34th

Annual Report

2012

Kuwait Finance House K.S.C. and Subsidiaries

بيت التمويل الكويتي
Kuwait Finance House

بسم الله الرحمن الرحيم

In the name of Allah the Most Gracious, the Most Merciful.
Ye who Believe! Fear Allah and give up what remains of your demand for usury, if ye are indeed believers (278). If ye do it not, take notice of war from Allah and his Apostle, but if ye turn back, ye shall have your capital sums deal not unjustly and ye shall not be dealt unjustly (279).

Al Baqara (278 - 279) Al-Quran

His Highness
Sheikh Sabah Al Ahmad Al Jaber Al Sabah
The Amir of Kuwait

His Highness
Sheikh Nawaf Al Ahmad Al Jaber Al Sabah
The Crown Prince

His Highness
Sheikh Jaber Mubarak Al-Hamad Al-Sabah
The Prime Minister

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Kuwait Finance House (KFH)

Contents

KFH Best Islamic Bank
in the Middle East

Board of Directors

Mohammed Ali Al-Khudairi
Chairman

Dr. Nabeel Ahmed Al-Mannae
Vice Chairman

Saud Abdulaziz Al-Babtain
Board Member

Ali Mohammed Al-Elaimi
Board Member

Essam Saud Al-Rashid
Board Member

Khaled Abdulaziz Al-Hasson
Board Member

Ahmed Abdullah Al-Omar
Board Member

Adel Abdul Muhsen Al-Subeih
Board Member

Eman Mohammed Al-Humiedan
Board Member

Hamad Ahmed Al-Ameeri
Board Member

In the name of Allah, Most Gracious, Most Merciful

Annual Report of Al-Fatwa and Sharia Supervisory Board

To respected KFH shareholders

Assalamu alaykum warahmatu Allah wabarakatuh.

Praise be to Allah the Almighty and Peace and Blessings be upon our Prophet Muhammad (PBUH), his family and his companions.

We have reviewed and endorsed the policies, products, services and the activities that KFH had carried out in 2012. We have also conducted the necessary review to provide our opinion as to whether KFH had complied with the Shariah principles through the fatawa, resolutions and recommendations that we have issued.

To achieve this compliance assurance the Fatwa and Shariah Supervisory Board held (43 meetings) during the year 2012, in which it had reviewed and endorsed samples of the contracts and agreements after obtaining the necessary information to issued its opinion. The Shariah Audit has been conducted on randomly selected samples of all financing operations of KFH with the shareholders, investors and others in accordance with the Annual Shariah Audit plan for all Departments. The Shariah Board has also received the periodic reports that the Shariah Audit Department has prepared about the Shariah Audit process and operations, site visits and the compliance status of the process and implementation of the Fatwa and resolutions issued by KFH Fatwa and Shariah Supervisory Board.

We have also obtained all necessary information and clarifications to give us sufficient evidence to provide reasonable confirmation that KFH had complied with Shariah rules and principles in all its operations that have been presented to the Fatwa and Shariah Supervisory Board.

Through the process and steps that we followed to ascertain the compliance of KFH to the Shariah rules, we confirm the following:

First: That the contracts and transactions which KFH had entered into during the financial year ending on 31 December 2012 as presented to us had complied with the Shariah rules, principles and resolutions and recommendations of KFH Fatwa and Shariah Supervisory Board.

Second: That the profit distribution and loss bearing on the investment accounts are in compliance with the terms of our approval in accordance with the rules and principles of Shariah.

Third: That all incomes that have been received from non-Shariah compliance sources or by means prohibited by Shariah have been cleansed and donated to charitable purposes.

Fourth: That the Zakat calculation has been carried out in accordance with the Companies' Zakat Manual issued by Kuwait Zakat House, and in accordance with the resolution and recommendations of KFH Fatwa and Shariah Supervisory Board.

Fifth: That the Shariah Audit 2012 on KFH activities and operations had observed some Shariah non-compliance observations. The Shariah non-compliance observations are as follows:

- The Branch Management Department had concluded a contract with Real Estate Company without presenting the agreement to KFH Shariah Fatwa and Supervisory board. It was discovered that the agreement contains late payment penalty clause which KFH Fatwa and Shariah Supervisory Board does not approve and it has been rectified.
- The KFH Fatwa and Shariah Supervisory Board had observed that an Associate Company with KFH had a currency trading on credit which is not allowed by the Resolutions and Fatawa of KFH Fatwa and Shariah Supervisory Board.

The Shariah Supervisory Board has requested that incomes earned from this activity shall be cleansed, and this income cleansing request has been complied.

Peace be upon our Prophet Muhammad, his family members and companions and praise be to Allah, the Lord of the Universe.

TO LEAD THE INTERNATIONAL DEVELOPMENT OF ISLAMIC FINANCIAL SERVICES AND BECOME THE MOST TRUSTED AND SUSTAINABLY MOST PROFITABLE SHARIAH-COMPLIANT BANK IN THE WORLD.

VISION

TO DELIVER SUPERIOR INNOVATION AND CUSTOMER SERVICE EXCELLENCE WHILE PROTECTING AND ENHANCING THE INTERESTS OF ALL OUR STAKEHOLDERS.

MISSION

Their Eminences, Members of Al-Fatwa & Sharia Supervisory Board

Sheikh Dr.
Ajeel Jasem Al-Nashmi
Chairman - Sharia Board

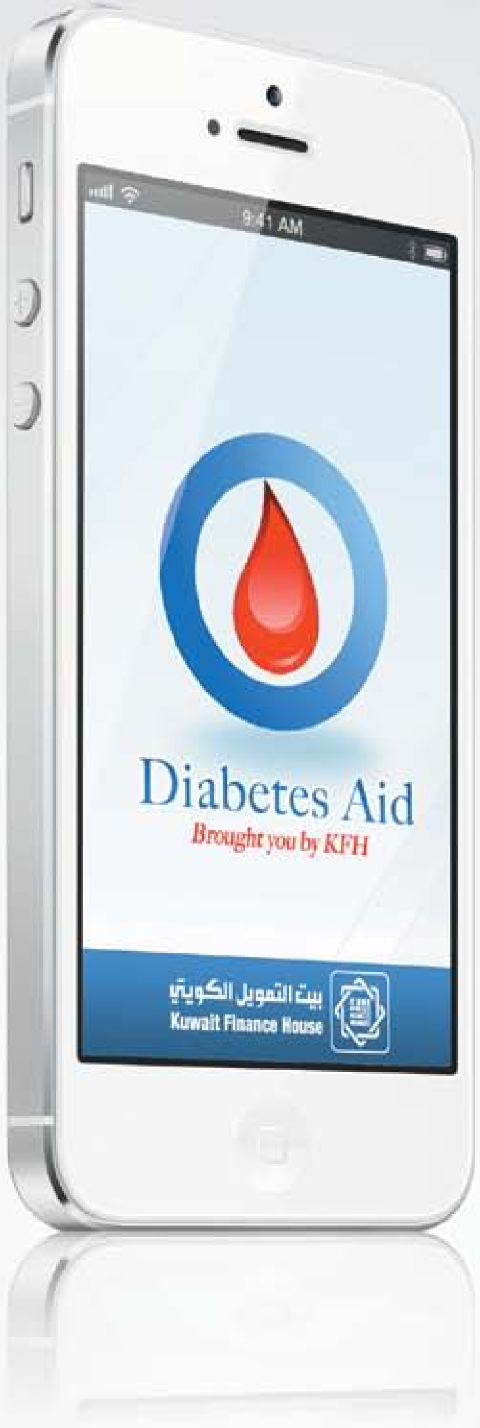
Sheikh Dr.
Khaled Mathkour Al-Mathkour
Sharia Board Member

Sheikh Dr.
Anwar Shuaib Abdulsalam
Sharia Board Member

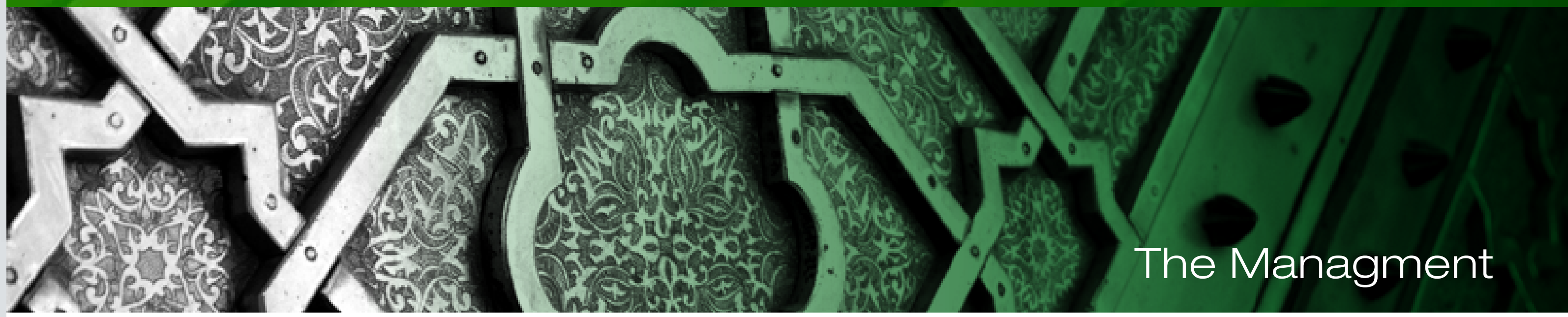
Sheikh Dr. Mohammad
Abdul Razak Al-Tabtabae
Sharia Board Member

Sheikh Dr.
Mubarak Jaza Al-Harbi
Sharia Board Member

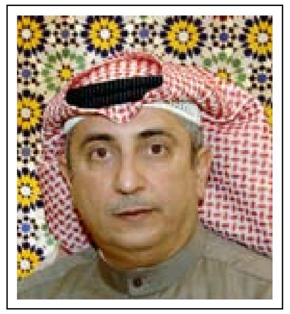
From KFH



An App for Diabetic Patients
For iPad & iPhone



The Managment

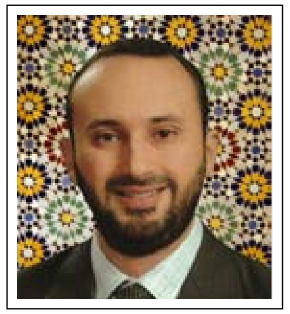


Mohammad Sulaiman Al-Omar
Chief Executive Officer

Anwar Al-Ghaith
Chief Operating Officer

Abd Al-Naser-Al Subeih
Chief Investment Officer

Mohammed Naser Al-Fawzan
Chief Retail Banking Officer



Muhammad Said Abdel Wahab
Chief Financial Officer

Paul Quigley
Chief Risk Officer

Shaheen Al-Ghanem
General Manager
International Banking

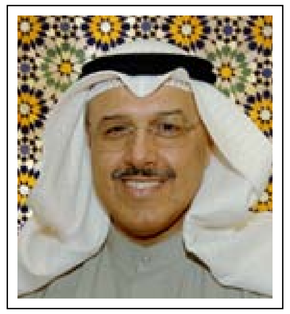
Fahad Al-Mukhaizeem
General Manager
Strategy and Corporate Affairs

KUWAIT FINANCE HOUSE

Global Economic Real Estate Conference 2012

In the name of Allah, Most Gracious, Most Merciful

Speech of the Chairman



Mohammed Ali Al-Khudairi
Chairman

Toward a New Era of Innovation and Development

Praise is to the All Mighty Allah, and peace and blessings be upon his Prophet, Muhammad, his Folks, Companions and Followers to the Day of Judgement.

Dear Shareholders,

On behalf of the Board of Directors of Kuwait Finance House ("KFH") and myself. It is a pleasure for me to present to you the annual report of KFH Group for 2012. During the year we were able to achieve good financial results, despite the unfavourable operating environment, global uncertainty, growing economic challenges experienced by the world as a result of the consequences of the global financial crisis, geopolitical developments in the Arab region, and soaring sovereign debt in the United States and the European countries which went into recession this year despite the international efforts to end the crisis and restore confidence to the markets.

On the domestic level, the pace of economic growth continued due to stable oil prices. In addition, the year witnessed the issuance of a number of legislations which are expected to have a positive impact on the improvement of the operational environment of the economic and commercial businesses in general and on KFH in particular, where a new law for companies was passed after more than fifty years of implementing the old law. With the new law, it is expected to witness development in the operational environment, expansion in investment initiatives as well as opening up new horizons for promising investment instruments such as Islamic Finance Sukuk. However, there are still a number of challenges including weak government spending, the failure to pass the recent economic development plan by the previous parliament, the continuous decline in the KSE performance and the poor performance of investment and real estate companies.

Despite the difficult unstable challenges witnessed by the business environment, KFH achieved sound financial performance due to developing a comprehensive vision of transformation and restructuring in cooperation with the largest global consultancy firms led by the global consultancy firm Booz & Co., which aims to take KFH to new horizons by leading the international development of Islamic Financial services, thus becoming the most trusted and sustainably the most profitable Sharia compaliant bank in the world, and to draw a clear strategy to enable KFH to maintain its leading position in the local and regional markets, opening new horizons for innovation and excellence in customer service.

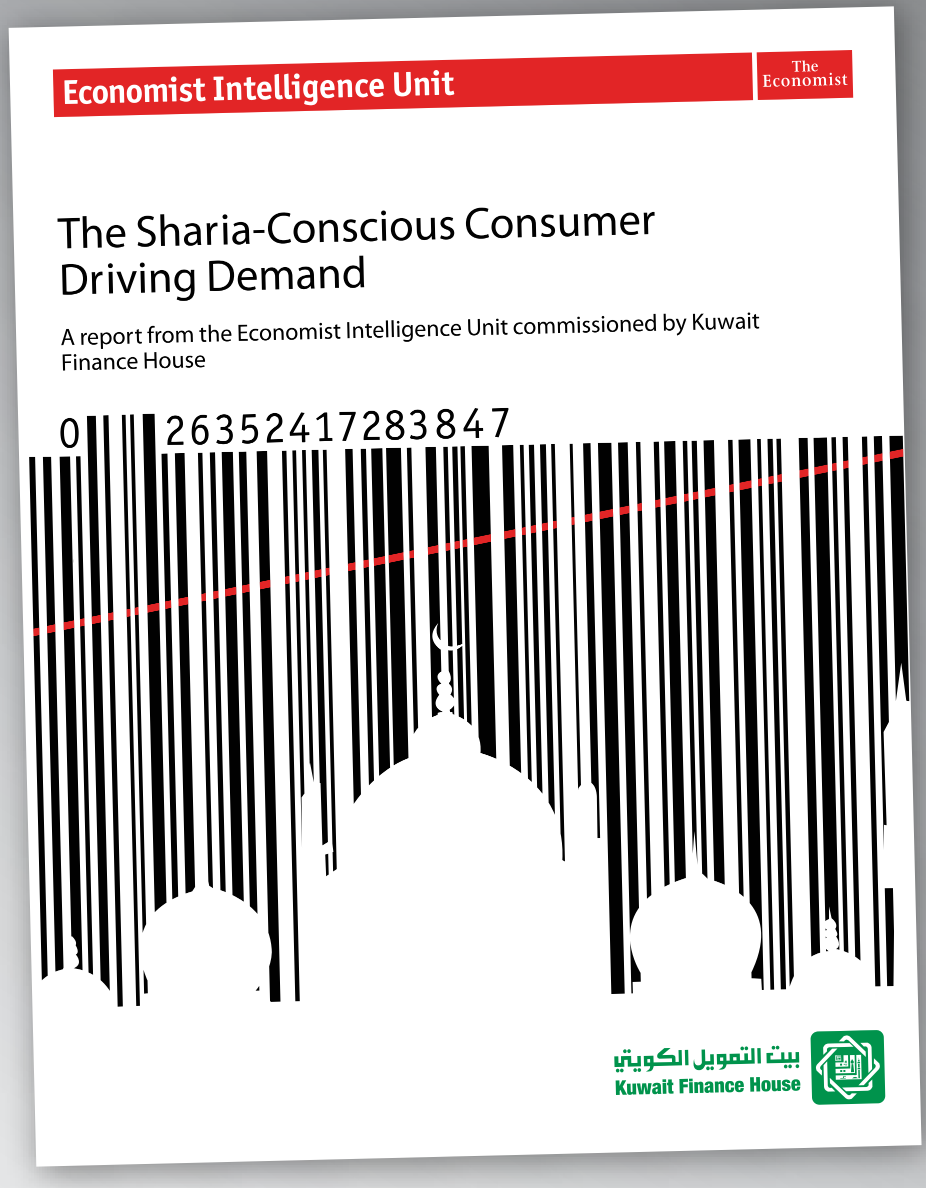
This comes through adopting the best risk management practices, responding to regulatory requirements, implementing conservative credit policy, ensuring productive investment and international presence at a global level through the reformulation of foreign investments, focusing on our international banking subsidiaries, enhancing their returns and stability by recruiting talented staff with global experience.

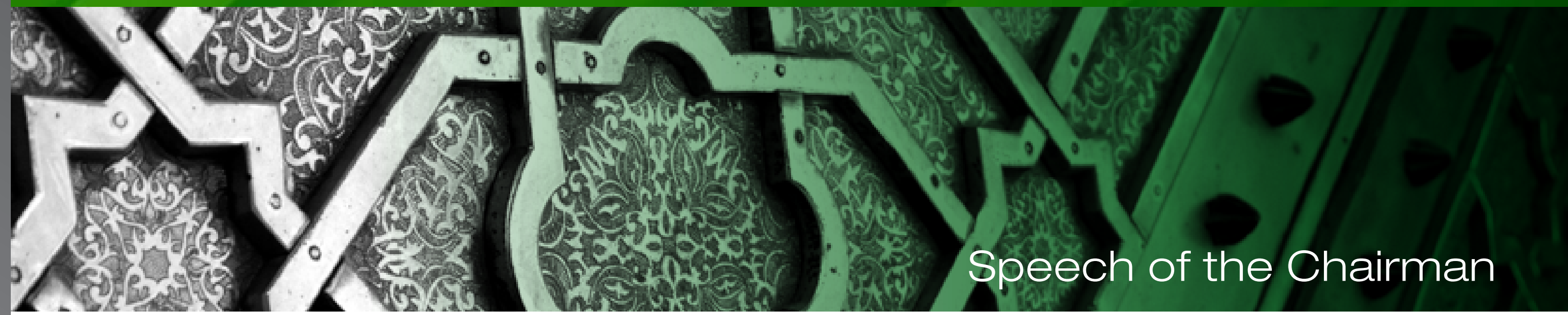
In the framework of the "Transformation and Restructuring Program," whose implementation commenced last year in KFH, we will progressively move towards activating the new organizational structure that is based on serving customers as well as meeting all their needs to go along with offering better services to our wide customer base, improve the aspects of coherence, coordination and cooperation across KFH Group, enhance expertise and responsibilities, ensuring the existence of organizational structure that supports the optimal performance in line with our strategic priorities.

KFH Group realized a net profit of KD 87.676 million, with earnings per share of 30.80 Fils. Total assets reached KD 14.703 billion at the end of Q4 of 2012 with an increase of 9.2% compared to the same period last year. Also, KFH customers' deposits amounted to KD 9.393 billion or 5.8% increase compared to the same period last year that reached KD 8.882 billion. These figures reflect a strong financial position amidst a hard period witnessed by the local and global economy. KFH Group has worked to maintain the existence and assets of KFH aiming for the best financial results.

In an initiative that aims to control and perform periodic review over operational costs on the level of KFH Group, concentrating on the development of the operational performance measures on the level of the Group, the matter which reflected on the

Promoting Islamic Industry Awareness





Speech of the Chairman

improvement of all ratios, especially the total cost-revenues ratios, and rationalization of most expenditure items compared to the previous year and the estimated budget for the Group.

