlling stakeholders		5,745	9,650
Adjustments for:			
Share of income of joint ventures and associates	10	(1,943)	(654)
Depreciation		1,637	2,082
(Reversals) Provisions - net	27	(1,217)	417
Net unrealised (gain) loss on investments	24	(967)	696
Net gain on sale of investments	24	(3,452)	(5,132)
Net gain on sale of investment in real estate	24	(1,151)	(3,323)
Operating (loss) income before changes in operating assets and liabilities		(1,348)	3,736
Changes in operating assets and liabilities:			
Mandatory reserve with Central Bank of Bahrain	6	(3,340)	3,940
Financing contracts with customers		(42,733)	47,412
Receivables, prepayments and other assets		8,897	17,032
Murabaha and due to banks		3,285	(363)
Murabaha due to non-banks		64,629	(54,827)
Subordinated murabaha payable		(407)	(989)
Customers' current accounts		25,732	(22,241)
Other liabilities		(5,324)	(916)
Net cash flows from (used in) operating activities		49,391	(7,216)
INVESTING ACTIVITIES			
Purchase of investments		(18,702)	(1,885)
Proceeds from sale / maturity of investments		11,116	33,140
Purchase of investments in joint ventures	10	-	(45,888)
Purchase / construction of investment in real estate	11	(1,300)	(2,462)
Proceeds from sale of investment in real estate		10,355	15,379
Purchase of equipment		(1,342)	(1,474)
Net cash flows from (used in) investing activities		127	(3,190)
FINANCING ACTIVITIES			
Net movement in equity of investment account holders		634	6,582
Net movement in share of non-controlling stakeholders		(1,651)	(481)
Purchase of treasury shares		(21,923)	-
Net cash flows (used in) from financing activities		(22,940)	6,101
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		26,578	(4,305)
Cash and cash equivalents at 1 January		116,462	120,767
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	30	143,040	116,462

The attached notes 1 to 40 form part of these consolidated financial statements.

Consolidated Statement of Changes in Off-Balance Sheet Equity of Investment Account Holders

31 December 2013

	Balance at 1 January 2013 BD 000	Additional Investments BD 000	Gross Income BD 000	Mudarib Share BD 000	Withdrawals / distributions BD 000	Balance at 31 December 2013 BD 000
Murabaha contracts	94,345	106,865	8,983	(1,549)	(109,468)	99,176
Ijarah Muntahia Bittamleek contracts	855	-	30	(9)	(876)	-
	95,200	106,865	9,013	(1,558)	(110,344)	99,176

	Balance at 1 January 2012 BD 000	Additional Investments BD 000	Gross Income BD 000	Mudarib Share BD 000	Withdrawals / distributions BD 000	Balance at 31 December 2012 BD 000
Murabaha contracts	55,575	97,490	6,433	(1,003)	(64,150)	94,345
Ijarah Muntahia Bittamleek contracts	978	-	61	(15)	(169)	855
	56,553	97,490	6,494	(1,018)	(64,319)	95,200

The attached notes 1 to 40 form part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

31 December 2013

1 CORPORATE INFORMATION AND ACTIVITIES

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 an Islamic retail banking license. 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, P.O. Box 2066, Manama, 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 Islamic Banking Services as defined in the licensing framework.

The Bank is a subsidiary of Kuwait Finance House K.S.C. (the "ultimate parent"), a public company incorporated in the State of Kuwait and listed at the Kuwait Stock Exchange. The ultimate parent is regulated and supervised by the Central Bank of Kuwait. The Bank's Shari'a Supervisory Board is entrusted to ensure that the Bank and its Subsidiaries (the 'Group') adhere to Shari'a rules and principles in its transactions and activities.

The Group operate in the Kingdom of Bahrain, Hashemite Kingdom of Jordan and the United Kingdom. The activities of the Bank's key subsidiaries are mentioned in note 4.

The Bank has nine branches (2012: nine), all operating in the Kingdom of Bahrain.

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors passed on 17 February 2014.

2.1 BASIS OF PREPARATION

The consolidated financial statements have been prepared under the historical cost basis, except for investments and investment in real estate 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, unless otherwise indicated.

2.2 STATEMENT OF COMPLIANCE

The consolidated financial statements of the Group have been prepared in accordance with the Financial Accounting Standards ("FAS") issued by the Accounting and Auditing Organization for Islamic Financial Institutions ("AAOIFI"), the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank, the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6) and CBB directives. For matters not covered by FAS, the Group uses the relevant International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB").

2.3 BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries as at 31 December 2013. 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 and continue to be consolidated until the date when such control ceases. 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, if any, are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate. A change in the Group's ownership of a subsidiary, without a loss of control, is accounted for as an equity transaction.

Share of non-controlling stakeholders represents 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 owners' equity in the consolidated statement of financial position, separately from the equity attributable to shareholders of the parent.

Notes to the Consolidated Financial Statements

31 December 2013

3.1 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of the Group's consolidated financial statements requires management to make judgments, estimates and assumptions that affect the amounts reported in the consolidated financial statements. The most significant uses of judgments and estimates are as follows:

3.1.1 Going concern

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

3.1.2 Fair value of unquoted equity securities and investment in real estate

Fair value is determined for each investment individually in accordance with the valuation policies set out in note 3.2.25. Where the fair values of the Group's unquoted equity securities cannot be derived from an active market, they are derived using a variety of valuation techniques. Judgment by management is required to establish fair values through the use of appropriate valuation models, consideration of comparable assets, discount rates and the assumptions used to forecast cash flows.

Investment in real estate projects are carried at fair value as determined by independent real estate valuation experts. The determination of the fair value for such assets requires the use of judgment and estimates by the independent valuation experts that are based on local market conditions existing at the date of the consolidated statement of financial position.

3.1.3 Impairment provisions against financing contracts with customers

The Group reviews its financing contracts at each reporting date to assess whether an impairment provision should be recorded in the consolidated financial statements. 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 factors involving varying degrees of judgment and uncertainty and actual results may differ resulting in future changes to the provisions.

In addition to impairment against individually impaired financing contracts, the Group also makes a collective impairment provision against exposures which, although not specifically identified as requiring an individual impairment, 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.

3.1.4 Impairment of investments at fair value through equity

The Group treats investments carried at fair value through equity as impaired when there is 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 historical share price volatility for comparable quoted equities and future cash flows and the discount factors for comparable unquoted equities.

3.1.5 Liquidity

The Group manages its liquidity through consideration of the maturity profile of its assets, liabilities and equity of investment account holders which is set out in the liquidity risk disclosures in note 35. This requires judgment when determining the maturity of assets and liabilities with no specific maturities.

3.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

3.2.1 Foreign currency translation

The consolidated financial statements are presented in Bahraini Dinars, which is the 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.

Notes to the Consolidated Financial Statements

31 December 2013

3.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Transactions and balances

Transactions in foreign currencies are initially recorded in the functional currency using the rate of exchange prevailing 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 date of the consolidated statement of financial position. All differences are taken to the consolidated statement of income with the exception of all monetary items that provide an effective protection for a net investment in a foreign operation. These are recognised in other comprehensive income until the disposal of the net investment, at which time they are recognised in 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 is determined. Exchange gains and 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 "fair value through equity" such differences are taken to the consolidated statement of comprehensive income. 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 (Bahraini Dinars) at the rate of exchange prevailing at the date of the consolidated statement of financial position, and their statements of income are translated at the weighted average exchange rates for the year. Exchange differences arising on translation are recognised in other comprehensive income. On disposal of a foreign subsidiary, the cumulative amount recognised in other comprehensive income relating to that particular foreign subsidiary is recognised in the consolidated statement of income in 'other operating expenses' or 'other income'.

3.2.2 Financial instruments - Initial recognition and subsequent measurement

Date of recognition

All financial assets and liabilities are initially recognised on the trade date, i.e. the date that the Group becomes a party to the contractual provisions of the instrument.

Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on the purpose and the management's intention for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus transaction costs, except in the case of financial assets recorded at fair value through statement of income.

(i) Murabaha and due from banks

Murabahas are international commodity murabaha transactions. The Bank arranges a murabaha transaction by buying a commodity (which represents the object of the murabaha) and then resells this commodity to the beneficiary murabeh (after computing a profit margin). The sale price (cost plus the profit margin) is paid either lump sum at maturity or in installments by the murabeh over the agreed period.

Murabaha with banks are stated net of deferred profits and provision for impairment, if any. Due from banks are on wakala basis. These are stated at amortised cost.

Notes to the Consolidated Financial Statements

31 December 2013

3.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(ii) Financing contracts with customers

(a) Murabaha

Murabaha represents the sale of goods at cost plus an agreed profit. 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. Promise made in the murabaha to the purchase orderer is not obligatory upon the customer.

(b) Ijarah Muntahia Bittamleek

Ijarah Muntahia Bittamleek mainly comprise of land and buildings and certain other assets. 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.

Assets under Ijarah Muntahia Bittamleek are initially recognised at cost and subsequently depreciated at rates calculated to write off the cost of each asset over its useful life to its residual value.

(c) Musharaka

Musharaka represents a partnership between the Group and a customer whereby each party contributes to the capital in equal or varying proportions to establish a new project or share in an existing one, and whereby each of the parties becomes an owner of the capital on a permanent or declining basis and shall have a share of profits or losses. These are stated at the fair value of consideration given less any amounts written off and provision for impairment, if any.

(iii) Investments

Investments are classified as follows:

- Investments at fair value through statement of income
- Investments at fair value through equity
- Investments at amortised cost

(a) Investments at fair value through statement of income

Investments at fair value through statement of income include investments designated upon initial recognition as investments at fair value through statement of income.

In addition to the above, the Group utilises the exemption available to associates and joint ventures as per IAS 28 and FAS 24 as applicable to venture capital organisations and classifies such investments as “investments at fair value through statement of income”. Financial assets carried at fair value through statement of income are recognised at fair value, with transaction costs recognised in the consolidated statement of income.

Investments classified as ‘at fair value through statement of income’ are subsequently measured at fair value. The unrealised gains and losses arising from the remeasurement to fair value are included in the consolidated statement of income.

(b) Investments at fair value through equity

Investments at fair value through equity are those which are designated as such or are not classified as carried at fair value through statement of income or at amortised cost. These include investments in equity securities and managed funds.

After initial measurement, investments at fair value through equity are subsequently measured at fair value. Unrealised gains and losses are recognised in statement of comprehensive income and then transferred to the fair value through equity reserve in the consolidated statement of changes in equity. When the investment is disposed of or determined to be impaired, the cumulative gain or loss, previously transferred to the fair value through equity reserve, 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 of on a weighted average basis.

Notes to the Consolidated Financial Statements

31 December 2013

3.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Investments at amortised cost

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as such when the Group has the positive intention and ability to hold them to maturity. After initial measurement, these investments are measured at amortised cost using the effective profit rate (EPR), less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EPR. The EPR amortisation is included in the consolidated statement of income. The losses arising from impairment are recognised in the consolidated statement of income under 'provisions'.

(iv) Murabaha and due to banks

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

(v) Murabaha due to non-banks

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

(vi) Equity of investment account holders

Equity of investment account holders is invested in murabaha and due from banks, sukuk and financing contracts with customers. No priority is granted to any party for the purpose of distribution of profits. According to the terms of acceptance of the investment account holders funds, 100% of these funds are invested after deductions of mandatory reserve and sufficient operational cash requirements.

Equity of investment account holders is carried at fair value of consideration received less amounts settled. Expenses are allocated to investment accounts in proportion of average equity of investment account holders to average assets, however, investment related expenses and assets are excluded.

Income is allocated proportionately between equity of investment account holders and owners' equity on the basis of the average balances outstanding during the year and share of the funds invested.

3.2.3 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 rights to receive cash flows from the asset have 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 rights 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.

3.2.4 Impairment of financial assets

The Group assesses at each reporting 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 has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Notes to the Consolidated Financial Statements

31 December 2013

3.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in profit or principal repayments, 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) Financial assets carried at amortised cost

For financial assets carried at amortised cost, the Group first assesses whether objective evidence of impairment exists for individually significant financial assets, 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 the 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.

Financing contracts together with the associated provisions are written off when there is no realistic prospect of future recovery and 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 in the consolidated statement of income.

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 of 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 which 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) Investments at fair value through equity

For investments at fair value through equity, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as "fair value through equity", 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 comprehensive income is removed from fair value through equity reserve 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 subsequent to impairment are recognised directly in equity.

3.2.5 Offsetting financial instruments

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

Notes to the Consolidated Financial Statements

31 December 2013

3.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2.6 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.

3.2.7 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 recognised on a time-apportioned basis over the period of the contract based on the principal amounts outstanding. Accrual of income is suspended when the Group believes that the recovery of these amounts may be doubtful.

(b) Ijarah Muntahia Bittamleek

Ijarah income is recognised on a time-apportioned basis, net of depreciation, over the lease term. Accrual of income is suspended when the Group believes that the recovery of these amounts may be doubtful.

(c) Musharaka

Income on musharaka contracts is recognised when the right to receive payment is established or on distribution by the musharek.

(d) Dividends

Dividends from investments in equity securities are recognised when the right to receive the payment is established.

(e) Fees and commission income

Fees and commission income is recognised when earned.

(f) Sale of property under development

Revenue on sale of real estate 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; and
- The Group has transferred to the buyer the 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.

Where property is under development and agreement has been reached to sell such property when construction is complete, the Group considers whether the contract comprises:

- contract to construct a property; or
- contract for the sale of a completed property.

Where a contract is determined to be a construction contract, revenue is recognised using the percentage of completion method as construction progresses. The percentage of work complete is measured based on the costs incurred up until the end of the reporting period as a proportion of total costs expected to be incurred.

Where the contract is judged to be for the sale of a completed property, revenue is recognised when the significant risks and rewards of ownership of the property are transferred to the buyer.

(g) Service income

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

(h) 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.

Notes to the Consolidated Financial Statements

31 December 2013

3.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

i) Group's share as a mudarib

The Group's share as a mudarib for managing the equity of investment account holders is accrued based on the terms and conditions of the related mudaraba agreements whereas, for off balance sheet equity of investment account holders, mudarib share is recognised when distributed.

(ii) Expense recognition

(a) Profit on murabaha payables (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) Return on equity of investment account holders

Return on equity of investment account holders is based on the income generated from jointly financed assets after deducting mudarib share and is accrued based on the terms and conditions of the underlying mudaraba agreement. Investors' share of income represents income generated from assets financed by investment account holders net of allocated operating expenses excluding investment related expenses. The Group's share of profit is deducted from the investors' share of income before distribution to investors.

3.2.8 Investment in associates

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 consolidated statement of financial position 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 amortised nor individually tested for impairment.

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

The consolidated statement of income reflects the share of the results of operations of the associate. Where there has been an income or expense recognised in the other comprehensive income of the associate, the Group recognises its share of any such income or expense, when applicable, in the consolidated statement of comprehensive income. Gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of stake in the associate.

The reporting dates of the associates and the Group are identical and their accounting policies conform to those used by the Group for like transactions and events in similar circumstances. In case of any difference in the associates' accounting policies, their results are adjusted to bring them in line with the Group accounting policies.

Upon loss of significant influence over the associate, the Group measures and recognises any retaining investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retaining investment and proceeds from disposal is recognised in the consolidated statement of income.

3.2.9 Investment in joint ventures

The Group has arrangements with other parties which represent joint ventures. These take the form of agreements to share control.

The reporting dates of the joint ventures and the Group are identical and their accounting policies conform to those used by the Group for like transactions and events in similar circumstances. In case of any difference in the joint ventures' accounting policies, their results are adjusted to bring them in line with the Group accounting policies.

Where the joint venture is established through a stake in a company (a jointly controlled entity), the Group recognises its stake in the entity's assets and liabilities using the equity method of accounting. Under the equity method, the investment in a joint venture is carried in the consolidated statement of financial position at cost plus post acquisition changes in the Group's share of its net assets, less distributions received and less impairment in value of individual investments.

Notes to the Consolidated Financial Statements

31 December 2013

3.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2.10 Investment in real estate

Properties held to earn rental income, for capital appreciation or both are classified as investment in real estate. Investments in real estate are measured initially at cost, including transaction costs. Subsequent to initial recognition, investments in real estate are stated at fair value, which reflects market conditions at the date of the consolidated statement of financial position. The Group engages independent valuation specialists to determine fair value as at the year end.

Unrealised gains arising from a change in the fair value of investment in real estate are recognised directly in the consolidated statement of changes in owners' equity under "Property fair value reserve" for the period in which they arise.

Unrealised losses resulting from re-measurement at fair value of investment in real estate are adjusted in equity against the property fair value reserve, to the extent of the available credit balance of this reserve. In case such losses exceed the available balance, the unrealised losses are recognised in the consolidated statement of income. In case there are unrealised losses relating to investment in real estate that have been recognised in the consolidated statement of income in a previous financial period, the unrealised gains relating to the current financial period are recognised in the consolidated statement of income to the extent of crediting back such previous losses in the consolidated statement of income.

Realised gains or losses resulting from the sale of any investment in real estate are measured as the difference between the carrying value and the net cash or cash equivalent proceeds from the sale for each investment separately. The resulting gain or loss together with the available balance in the property fair value reserve is recognised in the consolidated statement of income for the current financial period.

Investment in real estate under construction is measured at cost until the construction is completed. Once the construction is completed and the property is ready for its intended use, it is measured at its fair value.

Investments in real estate are derecognised when they have been disposed of or permanently withdrawn from use and no future economic benefit is expected from their disposal. Any gains or losses on the retirement or disposal of these real estate investments are recognised in the consolidated statement of income in the year of retirement or disposal.

Transfers are made to investment in real estate when, and only when, there is a change in use, evidenced by the end of owner occupation or commencement of an operating lease. Transfers are made from investment in real estate when, and only when, there is a change in use, evidenced by commencement of owner occupation or commencement of development with a view to sale.

3.2.11 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, if any.

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
Telecom & Wimax equipment	10 - 25
Equipment	3 - 7
Motor vehicles and office furniture	3 - 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.

3.2.12 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 gain on acquisition is recognised directly as income in the consolidated statement of income in the year of acquisition.

Notes to the Consolidated Financial Statements

31 December 2013

3.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 stake 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.

3.2.13 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 accumulated amortisation and any accumulated impairment losses.

Intangible assets with finite useful lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset maybe impaired. 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 on intangible assets with finite useful lives is recognised in the consolidated statement of income. Amortisation of license rights is calculated using the straight-line method to write down the cost of these intangible assets to their residual values over their estimated useful lives of 4 - 25 years.

3.2.14 Impairment of non-financial assets

The Group assesses at each reporting date or more frequently whether there is an 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.

3.2.15 Financial guarantees

In the ordinary course of business, the Group provides financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recorded in the consolidated statement of financial position 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 the guarantee.

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

3.2.16 Treasury shares

Own equity instruments that are reacquired (treasury shares) are recognised at cost and deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments. Any difference between the carrying amount and the consideration, if reissued, is recognised in share premium. Any share options exercised during the reporting period are satisfied with treasury shares.

3.2.17 Provisions

Provisions are recognised 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.

3.2.18 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Chief Operating Decision Maker (CODM). CODM is a person or group that allocates resources to and assesses the performance of the operating segments of the entity. The Group has determined the Managing Director and Chief Executive Officer as its CODM.

Notes to the Consolidated Financial Statements

31 December 2013

3.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2.19 Cash and cash equivalents

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

3.2.20 Employees' end of service benefits

Provision is made for leaving indemnity payable under the Bahraini Labor Law applicable to non-Bahraini employees' accumulated periods of service at the consolidated statement of financial position date.

Bahraini employees of the Group are covered by contributions made to the Social Insurance Organisation ("SIO") as a percentage of the employees' salaries. The Group's obligations are limited to these contributions, which are expensed when due. For Bahrainis with basic salaries above a certain threshold, the Bank recognises leaving indemnity in line with the requirements of Bahrain Labour Law.

3.2.21 Off-balance sheet equity of investment account holders

Off-balance sheet equity of investment account holders represents funds received by the Bank on the basis of mudaraba to be invested in specified products as directed by the investment account holders. The assets funded by these funds are managed in a fiduciary capacity by the Bank for which the Bank earns mudarib share which is disclosed as part of 'income from retail and corporate banking activities'. These assets are not included in the consolidated statement of financial position as the Group does not have the right to use or dispose of them except within the conditions laid down in the underlying mudaraba contract.

3.2.22 Earnings prohibited by Shari'a

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is transferred to charity.

3.2.23 Inventories

Inventories are carried 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.

3.2.24 Non-current assets held for sale and discontinued operations

The Group classifies non-current assets and disposal groups as held for sale if their carrying amounts will be recovered principally through a sale rather than through continuing use. Such non-current assets and disposal groups classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

The criteria for held for sale classification is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition. Actions required to complete the sale should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. Management must be committed to the plan, expected within one year from the date of the classification.

Property, plant and equipment and intangible assets are not depreciated or amortised once classified as held for sale.

Assets and liabilities classified as held for sale are presented separately in the statement of financial position.

A disposal group qualifies as discontinued operation if it is:

- A component of the Group that is a cash generating unit (CGU) or a group of CGUs; or
- classified as held for sale or already disposed in such a way; or
- A major line of business or major geographical area

Discontinued operations are excluded from the results of continuing operations and are presented as a single amount as income or loss from discontinued operations in the consolidated statement of income. Additional disclosures are provided in note 14.

3.2.25 Fair value of financial instruments

The Group measures financial instruments and non-financial assets such as investment in real estate, at fair value at the date of statement of financial position. Fair values of financial instruments are disclosed in Note 32.

Notes to the Consolidated Financial Statements

31 December 2013

3.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible to the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. Observable data used along with the Group's approach to determining fair values of financial instruments and quantitative disclosure are disclosed in Note 34.

3.2.26 Taxation

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on overseas operations is provided for in accordance with the fiscal regulations of the respective countries in which the Group operates and is included in the accompanying consolidated statement of income under "other operating expenses".

3.2.27 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.

3.3 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

New and amended standards and interpretations

The Group has adopted Financial Accounting Standard (FAS) 26 - "Investment in Real Estate" issued by AAOIFI which is mandatorily applicable effective 1 January 2013. FAS 26 prescribes rules in respect of the recognition, measurement, presentation and disclosure of investment in real estate that is acquired for the purpose of earning periodical income or held for future capital appreciation or both.

The adoption of FAS 26 did not have any material effect on the classification and measurement of the Group's direct investment in real estate. However, it resulted in certain changes in nomenclature. No adjustment to opening retained earnings due to application of this standard was required.

Notes to the Consolidated Financial Statements

31 December 2013

4 LIST OF SUBSIDIARIES

Key subsidiaries, all of which have 31 December as their year end, are listed below. There was no change in the percentage holding of the subsidiaries during the year.