In the light of these financial results, the Board of Directors suggested to distribute cash dividends of 10% and to distribute bonus shares of 10%. In a step to enhance KFH's liquidity position ,and benefiting from the available opportunities for local and global expansion, strongly strengthening our financial and credit capabilities, and responding to the regulatory requirements, KFH suggested to increase the Group Capital by 20%. This suggestion is subject to the approval of KFH General Assembly and the concerned regulatory authorities. Also, profits were distributed to investor depositors as follows:

Account Type	2011	2012
Al-Khumasiya Investment Deposit	1.920%	2.147%
Continuous Investment Deposit	1.728%	1.932%
Al-Sedra Investment Deposit	1.344%	1.503%
Investment Saving Account	1.152%	1.288%

KFH has maintained a number of international ratings from major international rating agencies. Capital Intelligence, the international credit rating agency, had affirmed the Long-Term and Short-Term Ratings of KFH at ‹A+› and ‹A-1›, respectively. Furthermore, Fitch had affirmed the Long-Term and Short-Term Ratings of KFH at ‹A+› and ‹F-1›, respectively. Moreover, Moody's had affirmed it's Long-Term and Short-Term Ratings for KFH at ‹Aa3› and ‹P-1›, respectively. KFH also has won a well-deserved set of awards such as the "Best Regional Corporate Bank" award. Furthermore, KFH received the Best Islamic Bank Award in Kuwait from Asiamoney magazine and the Best Islamic Financial Institution Award in Kuwait from Global Finance magazine.

Moreover, EMEAfinance magazine awarded KFH many awards including The Best Islamic Bank in the Middle East and the Best Islamic Bank in Kuwait. KFH-Turkey has been awarded the Best Islamic Financial Institution Award in Turkey granted by Global Finance. KFH-Malaysia also won the Best Investment Bank Award in Asia, and KFH-Bahrain won the Best Real Estate Investment Award. Further, ITS, a subsidiary of KFH, won the Best Service Provider Award, while the KFH's CEO won 'Banker of the Year 2012'.

Global and Regional Economic Developments

The global economic uncertainty continued during 2012, and the hope for recovery seemed to be far away from the global economic scene. Recovery and growth restoration continued to be a fragile issue, coming to a state of economic stagnation in some regions, as the total figures conceal the wide variance in the growth rates among different countries, as the International Monetary Fund forecasts refer to a reduction in growth in 2012 to reach 2.2% compared to 2.6% in 2011.

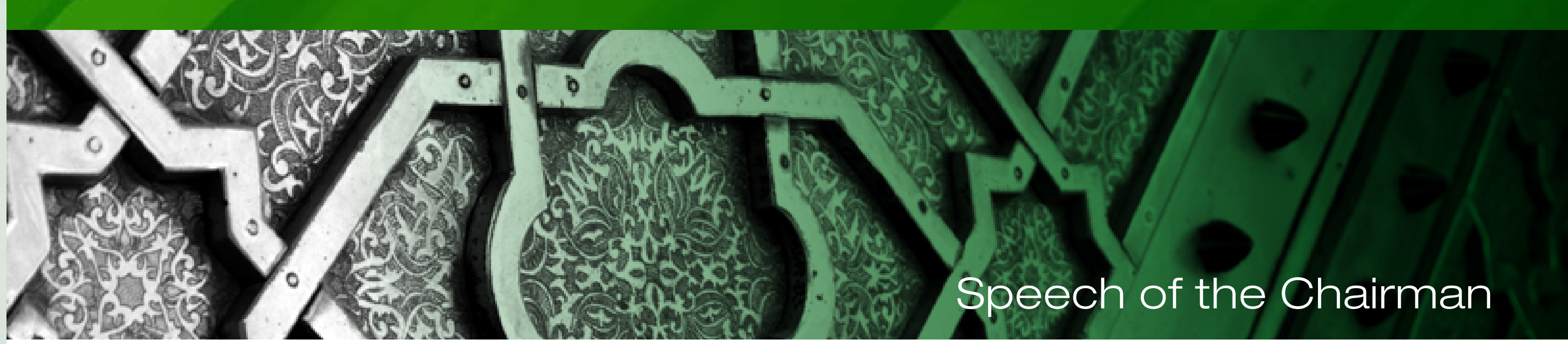
In 2013, the International Monetary Fund ("IMF") adjusted growth forecasts as they were reduced from 2% to 1.5% for the developed economies and from 6% to 5.6% for emerging market and developing economies. This is due to a number of setbacks resulted from financial austerity, continued weakness of the financial system, growing concerns about the USA financial position and the debt crisis in the US and the Euro Zone which went into a phase of recession during the year, as well as the state of instability and political tension prevailing the Middle East region, high oil prices, high unemployment rates, rise in the food price index, increased inflation rates in China and emerging markets that were attributed to helping the global recovery as they witnessed growth rates higher than those in the developed countries.

The Gulf economy is expected to grow at a rate ranging between 4% and 4.5% supported by the flexibility of growth in the oil and gas sector in the GCC countries heading towards the fast-growing emerging markets. Financial incentive policies provided a sizable opportunity for the growth of public expenditure by 20%, double the growth of the past two years. Most of the spending was directed to the current expenditure aiming to reduce the rate of unemployment and to provide job opportunities for the youth. Also, capital expenditures substantially increased in the Kingdom of Saudi Arabia.

Local Economic Developments

In 2012, the Kuwaiti economy continued to achieve positive outcomes recording a growth rate of 5.2% on an annual basis, compared to 8.2 in 2011, with the stable oil prices at $ 100 per barrel, as Kuwait has the largest oil reserves to production in the world which are enough for production for over 100 years, proof of Kuwait's robust oil sector. The Kuwait Economic Development Plan 2010-2014 still suffers from delay in implementation, and economic growth is still greatly associated with the volume of the governmental investment expenditure, driven by the flexibility shown by private consumption and fixed investment growth.

As for monetary policy, The Central Bank of Kuwait (CBK) has continued its general policies designed to achieve stability in the exchange rate for the Kuwaiti Dinar. Also, The CBK continued its great efforts to maintain the safety and stability of the banking system by implementing precautionary measures, that are in in accordance with the international standards as well as paying great attention to governance of local banks.



In its quest to stimulate growth in non-oil sectors, reduce financing cost, support the financial sector and ensure the competitiveness of the Kuwaiti dinar, last October the CBK announced a new reduction in the bank rate of discount by 50 basis points from 2.5% to 2%. It is the first time, that the CBK has performed such a reduction since the last one in February 2010. This is accompanied by the slowdown of inflation rates to reach 2.8% on an annual basis according to the latest estimates.

The IMF expects that the economic recovery will be strengthened, driven by the increase in the government expending, particularly in salaries and capital expenditures, and the budget surplus to continue in the public finance and in the external account. Inflation is expected to ease slightly, but the risks of inflation remain even in positive projections. These risks include the fall of rates of implementation of the capital budget and deficiency in legislations, which could slow down recovery. Kuwait is similar to other countries in terms of exposure to external risks including the intensification of the European crisis, yet these risks can be managed.

The draft of the third year 2012-2013 development plan was not approved by the National Assembly last June. The new plan targeted to expand the private sector's role in the Kuwaiti economy, provide job opportunities to absorb the new expected supply of Kuwaiti labor, and to put forward new projects such as Al-Zour Port Project which considered as one of the leading major projects, in addition to the health insurance hospitals project for residents.

The draft of the third year 2012-2013 of the development plan was aimed to raise the GDP at market price from KD 32.0 billion (US dollar 113 billion) in 2011/2012 to KD 34.3 billion (US dollar 121.5 billion) in 2012/2013 with an expected growth rate of 7.3% per annum.

Moderate growth in GDP at market price is due to the expected high in oil prices amounting to $ 65 per barrel in 2012-2013 compared to the average of $ 60 per barrel in 2011/2012, and net income of production factors abroad represent 6.7% and 6.5% respectively of GDP in the years 2011/2012 and 2012/2013. It also targeted macro investments estimated at about KD 23.9 billion (US dollar 84.56 billion) in 2012/2013 compared to investments amounted to KD 22.9 billion (US dollars 81.2 billion) in 2011/2012.

Despite obstacles facing the development plan in its third year, the government fiscal policy over the medium run is expected to be a positive and expansive policy as spending volume is expected to increase in the State public budget in 2012/2013 and reach KD 22 billion (US dollar 77.83 billion), or an increase of 13% over the current budget.

Also, the year witnessed the passing of several laws such as the small projects law and a new law for companies. These laws are expected to reflect positively on the operational environment of economic and commercial businesses in general and on KFH in particular, and expanding the circle of investment initiatives paving the way for new horizons of promising investment instruments such as Islamic Finance Sukuk.

Throughout 2012, the Kuwait Stock Exchange (KSE) index retreated as trading value dropped to about KD 25 billion compared to KD 31 billion in 2011. Furthermore, the Capital Markets Authority could move forward towards the implementation of the provisions of law No. 7 of 2010 according to the schedule in order to restore investor confidence through the activation of the regulatory and organizational procedures and the application of law, transparency, rational governance and raising the awareness of the investment community.

KFH Group Activities Report

Since change is a universal law, its implications struck the global economy with the unprecedented financial crisis and the intensification of competition and the increase of customer, expectations needs and their desires on the level of service, innovation as well as the severity of the regulatory requirements at a time when shareholders expect greater returns and less risks.

Since our noble religion calls on us to work and look forward to achieve success in life and the hereafter,the KFH Group Management sided towards change and reorganizing the home from inside in a way in which we could say that 2012 is the year of change towards a new era of innovation and development.

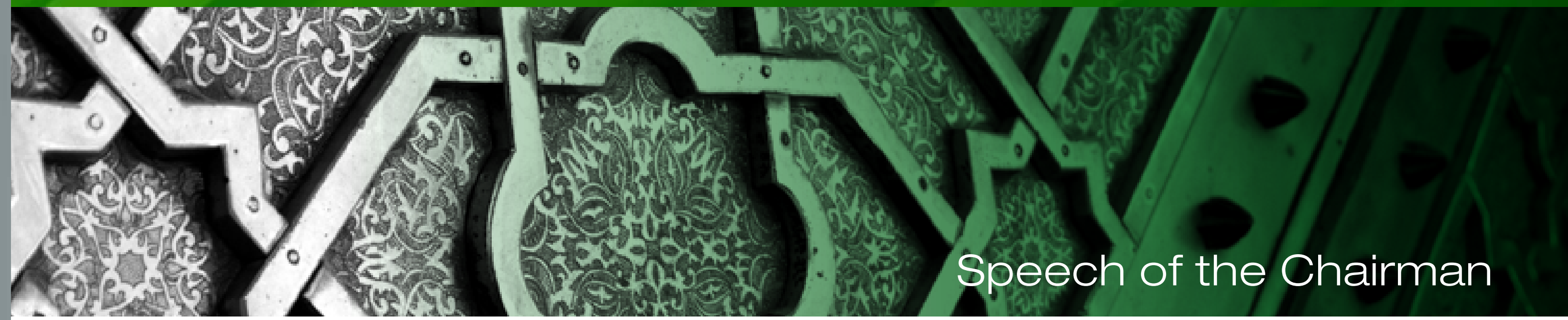
Proceeding from a conscious vision that seeks to lead the International development of Islamic Financial services, thus becoming the most trusted and sustainably the most profitable Sharia compliant bank in the worls through adopting a five-year strategic plan based on three basic pillars.

The first strategic pillar is based on the position of KFH in the local market, especially in the area of retail banking service to include the development of wealth management, increased rates of cross-selling with a wide range of segments in the market and corporate banking services in addition to the necessary requirements to increase the penetration of the bank in large and medium sized projects.

The second strategic pillar aims to reformulate the KFH investment strategy, concentrating on diversified areas and the necessary procedures required to rebuild a new operating model characterized by simplicity devoid of complexity, through reducing the number of investment companies in KFH's diversified portfolio gradually to fewer entities.

The third strategic pillar aims to achieve greater coordination among KFH international banking susbsidiaries, building up centres of excellence across internal operations as well as uti-

KFH Best “Car Loan Award” in the Middle East in 2012



lization of available opportunities in the foreign markets. These strategic pillars are built on an organizational structure focused on customers and a detailed set of recommendations and initiatives targeting to strengthen internal capacities, particularly human resource development, operations and technology.

Retail Banking Services

KFH is successfully moving towards the design and implementation of a new strategy over the next five years seeking to lead the Kuwaiti market in the banking industry through enhancing profitability, creating new series of diversified channels to attract customers with a focus on cross-selling, working on the development and innovation of new instruments suiting the requirements of various banking segments through combining commercial and banking sectors in a single entity to provide better banking services for individuals. This shift has created significant value to KFH through the exchange of successes between the banking sector and commercial sector, where the trend depends on the development of KFH products for all segments of customers, promoting alternative channels, restructuring its branch network, and creating an encouraging environment to promote the culture of motivating and strengthening performance.

In the fourth quarter of the year, KFH performed comprehensive changes in its banking and commercial branches network as upgrades to four new branches were established in Granada, United Tower, Dahar and Abu Heilifa, bringing the total number of local branches to 56 including 39 branches with sections specialized in serving ladies.

Moreover, work is under progress for the opening of the main banking hall of KFH in its new shape with added convenience to cleints of our retail sector services. Sheikh Ahmed Bazea Al-Yassin name was given to this hall in recognition and appreciation to his leading role in the incorporation of this great establishment. Also, a great expansion in the banking network was made through increasing the number of ATM machines and POS throughout Kuwait by up to 28% compared to last year. Also the commercial branches and Auto showrooms witnessed a remarkable expansion as Al-Sour and Jleeb Al-Shuyoukh branches were operated and a building for car valuation was established in Shuwaikh Showroom, targeting to get closer to KFH customers providing them with comprehensive services.

Throughout the year, KFH focused on applying automated organizational solutions to enable first-line staff in banking and commercial branches to utilize the customer information system, which KFH spares no effort to finalize, as well as the requirements necessary to develop and update customers data, in addition to creating new sales opportunities, enhancing sustainable profitability. In this area, five banking branches with large customer base were developed, to offer different products and services according to the cross-sell method through internal reorganization, increasing the various training courses which concentrate on enhancing the skills of customer services and supporting sales operation through offering strong comprehensive incentive programs. In this regard, more than 25 promotional campaigns were launched, and currently branches management is studying the application of an integrated and comprehensive system for customer service.

The Banking Cards Department pursues its efforts to develop a number of products and services. They offered KFH Dollar Card in the US dollar, MasterCard Al-Kheir, and Al-Tayseer Card backed by a deposit, which reflected positively on the increase in the volume of sales of these cards by approximately 30% as well as expanding the customer base as the total number of issued credit cards came close to a Quarter million cards.

Through strategic alliance with some entities like Kuwait Airways, and via launching the project of e-payment gateway, the marketing and sales teams could achieve consecutive increases in the volume of sales of these cards.

KFH was ranked first in issuing prepaid cards, as it acquired 40% of the local market share. Moreover, feedback from clients regarding KFH prepaid cards (Al-Ousra & Al-Kheir) launched last year were positive and encouraging. Furthermore, more than 50 thousand privilege discount cards were distributed with prepaid cards. In addition, KFH launched several marketing campaigns to promote the usage of banking cards among KFH customers, especially new cards in the US dollar.

KFH is the first place in terms of market share regarding the number of transactions via the Shared Electronic Banking Service Company (K-net) and the number of transactions executed on the internet in 2012 through electronic payment channels, POS, and ATM.

Seeking to get closer to our customers via all direct and e-channels, KFH Call Centre “Allo Baitak” has continued to work around the clock. The Call Center staff receive several million calls monthly along with KFH Online Service, which has witnessed a remarkable growth, particularly on smart phones, SMS, and the direct communication via social networks Twitter and Facebook, to disseminate marketing expertise of “KFH,” as KFH has won The Best Consumer internet bank Award for Kuwait over by the Global Finance magazine, among the magazine’s annual awards for the best global banks in the field of internet banking services for the year 2012, in recognition of KFH efforts and excellence in the provision of a set of innovative services to its customers supported by the latest technical applications via its website and the other channels.

During the year, KFH gained a well-deserved award, as the Best car finance in the Middle East region, being a leader in the area of Islamic finance service and leasing services in a manner that satisfies customers' requirements and needs since 1979, as KFH is considered a key driver for the market of financing autos in Kuwait. Also, KFH succeeded in adding numerous products and services which made the auto trading sector important and effective among the Kuwaiti economic sectors. Since its early beginnings, KFH adopted the policy of cooperation and working with others in accordance with the principle of partnership and integration.

KFH devoted itself to attracting customers in Kuwait through participating in specialized exhibitions, organizing marketing campaigns to promote the finance of construction material, used cars, leasing with maintenance, lease to own and direct communication with customers and suppliers with whom more than 40 agreements were concluded as well as performing more than 450 monthly visits to them in addition to the implementation of incentive programs to suppliers' sales persons, in addition to organizing the first annual meeting for KFH Suppliers.

Banking Services and Financing for Companies

Under economic instability at regional and international levels, the slowdown in approving the recent economic development plan and the stagnation witnessed by KSE, KFH continued in financing customers to buy the residential and investment real estate realizing profitable returns. In addition, KFH completed the development of some real estate directed for rent during 2012. Furthermore, KFH continued its policy of targeting to expand the level of economic and real estate awareness, monitoring the developments in this market through periodic economic reports, as a new real estate report is issued on a monthly basis in addition to the quarterly report, a step which found wide approval among people having interest in the real estate issues.

During the year, a new service for corporate finance via the internet "E Corporate" was launched. This product provides a wide range of services for corporate sector in the State of Kuwait, enabling companies to finalize all operations and transactions automatically in accordance with the highest international security standards. In the field of adapting technology for serving customers, a great number of technological services were offered including adding a new mechanism for collection via the internet for corporate sectors after successful application in the retail sector. Also, a service for issuing cheque books was launched via ATMs as well as applying SMS service for corporates and offering the service of documentary credit via the internet.

KFH pays special attention to cementing its relationships with its customers from the corporate sector, offering all kinds of support to analyze their performance, and developing better strategies for them, particularly in cases of poor performance affected by the operational environment. Also, KFH gives high priority to the protection of its assets and maintaining the quality of its commercial credit portfolio to be able to meet challenges, so it continued to form appropriate provisions to encounter the contingent obligations and any other unexpected risks in the future.

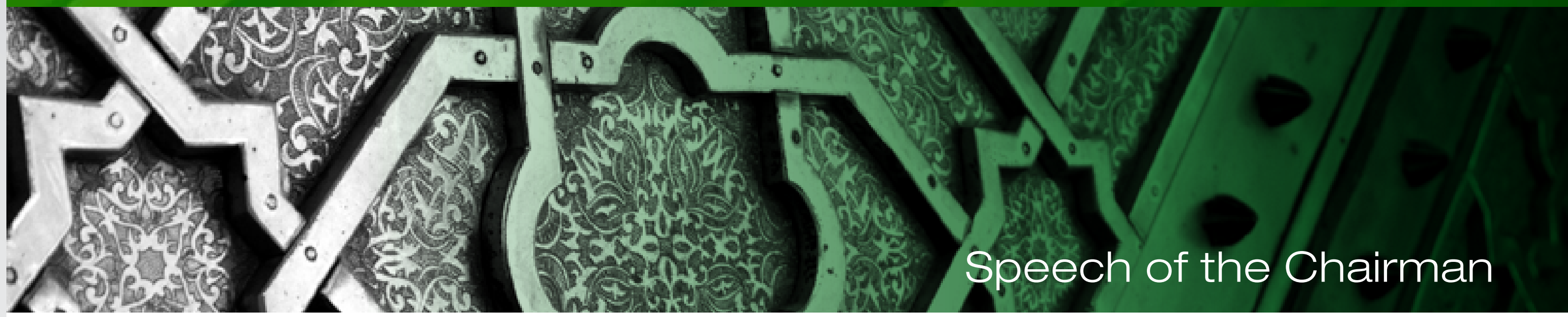
Operations, Information Technology and Human Resources

In light of the development and changes undertaken by KFH, the Operations Department was merged with Information Technology and Support Services under one umbrella, managed by the COO targeting to enhance the efficiency and to improve communication among the Group entities.