Subsidiary	Activities	Year of incorporation	Country of incorporation	Ownership %
Miracle Graphics Company W.L.L.	The company is engaged in the business of design, printing and publishing.	2003	Kingdom of Bahrain	70.00
Al-Enma House for Real Estate B.S.C. (c)	The company is engaged in property management of commercial, industrial and residential buildings and the provision of security services to buildings and facilities.	2003	Kingdom of Bahrain	59.28
Bayan Group for Property Investments W.L.L.	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	100.00
Kuwait Finance House - Jordan and its subsidiaries	The company and its subsidiaries are engaged in investment advisory and investments in private equities and real estate development.	2007	Hashemite Kingdom of Jordan	100.00
Ishbiliya Village W.L.L.	The principal activity of the company is to invest in and develop real estate projects and consequently buying, selling and marketing of such properties.	2005	Kingdom of Bahrain	79.64
Motherwell Bridge Limited	The company is engaged in design, engineering, construction management and manpower management of engineering projects principally in the oil, gas, petrochemical and steel industries.	2008	United Kingdom	79.67
Mena Telecom W.L.L.	The company is a licensed telecommunications company and a Satellite Access Service Provider.	2003	Kingdom of Bahrain	100.00

Notes to the Consolidated Financial Statements

31 December 2013

5 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

The Group's financial instruments have been classified in accordance with their measurement basis as follows:

	Financial assets at fair value through statement of income BD 000	Financial assets at fair value through equity BD 000	Financial assets at cost/ amortised cost BD 000	Financial liabilities at cost/ amortised cost BD 000	Total 2013 BD 000
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	-	-	54,733	-	54,733
Murabaha and due from banks	-	-	117,902	-	117,902
Financing contracts with customers	-	-	600,544	-	600,544
Investments	201,830	11,104	55,342	-	268,276
Receivables	-	-	40,234	-	40,234
	201,830	11,104	868,755	-	1,081,689

LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS

Customers' current accounts	-	-	-	77,293	77,293
Murabaha and due to banks	-	-	-	216,363	216,363
Murabaha due to non-banks	-	-	-	300,490	300,490
Other liabilities	-	-	-	33,715	33,715
Subordinated murabaha payable	-	-	-	98,790	98,790
Equity of investment account holders	-	-	-	452,504	452,504
	-	-	-	1,179,155	1,179,155

	Financial assets at fair value through statement of income BD 000	Financial assets at fair value through equity BD 000	Financial assets at cost/ amortised cost BD 000	Financial liabilities at cost/ amortised cost BD 000	Total 2012 BD 000
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ASSETS

Cash and balances with banks and Central Bank of Bahrain	-	-	41,525	-	41,525
Murabaha and due from banks	-	-	100,672	-	100,672
Financing contracts with customers	-	-	551,717	-	551,717
Investments	208,275	11,444	38,756	-	258,475
Receivables	-	-	35,666	-	35,666
	208,275	11,444	768,336	-	988,055

LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS

Customers' current accounts	-	-	-	51,561	51,561
Murabaha and due to banks	-	-	-	213,078	213,078
Murabaha due to non-banks	-	-	-	235,861	235,861
Other liabilities	-	-	-	40,109	40,109
Subordinated murabaha payable	-	-	-	99,197	99,197
Equity of investment account holders	-	-	-	451,870	451,870
	-	-	-	1,091,676	1,091,676

Notes to the Consolidated Financial Statements

31 December 2013

6 CASH AND BALANCES WITH BANKS AND CENTRAL BANK OF BAHRAIN

	Note	2013 BD 000	2012 BD 000
Cash		5,605	5,525
Balances with banks		13,399	9,289
Balance with Central Bank of Bahrain		6,654	976
CBB Mandatory Reserve	6.1	29,075	25,735
	6.2	54,733	41,525

6.1 This mandatory reserve is not available for use in the Group's day to day operations.

6.2 This balance includes BD 30,040 thousand (2012: BD 27,152 thousand) financed by investment account holders' funds.

7 MURABAHA AND DUE FROM BANKS

	Note	2013 BD 000	2012 BD 000
Murabaha and due from banks		117,924	100,680
Deferred profits		(22)	(8)
		117,902	100,672

The above amounts are entirely financed through investment account holders' funds. These carry profit rates ranging from 0.25% to 1.25% per annum (2012: 0.05% to 0.80% per annum).

8 FINANCING CONTRACTS WITH CUSTOMERS

	Self financed		Financed through investment account holders' funds		Total	
	2013 BD 000	2012 BD 000	2013 BD 000	2012 BD 000	2013 BD 000	2012 BD 000
Murabaha	221,619	171,978	142,096	181,103	363,715	353,081
Deferred profits	(25,775)	(21,843)	(20,088)	(22,033)	(45,863)	(43,876)
Individual impairment provision	(1,257)	(2,664)	(980)	(2,089)	(2,237)	(4,753)
	194,587	147,471	121,028	156,981	315,615	304,452
Ijarah Muntahia Bittamleek (note 8.1)	163,912	114,037	125,350	132,655	289,262	246,692
Individual impairment provision	(415)	(772)	(323)	(896)	(738)	(1,668)
	163,497	113,265	125,027	131,759	288,524	245,024
Musharaka	2,576	7,983	-	-	2,576	7,983
	360,660	268,719	246,055	288,740	606,715	557,459
Collective impairment provision					(6,171)	(5,742)
					600,544	551,717

Notes to the Consolidated Financial Statements

31 December 2013

8 FINANCING CONTRACTS WITH CUSTOMERS (continued)

8.1 These mainly comprise of land and building and are presented net of accumulated depreciation amounting to BD 44,610 thousand (2012: BD 46,245 thousand).

8.2 During the year, the Bank took possession of properties with a carrying value of BD 7,155 thousand (2012:BD 17,699 thousand). These include properties amounting to BD 1,823 thousand (2012:BD 17,699 thousand) classified as investment in real estate and properties amounting to BD 5,332 thousand (2012: Nil) classified as repossessed assets (Note 12).

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

	Individual impairment 2013 BD 000	Collective impairment 2013 BD 000	Total 2013 BD 000	Individual impairment 2012 BD 000	Collective impairment 2012 BD 000	Total 2012 BD 000
At 1 January	6,421	5,742	12,163	2,708	11,743	14,451
Charge for the year	310	-	310	417	-	417
Reversals for the year	-	(1,959)	(1,959)	-	-	-
Provision for the year	310	(1,959)	(1,649)	417	-	417
Transfer to other assets	(864)	-	(864)	-	(1,500)	(1,500)
Write-offs	(504)	-	(504)	(1,205)	-	(1,205)
Transfers	(2,388)	2,388	-	4,501	(4,501)	-
At 31 December	2,975	6,171	9,146	6,421	5,742	12,163

9 INVESTMENTS

The Group's investments are classified as follows:

	Note	2013 BD 000	2012 BD 000
Investments at fair value through statement of income	9.1	201,830	208,275
Investments at fair value through equity	9.2	11,104	11,444
Investments at amortised cost	9.3	55,342	38,756
		268,276	258,475

9.1 Carried at fair value through statement of income

	2013 BD 000	2012 BD 000
Unquoted equity securities	193,872	200,794
Managed funds - at Net Asset Value	7,958	7,481
	201,830	208,275

Notes to the Consolidated Financial Statements

31 December 2013

9 INVESTMENTS (continued)

9.2 Carried at fair value through equity

	2013 BD 000	2012 BD 000
Quoted equity securities	3,038	3,757
Unquoted equity securities	8,066	760
Managed fund - at Net Asset Value	-	6,927
	11,104	11,444

The movement of investments carried at fair value through equity during the year is as follows:

	2013 BD 000	2012 BD 000
At 1 January	11,444	14,535
Acquisitions	7,306	1,640
Transfers	-	(121)
Fair value changes	1,643	326
Disposal	(9,289)	(4,936)
At 31 December	11,104	11,444

9.3 Carried at amortised cost

	2013 BD 000	2012 BD 000
Quoted sukuk		
Government *	15,003	-
Others *	943	2,828
Unquoted sukuk		
Government *	3,468	-
Others *	35,928	35,928
	55,342	38,756

* As at 31 December 2012 and 2013, investment in sukuk is entirely financed through equity of investment account holders' funds. All other investments are self financed. Fair value of investment in sukuk as at 31 December 2013 amounted to BD 57,141 thousand (2012: BD 38,807 thousand).

9.4 Composition of investment portfolio

The industry and geographic composition of the Group's investment portfolio is as follows:

	Middle East BD 000	Others BD 000	Total 2013 BD 000	Total 2012 BD 000
Real estate development	213,020	-	213,020	219,995
Banking and financial services	37,557	2,656	40,213	23,437
Others	340	14,703	15,043	15,043
	250,917	17,359	268,276	258,475

Notes to the Consolidated Financial Statements

31 December 2013

9 INVESTMENTS (continued)

9.5 Reclassification of investments

During the year ended 31 December 2008, the Group reclassified certain of its held for trading equity investments to fair value through equity. The investments were reclassified to reflect the change in Group's intention to hold the said investments for foreseeable future rather than exit or trade in the short term as allowed under amendments to IAS 39 and IFRS 7, "Reclassification of Financial Assets".

As at 31 December 2013, the carrying and fair value of reclassified investments is BD 1,951 thousand (2012: BD 2,117 thousand). During the year ended 31 December 2013, the Group recognised fair value gains amounting to BD 902 thousand (2012: BD 243 thousand) in other comprehensive income.

10 INVESTMENT IN JOINT VENTURES AND ASSOCIATES

The Group has the following joint ventures and associates as at 31 December 2013 :

Name of the joint venture / associate	Nature of business	Country of incorporation	Holding
Joint Ventures			
Diyar Homes Company W.L.L.	Real estate development, project management and the buying and selling of properties.	Kingdom of Bahrain	50.0%
Durrat Khaleej Al Bahrain B.S.C. (c)	Development of Durrat Al Bahrain project with a view of sale of land, residential and commercial properties.	Kingdom of Bahrain	50.0%
Durrat 4 W.L.L. (formerly Al Durrat Al Tijaria Company W.L.L.)	Real estate development, project management and the buying and selling of properties.	Kingdom of Bahrain	50.0%
Associates			
Deera Investment and Real Estate Development Company	Real estate project development and property management.	Hashemite Kingdom of Jordan	28.0%
Energy Central B.S.C.(c)	Providing district cooling, sea water desalination, waste water treatment and related services.	Kingdom of Bahrain	33.5%
Seef Properties B.S.C	Engaged in the real estate development and operation sector.	Kingdom of Bahrain	15.6%

Durrat Khaleej Al Bahrain B.S.C. (c), Durrat 4 W.L.L. (formerly Al Durrat Al Tijaria Company W.L.L.) and Diyar Homes Company W.L.L. are jointly controlled entities whereby the venturers have an arrangement that establishes joint control over the economic activities of these entities. The Group recognises its stake in the joint ventures using the equity method of accounting.

Although the Group holds less than 20% of the equity shares of Seef Properties B.S.C., the Group exercises significant influence by virtue of its contractual right to appoint three directors to the board of directors of the company and has the power to participate in the financial and operating policy decisions.

Notes to the Consolidated Financial Statements

31 December 2013

10 INVESTMENT IN JOINT VENTURES AND ASSOCIATES (continued)

The following table illustrates the summarised financial information of joint ventures and associates:

	2013 BD 000	2012 BD 000
Current assets	218,436	194,919
Non-current assets	322,179	336,059
Current liabilities	(39,225)	(36,826)
Non-current liabilities	(87,206)	(86,463)
Total net assets	414,184	407,689

	2013 BD 000	2012 BD 000
Commitments	29,224	21,934

Total revenue and net income of joint venture and associates for the year:

	2013 BD 000	2012 BD 000
Revenues	47,583	19,931
Net profit (loss)	8,864	3,674

The movement of the Group's investment in joint ventures and associates is as follows:

	2013 BD 000	2012 BD 000
At 1 January	167,749	123,217
Investment during the year	-	45,888
Share of other comprehensive income (loss) of joint venture	546	(266)
Share of income of joint ventures and associates	1,943	654
Other movements	(1,569)	(1,744)
At 31 December	168,669	167,749

The quoted value of the investment in associates for which quoted prices are available is BD 16,934 thousand (2012: BD 12,957 thousand). However, the quoted price does not represent the fair value as the shares are not actively traded. The fair value based on internal models approximates their carrying value.

Notes to the Consolidated Financial Statements

31 December 2013

11 INVESTMENT PROPERTIES

	2013 BD 000	2012 BD 000
Cost		
At 1 January	138,133	131,007
Additions / transfers	6,285	32,797
Disposals / transfers	(9,819)	(25,671)
At 31 December	134,599	138,133
Fair value adjustment		
At 1 January	15,365	21,308
Relating to disposals	(2,179)	(5,943)
At 31 December	13,186	15,365
Total	147,785	153,498

Investment in real estate, held in the Kingdom of Bahrain, at 31 December consists of the following:

	2013 BD 000	2012 BD 000
Buildings	44,348	48,548
Lands	103,437	104,950
	147,785	153,498

Rental income included in the consolidated statement of income from investment in real estate amounted to BD 594 thousand (2012: BD 1,155 thousand).

Direct operating expenses (including repairs and maintenance) amounting to BD 62 thousand (2012: BD 101 thousand) arising from investment in real estate that generated rental income during the year are included in the consolidated statement of income under other expenses.

Direct operating expenses (including repairs and maintenance) amounting to BD 225 thousand (2012: BD 489) arising from investment in real estate that did not generate rental income during the year are included in the consolidated statement of income under other expenses.

Investments in real estate are stated at fair value which has been determined based on valuations performed by independent valuers possessing relevant professional qualification, with recent experience in the location and category of the properties being fair valued, at dates close to 31 December 2013 and 31 December 2012. The fair values have been determined based on recent transactions in the market, the independent valuers' knowledge and professional judgement.

Investment in real estate include the Bank's share of BD 13,817 thousand (2012: BD 13,817 thousand) which are jointly owned with third parties and are subject to normal conditions applicable to joint ownership.

The Group's investment in real estate is not subject to any other charge, pledge or restriction on transfer of title.

Notes to the Consolidated Financial Statements

31 December 2013

12 RECEIVABLES, PREPAYMENTS AND OTHER ASSETS

	Note	2013 BD 000	2012 BD 000
Land and development cost	12.2	66,436	81,747
Fees receivable	32	8,173	9,813
Project expenses receivable		5,850	3,837
Inventories		1,471	2,247
Profit receivable		1,041	949
Repossessed asset	8.2	5,332	-
Trade receivables of subsidiaries		9,820	13,934
Prepaid expenses		1,723	1,275
Receivables relating to sale of investments		6,970	2,972
Receivables from corporate customers		8,903	7,423
Other assets	12.3	2,273	1,828
Gross receivables, prepayments and other assets		117,992	126,025
Impairment provisions	12.1	(2,796)	(1,500)
		115,196	124,525

12.1 Movement in impairment provisions relating to receivables, prepayments and other assets.

	2013 BD 000	2012 BD 000
At 1 January	1,500	-
Charge for the year	432	-
Transfer from financing contracts with customers	864	1,500
At 31 December	2,796	1,500

12.2 Land and development costs

	2013 BD 000	2012 BD 000
Land	47,537	53,906
Development costs	18,899	27,841
	66,436	81,747

12.1 These development costs represent construction, consultancy and profit paid on murabaha financing, capitalised relating to various real estate projects being undertaken by the Group.

Notes to the Consolidated Financial Statements

31 December 2013

13 GOODWILL AND INTANGIBLES

	Note	2013 BD 000	2012 BD 000
Goodwill	13.1 & 14.4	383	24,658
Intangibles	13.2 & 14.2	-	3,839
		383	28,497

13.1 Goodwill related to Motherwell Bridge Limited amounting to BD 24,328 thousand (2012: BD 23,858 thousand) has been classified as assets of disposal group classified as held for sale.

13.2 Intangibles amounting to BD 3,604 thousand (2012: BD 3,839 thousand) related to Mena Telecom W.L.L. have been classified as assets of disposal group classified as held for sale.

14 ASSETS OF DISPOSAL GROUP CLASSIFIED AS HELD FOR SALE

Mena Telecom W.L.L. ("Mena")

As part of the on-going investment activities, the Group constantly evaluates exit opportunities for its investments after having developed these over the investment life cycle. Accordingly, the Group appointed an external advisor ("Advisor") to assist with the sale process of its investment in its wholly owned subsidiary, Mena Telecom W.L.L. ("Mena"). Mena is incorporated in the Kingdom of Bahrain and engaged in providing telecommunication services under licenses issued by the Telecommunications Regulatory Authority ("TRA") of the Kingdom of Bahrain. The principal activities of the Company include provision of wireless broadband services, and other telecommunication services to both retail and corporate customers.

On 6 February 2013, the Group appointed an external advisor to assist with the sale process. The Board of Directors (BOD) of the Bank approved management's plans on 28 March 2013. The Advisor is currently engaged in discussions with the interested buyers. As a result Mena has been classified as "held for sale" and the assets and liabilities of Mena have not been consolidated on a line by line basis. The Group is taking all the necessary steps to achieve the sale within a reasonable timeframe.

Motherwell Bridge Group Limited ("Motherwell")

During October 2013 the Group decided to dispose of its investment in Motherwell Bridge Limited ("Motherwell"), a United Kingdom (UK) based subsidiary acquired in June 2008 in which the Bank currently owns 79.67% equity. Accordingly Motherwell has been classified as a non-current asset held for sale under IFRS 5 – Non Current Assets Held for Sale with effect from 1 October 2013. Motherwell is an engineering services contractor which provides a range of on-site and off-site engineering services including design, manufacture, installation and maintenance services principally for the oil, gas, petrochemical and steel industries.

Motherwell is currently under a sales process and management is negotiating a sale with potential buyers. The target completion date for the full exit is first quarter of 2014.

As of 31 December 2013 the Bank has an equity exposure of BD 17.91 million. The Bank had acquired Motherwell in 2008 with a view to selling down majority of the equity stake within a period of one year from the date of acquisition and accordingly designated Motherwell as held for sale in 2008, however due to market conditions and Motherwell's Business Strategy at that time, management decided not to pursue the sale plan, accordingly Motherwell was consolidated on a line by line basis thereafter during the years ended 31 December 2009, 2010, 2011 and 2012.

Notes to the Consolidated Financial Statements

31 December 2013

14 ASSETS OF DISPOSAL GROUP CLASSIFIED AS HELD FOR SALE (continued)

The results of Mena and Motherwell, included in the consolidated statement of income are as follows:

	Note	2013 BD 000	2012 BD 000
Revenue		41,350	29,319
Cost of sales	14.1	(29,770)	(19,917)
Operating income		11,580	9,402
Other operating expenses and finance cost		(11,709)	(8,452)
Net income for the group before adjustment for non-controlling stakeholders		(129)	950
Adjustment attributable to non-controlling stakeholders of assets held for sale		(567)	(382)
		(696)	568

14.1 Depreciation amounting to BD 4.3 million has not been booked by the Group as per the requirements of IFRS 5.

The major classes of assets and liabilities of Mena and Motherwell, classified as held for sale as at 31 December 2013 are as follows:

	2013 BD 000
ASSETS	
Equipment and furniture	41,633
Goodwill	24,328
Intangibles	3,604
Inventories	286
Accounts receivable and prepayments	9,043
Cash and bank balances	2,423
	81,317
LIABILITIES	
Due to banks and financial institutions	2,765
Financing payable	3,192
Accounts payable and accruals	12,253
	18,210

14.2 Intangibles are presented net of accumulated amortisation amounting to BD 1,385 thousand (2012: BD 1,150 thousand).

The net cash flows received (incurred) by Mena and Motherwell are as follows:

	2013 BD 000	2012 BD 000
Cash flows from operating activities	1,884	5,833
Cash flows used in investing activities	(9,550)	(5,269)
Cash flows from financing activities	12,796	57
	5,130	620

Notes to the Consolidated Financial Statements

31 December 2013

14 ASSETS OF DISPOSAL GROUP CLASSIFIED AS HELD FOR SALE (continued)

14.3 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 nine years. The discount rate of 11.1% (2012: 11.1%) has been applied to cash flow projections, which represents weighted average 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.

The recoverable amount of Goodwill relating to assets classified as held for sale is based on the indicative offers received during the year.

15 MURABAHA AND DUE TO BANKS

	2013 BD 000	2012 BD 000
Murabaha payable to banks	26,657	165,439
Due to banks	189,706	47,639
	216,363	213,078

16 FUNDS UNDER MANAGEMENT

At 31 December 2013, clients' funds managed in a fiduciary capacity amounted to BD 46,691 thousand (2012: BD 64,410 thousand).

17 OTHER LIABILITIES

	2013 BD 000	2012 BD 000
Pay orders issued not presented	3,842	2,297
Payable on account of financing contracts	339	322
Staff related accruals	3,079	2,871
Profit payable on account of murabaha and due to banks and non-banks	1,933	2,489
Profit payable on equity of investment account holders	1,404	1,651
Trade payables of subsidiaries	19,452	24,112
Due to investors	440	3,801
Others	3,226	2,566
	33,715	40,109

Notes to the Consolidated Financial Statements

31 December 2013

18 SUBORDINATED MURABAHA PAYABLE

The subordinated murabaha payable carries a profit equivalent to a rate of 2% over the six month Kuwait Inter Bank Offer Rate (KIBOR). The facility has been approved by CBB to be recognised as Tier II capital and is unsecured and sub-ordinate to the claim of all creditors, including equity of investment account holders. This facility will expire in 2019 but can be terminated at the option of the Bank after third quarter of 2014, subject to the prior approval of the CBB.

During the year, an amount of BD 2,980 thousand (2012: BD 3,601 thousand) has been charged to the consolidated statement of income in respect of subordinated murabaha payable.

19 EQUITY OF INVESTMENT ACCOUNT HOLDERS

The mudarib share on investment accounts ranges from 20% to 40% (2012: 20% to 40%) depending on the investment period and in the case of saving accounts, where there is no restriction on cash withdrawal, the mudarib share ranges from 50% to 60% (2012: 50% to 60%). Mudarib share for the year ended 31 December 2013 amounted to BD 2,914 thousand (2012: BD 4,027 thousand) and is included within financing income from retail and corporate banking activities. The rate of return to investment account holders, as at 31 December 2013 and 2012, for various types of investment accounts, denominated in BD and USD, is as follows:

	2013 Rate of return %	2012 Rate of return %
Investment Accounts - Denominated in BHD		
Saving Account	0.50	0.50
VIP Saving Account	0.60	0.60
One Month Investment Account	1.75	2.00
Three Months Investment Account	2.00	2.25
Six Months Investment Account	2.25	2.50
One Year Investment Account	2.50	3.00
Investment Accounts - Denominated in USD		
Saving Account	0.40	0.41
VIP Saving Account	0.50	0.52
One Month Investment Account	1.05	1.82
Three Months Investment Account	1.23	2.12
Six Months Investment Account	1.32	2.28
One Year Investment Account	1.40	2.43

Notes to the Consolidated Financial Statements

31 December 2013

19 EQUITY OF INVESTMENT ACCOUNT HOLDERS (continued)

19.1 Investment Accounts by type

	2013 BD 000	2012 BD 000
Saving Accounts	99,715	78,876
VIP Saving Accounts	15,316	17,525
One Month Investment Accounts	94,425	121,140
Three Months Investment Accounts	131,741	135,609
Six Months Investment Accounts	63,561	53,777
One Year Investment Accounts	47,746	44,943
	452,504	451,870

20 SHARE CAPITAL AND RESERVES

Share capital

	2013 BD 000	2012 BD 000
Authorised:		
3,500,000 thousand (2012: 3,500,000 thousand ordinary shares of BD 0.1 each)	350,000	350,000
Issued and fully paid up:		
As at the beginning and end of the year		
1,771,405 thousand (2012: 1,771,405 thousand) shares	177,140	177,140

Nature and purpose of reserves

Share premium

Amounts collected in excess of the par value of the issued share capital during any new issue of shares, net of issue expenses, are treated as share premium. This amount is not available for distribution, but can be utilised as stipulated by the Bahrain Commercial Companies Law.