Operations and IT work on providing technological infrastructure suitable for the system in KFH, aiming to develop the technological systems to absorb everything new and innovative in the area of operations and banking transactions, so as to meet the customers increasing requirements and needs. Main systems for banking and financing activities were updated through adopting Ethex Software ,being the latest innovation in the area of banking operating systems in accordance with the provisions of Islamic Sharia. Moreover, central and unified databases were completed and updated so as to serve the new projects, ensure the continuity of running systems and networks, develop the applied software, activate emergency system, rationalize the volume of expenditure and to reduce the operational costs.

KFH has pursued its efforts towards strengthening the integration and consolidation among all its units and overseas branches. It connected all financial data and information for all KFH overseas branches with the main office in Kuwait in an effort to improve and develop the process of issuing, reviewing, auditing the financial operations and to improve the system of electronic services in Turkey, Bahrain, Saudi Arabia and Malaysia.

In integrating technology for customer service, a great deal of technological services was offered. A new service for KFH customers was launched that enables customers to open investment deposit around the clock, seven days a week through ATM machine found in many locations throughout Kuwait. The procedures for opening an investment deposit via the new service are user- friendly and very simple. It only requires KFH customers to go to any ATM machine at any of the bank branches with the minimum limit of balance required for opening the deposit, and thus through using ATM machines, customer will be able to invest their funds and savings through one of the investment deposit packages offered by KFH, where all procedures will performed and finalized via ATM machines. Customers won't have to go to the bank branch or to obtain any later approval, and calculation of the deposit profits will commence as per the outcomes of the businesses as of the investment date.



Comprehensive Services

to meet your **aspirations**

Throughout the year, the HR department gave great attention to the implementation of organizational change initiatives for KFH administrative units, aiming to increase the effectiveness, creativity and innovation of KFH staff, improving the working environment motivating to causing the change, launching self-help initiatives for development in a manner that reflects on the overall performance of KFH, considering that HR is a key part of the establishment wealth that works to maintain and develop it at all times. In that framework, KFH hired the best global advisory houses in this area to implement the requirements of restructuring and the participation of KFH family in realizing the established goals.

The goal of recruiting Kuwaiti labour, giving them the skills, capabilities and the contribution in the development of the domestic Human Resource as well as providing the experience and competent staff capable of competition is one of the main objectives of KFH as the percentage of employment of Kuwaiti personnel recorded more than 62% by the end of 2012 in order to support and qualify Kuwaiti youth to join KFH. In this concern, more than 194 new employees were trained during the year. Also, in this regard, a series of training programs up to 385 training programs for 5293 training seats were implemented. The number of e-learning programs reached 230 training programs for 1095 training seats.

Investment

Based on KFH's vision and its new five-year strategy targeting to lead the international development of Islamic Financial services, as the most trusted and sustainably the most profitable Sharia compliant bank in the world in terms of customer service, and the required fruitful international presence for achieving this goal, KFH has sought to establish strong business relations with the domestic, regional and global banks with a view to support KFH customers. The International Investment Department has granted lines of credit to new banks and the Treasury Department expanded its businesses and customer base of banks with distinguished credit rating.

On the other hand, the Treasury Department expanded its investments in the local money market and the foreign exchange market. It strengthened its role in foreign exchange market and the development Islamic finance Sukuk market with profitable return and low risks, especially sovereign government finance Sukuk, as KFH is considered one of the most important player and maker of Sukuk market at the global level. In this concern, the Treasury Department has established a secondary market for trading short term Sukuk in coordination and cooperation with the International Islamic Liquidity Management Corporation and Liquidity Management House for Investment.

Moreover, the Treasury Department succeeded in developing business relationship with customers wishing to obtain treasury products. The Direct Investment Department is working on a new model of investment for KFH as well as studying the investment and exits from certain assets and subsidiaries.

In international real estate, KFH has commenced a new real estate partnership with the US company (UDR) through offering real estate portfolio specialized in income-generating residential real estate with a maximum value of approximately $ 500 million during the recent years, in addition to other deals in the US markets, especially in health related real estate and nursing houses.

On the other hand, in a step that reflects the market position of KFH in the US real estate market, KFH was honoured and elected as a member in Association of Foreign Investors in Real Estate (AFIRE) in its last session. This Association is considered the largest and most comprehensive of real estate associations worldwide. Also, KFH managed to establish a real estate fund in Canada with a value of up to 450 million Canadian dollars for investment in income-generating real estate through cooperation with one of the biggest Canadian companies.

International Banking Subsidiaries

Within the framework of the strategy and plan of "KFH", an entity has been established dedicated to follow the banks outside Kuwait such as Kuwait Finance House-Turkey (Kuveyt Turk), Kuwait Finance House Bahrain, and Saudi Kuwaiti Finance House, Kuwait Finance House in Malaysia in order to achieve full integration between the branches of the group, permanent coordination between the Group which reflects on enhancing profitability and performance of international branches, and to be able to study many investment opportunities for foreign investment in promising markets. The aim of such a trend is to have international proceeds to constitute approximately 50% of its income, as the current international operations are ranging between 40 - 42%.

KFH seeks to strengthen its investment presence in the global sukuk market through its investment arm "Liquidity Management House" and also through its international branches. KFH has succeeded in the issuance of sukuk worth USD 350 million within two consecutive deals through Kuveyt-Turk, which is considered to be the first Islamic bank in Turkey and Europe. Such issuance has won many awards. Kuveyt Turk is one of the oldest international banking subsidiaries of "KFH" and a main gateway towards the European market. It was established in 1989 and KFH owns 62.5% of the bank's share. It has recently opened a branch in Germany, and looks forward to further expansion in Europe during the coming period. In Turkey, the bank is considered to be one of the biggest Islamic banks in Turkey and is planning to increase its market share from 5% to 10%. The bank also has 221 branches throughout Turkey.

Comprehensive Services

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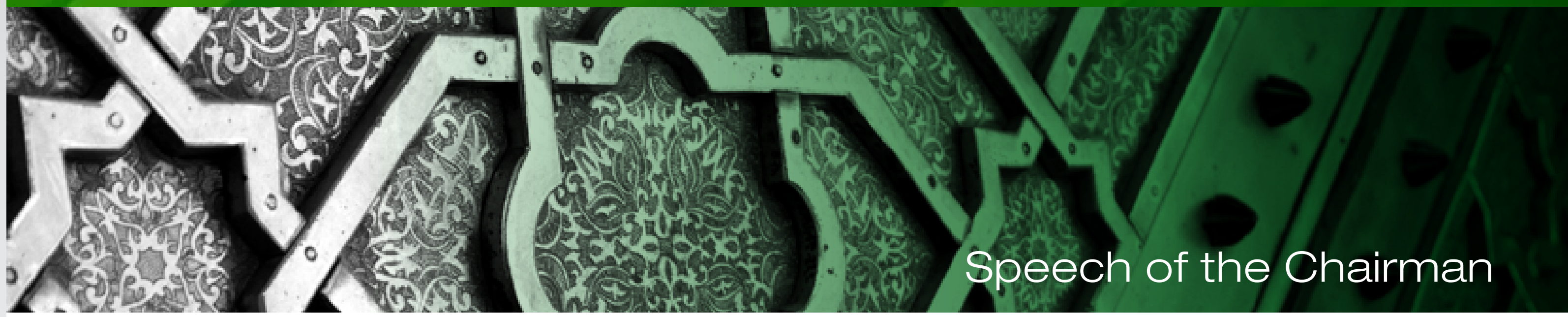


Kuveyt- Turk seeks to promote the close growing cooperation of the economic relations between Turkey and Kuwait, and between them and the GCC. In this regard, several joint visits have been organized to businessmen from both sides which include demonstrating the available investment opportunities, and the facilities and benefits provided to the businessmen from the GCC and to KFH's customers, where a team from KFH-Kuwait was delegated to provide banking services to our customers visiting Turkey during the summer holiday.

The Executive Management of "Kuveyt-Turk" is carrying on the organization of meetings with small and medium enterprises in various areas and regions in Turkey, and continued the campaign of the Gold Account, which is unique to "Kuveyt Turk" in more than one area and province. Such a campaign is supported by an extensive advertising campaign organized by Kuveyt Turk.

KFH Malaysia

KFH Malaysia has managed in collaboration with the Government of Malaysia, Maybank Investment Bank and Am Investment Bank to issue Islamic financing sukuk worth 3 million Malaysian Ringiit (about 280 million Kuwaiti Dinars). KFH Malaysia offers its services through a network of branches in Malaysia. It has opened recently its twelfth branch in Malaysia at Taman Bermeyta to meet the growing needs of its customers in a more readily way. Furthermore, in response to the growing demand for products and services of the Islamic finance, KFH - Malaysia sponsored Kuala Lumpur Islamic Finance Forum.

Moreover, KFH Malaysia also participated in the summit of "Arabs - Malaysia" to perform its role as an economic link between Malaysia, its neighbouring countries and the GCC and Kuwait.

KFH - Bahrain

KFH has supervised the merger of three Bahrain-based Islamic banks. Also participated in establishing a legal forum in cooperation with the international legal institutions to contribute with some projects intended to serve the Bahraini community and represent a distinct qualitative addition on both economic and development levels.

Risk and Governance

Risk plays a major role in spreading the culture of risk management across all of KFH Group's departments and operations, so that risk management is a core of all its activities. A new strategic plan has already been developed in order to improve the capacity of KFH to accommodate the concepts of governance, and improve the mechanism and streamline of decision-making, where an integrated system has been created to manage business risks and to provide sound analysis based on transparency and allow for accountability.

During the year, risk management has taken several initiatives to develop its capabilities which help in achieving development and improvement of the process of internal capital adequacy assessment (ICAAP). Qualitative and quantitative disclosures related to Capital Adequacy Ratio under Basel II for Islamic banks licensed in the State of Kuwait have been prepared in accordance with the CBK rules and regulations. General disclosures related to Capital Adequacy Ratio under Basel II rely on calculating the minimum capital required covering credit and market risks using the Standardized Approach and the minimum capital required to cover operational risk using the Basic Indicator Approach.

On another hand, management has strengthened governance framework, contributed to the building of the new organizational structure, and improved the internal capacity of evaluating the risks faced by the bank. Management also has conducted procedures for stress tests on a regular basis in the light of the instructions and directives of the CBK.

In accommodating the principles of governance, KFH continued the implementation of the approved "Governance" standards, as many committees were launched during the year. KFH has enhanced the supervision over its operations and the implementation of its plans. KFH has also improved the daily monitoring of its activities in the field of Anti-Money Laundering. On a Group level, it has been working on expanding the powers of the committee of "risk managers", to ensure the coordination of risk management within the KFH Group through regular meetings and through working on submitting their reports and raise its observations to the Board Risk and Assets Committee (BRAC), which undertakes the responsibility of maintaining and overseeing the management of assets and liabilities to ensure compatibility with the approved risk trend. The Asset and Liability Committee (ALCO) is responsible for the development of the Treasury strategy, and reviewing the exposures to exchange rate and rate of return of the bank periodically. In general, ALCO ensures the obligation to all the policies of approved market risk and also ensures the approval on the exceptional cases appropriately. Moreover, ALCO takes the decisions on the hedging policy and the required mechanisms.

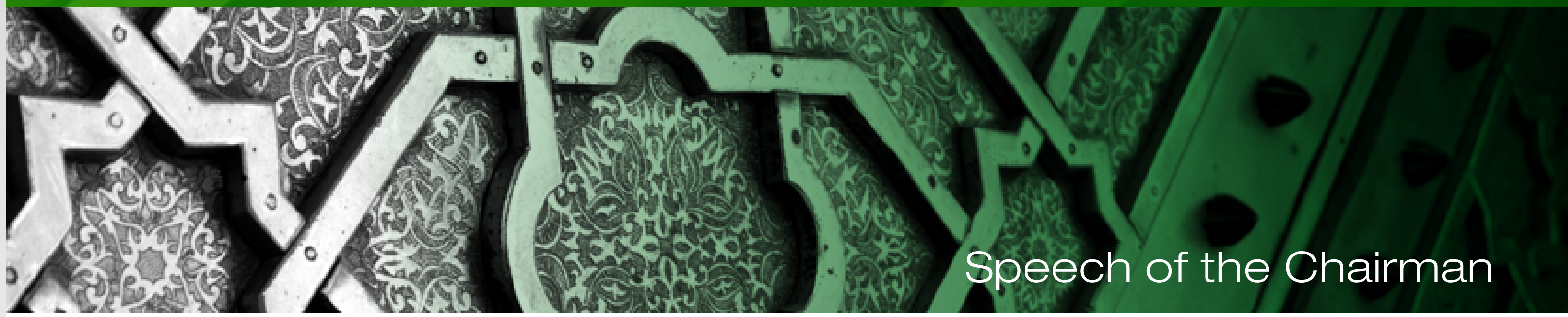
In investments, the»Real Estate Investment» Committee and «Direct Investment» Committee were formed to ensure the keeping up with the investment strategy of KFH, which was adopted recently.

Regarding the Information Technology sector, the scope of the "IT Steering" committee was expanded, while the scope of its responsibilities was developed, so that the overall main responsibility is to be limited to review and approve the IT strategy at KFH, and to review and approve the priorities of projects annually.

Comprehensive Services

to meet your **aspirations**

CONTINUOUS DEPOSIT · AL-SEDRA DEPOSIT · AL-THULATHIYA DEPOSIT · AL-KAWTHAR DEPOSIT · AL-KHUMASIYA DEPOSIT



KFH and Society

KFH is a role model in the field of community service and development, as KFH is an integral part of the components of Kuwaiti society through its long history, during which KFH was and is still a pioneer in the development of social environment through its cooperation with all Kuwaiti institutions that operate in this area. Asserting on this principle, KFH had transferred the KFH Group's Zakat amounted to KD 16 million to be used in the field of humanitarian relief and community service.

In order to affirm its social responsibility, KFH worked on building the ambulance station and the Main Paramedics Training Institute at Al Sabah Health Area in Shuwaikh with Kuwaiti Dinars 1.5 million. KFH continued giving special care for the education sector through supporting schools via providing technical and electronic devices which support the educational process in the different areas of Kuwait. KFH also is honouring the superior and excellent students, supporting student unions and sponsoring many of the university activities and specialized scientific programs in various fields, as well as annually contributing to the Learner Fund which is spending on students who are unable to meet the education expenditures until the completion of their education.

KFH also focused on the athletes and talented youth by providing them with all forms of support. As for the health sector, KFH organized blood donation campaign for its employees, supported and sponsored many conferences and seminars that address the population health. Further, KFH continued in its efforts aiming at giving special care for diabetes' patients and spreading awareness among them, where KFH launched a new app for smart phone users about the awareness and taking care of diabetes' patients in order to complete its efforts in this area. The year has witnessed the launch of developed and new version of Holy Quran Apps on smart phones. KFH also participated in the many activities and scientific conferences, where it organized the first conference in Kuwait entitled "Real Estate and Economic Conference."

Finally, we are grateful to Allah for the achievements realized by KFH in 2012 which aimed at promoting its leading position globally. I am therefore confident that KFH will enhance its growth and status during the coming years to serve as the world's leading Islamic bank and on all levels of new and innovative products and services.

I will not conclude without extending my appreciation and special gratitude on behalf of myself and on behalf of the Board of Directors to His Highness, The Emir Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah, His Highness the Crown Prince Sheikh Nawaf Al-Ahmad Al-Jaber Al-Sabah and His Highness the Prime Minister, Sheikh Jaber Mubarak Al-Sabah, May Allah protect them, and as well to thank His Excellency the Governor of the CBK and to His Excellency the Deputy Governor of the CBK. I would also like to extend my thanks to all concerned authorities for their continued support to the banking sector in Kuwait.

Let me seize this opportunity to extend my sincere thanks to the Board Members for their constructive support to KFH executive management team. Let me also congratulate the executive management and employees in the "KFH Group" for their active role in promoting the position of KFH. The executive management team has taken several actions which contributed to meeting the challenges posed by the current financial crisis. I would like also to thank the esteemed Fatwa and Sharia Supervisory Board at KFH for their distinctive efforts which enhance the position and credibility of KFH.

Finally, I would like to extend my thanks to Mr. Mohammed Sulaiman Al-Omar, Chief Executive Officer, as well as the management team and all the employees at KFH whom we consider the most valuable assets for their dedication, efforts and utmost positive dealings with the challenges they faced and the results they have achieved.

The Board of Directors also extend its thanks to yourselves, KFH's shareholders, for your continuous support and valuable confidence, and thanks also extended to KFH's customers and suppliers as they have chosen KFH, its products and services. The Board of Directors promises to be committed to proceed with the process of development and growth and to realize the best achievement and positive results.

Al-Salam alaikom wa rahmatullahi wabarakatuh,

Mohammed Ali Al-Khudairi

Chairman

Briefing on Internal Audit Department

Internal Audit Department (IAD)

The Board Audit Committee (BAC) is composed of four Board members. The BAC ensures that the IAD is commensurate with the size, nature and extent of business conducted by the Bank. It approves the internal audit charter, the risk based internal audit plans, resources and it evaluates the effectiveness of the IAD.

The IAD reports to the Board Audit Committee and has unrestricted access to the Chairman of the Board Audit Committee. It is responsible for the independent assessment of risk management, control and governance processes regarding the reliability and integrity of financial and operational information; effectiveness and efficiency of operations and programs; safeguarding of assets; and compliance with laws, regulations, policies, procedures, and contracts.

An assessment by external assurance provider is also carried out periodically to determine the degree of IAD's conformance to the standards set by the Institute of Internal Auditors.

Capital Adequacy Disclosure

Capital Adequacy Disclosures

Qualitative and quantitative disclosures related to Capital Adequacy Standard under Basel II have been prepared in accordance with Central Bank of Kuwait instructions and regulations issued as per their circular No.2/RBA/44/2009 dated 15 June 2009. General disclosures related to Capital Adequacy Standard under Basel II rely on calculating the minimum capital required to cover credit and market risks using the Standardized Approach and the minimum capital required to cover operational risk using the Basic Indicator Approach.

First: Group Structure

Kuwait Finance House (the "Bank") and its subsidiaries' (collectively the "Group") are engaged in providing Islamic banking, finance and investment services that comply with Islamic Shari'a. The subsidiaries are fully consolidated into the Bank's financial statements based on similar accounting policies. The associates' activities include Takaful insurance are accounted for using the equity method. Details about subsidiaries and associates are as follows:

1. Subsidiaries:

1.1 Kuwait Finance House (Malaysia) Berhard: is a 100% (2011: 100%) owned Islamic Bank registered in Malaysia since 2006. Its main activities include providing Islamic finance products, investment in real estate, and corporate finance.

1.2 KFH Private Equity Ltd: is a 100% (2011: 100%) owned investment company registered at the Cayman Islands. Its main activities comprise global private equity investments

1.3 KFH Financial Services Ltd: is a 100% (2011: 100%) owned subsidiary company, registered in Cayman Islands. It has one subsidiary and one associate company. Its main activity is in the real estate sector outside Kuwait.

1.4 Al Muthanna Investment Company K.S.C. (Closed): is a 100% (2011: 100%) owned investment company. Its activities comply with Islamic Shari'a that includes investments, Islamic financing services, equity trading, private equity investments, real estate investments and asset management services.

1.5 Al-Nakheel United Real Estate Company K.S.C (Closed): is a 100% (2011: 100%) owned real estate investment company. It is engaged in owning, sale and purchase of real estate, development of the company's properties, development of properties and land on behalf of customers inside and outside Kuwait.