Treasury shares

The amount of consideration paid including all directly attributable costs incurred in connection with the acquisition of treasury shares are recognised in equity. This represents the amount paid by the Bank during the year to purchase shares from Themar Baytik Company B.S.C. (c). The Bank decided to purchase 120,455,525 shares at BD 0.182 per share. The legal procedure for the transfer of these shares is a matter which will require the approval of the Annual General Meeting of the Bank, which will be obtained in due course.

Statutory reserve

As required by Bahrain Commercial Companies Law ("BCCL") and the Bank's articles of association, 10% of the net income for the year has been transferred to the statutory reserve. However, as allowed under BCCL 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 BCCL and following the approval of the CBB.

General reserve

The general reserve is established in accordance with the articles of association of the Group and is distributable following a resolution of shareholders at a general meeting and the approval of CBB. The Group may transfer any amount to the general reserve, as approved by the shareholders at a general meeting, out of the net income for the year after appropriating statutory reserve.

Notes to the Consolidated Financial Statements

31 December 2013

20 SHARE CAPITAL AND RESERVES (continued)

Fair value through equity reserve

Unrealised gains and losses resulting from investments carried at fair value through equity, if not determined to be impaired, recorded in the fair value through equity reserve and not available for distribution. Upon disposal of such assets, the related cumulative gains or losses are transferred to retained earnings and become available for distribution.

Property fair value reserve

Unrealised gains on investment in real estate are recognised in the property fair value reserve in owners' equity and are not available for distribution. Any unrealised loss on investment in real estate is first adjusted against any unrealised gain lying in this reserve and the remainder is taken to the consolidated statement of income. Upon disposal of such assets, the related cumulative gains or losses are transferred to retained earnings and become available for distribution.

Included in the property fair value reserve is an unrealised gain of BD 24,403 thousand, on an investment carried at fair value through income statement pertaining to prior years. No gain is recognised in the current year (2012 : Nil).

Foreign currency translation reserve

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries.

Retained earnings

Retained earnings is the cumulative amount of annual earnings not paid out as dividends. Included in retained earnings is a non-distributable reserve amounting to BD 1,523 thousand (2012: BD 1,523 thousand) relating to subsidiaries of the Bank.

21 TOTAL COMPREHENSIVE INCOME

	2013 BD 000	2012 BD 000
Net income from continuing operations before adjustment for non-controlling stakeholders	5,874	8,700
Other comprehensive income (loss):		
Fair value adjustments against fair value through equity investments	370	(5)
Net movement in foreign currency translation reserve	7	(16)
Share of other comprehensive income (loss) of joint venture	546	(266)
Total other comprehensive (loss) income for the year	923	(287)
Total comprehensive income for the year	6,797	8,413
Net (loss) income for the year from assets classified as for sale	(129)	950
Adjustment attributable to non-controlling stakeholders	2,214	775
Adjustment attributable to non-controlling stakeholders of assets held for sale	(567)	(382)
TOTAL COMPREHENSIVE INCOME ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT	8,315	9,756

Notes to the Consolidated Financial Statements

31 December 2013

22 CONTINGENT LIABILITIES AND COMMITMENTS

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

	Note	2013 BD 000	2012 BD 000
Contingent liabilities:			
Letters of credit		14,645	15,700
Guarantees	22.1	9,521	10,816
		24,166	26,516
Irrevocable commitments to extend credit:			
Original term to maturity of one year or less		24,786	9,402
Investment commitment			
		9,000	9,000
		57,952	44,918

22.1 Included herein is an amount of BD 3.77 million on account of a guarantee issued by the Bank on behalf of the Bank and its Parent (together "the Consortium") to a government organisation ("Counterparty") in the Kingdom of Saudi Arabia for development of a tourism project in 2008. The Consortium through a tender process was awarded the contract to develop the project, however due to a dispute between the Consortium and Counterparty, no final agreement was reached and consequently, the guarantee issued by the Bank was called in 2010.

The Bank challenges the grounds on which the guarantee was called. However, the Counterparty initiated legal action for enforcement of the guarantee and the dispute was heard by the Saudi Arabian Monetary Agency (SAMA) Banking Disputes Settlement Committee (the "Committee") in Saudi Arabia. The committee's decision went against the Bank and whereafter the counterparty demanded payment of the guarantee amount. However, the Bank's view is that the legal action is not finished and the Bank's lawyers have advised that the consortium can buy a new claim against the Counterparty for wrongfully demanding payment under the guarantee.

As of the date of approval of these consolidated financial statements, no provision is required as the Consortium is in the process of filing a new claim against the Counterparty for wrongfully demanding the guarantee. The Bank's legal counsel is of the view that it may take up to eighteen months from the date of filing the claim to obtain a judgment, which shall be subject to a 30 day appeal period from the date of receiving the judgment by the party wishing to file the appeal.

Operating lease commitments

At 31 December 2013, the Group had commitments in respect of non cancellable operating leases amounting to BD 4,568 thousand (2012: BD 6,288 thousand) relating to leasehold premises. Of the commitments in respect of operating leases, BD 1,221 thousand (2012: BD 1,543 thousand) are due within one year, BD 3,106 thousand (2012: BD 4,685 thousand) are due in one to five years and the remaining over five years.

Construction commitments

At 31 December 2013, the Group had commitments in respect of construction contracts amounting to BD 3,707 thousand (2012: BD 3,701 thousand).

Notes to the Consolidated Financial Statements

31 December 2013

23 INCOME FROM RETAIL AND CORPORATE BANKING ACTIVITIES

	Note	2013 BD 000	2012 BD 000
Murabaha		21,152	23,954
Ijarah muntahia bittamleek	23.1	18,252	16,807
Musharaka		268	324
Murabaha and due from banks		440	249
Financing income from retail and corporate banking activities		40,112	41,334
Mudarib share from off balance sheet equity of investment account holders		2,054	1,018
Fees and commission income		779	594
		42,945	42,946

23.1 This is presented net of depreciation on ijarah muntahia bittamleek assets amounting to BD 32,602 thousand (2012: BD 24,467 thousand).

24 INCOME FROM INVESTMENT ACTIVITIES

	Note	2013 BD 000	2012 BD 000
Net unrealised gain (loss) on investments		967	(696)
Net gain on sale of investments		3,452	5,132
Net gain on sale of investment in real estate	24.1	1,151	3,323
Fee income		364	1,844
Rental income		594	1,155
Income from sukuk		2,216	2,622
Other income		2	320
		8,746	13,700

24.1 This relates solely to owner's equity.

25 INCOME AND EXPENSE RELATING TO FINANCING CONTRACTS AND SUKUKS

	2013 BD 000	2012 BD 000
Financing income from retail and corporate banking activities	40,112	41,334
Income from sukuk	2,216	2,622
	42,328	43,956
Less: Profit on murabaha and due to banks, murabaha due to non-banks and subordinated murabaha payable	14,094	15,964
Less: Return on equity of investment account holders, net of mudarib share	7,745	8,713
	21,839	24,677
	20,489	19,279

Notes to the Consolidated Financial Statements

31 December 2013

26 OTHER (LOSS) INCOME

This amount comprises revenue arising from subsidiaries of the Bank through the sale of goods, rendering of services, and the sale of real estate properties net of directly attributable expenses as detailed below:

	Revenue 2013 BD 000	Direct expenses 2013 BD 000	Net 2013 BD 000	Revenue 2012 BD 000	Direct expenses 2012 BD 000	Net 2012 BD 000
Sale of goods	-	-	-	449	(253)	196
Rendering of services	1,397	(934)	463	3,365	(2,121)	1,244
Sale of real estate properties	7,180	(8,284)	(1,104)	5,211	(3,635)	1,576
Others	99	-	99	56	-	56
	8,676	(9,218)	(542)	9,081	(6,009)	3,072

27 (REVERSALS) PROVISIONS - NET

	Note	2013 BD 000	2012 BD 000
Provision (reversal) charge against financing contracts with customers	8.3	(1,649)	417
Provisions against receivables, prepayments and other assets	12.1	432	-
		(1,217)	417

28 OTHER EXPENSES

	2013 BD 000	2012 BD 000
Business development	1,992	2,278
Technology and communication	1,710	1,570
Legal, consulting and outsourcing	1,605	1,414
Premises - rentals and maintenance	3,284	3,340
Administration, selling and others	3,386	3,448
	11,977	12,050

29 PROFIT ON MURABAHA DUE TO BANKS, MURABAHA DUE TO NON-BANKS AND SUBORDINATED MURABAHA PAYABLE

	2013 BD 000	2012 BD 000
Murabaha and due to banks	3,372	4,347
Murabaha due to non-banks	7,742	8,016
Subordinated murabaha payable (note 18)	2,980	3,601
	14,094	15,964

Notes to the Consolidated Financial Statements

31 December 2013

30 CASH AND CASH EQUIVALENTS

Cash and cash equivalents for the purpose of the consolidated statement of cash flows comprise of the following amounts:

	2013 BD 000	2012 BD 000
Cash	5,605	5,525
Balances with banks	13,399	9,289
Balances with CBB excluding mandatory reserve deposit	6,654	976
Murabaha and due from banks with original maturity of less than ninety days	117,382	100,672
	143,040	116,462

31 EMPLOYEES SHARE OWNERSHIP PROGRAM

During the current period, the Bank has purchased the Bank's shares allocated to Themar Baytik Company B.S.C. (c) ("Themar"), a special purpose vehicle incorporated in 2006 for the purpose of administering the Employee Share Option Plan ("ESOP"). The Bank had allocated 15,600,000 shares to Themar at the time of Themar's incorporation, which was subsequently increased to 120,455,525 (due to stock split, bonus and right issues by the Bank after the original allocation to Themar).

Themar issued units to eligible employees under the ESOP, which mirrored shares of the Bank. To enable eligible employees to purchase these units, the Bank granted murabaha financing to Themar, which in turn offered employees financing for purchase of units.

Pursuant to a resolution passed by the Board of Directors of the Bank on 30 September 2013, authorising the purchase of all outstanding shares allocated to Themar, the Bank purchased a total of 120,455,525 shares at 182 fils per share, which was duly approved by the Board of Directors in its above resolution. Accordingly the Bank has classified the entire amount as Treasury Shares as of 30 September 2013. The employees were also informed of the net settlement due to/from them on account of the financing availed by them for purchase of the shares. As a result Themar made a net payment of BD 889 thousand to the employees and the Bank recorded income of BD 2.585 million on the financing extended to employees. Subsequent to settlement of ESOP, the Bank has classified shares purchased under ESOP as treasury shares in the equity of the Bank amounting to BD 21.922 million. All necessary Sharia and legal formalities pertaining to the above transaction have been addressed, further approval of the shareholders will be obtained in the upcoming annual general meeting.

32 RELATED PARTY TRANSACTIONS AND BALANCES

Related parties represent associated companies, the parent and its major shareholders, directors and key management personnel of the Bank, the Bank's Shari'a Supervisory Board and entities controlled, jointly controlled or significantly influenced by such parties. Transactions with related parties arise from the ordinary course of business. Pricing policies and terms of these transactions are approved by the Group's management. Outstanding balances at the year end, excluding financing contracts with customers, are unsecured.