1.6 Development Enterprises Holding Company K.S.C: is a 100% (2011: 100%) owned subsidiary its main activities include owning long-term strategic assets through investment or financing in companies with industrial and commercial activities.

1.7 Baitak Real Estate Investment Company S.S.C. (Closed): is a 100% (2011: 100%) owned real estate investment company registered in the Kingdom of Saudi Arabia. Its main activities comprise investments and real estate development.

1.8 Liquidity Management House K.S.C. (Closed): is a 100% (2011: 100%) owned investment company. Its activities include financing activities, which comply with Islamic Shari'a, and high quality/low risk investments.

1.9 Saudi Kuwaiti Finance House S.S.C. (Closed): is a 100% (2011: 100%) owned subsidiary, registered in Kingdom of Saudi Arabia. The main activities of the company are to provide services as a principal or as an agent of underwriting, management, arrangement, advisory services and custody in relation to securities.

1.10 International Turnkey Systems Company K.S.C. (Closed): is a 97% (2011: 97%) owned subsidiary whose activities include marketing, developing of hardware and software and other activities that include providing specialized technical consultancies.

1.11 Kuwait Finance House B.S.C. : is a 93% (2011: 93%) owned Islamic bank registered in the Kingdom of Bahrain since 2002. Its activities include providing products and banking services that comply with Islamic Shari'a, management of investment accounts on profit sharing basis and providing Islamic finance contracts including retail services. Subsidiaries' activities include services & communications sector and the real estate investment activities.

1.12 Kuwait Turkish Participation Bank: is a 62% (2011: 62%) owned Islamic bank registered in Turkey since 1989. Its main activities include providing Islamic banking and finance services, investment of funds on a profit/loss sharing basis. Subsidiaries' activities include financing real estate development.

1.13 ALAFCO – Aviation Lease & Finance Company K.S.C. (Closed): is a 53% (2011: 53%) owned subsidiary. Its main activities include the purchase and leasing of aircraft according to Islamic Shari'a principles.

1.14 Aref Investment Group K.S.C. (Closed): is a 52% (2011: 52%) owned investment company and is engaged in a wide variety of activities that include real estate investments and Islamic financing activities which comply with Islamic Shari'a. Aref's subsidiaries activities include the energy sector, educational services, medical services, transportation and information technology.

1.15 Al Enma'a Real Estate Company K.S.C. (Closed): is a 50% (2011: 50%) owned subsidiary engaged in real estate activities including operating leases.

2. Direct Investment in Associates:

2.1 First Takaful Insurance Company K.S.C. (Closed): is a 28% (2011: 28%) owned associate company operating in the field of Islamic Takaful Insurance, advisory and technical research services related to reinsurance activities. In addition, investments are made through funds that comply with Islamic Shari'a.

2.2 Gulf Investment House K.S.C. (Closed): is 20% (2011: 20%) owned associate. Its main activities include investment and financing activities and financial & advisory services.

2.3 Sharjah Islamic Bank P.J.S.C. : is a 20% (2011: 20%) owned bank registered in Sharjah – United Arab Emirates since 1975. its main activities include providing Islamic banking and finance services and products, corporate finance, Treasury investments and asset management services.

2.4 Specialties Group Holding Company K.S.C. (Closed): is 40% (2011: 30%) owned associate, it conducts various activities represented in equities acquirement, establishment of new companies which includes management, financing and guaranteeing, acquisition of industrial patents and trademarks and investing in portfolios managed by others.

Second: Capital Structure

The group capital comprises Tier (1) capital which demonstrates the group's strength and includes share capital, reserves, minority interest, minus the treasury shares, goodwill and unconsolidated Financial Institutions, significant minority interest and investment in insurance companies according to rules and regulations.

The group does not have structure or complex equity instruments which is prohibited with Islamic Shari'a principle.

As at 31 December 2012, Tier (1) "Core Capital" amounted KD 1,503,852 thousand (2011: KD 1,404,493 thousand), Tier (2) "Supplementary Capital" amounted KD 40,851 thousand (2011: KD 23,206 thousand) as detailed below:

	2012 (KD' 000)	2011 (KD' 000)
Capital Structure		
Tier (1) Core Capital		
Share Capital	290,416	268,904
Disclosed reserves	1,063,281	1,030,639
Minority interest in consolidated subsidiaries	311,318	264,659
Total (1)	1,665,015	1,564,202
Deduction from Tier (1) – Core Capital		
Treasury shares	54,028	46,813
Goodwill	45,612	46,291
Unconsolidated institutions	1,556	1,556
Significant minority investments	57,592	62,674
Investment in insurance entities	2,375	2,375
Total (2)	161,163	159,709
A) Total Tier (1) capital	1,503,852	1,404,493
Tier (2) Supplementary Capital		
Asset revaluation reserves	(14,438)	(20,197)
Fair value reserves	(2,482)	(3,511)
General provisions	119,294	113,519
Total (3)	102,374	89,811
Deduction from Tier (2) Supplementary Capital		
Unconsolidated financial institutions	1,556	1,556
Significant minority investments	57,592	62,674
Investment in insurance entities	2,375	2,375
Total (4)	61,523	66,605
B) Total tier (2) of capital	40,851	23,206
Total Available Capital	1,544,703	1,427,699

Third: Capital Adequacy Ratios

At 31st of December 2012 the total Capital Adequacy ratio 13.93% and Tier (1) 13.57% (2011: The total of Capital Adequacy ratio was 13.73%, and Tire (1) 13.51%) compared to the ratio required by regulatory authorities of 12%.

The group ensures the fulfillment of Central Bank of Kuwait requirements in relation to capital adequacy through monitoring the internal limits which are supported by a special capital planning mechanism.

Capital Adequacy ratio for banking subsidiaries

The Group's banking subsidiaries are subject to direct supervision by regulatory authorities of the country in which they are registered. Also, capital Adequacy Ratio (Basel II) is calculated as per Central Bank of Kuwait circulated regulations to Islamic banks. The main Capital Adequacy information for the banking subsidiaries is as follows:

	2012		2011	
Banking group	Tier (1)/ risk weighted assets	Total capital/ risk weighted assets	Tier (1)/ risk weighted assets	Total capital/ risk weighted assets
Kuwait Finance House – Malaysia	13.75%	14.87%	12.93%	14.02%
Kuwait Finance House – Bahrain	19.95%	22.25%	21.32%	23.20%
Kuwait Turk Participation – Turkey	15.42%	16.59%	16.83%	18.14%

Fourth: Risk weighted assets and Minimum Capital Requirement

1. Credit risk

The minimum required capital for credit risk exposures was KD 1,126,853 thousand as at 31 December 2012 (2011: KD 1,067,929) as detailed below:

2012

(KD' 000)

Ser.	Exposures to credit risks	Total Exposures	Net Exposures	Risk weighted Assets	Required Capital
1	Cash item	444,262	444,262	-	-
2	Claims on sovereigns	1,422,286	1,418,447	148,098	17,772
3	Claims on public sector entities	70,588	70,588	11,091	1,331
4	Claims on banks	1,150,758	1,150,758	325,357	39,043
5	Claims on corporates	3,579,218	2,922,196	2,177,141	261,257
6	Regulatory retail exposure	2,565,826	2,311,943	1,715,167	205,820
7	Qualifying residential housing financing facilities	292,574	92,584	25,458	3,055
8	Past due exposures	431,002	203,778	107,066	12,848
9	Inventory and commodities	541,247	541,247	527,620	63,314
10	Real estate investments	872,131	872,131	1,371,206	164,545
11	Investment and financing with customers	2,477,522	1,462,986	1,731,658	207,799
12	Sukuk and taskeek	164,254	164,254	108,229	12,987
13	Other exposures	1,453,889	1,453,889	1,142,360	137,082
	Total	15,465,557	13,109,063	9,390,451	1,126,853

2011

(KD' 000)

Ser.	Exposures to credit risks	Total Exposures	Net Exposures	Risk weighted Assets	Required Capital
1	Cash item	262,951	262,951	308	37
2	Claims on sovereigns	1,207,920	1,207,920	63,997	7,680
3	Claims on public sector entities	49,777	49,777	7,932	952
4	Claims on banks	1,090,160	1,085,703	237,658	28,519
5	Claims on corporates	3,306,222	2,652,083	1,976,793	237,215
6	Regulatory retail exposure	2,070,100	1,866,245	1,406,020	168,722
7	Qualifying residential housing financing facilities	265,198	104,501	29,143	3,497
8	Past due exposures	412,020	360,462	240,392	28,847
9	Inventory and commodities	565,359	565,359	557,457	66,895
10	Real estate investments	884,248	884,248	1,409,811	169,177
11	Investment and financing with customers	2,504,906	1,413,890	1,707,844	204,941
12	Sukuk and taskeek	133,525	133,525	68,924	8,271
13	Other exposures	1,496,541	1,496,541	1,193,126	143,176
	Total	14,248,927	12,083,205	8,899,405	1,067,929

2. Market risk

Market Risk Weighted Exposure during the financial year 2012 amounted KD 839,292 thousand (2011: KD 722,492 thousand), based on the standardized approach. The minimum required capital for market risk exposures amounts to KD 100,715 thousand (2011: KD 86,699 thousand).

One of the methods used to mitigate exchange rate risks for which the bank is exposed to, include netting of exchange of deposits transactions with banks and financial institutions.

3. Operational risk

Operational risk weighted exposures calculated during the year 2012 amounted to KD 856,008 thousand (2011: KD 777,844 thousand) as per the Basic Indicator Approach. The amount calculated for operational risk weighted exposures is adequate to cover any projected risks to maintain a reasonable profit ratio for shareholders and investment account owners. The minimum required capital for operational risk exposures amounts to KD 102,721 thousand (2011: KD 93,341 thousand).

Fifth. Risk Management

Risk management is an integral part of the decision-making processes for the Group. It is implemented through a governance process that emphasizes independent risk assessment, control and monitoring, overseen directly by the Board and Senior Management. KFH continues to upgrade its risk management capabilities in the light of developments in the business, banking and stock market regulations and risk management best practices. KFH operate a "three lines of defence" system for managing risk:

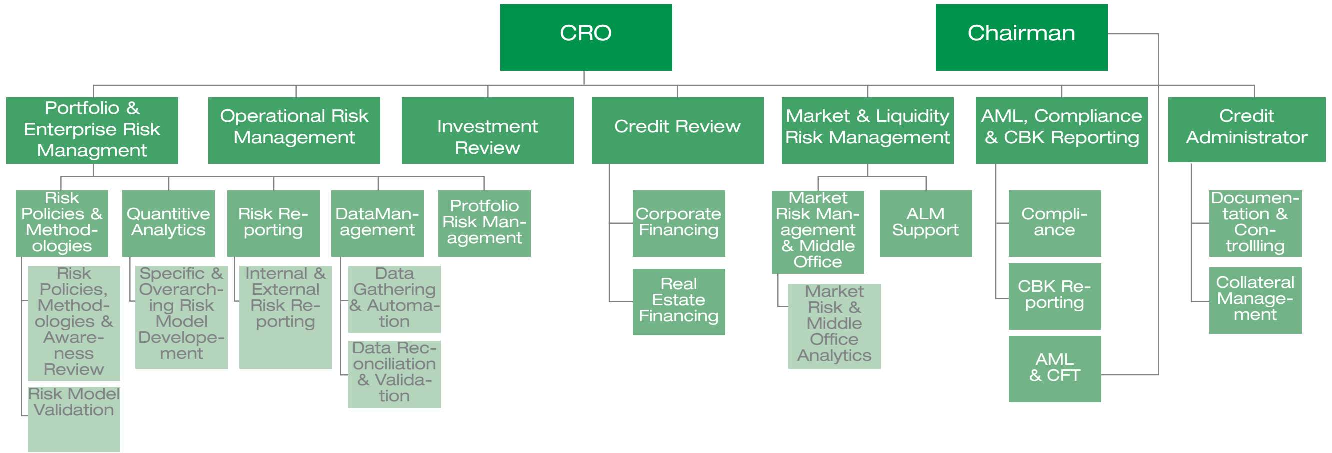
- The first line of defence is the business unit, which manages the relationship with the customer. Its responsibility is to understand customer requirements to mitigate the risk of default or early withdrawal of deposits and to maintain and improve the processes through which KFH serves the customer to mitigate operational failures leading to loss or damage to reputation.
- The second line of defence are the control functions of Risk Management and Financial Control. These are responsible for establishing the risk management and control frameworks and for conducting independent assessment and direction of risk management and control activities.
- The third line of defence contains the assurance functions, namely Regulatory Compliance, Anti-Money Laundering and Internal Audit. They are responsible for ensuring compliance with regulatory requirements and internal policies and for identifying weaknesses in such policies so that remedial action may be taken by the management.

1. Risk governance structure at the group level

The Board of Directors has ultimate responsibility for oversight of risk management and control in KFH. It sets the Risk Appetite of the Group. It delegates part of this responsibility to the Board Risk and Assets Committee and the Board Audit Committee.

At the executive level, risk is managed by the Executive Management Team, reporting to the Chief Executive Officer. KFH has an independent Chief Risk Officer (CRO) and Chief Financial Officer (CFO) who have direct access to the Board Risk and Assets Committee and the Board Audit Committee respectively. At this level, risk is governed through a set of committees, such as the Credit Committee, the Asset and Liability Committee (ALCO) and the Operational Risk Committee. KFH co-ordinates its Group-wide risk management and control activities through Committee's of the Group's CRO's and CFO's, while the Group CRO and CFO maintain daily contact with the subsidiaries for risk management and control operations.

2. Organizational structure of the Risk Management Department in Kuwait Finance House



The risk management department in KFH is organized on functional lines. Risk management executives have explicit responsibility for Credit Risk, Market and Liquidity Risk, Investment Risk, Operational Risk and Portfolio and Enterprise Risk Management. For administrative reasons, Regulatory Compliance, Regulatory Reporting and Credit Administration also report to the CRO, while the Anti-Money Laundering unit reports directly to the Chairman of the Board. This Department is responsible for developing and implementing the processes to identify, assess, control, monitor and report risks. It operates independently from the profit generating units and provides a rigorous review and challenge for all investment and financing proposals as well as strategic initiatives such as new products and markets. It also promotes better balance sheet management through capital optimization and works closely with the Treasury to mitigate the funding and liquidity risks in all of the currencies in which the Group operates.

3. A culture of risk management, training and awareness-raising

KFH strives hard to promote awareness of and strengthen the culture of risk management across the Group. With the strong support of the Board, KFH is upgrading its risk management policies and procedures and clarifying roles and responsibilities for managing risk. The aim is to ensure that risk is considered in all key financing, investment and funding decisions as well as in all key operations to protect the bank from future loss and strengthen the value of the commitments to shareholders and depositors. The risk management department is active in conducting workshops and awareness sessions across the Group to improve staff understanding of the risks inherent in their activities and the steps required to mitigate such risks.

4. Types of Risks

Kuwait Finance House (Closed) "the Bank" and its subsidiaries "The group" are exposed to various types of risks including credit, market and operational risks.

The main risk to which the Group is exposed are:

4.1. Credit risk

Kuwait Finance House is exposed to credit risk in its financing, leasing and investment activities where customers fail to perform in accordance with Murabaha, Istisnaa and Ijara contracts or where there is default or partial default by counterparties to Sukuk transactions, which are held to maturity in the Bank's records or according to the regulatory classification standards for specialized finance.

- The risk can materialize in large exposures to individuals or groups or in concentrations of financing in any particular sector which is subject to financial stress

4.1.1 Credit Risk Governance

The objective of Credit Risk Governance is to establish and maintain a performing financing portfolio that minimizes the incidence of customer default. The process of risk management begins with the relationship manager who is responsible for developing and maintaining an understanding of the customers financing needs and financial position with a view to ensuring that the customer is not exposed to excessive leverage in his financing activities. In KFH, credit decisions are taken, based on an assessment of the customer's ability to service and repay the debt. Collateral is taken as security to mitigate loss in the event of a default by the customer.

With the exception of consumer financing, applications for new or renewed financing are reviewed independently in the business before being submitted to the risk management department for assessment and recommendation. The Credit Committee reviews and challenges all applications and approves or denies those that fall within its Board-delegated authority. The CRO is a non-voting member of the Credit Committee and provides an independent recommendation. He has the authority to escalate a proposal to the Board if he disagrees with the decision of the Credit Committee.

The Board of Directors decides on all proposals in excess of the delegated authority of the Credit Committee.

Net Credit Exposures classified as Rated or Unrated (External Ratings)

2012
(KD' 000)

Ser.	Credit risk exposures	Net credit exposures	Rated exposures	Unrated exposures
1	Cash item	444,262	-	444,262
2	Claims on sovereigns	1,418,447	1,418,447	-
3	Claims on public sector entities	70,588	-	70,588
4	Claims on banks	1,150,758	770,893	379,865
5	Claims on corporates	2,922,196	684,447	2,237,749
6	Regulatory retail exposure	2,311,943	-	2,311,943
7	Qualifying residential housing financing facilities	92,584	-	92,584
8	Past due exposures	203,778	-	203,778
9	Inventory and commodities	541,247	-	541,247
10	Real estate investments	872,131	-	872,131
11	Investment and financing with customers	1,462,986	306,020	1,156,966
12	Sukuk and taskeek	164,254	164,254	-
13	Other exposures	1,453,889	-	1,453,889
	Total	13,109,063	3,344,061	9,765,002

2011
(KD' 000)

Ser.	Credit risk exposures	Net credit exposures	Rated exposures	Unrated exposures
1	Cash item	262,951	-	262,951
2	Claims on sovereigns	1,207,920	1,207,920	-
3	Claims on public sector entities	49,777	-	49,777
4	Claims on banks	1,085,703	736,515	349,188
5	Claims on corporates	2,652,083	642,588	2,009,495
6	Regulatory retail exposure	1,866,245	-	1,866,245
7	Qualifying residential housing financing facilities	104,501	-	104,501
8	Past due exposures	360,462	-	360,462
9	Inventory and commodities	565,359	-	565,359
10	Real estate investments	884,248	-	884,248
11	Investment and financing with customers	1,413,890	298,458	1,115,432
12	Sukuk and taskeek	133,525	133,525	-
13	Other exposures	1,496,541	-	1,496,541
	Total	12,083,205	3,019,006	9,064,199

Total Credit Risk exposures classified as Self Financed or Financed from Investment Accounts:

2012 (KD'000)

Ser.	Credit risk exposures	Self financed	Finance from Investment Accounts
1	Cash item	265,176	179,086
2	Claims on sovereigns	848,948	573,338
3	Claims on public sector entities	42,133	28,455
4	Claims on banks	662,643	447,516
5	Claims on corporates	1,429,304	965,282
6	Regulatory retail exposure	1,427,526	964,081
7	Qualifying residential housing financing facilities	174,634	117,939
8	Past due exposures	255,820	172,768
9	Inventory and commodities	323,065	218,182
10	Real estate investments	519,285	350,699
11	Investment and financing with customers	1,475,956	996,788
12	Sukuk and taskeek	98,042	66,213
13	Other exposures	867,408	585,804
	Total	8,389,940	5,666,151

2011 (KD'000)

Ser.	Credit risk exposures	Self financed	Finance from Investment Accounts
1	Cash item	164,652	98,299
2	Claims on sovereigns	756,364	451,557
3	Claims on public sector entities	31,169	18,608
4	Claims on banks	650,726	388,489
5	Claims on corporates	1,406,332	839,594
6	Regulatory retail exposure	1,216,981	726,549
7	Qualifying residential housing financing facilities	166,059	99,139
8	Past due exposures	257,553	153,762
9	Inventory and commodities	354,011	211,348
10	Real estate investments	552,489	329,841
11	Investment and financing with customers	1,564,590	934,075
12	Sukuk and taskeek	83,609	49,915
13	Other exposures	934,669	558,006
	Total	8,139,204	4,859,182

Kuwait Finance House K.S.C. and Subsidiaries

Average Credit Risk exposures, average Self Financed Assets and average Assets Financed from Investment Accounts on quarterly basis:

2012 (KD'000)

Ser.	Credit risk exposures	Average Credit Risk Exposure	Average Self financed	Average Finance from Investment Accounts
1	Cash item	295,573	181,280	114,294
2	Claims on sovereigns	1,432,440	877,308	555,132
3	Claims on public sector entities	48,824	29,895	18,929
4	Claims on banks	1,221,495	716,706	462,074
5	Claims on corporates	3,445,034	1,385,375	883,186
6	Regulatory retail exposure	2,341,348	1,333,035	854,024
7	Qualifying residential housing financing facilities	292,825	178,756	114,069
8	Past due exposures	523,677	319,244	202,711
9	Inventory and commodities	555,544	339,441	216,103
10	Real estate investments	890,258	543,298	345,323
11	Investment and financing with customers	2,408,003	1,468,043	935,196
12	Sukuk and taskeek	148,837	90,873	57,965
13	Other exposures	1,462,493	892,311	567,984
	Total	15,066,351	8,355,565	5,326,990

2011 (KD' 000)

Ser.	Credit risk exposures	Average Credit Risk Exposure	Average Self financed	Average Finance from Investment Accounts
1	Cash item	197,507	121,470	76,037
2	Claims on sovereigns	1,228,117	753,816	474,301
3	Claims on public sector entities	51,017	31,294	19,724
4	Claims on banks	916,397	532,816	334,413
5	Claims on corporates	3,125,395	1,360,656	857,193
6	Regulatory retail exposure	1,877,000	1,083,645	680,944
7	Qualifying residential housing financing facilities	249,741	153,369	96,373
8	Past due exposures	459,395	280,972	177,337
9	Inventory and commodities	564,915	346,595	218,320
10	Real estate investments	921,881	564,395	355,571
11	Investment and financing with customers	2,386,361	1,461,783	919,191
12	Sukuk and taskeek	143,068	87,787	55,282
13	Other exposures	1,583,796	967,789	610,022
	Total	13,704,590	7,746,387	4,874,708

Excess Risk Concentrations

Concentration risks arise when several counterparties are engaged in similar activities in the same geographical area 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 relative sensitivity of the Group's performance to developments affecting a particular industry sector or geographical location.

Kuwait Finance House K.S.C. and Subsidiaries

In order to avoid excessive risk concentrations, the Bank's policies and procedures include specific guidelines to focus on maintaining diversified portfolio, thus establishing control over certain credit risk concentrations. Hedging is used by the Bank to manage risk concentrations both at the relationship and industry levels.

The Bank depends on a group of Central Bank of Kuwait approved external rating agencies including S&P, Moody's and Fitch to support internal credit ratings.

Geographical Distributions for Credit Risk Exposure

2012
(KD' 000)

Ser.	Credit risk exposures	MENA	North America	Europe	Asia	Others	Total
1	Cash item	41,791	-	385,068	1,942	15,461	444,262
2	Claims on sovereigns	907,132	-	388,078	126,168	908	1,422,286
3	Claims on public sector entities	70,588	-	-	-	-	70,588
4	Claims on banks	813,478	24,270	167,118	125,561	20,331	1,150,758
5	Claims on corporates	1,102,998	61,583	1,894,581	470,588	49,468	3,579,218
6	Regulatory retail exposure	1,575,827	12,042	828,124	149,829	4	2,565,826
7	Qualifying residential housing financing facilities	35,144	3	257,427	-	-	292,574
8	Past due exposures	357,753	-	31,847	41,402	-	431,002
9	Inventory and commodities	218,375	12,619	147,638	162,615	-	541,247
10	Real estate investments	719,734	55,094	71,440	2,823	23,040	872,131
11	Investment and financing with customers	2,203,788	85,310	44,528	140,227	3,669	2,477,522
12	Sukuk and taskeek	86,881	27,026	43,248	-	7,099	164,254
13	Other exposures	1,190,418	29,318	135,283	89,827	9,043	1,453,889
	Total	9,323,907	307,265	4,394,380	1,310,982	129,023	15,465,557

2011
(KD'000)

Ser.	Credit risk exposures	MENA	North America	Europe	Asia	Others	Total
1	Cash item	36,827	-	211,017	15,107	-	262,951
2	Claims on sovereigns	826,882	691	175,271	205,076	-	1,207,920
3	Claims on public sector entities	49,777	-	-	-	-	49,777
4	Claims on banks	882,998	18,587	66,404	108,790	13,381	1,090,160
5	Claims on corporates	1,151,942	168,130	1,381,235	603,449	1,466	3,306,222
6	Regulatory retail exposure	1,320,076	10,890	630,696	108,397	41	2,070,100
7	Qualifying residential housing financing facilities	66,054	-	199,144	-	-	265,198
8	Past due exposures	352,098	-	18,323	41,599	-	412,020
9	Inventory and commodities	283,674	12,888	138,012	130,785	-	565,359
10	Real estate investments	789,618	4,950	66,296	23,384	-	884,248
11	Investment and financing with customers	2,253,360	68,777	33,711	149,042	16	2,504,906
12	Sukuk and taskeek	65,422	22,270	19,395	25,861	577	133,525
13	Other exposures	1,295,171	37,971	101,595	59,548	2,256	1,496,541
	Total	9,373,899	345,154	3,041,099	1,471,038	17,737	14,248,927

Maturities of total Credit Risk exposures

2012
(KD' 000)

Ser.	Credit Risk exposures	Up to 3 months	3 to 12 months	Over 1 year	Total
1	Cash item	426,859	-	17,403	444,262
2	Claims on sovereigns	825,825	372,208	224,253	1,422,286
3	Claims on public sector entities	49,402	-	21,186	70,588
4	Claims on banks	942,986	134,940	72,832	1,150,758
5	Claims on corporates	673,381	1,177,887	1,727,950	3,579,218
6	Regulatory retail exposure	251,427	379,591	1,934,808	2,565,826
7	Qualifying residential housing financing facilities	1,169	9,939	281,466	292,574
8	Past due exposures	270,952	101,018	59,032	431,002
9	Inventory and commodities	480	2,832	537,935	541,247
10	Real estate investments	12,471	55,888	803,772	872,131
11	Investment and financing with customers	706,407	888,601	882,514	2,477,522
12	Sukuk and taskeek	30,468	16,979	116,807	164,254
13	Other exposures	39,981	30,248	1,383,660	1,453,889
	Total	4,231,808	3,170,131	8,063,618	15,465,557

2011
(KD' 000)

Ser.	Credit Risk exposures	Up to 3 months	3 to 12 months	Over 1 year	Total
1	Cash item	246,207	-	16,744	262,951
2	Claims on sovereigns	937,871	106,359	163,690	1,207,920
3	Claims on public sector entities	-	12,000	37,777	49,777
4	Claims on banks	853,543	123,409	113,208	1,090,160
5	Claims on corporates	698,666	984,295	1,623,261	3,306,222
6	Regulatory retail exposure	196,306	326,278	1,547,516	2,070,100
7	Qualifying residential housing financing facilities	1,072	13,096	251,030	265,198
8	Past due exposures	205,050	155,817	51,153	412,020
9	Inventory and commodities	881	5,457	559,021	565,359
10	Real estate investments	17,768	37,262	829,218	884,248
11	Investment and financing with customers	643,808	998,386	862,712	2,504,906
12	Sukuk and taskeek	42,468	41,194	49,863	133,525
13	Other exposures	122,340	63,708	1,310,493	1,496,541
	Total	3,965,980	2,867,261	7,415,686	14,248,927

Main sectors of total Credit Risk exposures

2012
(KD'000)

Ser.	Credit risk exposures	Manufacturing & Trade	Banks and financial institutions	Construction & real estate	Government	Others	Total
1	Cash item	-	388,823	-	-	55,439	444,262
2	Claims on sovereigns	-	389,893	2,759	1,023,467	6,167	1,422,286
3	Claims on public sector entities	-	-	-	-	70,588	70,588
4	Claims on banks	2,412	1,148,133	-	-	213	1,150,758
5	Claims on corporates	1,596,747	191,427	689,677	-	1,101,367	3,579,218
6	Regulatory retail exposure	338,047	2,260	122,925	-	2,102,594	2,565,826
7	Qualifying residential housing financing facilities	-	-	35,144	-	257,430	292,574
8	Past due exposures	71,584	94,979	122,508	64	141,867	431,002
9	Inventory and commodities	4,040	-	480	-	536,727	541,247
10	Real estate investments	-	-	692,694	-	179,437	872,131
11	Investment and financing with customers	121,488	9,984	1,116,581	-	1,229,469	2,477,522
12	Sukuk and taskeek	19,167	125,925	7,800	-	11,362	164,254
13	Other exposures	92,558	388,213	466,106	-	507,012	1,453,889
	Total	2,246,043	2,739,637	3,256,674	1,023,531	6,199,672	15,465,557

2011
(KD'000)

Ser.	Credit risk exposures	Manufacturing & Trade	Banks and financial institutions	Construction & real estate	Government	Others	Total
1	Cash item	-	216,234	-	-	46,717	262,951
2	Claims on sovereigns	-	175,276	-	1,004,742	27,902	1,207,920
3	Claims on public sector entities	-	-	-	-	49,777	49,777
4	Claims on banks	29	1,089,320	-	-	811	1,090,160
5	Claims on corporates	1,492,330	292,577	658,084	-	863,231	3,306,222
6	Regulatory retail exposure	314,049	6,553	105,007	-	1,644,491	2,070,100
7	Qualifying residential housing financing facilities	-	-	66,054	-	199,144	265,198
8	Past due exposures	49,539	135,565	70,678	-	156,238	412,020
9	Inventory and commodities	4,841	-	881	-	559,637	565,359
10	Real estate investments	-	-	664,321	-	219,927	884,248
11	Investment and financing with customers	120,698	15,574	1,213,086	-	1,155,548	2,504,906
12	Sukuk and taskeek	18,604	101,336	5,146	-	8,439	133,525
13	Other exposures	29,124	516,162	370,027	-	581,228	1,496,541
	Total	2,029,214	2,548,597	3,153,284	1,004,742	5,513,090	14,248,927

Kuwait Finance House K.S.C. and Subsidiaries

4.1.2 Irregular and past due credit facilities

1. Irregular Credit facilities (Impaired) consist the following categories:

- **Watchlist Category requiring specific provisions:** Includes regular clients but upon management's discretion, provisions have been taken to confront any possible future deterioration, in addition to credit facilities that are overdue for 90 days or less (inclusive). The specific provision percentage is determined based on each case and after a thorough study by the management and after deducting deferred, suspended profit and eligible collateral.

- **Sub-standard:** If facilities are irregular for a period of 91 – 180 days (inclusive), a provision rate of minimum 20% shall be applied on the total of the facilities net of deferred and suspended profit and eligible collateral.

- **Doubtful Debts:** if debts are irregular for a period of 181 – 365 days (inclusive),a provision rate of minimum 50% shall be applied on the total of the facilities net of deferred and suspended profit and eligible collateral.

- **Bad Debts:** if debts are irregular for more than 365 days, a provision rate of 100% shall be applied on the total of the facilities net of deferred and suspended profit and eligible collateral.

2. Past due credit facilities: these are defined as facilities which are overdue for 90 days or less (inclusive). These facilities are known as the "Watchlist Category" and no specific provision is taken against them.

At 31 December 2012, the Bank's non-performing finance facilities including receivables, leased assets and non cash facilities amounted KD 679,630 (2011: KD 721,528 thousand) , KD 627,697 thousand (2011: KD 688,199 thousand) after excluding deferred revenue and suspended profit and KD 361,915 thousand (2011: KD 542,759 thousand) after excluding eligible collaterals in accordance with CBK regulations for specific provision calculation.

As at 31 December 2012, Group's provisions amounted KD 482,612 thousand (2011: KD 556,073 thousand), including general provisions that amounted KD 272,400 thousand (2011: KD 280,599 thousand).

Irregular and past due financing facilities exposures based on standard portfolios

2012
(KD' 000)

Ser.	Description of credit risk exposures	Impaired	Specific Provision	Net financing facilities	Specific Provisions Write Off	Past Due
1	Claims on banks	481	240	241	8,084	-
2	Claims on corporate	395,943	129,802	266,141	225,001	464,046
3	Regulatory retail exposure	123,947	63,379	60,568	14,034	223,673
4	Qualifying residential housing financing Facilities	12,851	772	12,079	119	11,104
5	Investment and financing with customers	146,408	16,019	130,389	28,644	95,690
	Total	679,630	210,212	469,418	275,882	794,513

2011
(KD' 000)

Ser.	Description of credit risk exposures	Impaired	Specific Provision	Net financing facilities	Specific Provisions Write Off	Past Due
1	Claims on corporate	494,920	168,115	326,805	131,735	337,430
2	Regulatory retail exposure	144,537	80,729	63,808	18,541	50,917
3	Qualifying residential housing financing Facilities	4,651	737	3,914	393	4,769
4	Investment and financing with customers	77,420	25,893	51,527	565	160,958
	Total	721,528	275,474	446,054	151,234	554,074

Kuwait Finance House K.S.C. and Subsidiaries

Irregular and past due financing facilities exposures based on geographical distribution

2012
(KD' 000)

Ser.	Description of credit risk exposures	Impaired	Specific Provision	Net financing facilities	Specific Provisions Write Off	Past Due
1	Middle East & North Africa	502,116	116,701	385,415	230,578	516,304
2	Europe	70,857	29,719	41,138	7,717	104,875
3	Asia	106,657	63,792	42,865	37,587	173,334
	Total	679,630	210,212	469,418	275,882	794,513

2011
(KD' 000)

Ser.	Description of credit risk exposures	Impaired	Specific Provision	Net financing facilities	Specific Provisions Write Off	Past Due
1	Middle East & North Africa	571,310	191,499	379,811	135,691	388,594
2	Europe	45,043	21,366	23,677	15,543	81,753
3	Asia	105,175	62,609	42,566	-	83,727
Total		721,528	275,474	446,054	151,234	554,074

Irregular and past due financing facilities exposures based on Industrial

2012
(KD' 000)

Ser.	Description of credit risk exposures	Impaired	Specific Provision	Net financing facilities	Specific Provisions Write Off	Past Due
1	Manufacturing and Trade	135,082	68,276	66,806	65,975	142,479
2	Banks and financial institutions	143,119	22,191	120,928	109,953	23,581
3	Constructions & real estate	245,812	64,742	181,070	28,374	212,901
4	Others	155,617	55,003	100,614	71,580	415,552
	Total	679,630	210,212	469,418	275,882	794,513

2011
(KD' 000)

Ser.	Description of credit risk exposures	Impaired	Specific Provision	Net financing facilities	Specific Provisions Write Off	Past Due
1	Manufacturing and Trade	126,656	81,273	45,383	9,316	109,169
2	Banks and financial institutions	198,081	60,320	137,761	96,321	10,830
3	Constructions & real estate	156,001	62,568	93,433	6,266	177,987
4	Others	240,790	71,313	169,477	39,331	256,088
	Total	721,528	275,474	446,054	151,234	554,074

General provision

Ser.	Description of credit risk exposures	2012	2011
1	Claims on banks	980	926
2	Claims on corporates	200,995	229,079
3	Regulatory retail exposures	40,941	37,112
4	Real estate investments	2,318	2,397
5	Investment and financing with customers	27,166	26,085
	Total	272,400	295,599

4.1.3 Applicable Risk Mitigation Methods

Kuwait Finance House K.S.C (The Bank) ensures the diversification of exposures according to standard portfolios, business sectors and geographical distributions borders. In addition to the continuous evaluation of risk mitigation methods against finance obligations and credit limits of the customer as per the analytical study of the customer's financial position.

Eligible collaterals and guarantees are calculated as per Central Bank of Kuwait instructions. Netting is applied for exchange of deposits with banks and financial institutions. Bank guarantees are used to redirect risks to claim on banks portfolio. Standard Supervisory Haircuts are applied on Eligible Collaterals according to Central Bank of Kuwait regulations in relation to Basel II standard.

The Bank compliance with the credit concentration limits per customer 15% and maintaining adequate ratios of liquid assets 18% provides several methods to measure the quality and effectiveness of risk mitigation methods used to mitigate capital requirements.

Eligible Collaterals and Banking Guarantees given against Credit Risk Exposure

2012
(KD'000)

Ser.	Credit Risk Exposures	Gross credit exposures	Eligible Collaterals	Banking Guarantees
1	Cash items	444,262	-	-
2	Claims on sovereigns	1,422,286	3,839	-
3	Claims on public sector entities	70,588	-	-
4	Claims on banks	1,150,758	-	-
5	Claims on corporates	3,579,218	638,592	2,412
6	Regulatory retail exposures	2,565,826	253,741	142
7	Qualifying residential housing financing facilities	292,574	199,990	-
8	Past due exposures	431,002	227,223	-
9	Inventory and commodities	541,247	-	-
10	Real estate investment	872,131	-	-
11	Investment and financing with customers	2,477,522	1,014,536	-
12	Sukuk and taskeek	164,254	-	-
13	Other exposures	1,453,889	-	-
	Total	15,465,557	2,337,921	2,554

2011
(KD'000)

Ser.	Credit Risk Exposures	Goss credit exposures	Eligible Collaterals	Banking Guarantees
1	Cash items	262,951	-	-
2	Claims on sovereigns	1,207,920	-	-
3	Claims on public sector entities	49,777	-	-
4	Claims on banks	1,090,160	4,458	-
5	Claims on corporates	3,306,222	654,138	-
6	Regulatory retail exposures	2,070,100	203,855	-
7	Qualifying residential housing financing facilities	265,198	160,697	-
8	Past due exposures	412,020	51,558	-
9	Inventory and commodities	565,359	-	-
10	Real estate investment	884,248	-	-
11	Investment and financing with customers	2,504,906	1,091,016	-
12	Sukuk and taskeek	133,525	-	-
13	Other exposures	1,496,541	-	-
	Total	14,248,927	2,165,722	-

Kuwait Finance House K.S.C. and Subsidiaries

4.2. Market risk

Market Risk is the risk that the value of an asset or liability will fluctuate as a result of changes in market prices. In KFH, exposure arises from fluctuations in exchange rates, share prices, real estate prices and in the value of inventories and commodities. The market risks that the bank is exposed to are limited as all Islamic financing and investment transactions are interest free. Islamic finance contracts i.e. Mudarabah and Musharakah are based on profit and loss sharing. Other Islamic finance transactions are related to real economic transactions such as purchase and sale and merchandise through Murabahah, Istisnaa, Ijara or Salam transactions.

4.2.1. Market risk governance framework

Foreign exchange and commodity risk arising from KFH's Treasury activities are managed within Treasury. Equity price risk is managed within the Investment Department. The quantum of the exposures is measured and monitored by the risk management department and governed by the Asset and Liability Committee (ALCO) the activities of which are overseen by the Board Risk and Assets Committee. Real estate price risk arising from collateral pledged for financing facilities is managed by active monitoring of collateral values and topping up the collateral where the coverage of the debt is no longer acceptable to KFH.

4.3. Liquidity risk

Liquidity risk is the risk arising from the inability of the Bank to meet its obligations when due as a result of unavailability of funds at an economically viable price. Liquidity risk can arise from unexpected withdrawals of deposits or an inability to sell assets in the market due to absence of buyers.

4.3.1 Liquidity risk governance framework

Liquidity Risk Management in KFH is governed by the Liquidity Risk Management Framework. This sets specific responsibilities for Treasury Risk Management and Financial Control to measure, monitor and assess the Bank's funding requirements in the short and medium term under both normal operating and stressed conditions to ensure the availability of sufficient liquidity to meet its commitments (both expected and unexpected). The Bank has a contingency funding framework to bring in to operation where there is emerging evidence (based on triggers established in the Liquidity Risk Management Framework) of a future liquidity shortfall.