Notes to the Consolidated Financial Statements

31 December 2013

32 RELATED PARTY TRANSACTIONS AND BALANCES (continued)

The following table provides the total amount of transactions that have been entered into with related parties for the relevant financial year:

	Associated companies BD 000	Parent BD 000	Directors and key management personnel BD 000	Other related parties BD 000	Total 2013 BD 000	Total 2012 BD 000
Murabaha and due from banks	-	1,500	-	14,573	16,073	27,480
Financing contracts with customers	5,059	-	2,839	94,398	102,296	104,177
Individual impairment against financing contracts	-	-	-	-	-	2,600
Fees receivable	7,310	-	-	432	7,742	9,898
Project expenses receivable	12	-	-	-	12	12
Other assets	602	948	-	5,540	7,090	3,920
Murabaha and due to banks	-	113,100	-	-	113,100	116,147
Murabaha due to non-banks	-	-	-	142,761	142,761	113,317
Customers' current accounts	3,867	233	419	934	5,453	5,882
Other liabilities	336	-	-	-	336	336
Subordinated murabaha payable	-	98,790	-	-	98,790	99,197
Equity of investment account holders	23,440	-	1,081	18,542	43,063	66,451
Letters of credit	20	-	-	6,698	6,718	6,718
Commitments to extend credit	-	-	-	-	-	500

During the year, the Bank purchased 76,212,329 shares from its directors and key management personnel at BD 0.182 per share, which are included in treasury shares.

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

	Associated companies BD 000	Parent BD 000	Directors and key management personnel BD 000	Other related parties BD 000	Total 2013 BD 000	Total 2012 BD 000
Income from murabaha and due from banks	-	21	-	10	31	69
Income from financing contracts with customers	303	-	689	2,855	3,847	4,406
Fee income	127	-	-	-	127	1,843
Provisions against financing contracts	-	-	-	-	-	363
Profit on murabaha and due to banks	-	2,265	-	-	2,265	3,464
Profit on murabaha due to non-banks	-	-	-	3,478	3,478	2,162
Profit on subordinated murabaha payable	-	2,980	-	-	2,980	3,601
Profit on equity investment account holders	225	-	8	895	1,128	516
Operating expenses	-	-	-	221	221	1,599
Mudarib share of off-balance sheet equity of investment account holders	-	-	-	2,054	2,054	1,018

Notes to the Consolidated Financial Statements

31 December 2013

32 RELATED PARTY TRANSACTIONS AND BALANCES (continued)

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

	2013 BD 000	2012 BD 000
Short term employee benefits	3,528	2,909
Long term employee benefits	142	179

Directors' remuneration and attendance fee for the year ended 31 December 2013 amounted to BD 130 thousand and BD 75 thousand respectively (2012: BD 160 thousand and BD 100 thousand respectively).

33 SEGMENT INFORMATION

For management purposes, the Group is organised into the following segments.

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

No operating segments have been aggregated to form the above reportable segments.

Management monitors the operating results of its segments separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on segment profit (as reported in internal management reports) which is measured using the same measurement principles as are used in the preparation of these consolidated financial statements.

Group revenues for the current and prior year does not include significant revenues (i.e. more than 10% of the Group's total revenue) from any single external customer.

The following table presents revenue, net profit, total assets and total liabilities of the Group's segments for the year ended 31 December 2013:

	Retail & Corporate Group BD 000	Investment Banking Group BD 000	Total BD 000
Operating income	36,434	5,078	41,512
Operating income - discontinued operations	-	11,580	11,580
Segment profit (loss)	19,887	(12,366)	7,521
Segment loss - discontinued operations	-	(129)	(129)
Segment assets	549,204	923,220	1,472,424
Segment assets - discontinued operations	-	81,317	81,317
Unallocated assets			11,406
Total assets			1,565,147
Segment liabilities and equity of investment account holders	297,220	877,501	1,174,721
Segment liabilities - discontinued operations	-	18,210	18,210
Unallocated liabilities			4,434
Total liabilities, equity for investment account holders and equity			1,197,365

Notes to the Consolidated Financial Statements

31 December 2013

33 SEGMENT INFORMATION (continued)

The following table shows the distribution of the Group's net income and total assets by geographical segments, based on the location in which the transactions and assets are recorded, for the year ended 31 December 2013.

	Bahrain BD 000	Other countries BD 000	Total BD 000
Operating income	40,928	584	41,512
Operating income - discontinued operations	4,882	6,698	11,580
Segment assets	1,267,807	216,023	1,483,830
Segment assets - discontinued operations	46,024	35,293	81,317

Other countries mainly represent State of Kuwait, Republic of Turkey, Hashemite Kingdom of Jordan and United Kingdom.

The following table presents revenue, net profit, total assets and total liabilities of the Group's segments for the year ended 31 December 2012:

	Retail & Corporate Group BD 000	Investment Banking Group BD 000	Total BD 000
Operating income	39,260	21,112	60,372
Operating income - discontinued operations	-	9,402	9,402
Segment profit (loss)	19,893	(10,800)	9,093
Segment loss - discontinued operations	-	950	950
Segment assets	507,617	934,246	1,441,863
Unallocated assets			31,619
Total assets			1,473,482
Segment liabilities and equity of investment account holders	255,858	831,401	1,087,259
Unallocated liabilities			4,417
Total liabilities, equity for investment account holders and equity			1,091,676

The following table shows the distribution of the Group's net income and total assets by geographical segments, based on the location in which the transactions and assets are recorded, for the year ended 31 December 2012.

	Bahrain BD 000	Other countries BD 000	Total BD 000
Operating income	49,307	11,065	60,372
Operating income - discontinued operations	5,012	4,390	9,402
Segment Assets	1,196,634	276,848	1,473,482

Other countries mainly represent State of Kuwait, Republic of Turkey, Hashemite Kingdom of Jordan and United Kingdom.

Notes to the Consolidated Financial Statements

31 December 2013

34 FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments comprise of financial assets and financial liabilities. Financial assets consist of cash, balances with banks and Central Bank of Bahrain, murabaha and due from banks, financing contracts with customers, investments and receivables. Financial liabilities comprise of murabaha and due to banks, murabaha due to non-banks, customers' current accounts, other liabilities, equity of investment account holders and subordinated murabaha payable.

At 31 December 2013 and 2012, the fair value of financial instruments approximate their carrying values.

Financial instruments recorded at fair value

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

- Level 1: Quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: Other techniques for which all inputs which have a significant effect on the recorded fair value are market observable, either directly or indirectly; and
- Level 3: Techniques which use inputs that have significant effect on the recorded fair value and are not based on observable market data.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

	Level 1 2013 BD 000	Level 2 2013 BD 000	Level 3 2013 BD 000	Total 2013 BD 000
Investments at fair value through statement of income				
Unquoted equity securities	-	-	193,872	193,872
Managed funds	-	6,067	1,891	7,958
Investments at fair value through equity				
Quoted equity securities	3,038	-	-	3,038
Unquoted equity securities	-	-	8,066	8,066
Managed fund	-	-	-	-
	3,038	6,067	203,829	212,934
	Level 1 2012 BD 000	Level 2 2012 BD 000	Level 3 2012 BD 000	Total 2012 BD 000
Investments at fair value through statement of income				
Unquoted equity securities	-	-	200,794	200,794
Managed funds	-	5,400	2,081	7,481
Investments at fair value through equity				
Quoted equity securities	3,757	-	-	3,757
Unquoted equity securities	-	-	760	760
Managed fund	-	-	6,927	6,927
	3,757	5,400	210,562	219,719

During the year ended 31 December 2013, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

Notes to the Consolidated Financial Statements

31 December 2013

34 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

The following table shows a reconciliation of the opening and closing amount of Level 3 financial assets which are recorded at fair value.

	Unquoted equity securities 2013 BD 000	Managed funds 2013 BD 000	Unquoted equity securities 2012 BD 000	Managed funds 2012 BD 000
Balance at 1 January	201,554	9,008	201,772	10,292
Investments made during the year	7,307	-	208	-
Unrealised fair value (loss) gain	(10)	(190)	(24)	55
Disposals / Redemptions during the year	(6,913)	(6,927)	(402)	(1,339)
Other movements	-	-	-	-
Balance at 31 December	201,938	1,891	201,554	9,008

Impact on fair value of level 3 financial instruments measured at fair value of changes to key assumptions

	Carrying amount 2013 BD 000	Effect of reasonably possible alternative assumption 2013 BD 000	Carrying amount 2012 BD 000	Effect of reasonably possible alternative assumption 2012 BD 000
Investments at fair value through statement of income				
Unquoted equity securities	193,872	19,387	200,794	20,079
Managed funds	1,891	189	2,081	208
Investments at fair value through equity				
Unquoted equity securities	8,066	807	760	76
Managed fund	-	-	6,927	693
	203,829	20,383	210,562	21,056

In order to determine reasonably possible alternative assumptions the Group adjusted key unobservable models inputs as follows:

For equities, the Group adjusted the price earning ratio by increasing and decreasing the price earning ratio by 10 percent, which is considered by the Group to be within a range of reasonably possible alternatives based on the price earning ratios of companies with similar industry and risk profiles.

For managed funds, the Group values its investments based on a net asset value, which is determined by the fund manager. The Group adjusted the value of the funds to increase or decrease by ten percent, which is considered by the Group to be within a range of reasonably possible alternatives.

For equity investments in real estate sector, fair value is determined by reference to valuations by independent real estate valuation experts. The determination of the fair value of such assets is based on local market conditions existing at the date of the statement of financial position. The Group adjusted the value of these assets to increase or decrease by ten percent, which is considered by the Group to be within a range of reasonably possible alternatives.

Notes to the Consolidated Financial Statements

31 December 2013

35 MATURITY ANALYSIS OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS

The table below shows an analysis of assets, liabilities and equity of investment account holders analysed according to when they are expected to be recovered or settled. Group's contractual undiscounted repayment obligations are disclosed in note 34.3 'Risk Management - Liquidity Risk and Funding Management'.

	Up to one year			Over one year				Total
	3 months		Subtotal				Subtotal	
	Up to	to	upto	1 to 5	5 to 10	Over 10	Over	
	3 months	12 months	12 months	years	years	years	1 year	
	2013	2013	2013	2013	2013	2013	2013	
	BD 000	BD 000	BD 000	BD 000	BD 000	BD 000	BD 000	BD 000
Assets								
Cash and balances with banks and								
Central Bank of Bahrain	18,530	7,781	26,311	5,702	4,946	17,774	28,422	54,733
Murabaha and due from banks	117,382	520	117,902	-	-	-	-	117,902
Financing contracts with customers	58,101	117,775	175,876	292,728	83,567	48,373	424,668	600,544
Investments	1,951	18,021	19,972	63,549	184,755	-	248,304	268,276
Investment in joint ventures and associates	-	-	-	168,669	-	-	168,669	168,669
Investment in real estate	-	-	-	-	135,256	12,529	147,785	147,785
Receivables, prepayments and other assets	19,210	78	19,288	95,908	-	-	95,908	115,196
Goodwill and intangibles	-	-	-	383	-	-	383	383
Premises and equipment	-	-	-	-	10,342	-	10,342	10,342
Assets of disposal group classified as held for sale	46,024	35,293	81,317	-	-	-	-	81,317
Total	261,198	179,468	440,666	626,939	418,866	78,676	1,124,481	1,565,147
Liabilities and equity of investment account holders								
Customers' current accounts	25,135	6,732	31,867	15,142	15,142	15,142	45,426	77,923
Murabaha and due to banks	75,797	16,029	91,826	124,537	-	-	124,537	216,363
Murabaha due to non-banks	36,095	150,114	186,209	70,793	21,744	21,744	114,281	300,490
Other liabilities	9,635	3,161	12,796	20,919	-	-	20,919	33,715
Equity of investment account holders	84,360	45,038	129,398	107,702	107,702	107,702	323,106	452,504
Subordinated murabaha payable	-	-	-	98,790	-	-	98,790	98,790
Liabilities associated with disposal group classified as held for sale	3,974	14,236	18,210	-	-	-	-	18,210
Total	234,996	235,310	470,306	437,883	144,588	144,588	727,059	1,197,365
Net	26,202	(55,842)	(29,640)	189,056	274,278	(65,912)	397,422	367,782
Off-balance sheet equity of investment account holders	20,400	50,876	71,276	27,900	-	-	27,900	99,176