The Liquidity Risk Management Framework is the responsibility of the ALCO, which is in turn overseen by the Board Risk and Assets Committee.

4.4. Operational risks

Operational is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. It also includes losses resulting from failure to comply with Sharia's requirements. Operational risk includes therefore, the risks of theft or fraud, legal risks from failure of contracts, losses arising from damage to physical assets, failures in regulatory compliance leading to fines or intensive scrutiny, failure of IT systems or denial of service through external attacks on the banks operating and delivery processes.

4.4.1. Operational risk governance framework

Because operational risk arise from a multitude of processes, the primary focus of operational risk management is in developing awareness of operational weaknesses, strengthening the controls and installing additional risk mitigants where required. The Operational Risk Framework comprises a process for assessing risk based on likelihood of occurrence and severity of the impact if it does occur. The lessons learned from previous operational risk events also provides opportunities to strengthen controls. The Head of Operational Risk works with the business through a Group of operational risk co-ordinators to improve understanding of operational weaknesses and take preventative steps to mitigate the risk. The process is governed by the Operational Risk Committee which is overseen by the Board Risk and Assets Committee.

4.5. Reputation risk

The Bank defines risks reputation as risks arising from the negative perception by customers or other parties or shareholders or investors or employees or regulators that could adversely affect the Bank's ability to maintain current relationships or new relationships..As well as this, given the Islamic nature of the Bank's activities, it is also exposed to the risk of reputation arising from non-adherence to Sharia, which may lead to loss of customers and the many activities of Bank risk management reputation as follows:Reputation Risk arises from a failure on the part of the bank to perform as expected by its relevant stakeholders. As such this risk is mitigated through monitoring and managing the primary operational processes of the bank. The operational risk management framework plays a critical role in mitigating reputational risk.

4.6. Strategic risks

The Bank determines the strategic risks are risks arising from changes in market conditions and the results of decisions of business units and strategies of competitors or inappropriate responses to market developments that may impact on profits and capital. As well as this, the Bank faces risks arising from the investment strategy since it may not be compatible with the Bank's strategy and infrastructure which may impact on profits and capital.

Strategic risks are controlled primarily through the active participation of the senior management of the Bank's activities. As well as this, the follow-up of the objectives of the strategic plan and monitored regularly to ensure action and respond in a timely manner.

Sixth: Investment Accounts

The Bank receives deposits from customers as part of several unrestricted investment accounts "On Balance sheet" and restricted "Off Balance sheet"

Unrestricted Deposits, these are invested by the bank as Mudarib investing funds for limited or renewable periods at various investment ratios. Funds are invested in all finance activities that will achieve targeted return. Investment returns are distributed among the bank as a Mudarib and investment account holders on proportionate basis for each type of these accounts and the elapsed investment period.

Kuwait Finance House acts as an investment agent in restricted deposits. Such funds are invested based on determined maturity periods in pre-determined investment and finance activities with customers (depositors). Certain fees are charged on the investment of such funds.

Customers' deposits are received and invested according to certain regulations that are mentioned in the procedures manual and instructions guide to ascertain that these funds whether they were in Kuwaiti Dinar or foreign currency are invested according to Islamic Shari'a principles.

Seventh: Shari'a Regulations

Shari'a Control Department (SCD) is considered one of the main departments at Kuwait Finance House. The department monitors and executes Shari'a decisions issued by the Fatwa and Shari'a Control Committee as per certain rules and regulations approved by the Fatwa & Shari'a Control Committee at Kuwait Finance House. The committee supervises the implementation of such regulations on daily operations and answers all inquiries concerning issued Shari'a decisions.

Certain Non- Shari'a compliant funds are realized from dealing with conventional banks and sale of un-owned in Murabahas. Entries, agreements, products and advertising material...etc are reviewed by Shari'a auditors through periodical review sessions conducted during the year. Such funds are deposited in certain accounts and spent in public affairs other than the construction of Mosques and printing of Quran as per Shari'a committee opinion.

Shari'a Control Department, represented by Shari'a Audit Unit, conducts audit on Kuwait Finance House activities. The committee presents its report to the general assembly in its annual general assembly meeting.

In accordance with the Bank's Fatwa and Shari'a Supervisory Board approval held on 20th December 2011, the Bank has changed Zakat based calculation from reserve method to net working capital method. Accordingly the Bank calculates Zakat at 2.577% on net working capital on completing fiscal year and is paid under the direction of the Bank's Fatwa and Shari'a Supervisory Board. Such Zakat is charged to voluntary reserve.

Audit Report & Consolidated Financial Statements

AUDITORS' REPORT

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF KUWAIT FINANCE HOUSE K.S.C.

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Kuwait Finance House K.S.C. ("the Bank") and its subsidiaries (collectively "the Group"), which comprise the consolidated statement of financial position as at 31 December 2012 and the consolidated statement of income, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the consolidated Financial Statements

The management of the Bank is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2012, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait.

Report on Other Legal and Regulatory Requirements

Furthermore, in our opinion proper books of account have been kept by the Bank and the consolidated financial statements, together with the contents of the report of the Bank's Board of Directors relating to these consolidated financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the consolidated financial statements incorporate all information that is required by the Capital Adequacy Regulations issued by the Central Bank of Kuwait ("CBK") as stipulated in CBK Circular No. 2/RBA/44/2009 dated 15 June 2009, as amended, the Companies Law No. 25 of 2012, and by the Bank's Articles of Association, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of Capital Adequacy Regulations issued by the CBK as stipulated in CBK Circular No. 2/RBA/44/2009 dated 15 June 2009, as amended, the Companies Law No. 25 of 2012, nor of the Articles of Association have occurred during the year ended 31 December 2012 that might have had a material effect on the business of the Bank or on its financial position.

We further report that, during the course of our audit, we have not become aware of any material violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the CBK and the organisation of banking business, and its related regulations during the year ended 31 December 2012.

WALEED A. AL OSAIMI
LICENCE NO. 68 A
ERNST & YOUNG
AL AIBAN, AL OSAIMI & PARTNERS

BADER A. AL-WAZZAN
LICENCE NO. 62 A
DELOITTE & TOUCHE
AL-FAHAD AL-WAZZAN & CO.

17 February 2013
Kuwait

CONSOLIDATED STATEMENT OF INCOME Year ended 31 December 2012

	Notes	KD 000's 2012	KD 000's 2011	USD 000's 2012	USD 000's 2011
INCOME					
Financing income		573,515	523,964	2,039,164	1,862,983
Investment income	4	230,924	188,193	821,063	669,131
Fee and commission income		72,705	55,948	258,507	198,926
Gain of foreign currencies		19,538	3,742	69,468	13,305
Other income	5	36,118	100,235	128,420	356,391
		932,800	872,082	3,316,622	3,100,736
EXPENSES					
Staff costs		134,595	124,339	478,560	442,094
General and administrative expenses		113,590	101,760	403,876	361,813
Finance costs		59,137	53,780	210,265	191,218
Depreciation		72,523	79,383	257,860	282,251
Impairment	6	255,348	321,297	907,904	1,142,389
		635,193	680,559	2,258,465	2,419,765
PROFIT BEFORE DISTRIBUTION TO DEPOSITORS		297,607	191,523	1,058,157	680,971
Distribution to depositors		171,085	152,730	608,302	543,040
PROFIT AFTER DISTRIBUTION		126,522	38,793	449,855	137,931
Contribution to Kuwait Foundation for the Advancement of Sciences		909	820	3,232	2,916
National Labor Support tax		1,077	591	3,829	2,101
Zakat (based on Zakat Law No. 46/2006)		309	17	1,099	60
Directors' fees	23	905	260	3,218	924
PROFIT FOR THE YEAR		123,322	37,105	438,477	131,930
Attributable to:					
Equityholders of the Bank		87,676	80,342	311,736	285,662
Non-controlling interests		35,646	(43,237)	126,741	(153,732)
		123,322	37,105	438,477	131,930
BASIC AND DILUTED EARNINGS PER SHARE ATTRIBUTABLE TO THE EQUITYHOLDERS OF THE BANK	7	30.80 fils	28.02 fils	10.95 cents	9.96 cents

The attached notes 1 to 39 form part of these consolidated financial statements.

Kuwait Finance House K.S.C. and Subsidiaries

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME Year ended 31 December 2012

	Notes	KD 000's 2012	KD 000's 2011	USD 000's 2012	USD 000's 2011
Profit before distribution to depositors		297,607	191,523	1,058,157	680,971
Other comprehensive income (loss)					
Change in fair value of financial assets available for sale	19	(29,576)	(29,497)	(105,159)	(104,878)
Change in fair value of currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts	19	1,337	(154)	4,754	(548)
Loss realised on financial assets available for sale during the year	19	1,883	4,957	6,695	17,625
Impairment losses transferred to the consolidated statement of income	19	39,071	53,934	138,919	191,765
Share of other comprehensive income of associates	19	14	756	50	2,688
Exchange differences on translation of foreign operations	20	21,332	(85,303)	75,847	(303,300)
Other comprehensive income (loss) for the year included directly in fair value reserve and foreign exchange translation reserve		34,061	(55,307)	121,106	(196,648)
Total comprehensive income before estimated distribution to depositors		331,668	136,216	1,179,263	484,323

The attached notes 1 to 39 form part of these consolidated financial statements.

Kuwait Finance House K.S.C. and Subsidiaries

CONSOLIDATED STATEMENT OF FINANCIAL POSITION at 31 December 2012

	Notes	KD 000's 2012	KD 000's 2011	USD 000's 2012	USD 000's 2011
ASSETS					
Cash and balances with banks and financial institutions	8	814,256	619,554	2,895,132	2,202,859
Short-term murabahas		1,185,723	1,478,052	4,215,904	5,255,296
Receivables	9	6,652,918	5,864,821	23,654,820	20,852,697
Trading properties		255,925	273,686	909,955	973,106
Leased assets	10	1,653,510	1,422,442	5,879,147	5,057,572
Financial assets available for sale	11	1,376,260	1,302,177	4,893,369	4,629,963
Investment in associates	12	452,832	490,062	1,610,069	1,742,442
Investment properties	13	557,264	536,358	1,981,383	1,907,051
Other assets	14	1,020,937	705,551	3,629,998	2,508,626
Property and equipment	15	733,676	767,130	2,608,626	2,727,573
TOTAL ASSETS		14,703,301	13,459,833	52,278,403	47,857,185
LIABILITIES, DEFERRED REVENUE, FAIR VALUE RESERVE, FOREIGN EXCHANGE TRANSLATION RESERVE AND TOTAL EQUITY					
LIABILITIES					
Due to banks and financial institutions	16	2,254,850	1,818,636	8,017,244	6,466,262
Depositors' accounts	17	9,392,676	8,881,845	33,396,181	31,579,895
Other liabilities	18	734,985	681,673	2,613,280	2,423,724
TOTAL LIABILITIES		12,382,511	11,382,154	44,026,705	40,469,881
DEFERRED REVENUE		744,041	608,475	2,645,479	2,163,467
FAIR VALUE RESERVE	19	(9,194)	(13,003)	(32,689)	(46,233)
FOREIGN EXCHANGE TRANSLATION RESERVE	20	(53,473)	(74,805)	(190,126)	(265,973)
EQUITY ATTRIBUTABLE TO THE EQUITYHOLDERS OF THE BANK					
Share capital	21	290,416	268,904	1,032,590	956,103
Share premium		464,766	464,766	1,652,501	1,652,501
Proposed issue of bonus shares	23	29,042	21,512	103,260	76,487
Treasury shares	21	(54,028)	(46,813)	(192,100)	(166,446)
Reserves	22	569,473	544,361	2,024,793	1,935,506
		1,299,669	1,252,730	4,621,044	4,454,151
Proposed cash dividend	23	28,429	39,623	101,081	140,882
TOTAL EQUITY ATTRIBUTABLE TO THE EQUITYHOLDERS OF THE BANK		1,328,098	1,292,353	4,722,125	4,595,033
Non-controlling interests		311,318	264,659	1,106,909	941,010
TOTAL EQUITY		1,639,416	1,557,012	5,829,034	5,536,043
TOTAL LIABILITIES, DEFERRED REVENUE, FAIR VALUE RESERVE, FOREIGN EXCHANGE TRANSLATION RESERVE AND TOTAL EQUITY		14,703,301	13,459,833	52,278,403	47,857,185

MOHAMMED ALI AL-KHUDAIRI
(CHAIRMAN)

MOHAMMAD AL-OMAR
(CHIEF EXECUTIVE OFFICER)

The attached notes 1 to 39 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY Year ended 31 December 2012

KD 000's

	Attributable to equityholders of the Bank				Reserves									Non-controlling interests	Total equity
	Share capital	Share premium	Proposed issue of bonus shares	Treasury shares	Statutory reserve	Voluntary reserve	Employee share options reserve	Treasury shares reserve	Sub total	Profit for the year	Sub total	Proposed cash dividend	Sub total		
At 31 December 2010	248,985	464,766	19,919	(26,722)	254,288	270,359	4,239	5,192	534,078	-	1,241,026	49,304	1,290,330	311,999	1,602,329
Issue of bonus shares	19,919	-	(19,919)	-	-	-	-	-	-	-	-	-	-	-	-
Zakat paid	-	-	-	-	-	(10,413)	-	-	(10,413)	-	(10,413)	-	(10,413)	-	(10,413)
Cash dividends paid	-	-	-	-	-	-	-	-	-	-	-	(49,304)	(49,304)	-	(49,304)
Cancellation of share option	-	-	-	-	-	-	5	-	5	-	5	-	5	-	5
Profit for the year	-	-	-	-	-	-	-	-	-	80,342	80,342	-	80,342	(43,237)	37,105
Distribution of profit:															
Proposed issue of bonus shares	-	-	21,512	-	-	-	-	-	-	(21,512)	-	-	-	-	-
Proposed cash dividends	-	-	-	-	-	-	-	-	-	(39,623)	(39,623)	39,623	-	-	-
Transfer to statutory reserve	-	-	-	-	8,203	-	-	-	8,203	(8,203)	-	-	-	-	-
Transfer to voluntary reserve	-	-	-	-	-	11,004	-	-	11,004	(11,004)	-	-	-	-	-
Net movement in treasury shares (Note 21)	-	-	-	(20,091)	-	-	-	-	-	-	(20,091)	-	(20,091)	-	(20,091)
Profit on sale of treasury shares	-	-	-	-	-	-	-	1,484	1,484	-	1,484	-	1,484	-	1,484
Net change in non-controlling interest	-	-	-	-	-	-	-	-	-	-	-	-	-	(4,103)	(4,103)
At 31 December 2011	268,904	464,766	21,512	(46,813)	262,491	270,950	4,244	6,676	544,361	-	1,252,730	39,623	1,292,353	264,659	1,557,012
Issue of bonus shares	21,512	-	(21,512)	-	-	-	-	-	-	-	-	-	-	-	-
Zakat paid	-	-	-	-	-	(5,095)	-	-	(5,095)	-	(5,095)	-	(5,095)	-	(5,095)
Cash dividends paid	-	-	-	-	-	-	-	-	-	-	-	(39,623)	(39,623)	-	(39,623)
Cancellation of share option	-	-	-	-	-	-	2	-	2	-	2	-	2	-	2
Profit for the year	-	-	-	-	-	-	-	-	-	87,676	87,676	-	87,676	35,646	123,322
Distribution of profit:															
Proposed issue of bonus shares	-	-	29,042	-	-	-	-	-	-	(29,042)	-	-	-	-	-
Proposed cash dividends	-	-	-	-	-	-	-	-	-	(28,429)	(28,429)	28,429	-	-	-
Transfer to statutory reserve	-	-	-	-	9,087	-	-	-	9,087	(9,087)	-	-	-	-	-
Transfer to voluntary reserve	-	-	-	-	-	21,118	-	-	21,118	(21,118)	-	-	-	-	-
Net movement in treasury shares (Note 21)	-	-	-	(7,215)	-	-	-	-	-	-	(7,215)	-	(7,215)	-	(7,215)
Non-controlling interest arising on a business combination (Note 3)	-	-	-	-	-	-	-	-	-	-	-	-	-	33,691	33,691
Acquisition of non-controlling interest (Note 24)	-	-	-	-	-	-	-	-	-	-	-	-	-	(14,807)	(14,807)
Net change in non-controlling interest	-	-	-	-	-	-	-	-	-	-	-	-	-	(7,871)	(7,871)
At 31 December 2012	290,416	464,766	29,042	(54,028)	271,578	286,973	4,246	6,676	569,473	-	1,299,669	28,429	1,328,098	311,318	1,639,416

The attached notes 1 to 39 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS Year ended 31 December 2012

	Notes	KD 000's 2012	KD 000's 2011	USD 000's 2012	USD 000's 2011
OPERATING ACTIVITIES					
Profit for the year		123,322	37,105	438,477	131,930
Adjustment for:					
Depreciation		72,523	79,383	257,860	282,251
Impairment	6	255,348	321,297	907,904	1,142,389
Dividend income	4	(14,027)	(10,428)	(49,874)	(37,077)
(Gain) loss on part sale of associates	4	(4,269)	129	(15,179)	459
Gain on sale of financial assets available for sale	4	(34,581)	(15,364)	(122,955)	(54,628)
Sukook income	4	(19,388)	(16,061)	(68,935)	(57,106)
Gain on cancellation of aircraft contract	4	(7,043)	(29,980)	(25,042)	(106,596)
Gain on settlement of pre existing transactions between the Group and acquiree companies	4	(34,884)	-	(124,032)	-
Gain on bargain purchase	4	(14,285)	-	(50,791)	-
Loss on remeasurement of previously held equity	4	5,353	-	19,033	-
Share of (loss) result of associates	4	(1,636)	2,305	(5,817)	8,196
Other investment income	4	(4,058)	(7,310)	(14,428)	(25,991)
		322,375	361,076	1,146,221	1,283,827
Changes in operating assets and liabilities					
(Increase) decrease in operating assets:					
Receivables		(903,811)	(572,922)	(3,213,550)	(2,037,056)
Trading properties		20,695	(66,264)	73,582	(235,605)
Leased assets		(226,321)	(148,395)	(804,697)	(527,627)
Other assets		(310,604)	(115,890)	(1,104,370)	(412,053)
Statutory deposit with Central Banks		(212,317)	(106,781)	(754,905)	(379,666)
Increase (decrease) in operating liabilities:					
Due to banks and financial institutions		436,214	(392,944)	1,550,983	(1,397,134)
Depositors' accounts		510,831	1,232,763	1,816,288	4,383,157
Other liabilities		89,809	73,916	319,321	262,812
Net cash (used in) from operating activities		(273,129)	264,559	(971,127)	940,655
INVESTING ACTIVITIES					
Purchase of financial assets available for sale, net		(37,173)	(322,641)	(132,171)	(1,147,168)
Purchase of investment properties		(244,590)	(125,447)	(869,653)	(446,034)
Proceeds from sale of investment properties		198,057	128,002	704,203	455,118
Purchase of property and equipment		(87,423)	(153,139)	(310,837)	(544,494)
Proceeds from sale of property and equipment		46,274	82,519	164,530	293,401
Purchase of investments in associates		(81,190)	(14,902)	(288,676)	(52,985)
Proceeds from sale of investments in associates		116,771	9,451	415,186	33,604
Sukook income received	4	19,388	16,061	68,935	57,106
Cash proceeds from cancellation of aircraft contracts	4	7,043	29,980	25,042	106,596
Dividend income received		35,477	13,155	126,140	46,773
Net cash used in investing activities		(27,366)	(336,961)	(97,301)	(1,198,083)
FINANCING ACTIVITIES					
Cash dividends paid		(39,623)	(49,304)	(140,882)	(175,303)
Cash received on cancellation of share options		2	5	7	18
Payment of Zakat		(5,095)	(11,092)	(18,116)	(39,438)
Net movement in treasury shares		(7,215)	(18,607)	(25,653)	(66,157)
Acquisition of non-controlling interest	24	(23,727)	-	(84,363)	-
Net cash used in financing activities		(75,658)	(78,998)	(269,007)	(280,880)
DECREASE IN CASH AND CASH EQUIVALENTS		(376,153)	(151,400)	(1,337,435)	(538,308)
Cash and cash equivalents at 1 January		1,368,515	1,519,915	4,865,831	5,404,142
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	8	992,362	1,368,515	3,528,396	4,865,834

The attached notes 1 to 39 form part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

1 CORPORATE INFORMATION

The consolidated financial statements of the Group for the year ended 31 December 2012 were authorised for issue by the Chairman on 17 February 2013 in accordance with a resolution of the Bank's Board of Directors on 14 January 2013. The general assembly of the equityholders of the Bank has the power to amend these consolidated financial statements after issuance.