Notes to the Consolidated Financial Statements

31 December 2013

35 MATURITY ANALYSIS OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS (continued)

	Up to one year			Over one year				Total 2012 BD 000
	3 months		Subtotal upto 12 months 2012 BD 000	1 to 5 years 2012 BD 000	Over one year		Subtotal Over 1 year 2012 BD 000	
	Up to 3 months 2012 BD 000	to 12 months 2012 BD 000			5 to 10 years 2012 BD 000	Over 10 years 2012 BD 000		
Assets								
Cash and balances with banks and								
Central Bank of Bahrain	12,927	7,002	19,929	4,567	4,567	12,462	21,596	41,525
Murabaha and due from banks	100,672	-	100,672	-	-	-	-	100,672
Financing contracts with customers	40,004	80,664	120,668	325,374	55,805	49,870	431,049	551,717
Investments	9,044	1,885	10,929	63,952	183,594	-	247,546	258,475
Investment in joint ventures								
and associates	-	-	-	167,749	-	-	167,749	167,749
Investment in real estate	-	-	-	-	141,024	12,474	153,498	153,498
Receivables, prepayments and								
other assets	16,785	87	16,872	107,653	-	-	107,653	124,525
Goodwill and intangibles	-	-	-	24,658	3,839	-	28,497	28,497
Premises and equipment	-	-	-	-	46,824	-	46,824	46,824
Total	179,432	89,638	269,070	693,953	435,653	74,806	1,204,412	1,473,482
Liabilities and equity of investment								
account holders								
Customers' current accounts	17,412	4,548	21,960	9,867	9,867	9,867	29,601	51,561
Murabaha and due to banks	37,160	16,793	53,953	159,125	-	-	159,125	213,078
Murabaha due to non-banks	36,021	134,443	170,464	46,495	9,451	9,451	65,397	235,861
Other liabilities	8,029	6,575	14,604	25,505	-	-	25,505	40,109
Equity of investment account holders	79,645	60,315	139,960	103,970	103,970	103,970	311,910	451,870
Subordinated murabaha payable	-	-	-	-	99,197	-	99,197	99,197
Total	178,267	222,674	400,941	344,962	222,485	123,288	690,735	1,091,676
Net	1,165	(133,036)	(131,871)	348,991	213,168	(48,482)	513,677	381,806
Off-balance sheet equity of								
investment account holders	13,620	68,065	81,685	12,660	855	-	13,515	95,200

Notes to the Consolidated Financial Statements

31 December 2013

36 RISK MANAGEMENT

36.1 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. These 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 of the Bank.

Audit, Risk, Governance and Compliance Committee (ARGCC)

The ARGCC is a Board appointed committee which is comprised of two directors and an independent member. The Chairman of the Committee is also an independent director. For audit related matters, the committee assists the Board of Directors 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 methods for monitoring compliance with law, regulations and supervisory and internal policies. For risk, governance and compliance related matters ARGCC has the overall responsibility for the development of risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions. The committee also decides the governance structure and manages the compliance and anti financial crimes requirements of the Bank.

Asset and Liability Committee (ALCO) / Risk Management Committee (RMC)

ALCO / RMC is a senior management committee responsible for maintaining oversight of the Bank's risk profile and governance aspects. It helps the ARGCC Committee in establishing the risk policies and strategies and monitors the risk appetite in terms of risk limits and reports. It also controls the risks by appropriate actions. ALCO / RMC establishes policy and objectives for the asset and liability management of the Bank in terms of structure, distribution, risk and return and its impact on profitability. It also monitors the cash flow, cost and yield profiles and tenor of assets and liabilities and evaluates both from profit rate sensitivity and liquidity points of view, makes corrective adjustments based upon perceived trends and market conditions and monitors liquidity, foreign exchange exposures and positions.

Shari'a Supervisory Board

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

Provisioning Committee (PC)

The Provisioning Committee (PC) is a senior management Committee responsible for ensuring adequate provisions and profit suspensions against all the past due and impaired exposures of the Bank. It reviews past due details and approve the resulting provisioning and profit suspension amounts submitted by the respective departments in line with the approved Provisioning Policy of the Bank. The PC also reviews credit classification and reclassification requests submitted by Business Units and recommends the provisions and profit suspensions to ARGCC and BOD for final approval.

Risk Management Department

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure an independent control process. It also helps the ALCO / RMC in establishing risk strategies, policies and limits, across the Bank. The department 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 department also ensures the complete capture of the risks in risk measurement and reporting systems and performs stress tests on the various portfolios of the Bank.

Treasury Department

The treasury department 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.

Notes to the Consolidated Financial Statements

31 December 2013

36 RISK MANAGEMENT (continued)

36.1 Introduction (continued)

Internal Audit

Independent, objective activity that reviews the effectiveness of risk management, internal control environment and governance processes. Internal Audit discusses the results of all assessments with the management, and reports its findings and recommendations to the ARGCC.

Compliance Department

The compliance department is responsible for managing all the compliance related issues with the external parties and regulators.

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 risks at an early stage. This information is presented and explained to the Board of Directors, the ARGCC and senior management. The report includes aggregate credit exposures, concentration limits, investment limits, foreign exchange exposures, profit rate limits, liquidity gaps and ratios and changes in Group's risk profile. On a periodic basis, detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the general allowance for credit losses on a quarterly basis. The Board of Directors receives the risk management 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. Periodic briefing is given to the Managing Director and Chief Executive Officer and all other relevant members of the Bank on the utilisation of market limits, proprietary investments and liquidity and any other risk developments.

36.2 Credit Risk

Credit risk is the risk that the Group will incur a loss because its customers, clients or counterparties fail 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 corporate customers 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 risk

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.

Risk concentrations of the maximum exposure to credit risk without taking collateral

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.

The maximum credit exposure to any client or counterparty as of 31 December 2013 was BD 52,336 thousand (2012: BD 52,336 thousand).

Notes to the Consolidated Financial Statements

31 December 2013

36 RISK MANAGEMENT (continued)

36.2 Credit Risk (continued)

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

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

	Gross maximum exposure 2013 BD 000	Gross maximum exposure 2012 BD 000
Balances with banks	49,128	36,000
Murabaha and due from banks	117,902	100,672
Financing contracts with customers	600,544	551,717
Investments at amortised cost	55,342	38,756
Receivables	40,234	39,256
Total	863,150	766,401
Contingent liabilities and commitments	57,952	44,918
Total credit risk exposure	921,102	811,319

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

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

	Middle East 2013 BD 000	North America 2013 BD 000	Europe 2013 BD 000	Other 2013 BD 000	Total 2013 BD 000
Balances with banks	45,164	3,388	558	18	49,128
Murabaha and due from banks	114,132	-	-	3,770	117,902
Financing contracts with customers	558,605	189	6,834	34,916	600,544
Investments at amortised cost	54,399	943	-	-	55,342
Receivables	30,150	6,038	3,098	948	40,234
Contingent liabilities and commitments	57,952	-	-	-	57,952
Total	860,402	10,558	10,490	39,652	921,102

Notes to the Consolidated Financial Statements

31 December 2013

36 RISK MANAGEMENT (continued)

36.2 Credit Risk (continued)

	Middle East 2012 BD 000	North America 2012 BD 000	Europe 2012 BD 000	Other 2012 BD 000	Total 2012 BD 000
Balances with banks	29,326	2,972	3,699	3	36,000
Murabaha and due from banks	100,672	-	-	-	100,672
Financing contracts with customers	528,782	2,774	-	20,161	551,717
Investments at amortised cost	35,928	943	-	1,885	38,756
Receivables	32,330	3,590	3,336	-	39,256
Contingent liabilities and commitments	44,918	-	-	-	44,918
Total	771,956	10,279	7,035	22,049	811,319

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

	Trading and manufacturing 2013 BD 000	Banking and financial 2013 BD 000	Construction and real estate 2013 BD 000	Other 2013 BD 000	Total 2013 BD 000
Balances with banks	-	49,128	-	-	49,128
Murabaha and due from banks	-	117,902	-	-	117,902
Financing contracts with customers	52,128	27,720	428,486	92,210	600,544
Investments at amortised cost	-	19,414	35,928	-	55,342
Receivables	7,671	103	9,634	22,826	40,234
Contingent liabilities and commitments	27,353	-	30,438	161	57,952
Total	87,152	214,267	504,486	115,197	921,102

	Trading and manufacturing 2012 BD 000	Banking and financial 2012 BD 000	Construction and real estate 2012 BD 000	Other 2012 BD 000	Total 2012 BD 000
Balances with banks	-	36,000	-	-	36,000
Murabaha and due from banks	-	100,672	-	-	100,672
Financing contracts with customers	55,348	15,357	371,652	109,360	551,717
Investments at amortised cost	-	2,828	35,928	-	38,756
Receivables	8,076	-	16,972	14,208	39,256
Contingent liabilities and commitments	26,516	-	18,402	-	44,918
Total	89,940	154,857	442,954	123,568	811,319

Notes to the Consolidated Financial Statements

31 December 2013

36 RISK MANAGEMENT (continued)

36.2 Credit Risk (continued)

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained by the Bank are as follows:

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

The Bank also obtains personal guarantees from companies owners for commercial financing obtained. 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 during its review of the adequacy of the allowance for impairment losses.

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:

Neither past due nor impaired

Good credits are those, which are performing, as the contract requires. There is no reason to suspect that the creditor's financial condition or collateral adequacy has depreciated in any way.

Past due but not impaired

Past due but not impaired facilities includes:-

- Watch list facilities which are between one and ninety days past due;
- Facilities more than ninety days past due, however, management, for reasons such as the availability of sufficient collateral after haircut, and other reasons, is confident that no losses will be incurred and as a result is not carrying any provisions on these facilities; and
- Facilities which have recently been restructured and have not yet met the minimum requirements set by the Bank for reclassification to the 'neither past due nor impaired' category.

Substandard

Substandard credits are inadequately protected by the repayment capacity of the obligor or by the collateral pledged. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets does not have to exist in individual assets classified as substandard. They may include facilities in past due for more than 90 days which are not classified as doubtful or loss (based on management's assessment).

Doubtful

Doubtful credits have all the weaknesses inherent in a credit classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable or improbable. They may include facilities in past due for more than 180 days but less than 365 days (based on management's assessment).

Loss

Loss facilities are considered uncollectible and of such little value that their continuance as assets is not warranted. Total loss is expected for loss credits however if management has reasons to believe that it could recover the exposure in full and no shortfalls are anticipated based on financial strength of the customers and/or collaterals provided, write off may be deferred. They include facilities in past due for more than 365 days (based on management's assessment).