The Group comprises Kuwait Finance House K.S.C. ("the Bank") and its consolidated subsidiaries (collectively "the Group") as noted in Note 24. The Bank is a public shareholding company incorporated in Kuwait on 23 March 1977 and was registered as an Islamic Bank with the Central Bank of Kuwait on 24 May 2004. It is engaged principally in providing banking services, the purchase and sale of properties, leasing, project construction for its own account as well as for third parties and other trading activities without practicing usury. Trading activities are conducted on the basis of purchasing various goods and selling them on murabaha at negotiated profit margins which can be settled in cash or on installment credit basis. The Bank's registered head office is at Abdulla Al-Mubarak Street, Murqab, Kuwait.

All activities are conducted in accordance with Islamic Shari'a, as approved by the Bank's Fatwa and Shari'a Supervisory Board.

The Bank operates through 56 local branches (2011: 54) and employed 2,408 employees as of 31 December 2012 (2011: 2,278) of which 1,496 (2011: 1,423) are Kuwaiti nationals representing 62% (2011: 62%) of the Bank's total work force.

2 SIGNIFICANT ACCOUNTING POLICIES

2.1 BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with the regulations of the Government of Kuwait for financial services institutions regulated by the Central Bank of Kuwait. These regulations require adoption of all International Financial Reporting Standards (IFRS) except for the IAS 39 requirement for collective provision, which has been replaced by the Central Bank of Kuwait's requirement for a minimum general provision as described under the accounting policy for impairment of financial assets.

The consolidated financial statements are prepared under the historical cost convention modified to include the measurement at fair value of financial assets available for sale, precious metals inventory, currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts.

The consolidated financial statements are presented in Kuwaiti Dinars (KD) and all values are rounded to the nearest thousand Dinars, except when otherwise indicated.

2.2 CHANGES IN ACCOUNTING POLICIES

New and amended standards and interpretations

The accounting policies adopted are consistent with those of the previous financial year, except for the following new and amended IFRS recently issued by the International Accounting Standards Board (IASB) and International Financial Reporting Interpretations Committee (IFRIC) interpretations effective as of 1 January 2012. However the implementation of new and amended IFRS and IFRIC interpretations did not have a significant impact on the Group's financial statements.

- *IAS 12 Income Taxes (Amendment) – Deferred Taxes: Recovery of Underlying Assets*
- *IFRS 1 First -Time Adoption of International Financial Reporting Standards (Amendment) – Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters IFRS 7 Financial Instruments: Disclosures (Amendments)*
- *IFRS 7 Financial Instruments : Disclosures – Enhanced Derecognition Disclosure Requirements*

IAS 12 Income Taxes (Amendment) – Deferred Taxes: Recovery of Underlying Assets

The amendment clarified the determination of deferred tax on investment property measured at fair value and introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. It includes the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 should always be measured on a sale basis. The amendment is effective for annual periods beginning on or after 1 January 2012 and has been no effect on the Group's financial position, performance or its disclosures.

IFRS 1 First-Time Adoption of International Financial Reporting Standards (Amendment) – Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters IFRS 7 Financial Instruments: Disclosures (Amendments)

The IASB provided guidance on how an entity should resume presenting IFRS financial statements when its functional currency ceases to be subject to hyperinflation. The amendment is effective for annual periods beginning on or after 1 July 2011. The amendment had no impact to the Group.

IFRS 7 Financial Instruments: Disclosures — Enhanced Derecognition Disclosure Requirements

The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Group's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about the entity's continuing involvement in derecognised assets to enable the users to evaluate the nature of, and risks associated with, such involvement. The amendment is effective for annual periods beginning on or after 1 July 2011. The Group does not have any assets with these characteristics so there has been no effect on the presentation of its consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 STANDARDS ISSUED BUT NOT YET EFFECTIVE

New and revised IASB Standards, IFRSs and IFRIC Interpretations issued, but not yet adopted

Standards issued but not yet effective up to the date of issuance of the Group's consolidated financial statements are listed below. This listing is of standards and interpretations issued, which the Group reasonably expects to be applicable at a future date. The Group intends to adopt those standards when they become effective. However, the Group expects no significant impact from the adoption of the amendments on its consolidated financial position or performance.

IAS 1 Financial Statement Presentation – Presentation of Items of Other Comprehensive Income

The amendment becomes effective for annual periods beginning on or after 1 July 2012. It changes the grouping of items presented in other comprehensive income. Items that could be reclassified (or 'recycled') to consolidated statement of income at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. The amendment affects presentation only and has no impact on the Group's financial position or performance.

IAS 19 Employee Benefits (Revised)

Amended standard is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted. With very few exceptions retrospective application is required. Numerous changes or clarifications are made under the amended standard. Among these numerous amendments, the most important changes are removing the corridor mechanism and making the distinction between short-term and other long-term employee benefits based on expected timing of settlement rather than employee entitlement. The Group is currently assessing the impact that this standard will have on the consolidated financial position and performance.

IAS 32 Financial Instruments: Presentation - Offsetting Financial Assets and Financial liabilities (Amended)

The amendments clarify the meaning of "currently has a legally enforceable right to set-off" and also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The Group is currently assessing the impact that this standard will have on the consolidated financial position and performance and become effective for annual periods beginning on or after 1 January 2014.

IFRS 7 Disclosures: Offsetting Financial Assets and Financial Liabilities — Amendments to IFRS 7

These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's consolidated financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with IAS 32 Financial Instruments: Presentation. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. The Group is currently assessing the impact that this standard will have on the consolidated financial position and performance and become effective for annual periods beginning on or after 1 January 2013.

IFRS 9 Financial Instruments: Classification and Measurement

IFRS 9 as issued reflects the first phase of the IASBs work on the replacement of IAS 39 and applies to classification and measurement of financial assets as defined in IAS 39. The standard is effective for annual periods beginning on or after 1 January 2015. In subsequent phases, the IASB will address classification and measurement of financial liabilities, hedge accounting and derecognition. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets. The Group is currently assessing the impact that this standard will have on the consolidated financial position and performance.

IFRS 10 Consolidated Financial Statements

This standard becomes effective for annual periods beginning on or after 1 January 2013. It replaces the portion of IAS 27 "Consolidated and Separate Financial Statements" that addresses the accounting for consolidated financial statements. The standard establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27. The Group is currently assessing the impact that this standard will have on the consolidated financial position and performance

IAS 27 Separate Financial Statements (as revised in 2011)

As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The Group does not present separate financial statements. The amendment becomes effective for annual periods beginning on or after 1 January 2013.

IFRS 11 Joint Arrangements

The standard becomes effective for annual periods beginning on or after 1 January 2013. It replaces IAS 31 "Interests in Joint Ventures". The standard removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. The Group is currently assessing the impact that this standard will have on the consolidated financial position and performance.

IFRS 12 Disclosure of Involvement with Other Entities

The standard becomes effective for annual periods beginning on or after 1 January 2013. IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required.

IFRS 13 Fair Value Measurement

The standard becomes effective for annual periods beginning on or after 1 January 2013. IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Group is currently assessing the impact that this standard will have on the consolidated financial position and performance.

IAS 28 Investments in Associates and Joint Ventures (as revised in 2011)

The amendment becomes effective for annual periods beginning on or after 1 January 2013. As a consequence of the new IFRS 11 and IFRS 12; IAS 28 has been renamed IAS 28 "Investments in Associates and Joint Ventures", and describes the application of the equity method to investments in joint ventures in addition to associates. The Group is currently assessing the impact that this standard will have on the consolidated financial position and performance.

2.4 BASIS OF CONSOLIDATION

The consolidated financial statements include the financial statements of the Bank for the year ended 31 December 2012 and its subsidiaries prepared to a date not earlier than three months of the Bank's reporting date as noted in Note 24. All significant intragroup balances, transactions and unrealized gains or losses resulting from intra group transactions and dividends are eliminated in full.

Since the subsidiaries' financial statements used in the consolidation are drawn up to different reporting dates, where practicable, adjustments are made for the effects of significant transactions or other events that occurred between the reporting date of the subsidiaries and the Bank's reporting date.

Certain consolidated subsidiaries use accounting policies other than that adopted in the consolidated financial statements for certain transactions and assets. Where practicable, appropriate adjustments for non-uniform accounting policies are made to their financial statements when included in the consolidated financial statements to bring them in line with the Group's accounting policies.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases.

Losses within a subsidiary are attributed to the owners of the group and to the non-controlling interest even if that results in a deficit balance.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

- Derecognizes the assets (including goodwill) and liabilities of the subsidiary.
- Derecognizes the carrying amount of any non-controlling interest.
- Derecognizes the cumulative translation differences, recorded in foreign exchange translation reserve.
- Recognizes the fair value of the consideration received.
- Recognizes the fair value of any investment retained.
- Recognizes any surplus or deficit in consolidated statement of income.
- Reclassifies the Group's share of components previously recognised in other comprehensive income to consolidated statement of income.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business combinations and goodwill

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded swaps and profit rate contracts in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through consolidated statement of income.

Kuwait Finance House K.S.C. and Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Business combinations and goodwill (continued)

Any contingent consideration to be transferred by the acquirer is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability, is recognised in accordance with IAS 39 either in the consolidated statement of income or as a change to other comprehensive income. If the contingent consideration is classified as equity, it is remeasured until it is finally settled within equity.

Goodwill is initially measured at cost being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in the consolidated statement of income.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

i) Financing income is income from murabaha, istisna'a and wakala investments and is determined by using the effective profit method. The effective profit method is a method of calculating the amortized cost of a financial asset and of allocating the financing income over the relevant period.

ii) Income from leased assets is recognized on a pattern reflecting a constant periodic return on the net investment outstanding and is included under financing income.

iii) Operating lease income is recognized on a straight line basis in accordance with the lease agreement.

iv) Rental income from investment properties is recognized on an accruals basis.

v) Dividend income is recognized when the right to receive payment is established.

vi) Fee and commission income is recognized at the time the related services are provided.

Cash and cash equivalents

Cash and cash equivalents comprise cash, balances with Central Bank of Kuwait, tawarruq balances with the Central Bank of Kuwait, balances with banks and financial institutions, short-term international murabaha contracts and exchange of deposits maturing within three months of contract date.

Short-term murabahas

Short-term murabahas are financial assets originated by the Group and represent commodity murabaha transactions with high credit quality banks and financial institutions maturing within one year of the financial position date. These are stated at amortized cost.

Receivables

Receivables are financial assets originated by the Group and principally comprise murabahas, international murabahas, istisna'a, and wakala receivables. These are stated at amortized cost.

Murabaha is the sale of commodities and real estate at cost plus an agreed profit mark up whereby the seller informs the purchaser of the price at which he purchases the product and also stipulates an amount of profit.

International murabahas are financial assets originated by the Group and represent commodity murabaha transactions with high credit quality banks and financial institutions. These are stated at amortized cost.

Istisna'a is a sale contract between a contract owner and a contractor whereby the contractor based on an order from the contract owner undertakes to manufacture or otherwise acquire the subject matter of the contract according to specifications, and sells it to the contract owner for an agreed upon price and method of settlement whether that be in advance, by installments or deferred to a specific future time.

Wakala is an agreement whereby the Group provides a sum of money to a customer under an agency arrangement, who invests it according to specific conditions in return for a fee. The agent is obliged to return the amount in case of default, negligence or violation of any terms and conditions of the wakala.

Trading properties

Trading properties are measured initially at cost. Subsequent to initial recognition, trading properties are carried at the lower of cost or net realizable value determined on an individual basis.

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date: whether fulfillment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset.

Group as a lessee

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of profit on the remaining balance of the liability. Finance charges are charged in the consolidated statement of income.

Capitalized leased assets are depreciated over the estimated useful life of the asset.

Operating lease payments are recognised as an expense in the consolidated statement of income on a straight line basis over the lease term.

Group as a lessor

Leased assets

This represents net investment in assets leased for periods which either approximate or cover a major part of the economic lives of such assets. The lease agreements provide a purchase option to lessees at a price equal or expected to be equal or lower than fair value of such assets at the time when such option is exercised.

Operating leases

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases.

Leased assets are stated at amounts equal to the net investment outstanding in the leases.

Financial assets available for sale

Financial assets available for sale include equity and debt securities (i.e. Sukook). Equity investments classified as available for sale are those, which are neither classified as held for trading nor designated at fair value through profit or loss. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions.

Financial assets available for sale are initially recognized at cost (including transaction costs associated with the acquisition of the investment) and after initial measurement, financial assets available for sale are subsequently measured at fair value unless fair value cannot be reliably determined. Changes in fair value of financial assets available for sale are reported in other comprehensive income until the investment is derecognized, at which time the cumulative change in fair value reserve is recognised in the consolidated statement of income, or determined to be impaired, at which time the cumulative change in fair value reserve is recognised in the consolidated statement of income in impairment of investment and removed from the fair value reserve.

Investment in associates

The Group's investment in its associate is accounted for using the equity method. An associate is an entity in which the Group has significant influence.

Under the equity method, investment in the associate is carried in the statement of financial position at cost plus post acquisition changes in the Group's share of net assets of the associate. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortized nor individually tested for impairment.

The consolidated statement of income reflects the share of the results of operations of the associate. Where there has been a change recognised directly in the equity of the associate, the Group recognizes its share of any changes and discloses this, when applicable, in the statement of changes in other comprehensive income. Unrealized gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

The share of profit of an associate is included in investment income (Note 4). This is the profit attributable to equityholders of the associate and therefore is profit after tax and non-controlling interests in the subsidiaries of the associate.

The financial statements of the associate are prepared for the same reporting period as the Group or to a date not earlier than three months of the Bank reporting date using consistent accounting policies. Where practicable, adjustments are made to bring the accounting policies in line with those of the Group.

After application of the equity method, the Group determines whether it is necessary to recognize an additional impairment loss on the Group's investment in its 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 recognizes the amount in the impairment in the consolidated statement of income.

Kuwait Finance House K.S.C. and Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investment in associates (continued)

Upon loss of significant influence over the associate, the Group measures and recognizes 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 recognized in consolidated statement of income.

Investment properties

Investment properties are measured initially at cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met; and excludes the costs of day to day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at depreciated cost less impairment.

Investment properties are derecognized when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal.

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 of derecognition.

Transfers are made to or from investment property only when there is a change in use. For a transfer from investment property to property and equipment, the deemed cost for subsequent accounting is the carrying value at the date of change in use. If property and equipment becomes an investment property, the Group accounts for such property in accordance with the policy stated under property and equipment up to the date of change in use.

When the Group begins to redevelop an existing investment property with a view to selling the property, it is transferred to trading properties at carrying value.

Depreciation is provided on a straight-line basis over the estimated useful lives of all rental properties other than freehold land which is deemed to have an indefinite life.

Freehold land is not depreciated. Depreciation on the building is calculated using the straight-line method to allocate their cost, net of their residual values, over their estimated useful lives that range from 20 - 25 years.

Properties under construction

Properties under construction or development for future use as an investment property are classified as investment properties and are carried at cost less any impairment in value. Costs are those expenses incurred by the Group that are directly attributable to the construction of the asset.

Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is its fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and accumulated impairment losses, if any. Internally generated intangible assets, excluding capitalized development costs, are not capitalized and expenditure is reflected in the consolidated statement of income in the year in which the expenditure is incurred.

The useful lives of intangible assets are assessed as either finite or indefinite.

Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognised in the consolidated statement of income in the expense category consistent with the function of the intangible assets.

Intangible assets with indefinite useful lives are not amortized, but are tested for impairment annually, either individually or at the cash-generating unit level. The assessment of indefinite life is reviewed annually to determine whether the indefinite life continues to be supportable. If not, the change in useful life from indefinite to finite is made on a prospective basis.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the consolidated statement of income when the asset is derecognized.

Precious metals inventory

Precious metals inventory primarily comprises Gold and is carried at the market price.

Trade receivable

Trade receivables that primarily relate to subsidiaries in businesses other than financing are carried at amounts due, net of amounts estimated to be uncollectible. An estimate for doubtful accounts is made when collection of the full amount is no longer probable. Bad debts are written off as incurred. This is included in other assets (Note 14).

Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation and any impairment in value. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the consolidated statement of income during the financial year in which they are incurred.

Freehold land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost, net of their residual values, over their estimated useful lives, as follows:

• Buildings, aircraft and engines	20 years (from the date of original manufacture for aircraft)
• Furniture, fixtures and equipment	3-5 years
• Motor vehicles	3 years

The assets' residual values, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each financial year end.

Properties under development

Properties under development are carried at cost less any impairment in value. Costs are those expenses incurred by the Group that are directly attributable to the construction of asset. Once completed the asset is transferred to buildings.

Deferred tax

Deferred tax is provided using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date. Deferred tax liabilities are recognised for all taxable temporary differences, except:

- When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss

- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future

Deferred tax assets are recognised for all deductible temporary differences, the carry forward of unused tax credits and any unused tax losses. Deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised, except:

- When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss

- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each reporting date and are recognised to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax relating to items recognised outside profit or loss is recognised outside profit or loss. Deferred tax items are recognised in correlation to the underlying transaction either in other comprehensive income or directly in equity.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Tax benefits acquired as part of a business combination, but not satisfying the criteria for separate recognition at that date, are recognised subsequently if new information about facts and circumstances change. The adjustment is either treated as a reduction to goodwill (as long as it does not exceed goodwill) if it was incurred during the measurement period or recognised in profit or loss.

Kuwait Finance House K.S.C. and Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 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 has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in profit or principal payments, the probability that they will enter bankruptcy or other financial reorganization 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.Financial assets carried at amortized cost

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

If there is objective evidence that an impairment loss has 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 present value of the estimated future cash flows is discounted at the financial asset's original effective profit rate.

The carrying amount of the asset is reduced by the amount of impairment and the amount of impairment loss is recognised 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.

In addition, in accordance with Central Bank of Kuwait instructions, a minimum general provision on all finance facilities net of certain categories of collateral, to which CBK instructions are applicable and not subject to specific provision, is made.

Financial assets available for sale

For available for sale financial assets, 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 financial assets available for sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. 'Significant' is to be evaluated against the original cost of the investment and 'prolonged' against the period in which the fair value has been below its original cost. Where there is evidence of impairment, the impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated statement of income is removed from fair value 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 after impairment are recognised directly in other comprehensive income.

In the case of sukook investments classified as available for sale, the amount recorded for impairment is the cumulative loss measured as the difference between the amortized cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated statement of income. If, in a subsequent year, the fair value of a sukook increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

Impairment of non-financial assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group estimates of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets and then its recoverable amount is assessed as part of the cash-generating unit to which it belongs. Where the carrying amount of an asset (or cash-generating unit) exceeds its recoverable amount, the asset (or cash-generating unit) is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset (or cash-generating unit). In determining fair value less costs to sell an appropriate valuation model is used. These calculations are corroborated by available fair value indicators.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. The increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of income. After such a reversal, the depreciation charge is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

The following assets have specific characteristics for impairment testing:

Goodwill

Goodwill is tested for impairment annually as at 31 December and when circumstances indicate that the carrying value may be impaired. Impairment is determined for goodwill by assessing the recoverable amount of each CGU (or group of CGUs) to which the goodwill relates. When the recoverable amount of the CGU is less than its carrying amount, an impairment loss is recognised. Impairment losses relating to goodwill cannot be reversed in future periods.