Notes to the Consolidated Financial Statements

31 December 2013

36 RISK MANAGEMENT (continued)

36.2 Credit Risk (continued)

Credit quality per class of financial assets (continued)

	Neither past due nor impaired 2013 BD 000	Past due but not impaired 2013 BD 000	Sub- standard 2013 BD 000	Doubtful 2013 BD 000	Loss 2013 BD 000	Total 2013 BD 000
Balances with banks	49,128	-	-	-	-	49,128
Murabaha and due from banks	117,902	-	-	-	-	117,902
Financing contracts with customers (gross)	469,582	107,122	28,697	1,329	2,960	609,690
Investments at amortised cost	55,342	-	-	-	-	55,342
Receivables (gross)	33,136	-	9,894	-	-	43,030
Total	725,090	107,122	38,591	1,329	2,960	875,092
	Neither past due nor impaired 2012 BD 000	Past due but not impaired 2012 BD 000	Sub- standard 2012 BD 000	Doubtful 2012 BD 000	Loss 2012 BD 000	Total 2012 BD 000
Balances with banks	36,000	-	-	-	-	36,000
Murabaha and due from banks	100,672	-	-	-	-	100,672
Financing contracts with customers (gross)	428,859	74,718	42,799	8,783	8,721	563,880
Investments at amortised cost	38,756	-	-	-	-	38,756
Receivables (gross)	35,666	-	5,090	-	-	40,756
Total	639,953	74,718	47,889	8,783	8,721	780,064

Included in past due but not impaired facilities are watchlist facilities of BD 6,392 thousand (2012: BD 34,814 thousand) and renegotiated facilities of BD 100,136 thousand (2012: BD 14,313 thousand).

Substandard, doubtful and loss categories are secured with collateral amounting to BD 98,916 thousand (2012: 77,647 thousand), BD Nil (2012: BD 9,364 thousand) and BD 1,456 thousand (2012: BD 3,705 thousand) respectively. The utilisation of the above collaterals will be on a customer by customer basis and will be limited to the customer's total exposure.

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.

Notes to the Consolidated Financial Statements

31 December 2013

36 RISK MANAGEMENT (continued)

36.2 Credit Risk (continued)

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

	Less than 30 days 2013 BD 000	31 to 60 days 2013 BD 000	61 to 90 days 2013 BD 000	More than 90 days 2013 BD 000	Total 2013 BD 000
Financing contracts with customers	32,525	1,258	29,311	44,028	107,122

	Less than 30 days 2012 BD 000	31 to 60 days 2012 BD 000	61 to 90 days 2012 BD 000	More than 90 days 2012 BD 000	Total 2012 BD 000
Financing contracts with customers	14,527	2,166	18,121	39,904	74,718

The restructured portion of the past due but not impaired receivables have been classified based on their past due status at the time of restructuring.

The estimated value of collateral held by the Bank against past due but not impaired financing contracts amounts to BD 215,768 thousand (2012: BD 276,770 thousand). The utilisation of the above collaterals will be on a customer by customer basis and will be limited to the customer's total exposure.

Carrying amount by class of financial assets whose terms have been renegotiated

The outstanding amount of financing contracts with customers for which financing terms have been renegotiated during the year and six months have not elapsed amounted to BD 74,404 thousand (2012: BD 57,119 thousand) and these are secured with collateral amounting to BD 157,300 thousand (2012: BD 96,821 thousand). As a condition to restructuring, the Bank has receives partial payment from customers and/or obtains additional collateral.

Included in the total amount of renegotiated facilities during the year is an amount relating to a related party of BD 9,023 thousand (2012: BD 8,682 thousand). This is secured with collateral amounting to BD 4,835 thousand (2012: Nil).

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.

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, 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 subjected to 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 as a part of the credit management framework 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.

Notes to the Consolidated Financial Statements

31 December 2013

36 RISK MANAGEMENT (continued)

36.3 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 arranges 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 mandatory reserve with the Central Bank of Bahrain equal to 5% 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 comprise of cash and balances with banks and Central Bank of Bahrain, murabaha and due from banks, investment in quoted securities and liquid sukuk. Customer liabilities comprise of customers' current accounts, investment accounts and murabaha due to non-banks. The ratios during the year were as follows:

	2013 %	2012 %
31 December	22.49	19.36
During the year:		
Average	21.99	16.41
Highest	24.78	19.36
Lowest	19.57	13.69

Analysis of financial liabilities and equity of investment account holders by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities and equity of investment account holders at 31 December 2013 and 2012 based on contractual undiscounted repayment obligations. Maturity analysis of assets, liabilities and equity of investment account holders by expected maturities is disclosed in Note 33. 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.

Notes to the Consolidated Financial Statements

31 December 2013

36 RISK MANAGEMENT (continued)

36.3 Liquidity risk and funding management (continued)

	On demand BD 000	Less than 3 months BD 000	3 to 12 months BD 000	1 to 5 years BD 000	Over 5 years BD 000	Total BD 000
At 31 December 2013						
Murabaha and due to banks	598	204,765	11,383	131	-	216,877
Murabaha due to non-banks	-	205,973	97,447	-	-	303,420
Customers' current accounts	77,293	-	-	-	-	77,293
Other liabilities	-	9,637	3,159	20,919	-	33,715
Equity of investment account holders	115,031	262,972	75,832	-	-	453,835
Subordinated murabaha payable	-	-	-	-	104,717	104,717
Total undiscounted financial liabilities 2013	192,922	683,347	187,821	21,050	104,717	1,189,857
At 31 December 2012						
Murabaha and due to banks	702	110,072	98,017	5,487	-	214,278
Murabaha due to non-banks	-	149,869	50,813	40,749	-	241,431
Customers' current accounts	51,561	-	-	-	-	51,561
Other liabilities	-	8,029	6,575	25,505	-	40,109
Equity of investment account holders	96,401	305,109	58,012	-	-	459,522
Subordinated murabaha payable	-	-	-	-	105,397	105,397
Total undiscounted financial liabilities 2012	148,664	573,079	213,417	71,741	105,397	1,112,298

Contingent liabilities and commitments

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

31 December 2013

36 RISK MANAGEMENT (continued)

36.3 Liquidity risk and funding management (continued)

Contingent liabilities and commitments (continued)

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

	On demand BD 000	Less than 3 months BD 000	3 to 12 months BD 000	1 to 5 years BD 000	Total BD 000
At 31 December 2013					
Letters of credit	2,567	-	12,078	-	14,645
Guarantees	9,521	-	-	-	9,521
Irrevocable commitments to extend credit	-	19,633	5,056	97	24,786
Investment commitment	-	-	1,000	8,000	9,000
Total	12,088	19,633	18,134	8,097	57,952
At 31 December 2012					
Letters of credit	3,062	-	12,638	-	15,700
Guarantees	10,816	-	-	-	10,816
Irrevocable commitments to extend credit	-	1,036	8,269	97	9,402
Investment commitment	-	-	1,000	8,000	9,000
Total	13,878	1,036	21,907	8,097	44,918

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

Notes to the Consolidated Financial Statements

31 December 2013

36 RISK MANAGEMENT (continued)

36.4 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 analysis.

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 Bank measures the profit rate risk by measuring and managing the repricing gaps. It also performs sensitivity analysis.

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 consolidated net income for the year, based on the non-trading financial assets and financial liabilities held as at the date of statement of financial position.

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

	2013 BD 000	Change in basis points	Effect on net income for the year BD 000
ASSETS			
Murabaha and due from banks	117,902	+25	295
Financing contracts with customers	410,861	+25	1,027
Investments at amortised cost	55,342	+25	138
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS			
Murabaha and due to banks	216,363	+25	(541)
Murabaha due to non-banks	300,490	+25	(751)
Subordinated murabaha payable	98,790	+25	(247)
Equity of investment account holders	452,504	+25	(1,131)
Total			(1,210)

Notes to the Consolidated Financial Statements

31 December 2013

36 RISK MANAGEMENT (continued)

36.4 Market risk (continued)

Profit rate risk (continued)

	2012 BD 000	Change in basis points	Effect on net income for the year BD 000
ASSETS			
Murabaha and due from banks	100,672	+25	252
Financing contracts with customers	337,023	+25	843
Investments at amortised cost	38,756	+25	97
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS			
Murabaha and due to banks	213,078	+25	(533)
Murabaha due to non-banks	235,861	+25	(590)
Subordinated murabaha payable	99,197	+25	(248)
Equity of investment account holders	451,870	+25	(1,130)
Total			(1,309)

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 Department and reported to the ALCO / RMC.

The Group had the following significant net exposures denominated in foreign currencies as of 31 December:

	Equivalent long (short) 2013 BD 000	Equivalent long (short) 2012 BD 000
Currency		
KWD	(124)	(639)
JOD	23,639	25,204
GBP	2,216	1,974
EUR	993	(230)

The table below indicates the currencies to which the Group had significant exposure at 31 December 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

31 December 2013

36 RISK MANAGEMENT (continued)

36.4 Market risk (continued)

Currency 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 2013 BD 000	Effect on equity 2013 BD 000	Change in currency rate %	Effect on profit 2012 BD 000	Effect on equity 2012 BD 000
KWD	+20	(25)	-	+20	(128)	-
JOD	+20	-	4,728	+20	-	5,041
GBP	+20	443	-	+20	395	-
EUR	+20	199	-	+20	(46)	-
Total		617	4,728		221	5,041

Equity price risk

Equity price risk is the risk that the fair values of equities decrease as a 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 2013) due to a reasonably possible change (i.e. +10%) in the value of individual investments, with all other variables held constant, is BD 19,387 thousand and BD 1,110 thousand (2012: BD 20,079 thousand and BD 452 thousand) respectively, except in cases where impairment loss occurred which will result in decrease being taken to the consolidated statement of income. The effect of decrease in the value of individual investments is expected to be equal and opposite to the effect of the increase shown.

36.5 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.

36.6 Real estate investment price risk

Real estate investment price risk is the risk that the fair values of real estate investments decrease as a result of downfall in the real estate market. The real estate investment price risk exposure arises from Group's holding of real estate investments (land and buildings).

The effect on income due to a reasonably possible change (i.e. +15%) in the value of individual investments in real estate, with all other variables held constant, is BD 22,168 thousand (2012: BD 23,025 thousand). The effect of decrease in the value of individual investment is expected to be equal and opposite to the effect of the increase shown.

36.7 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 Bank has implemented Risks Controls and Self Assessment process (RCSA) whereby each of the units identifies risks in processes, key risk indicators and implemented controls. The key risk indicators values and actual incidents to the operational risk unit are reported to senior management for action. 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

31 December 2013

37 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 Bank has also implemented the Internal Capital Adequacy and Assessment Plan (ICAAP) as per the CBB guidelines based on Pillar II recommendations of the Basel Committee. The Bank had identified the capital requirement for future five years based on the Bank's projected financials and the risk charges required for its significant risks including credit risk, market risk, profit rate risk, liquidity risk, investments risks and operational risks. The Board of Directors, on an annual basis, review and approve the ICAAP plan for both normal and stress conditions.

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 and risk-weighted assets

The regulatory capital and risk-weighted assets have been calculated in accordance with Basel II as adopted by the CBB.

	Note	2013 BD 000	2012 BD 000
Tier 1 capital	37.1	244,327	252,895
Tier 2 capital	37.2	42,167	48,801
Total capital		286,494	301,696
Credit risk-weighted assets		1,087,409	1,042,923
Market risk-weighted assets		33,195	44,167
Operational risk-weighted assets		129,781	130,118
Total risk weighted assets		1,250,385	1,217,208
Capital adequacy ratio		22.9%	24.8%
Minimum requirement		12.0%	12.0%

37.1 Tier 1 capital comprises share capital, share premium, general reserve, statutory reserve and retained earnings, less unrealised loss arising from fair valuing equities net of deductions.

37.2 Tier 2 capital comprises subordinated murabaha payable, collective impairment provision and asset revaluation reserves net of deductions. Certain adjustments are made to AAOIFI-based results and reserves, as prescribed by the Central Bank of Bahrain.

Notes to the Consolidated Financial Statements

31 December 2013

38 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

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

39 SOCIAL RESPONSIBILITY

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

40 COMPARATIVE FIGURES

Certain of the prior year figures have been reclassified to conform to the presentation adopted in the current year. Such reclassification does not affect previously reported net income or owners' equity.



بيت التمويل الكويتي

Kuwait Finance House

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