Intangible assets

Intangible assets with indefinite useful lives are tested for impairment annually as at 31 December either individually or at the CGU level, as appropriate, and when circumstances indicate that the carrying value may be impaired.

Derecognition of financial assets and financial liabilities

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

- the rights to receive cash flows from the asset have expired;
- 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 asset, 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 recognized to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability.

Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognized as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the reporting date and the amount recognised less cumulative amortisation.

Currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts

The Group uses currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts to mitigate exposure to foreign currency risk in forecasted transactions and firm commitments.

Currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts instruments ("the instruments") are initially recognised in the consolidated statement of financial position at cost (including transaction costs) and subsequently measured at their fair value. The fair value of these instruments includes unrealized gain or loss from marking to market the instruments using prevailing market rates or internal pricing models. The instruments with positive market values (unrealized gains) are included in other assets and the instruments with negative market values (unrealized losses) are included in accounts payable and accruals in the consolidated statement of financial position.

The resultant gains and losses from the instruments are taken directly to the consolidated statement of income, except for the effective portion of cash flow hedges, which is recognised in other comprehensive income.

For the purpose of hedge accounting, hedges are classified as cash flow hedges when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction or the foreign currency risk in an unrecognized firm commitment.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the effectiveness of changes in the hedging instrument's fair value in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

For those contracts classified as cash flow hedges, the effective portion of the gain or loss on the hedging instrument is recognised directly as other comprehensive income in the cash flow hedge reserve, while any ineffective portion is recognised immediately in the consolidated statement of income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts (continued)

Amounts recognised as other comprehensive income are transferred to the consolidated statement of income when the hedged transaction affects profit or loss, such as when the hedged financial income or financial expense is recognised or when a forecast sale occurs. Where the hedged item is the cost of a non-financial asset or non-financial liability, the amounts recognised as other comprehensive income are transferred to the initial carrying amount of the non-financial asset or liability.

If the forecast transaction or firm commitment is no longer expected to occur, the cumulative gain or loss previously recognised in fair value reserve are transferred to the consolidated statement of income. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, any cumulative gain or loss previously recognised in other comprehensive income remains in other comprehensive income until the forecast transaction or firm commitment affects profit or loss.

Embedded swaps and profit rate contracts

Embedded swaps and profit rate instruments (the forwards) are separated from the host contract if the economic characteristics and risks of the forwards are not closely related to the economic characteristics and risks of the host contract, a separate instrument with the same terms as the forwards would meet the definition of a derivative and the hybrid instrument is not measured at fair value with changes in fair value recognised in the consolidated statement of income.

Fair values

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Consequently differences can arise between carrying values and the fair value estimates.

Underlying the definitions of fair value is the presumption that the Group is a going concern without any intention or requirement to materially curtail the scale of its operations or to undertake a transaction on adverse terms.

Fair value measurements related to items recorded at fair value to be disclosed by source of inputs using a three level fair value hierarchy, by class, for all financial instruments recognised at fair value. In addition, reconciliation between the beginning and ending balance for level 3 fair value measurements is now required, as well as significant transfers between levels in the fair value hierarchy.

Financial assets available for sale

For investments traded in organized financial markets, fair value is determined by reference to stock exchange quoted market bid prices at the close of business on the consolidated financial position date.

For financial assets where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to recent arm's length transactions, current fair value of another instrument that is substantially the same, an earnings multiple, or an industry specific earnings multiple or is based on the expected cash flows of the investment discounted at current rates applicable for items with similar terms and risk characteristics. Fair value estimates take into account liquidity constraints and assessment for any impairment.

Financial assets with no reliable measures of their fair values and for which no fair value information could be obtained are carried at their initial cost less impairment in value, if any.

Currency swaps and profit rate swaps, forward foreign exchange contracts

The fair value of currency swaps and profit rate swaps and forward foreign exchange contracts is determined based on valuations obtained from counterparty/third parties.

Other financial assets and liabilities

For other financial assets and liabilities, fair value is determined based on expected future cash flows and management's estimate of the amount at which these assets could be exchanged for cash on an arm's length basis or a liability settled to the satisfaction of creditors.

Investment properties

For investment properties, fair value is determined by independent registered real estate valuers which have relevant experience in the property market.

IFRS 2 "Share-Based Payment"

IFRS 2 "Share-Based Payment" requires an expense to be recognized where the Group buys goods or services in exchange for shares or rights over shares ("equity-settled transactions"), or in exchange for other assets equivalent in value to a given number of shares or rights over shares ("cash-settled transactions").

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Share-based payment transactions

Entitled employees (including executive directors) of the Group receive remuneration in the form of share-based payment transactions, whereby entitled employees render services in exchange for shares or rights over shares ("equity-settled transactions").

Equity-settled transactions

The cost of equity-settled transactions with employees is measured under the intrinsic value method. Under this method, the cost is determined by comparing the fair value of the granted shares at each reporting date and the date of final settlement to the exercise price with any change in intrinsic value recognized in the consolidated statement of income.

The cost of equity settled transactions is recognized, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees exercise their rights. The cumulative expense recognized for equity-settled transactions at each reporting date until the exercise date reflects the extent to which the exercise period has expired and the number of awards that, in the opinion of the Board of Directors at that date, based on the best available estimate of the number of equity instruments that will ultimately vest.

Kuwait Foundation for the Advancement of Sciences (KFAS)

The Bank calculates the contribution to KFAS at 1% in accordance with the calculation based on the Foundation's Board of Directors resolution.

National Labour Support Tax (NLST)

The Bank calculates the NLST in accordance with Law No. 19 of 2000 and the Minister of Finance Resolutions No. 24 of 2006 at 2.5% of taxable profit for the year. Cash dividends from listed companies which are subjected to NLST are deducted from the profit for the year to determine the taxable profit.

Zakat

In accordance with the Bank's Fatwa and Shareea'a Supervisory Board approval held on 20 December 2011, the Bank has changed Zakat based calculation from reserve method to net working capital method. Accordingly the Bank calculates Zakat at 2.577% on net working capital on completing fiscal year and is paid under the direction of the Bank's Fatwa and Shareea'a Supervisory Board. Such Zakat is charged to voluntary reserve.

In addition, effective from 10 December 2007, the Bank has also provided for Zakat in accordance with the requirements of Law No. 46 of 2006. The Zakat charge calculated in accordance with these requirements is charged to the consolidated statement of income.

Foreign currency translation

The consolidated financial statements are presented in Kuwaiti Dinars, which is the Bank's functional and presentational 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.

Transactions and balances

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

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the financial position date. All differences are included within net gain/loss from foreign currencies 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 transactions. 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. The gain or loss arising on retranslation of non-monetary items is treated in line with the recognition of gain or loss on change in fair value of the item.

Prior to 1 January 2005, the Group treated goodwill, and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition, as assets and liabilities of the parent. Therefore, those assets and liabilities are already expressed in the functional currency or are non-monetary items and no further translation differences occur.

Group companies

On consolidation the assets and liabilities of foreign subsidiaries are translated into Kuwait Dinar at the rate of exchange prevailing at the reporting date and their income statements are translated at exchange rates prevailing at the dates of the transactions. The exchange differences arising on translation for consolidation are recognized in other comprehensive income. On disposal of a foreign subsidiary, the component of other comprehensive income relating to that particular is recognized in the consolidated statement of income.

Any goodwill arising on the acquisition of a foreign subsidiary subsequent to 1 January 2005 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 subsidiary and translated at the spot rate of exchange at the reporting date.

Kuwait Finance House K.S.C. and Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Trade payable

Trade payable relates to non financial subsidiaries of the Group. Liabilities are recognized for amounts to be paid in the future for goods whether or not billed to the Group.

Accrued expenses

Liabilities are recognized for amounts to be paid in the future for services received whether or not billed to the Group.

Due from/to customers for contract work

Due from/to customers of contracting subsidiaries for uncompleted contracts represents costs, which comprises direct materials, direct labour and an appropriate allocation of overheads including depreciation provided on property, furniture and equipment, on a consistent basis, plus attributable profit to the extent that it is reasonably certain less provision for contingencies and any losses incurred or foreseen in bringing contracts to completion, and less any amounts received or receivable as progress billings.

Other provisions and reserves

Other provisions and reserves are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, 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 the obligation. The expense relating to any reserve provision is presented in the consolidated statement of income net of any reimbursement.

Reserves for maintenance

Provisions for maintenance -related costs are recognised when the service provided. Initial recognition is based on historical experience. The initial estimate of maintenance -related costs is revised annually.

Employees' end of service benefits

The Group provides end of service benefits to its employees. The entitlement to these benefits is based upon the employees' final salary and length of service. The expected costs of these benefits are accrued over the period of employment.

Trade and settlement date accounting

All "regular way" purchases and sales of financial assets are recognized on the trade date, i.e. the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated financial position when there is a legally enforceable right to set off the recognized amounts and the Group intends to settle on a net basis so as to realize the assets and liabilities simultaneously.

Treasury shares

The Bank's holding of its own shares are accounted for as treasury shares and are stated at purchase consideration including directly attributable costs. When the treasury shares are sold, gains are credited to a separate account in equity (treasury share reserve) which is non distributable. Any realised losses are charged to the same account to the extent of the credit balance on that account. No cash dividends are distributed on these shares. The issue of bonus shares increases the number of shares proportionately and reduces the average cost per share without affecting the total cost of treasury shares.

Fiduciary assets

The Group provides trust and other fiduciary services that result in the holding or investing of assets on behalf of its clients. Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and accordingly are not included in the consolidated statement of financial position. These are disclosed separately in the consolidated financial statements.

Judgments

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which have the most significant effect on the amounts recognized in the consolidated financial statements:

Classification of real estate

Management decides on acquisition of a developed and under development real estate property whether it should be classified as trading, investment property or property and equipment.

The Group classifies property as trading property if it is acquired principally for sale in the ordinary course of business or when it is being redeveloped for sale.

The Group classifies property as investment property if it is acquired to generate rental income or for capital appreciation, or for undetermined future use.

The Group classifies property as property and equipment when it is acquired for owner occupation.

Impairment of financial assets available for sale

The Group treats financial assets available for sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgement. In addition, the Group evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

Estimation uncertainty

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

Impairment losses on finance facilities

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

Valuation of unquoted equity investments

Valuation of unquoted equity investments is normally based on one of the following:

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

The determination of the cash flows and discount factors for unquoted equity investments requires significant estimation. There are a number of investments where this estimation cannot be reliably determined (see note 11). As a result, these investments are carried at cost less impairment.

Basis of Translation

The United States dollar amounts in consolidated income statement, statement of comprehensive income, consolidated balance sheet and consolidated statement of cash flow represent supplimentary information and have been translated at a rate of KD 0.281250 per USD which represents the midmarket rate at 31 December 2012.

3 BUSINESS COMBINATION

On 27 December 2012, one of the indirect associates of the Group namely Sokouk Holding Company K.S.C. (Closed) ('Sokouk"), a shareholding company incorporated in the State of Kuwait and listed on Kuwait Stock Exchange, purchased its own shares ("treasury shares") from the Kuwait Stock Exchange. As a result, the Group's effective equity interest in Sokouk has increased from 48.88% to 50.62% based on net issued capital (net of treasury shares). Since this transaction meets the criteria of IFRS 3 – Business Combination for the business combination achieved without the transfer of consideration, the Group has reclassified its investment in Sokouk from investment in associate to investment in subsidiary and consolidated Sokouk and its subsidiaries from the effective date of control. The main objective of Sokouk is to own, sell and purchase real estate, and to manage properties on behalf of other parties.

As a result of Sokouk becoming the subsidiary of the Group, the following entities also became subsidiaries of the Group and have been consolidated from the effective date of control:

	Previously held equity interest by the Group	*Additional interest through Sokouk*	*Additional interest through Munshaat*	*Post acquisition equity interest*
Munshaat Real Estate Projects Company K.S.C (Closed) ("Munshaat")	25.24%	27.67%	-	52.91%
Qitaf GCC Real Estate Fund ("Qitaf")	44.91%	36.43%	9.13%	90.47%

Munshaat is incorporated in the State of Kuwait and listed on Kuwait Stock Exchange. The main objective of Munshaat is to own, sell and purchase real estate, and to manage properties on behalf of other parties.

Qitaf is incorporated in the State of Kuwait and is established to facilitate the acquisition of real estate assets as well as indirect real estate investment in the form of shares in real estate project companies in the GCC countries.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

3 BUSINESS COMBINATION (continued)

The business combinations of Sokouk, Munshaat and Qitaf (together referred to as "acquiree companies") were achieved in stages. Accordingly, the Group recognized a net gain of KD 40,369 thousand representing the net after loss on remeasurement of previously held equity interests at the acquisition date fair value, gain on bargain purchase and gain on effective settlement of pre-existing transactions between the Group and acquiree companies as part of business combination (i.e. KD 20,776 thousand due to the settlement of receivables between Group and Munshaat and KD 14,108 thousand due to the settlement of KD 43,398 thousand receivables between Sokouk and Munshaat), in the consolidated income statement. Net gain attributable to equity-holders of Parent Bank amounting to KD 17,447 thousand

The acquisitions have been accounted based on the provisional values assigned to the identifiable assets and liabilities of the acquiree companies as on the acquisition date and the management is in the process of determining the fair values of assets and liabilities acquired.

The Group recorded the identifiable assets and liabilities of acquire companies at their provisional fair values as at 30 September 2012 due to the unavailability of the financial information as at 27 December 2012. Based on the Group management's assessment there is no significant change in the provisional fair values of identifiable assets and liabilities of acquiree companies between 30 September 2012 and the date of acquisition.

The details of the provisional values of the assets acquired and liabilities assumed, equivalent to their carrying values, at 30 September 2012, as well as the non-controlling interest at the fair value of the acquiree companies identifiable net assets, are summarised as follows:

				KD 000's
	Sokouk	*Munshaat*	*Qitaf*	*Total*
Assets				
Cash and cash equivalents	2,319	14,498	364	17,181
Accounts receivable and other assets	31,478	25,249	125	56,852
Inventories	5,399	-	-	5,399
Financial assets available for sale	8,357	8,890	-	17,247
Investment properties	-	36,763	-	36,763
Investment in associates and joint ventures	9,170	3,507	-	12,677
Real Estate development projects	16,211	-	-	16,211
Intangible assets - leasehold rights (Note 14)	-	114,772	11,325	126,097
Property and equipment	-	862	-	862
	72,934	204,541	11,814	289,289
Liabilities				
Finance payables	15,831	76,852	2,142	94,825
Accounts payable and other liabilities	3,246	99,134	6	102,386
Obligations under finance leases	-	1,697	-	1,697
	19,077	177,683	2,148	198,908
Net assets acquired	53,857	26,858	9,666	90,381
Non-controlling interests in the acquiree at fair value	23,450	9,320	921	33,691
Fair value of acquirer's previously held interest	25,771	11,336	8,745	45,852
Gain on bargain purchase (Note 4)	4,636	6,202	-	10,838
Gain on settlement of pre-existing transactions between the Group and acquiree companies (Note 4)	-	34,884	-	34,884
Loss on remeasurement of previously held equity interests (Note 4)	(3,350)	(2,003)	-	(5,353)
Net gain on business combination	1,286	39,083	-	40,369

The share of results from Munshaat and Sokouk up to 30 September 2012 amounting to KD 1,356 thousand has been recorded as share of results of associates in the consolidated income statement.

4 INVESTMENT INCOME

		KD 000's
	2012	*2011*
Gain on sale of real estate properties	88,703	97,079
Rental income from investment properties	13,403	14,405
Dividend income	14,027	10,428
Gain (loss) on part sale of associates	4,269	(129)
Gain on sale of financial assets available for sale	34,581	15,364
Share of results (loss) of associates (Note 12)	1,636	(2,305)
Sukook income	19,388	16,061
Gain on cancellation of aircraft contract	7,043	29,980
Gain on bargain purchase (Notes 3,12)	14,285	-
Gain of settlement of pre existing transactions between the Group and acquiree companies (Note 3)	34,884	-
Loss on remeasurement of previously held equity (Note 3)	(5,353)	-
Other investment income	4,058	7,310
	230,924	188,193

5 OTHER INCOME

		KD 000's
	2012	*2011*
Gain on sale of property and equipment	6,689	20,163
Income from maintenance, services, and consultancy	16,171	27,374
Rental income from operating lease	8,466	7,255
Credit tax income	-	16,240
Real estate development and construction income	437	6,250
Other income	4,355	22,953
	36,118	100,235

6 IMPAIRMENT

		KD 000's
	2012	2011
Relating to receivables:		
International murabahas	9,383	17,763
Local murabahas and wakala	173,229	154,533
Istisna'a and other receivables	1,368	544
	183,980	172,840
(Reversal of) leased assets (Note 10)	(4,747)	(1,345)
Impairment of financial assets available for sale	39,071	95,770
Impairment of associates	16,382	1,310
Impairment of investment properties (Note 13)	19,426	(2,601)
(Reversal of) write down to net realizable value of trading properties	(2,934)	13,804
Impairment of property and equipment (Note 15)	8,281	1,732
Impairment of goodwill	573	-
Impairment of non cash facilities	671	2,044
Impairment of advance for purchase of real estate	-	27,624
(Reversal of) impairment of other assets	(5,355)	10,119
	255,348	321,297

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

7 BASIC AND DILUTED EARNINGS PER SHARE ATTRIBUTABLE TO THE EQUITYHOLDERS OF THE BANK

Basic earnings per share is calculated by dividing the profit for the year attributable to the equityholders of the Bank by the weighted average number of ordinary shares outstanding during the year after adjusting for treasury shares held by the Group.

Diluted earnings per share is calculated by dividing the profit for the year by the weighted average number of ordinary shares outstanding during the year after adjusting for treasury shares held by the Group plus the weighted average number of shares that would be issued on the conversion of all the dilutive potential shares into shares.

	2012	2011
Profit for the year attributable to the equityholders of the Bank (KD thousands)	87,676	80,342
Weighted average number of shares outstanding during the year (thousand shares)	2,846,990	2,867,703
Basic and diluted earnings per share (fils)	30.80	28.02

The comparative basic and diluted earnings per share have been restated for bonus shares issued on 26 March 2012 (see note 23).

8 CASH AND CASH EQUIVALENTS

	2012 KD 000's	*2011* KD 000's
Cash	96,437	91,990
Balances with Central Banks	345,225	239,103
Balances with banks and financial institutions - current accounts	192,025	192,377
Balances with banks and financial institutions - exchange of deposits	180,569	96,084
Cash and balances with banks and financial institutions	814,256	619,554
Short-term murabaha - maturing within 3 months of contract date	357,119	757,733
Tawarruq balances with Central Bank of Kuwait - maturing within 3 months of contract date	140,085	98,009
Less: Statutory deposits with Central Banks	(319,098)	(106,781)
Cash and cash equivalents	992,362	1,368,515

Statutory deposits with Central Banks represent balances that are not available for use in the Group's day to day operations.

The Group exchanges deposits with reputable banks and financial institutions in local and foreign currencies with the legal right reserved to set off such deposits exchanged in the event that a counter party bank or financial institution becomes insolvent. The gross balances of deposits exchanged were as follows:

	2012 KD 000's	*2011* KD 000's
Due from banks and financial institutions	492,388	409,434
Due to banks and financial institutions	(311,819)	(321,707)
	180,569	87,727

Included in the consolidated statement of financial position as net balances:

	2012 KD 000's	*2011* KD 000's
In assets:		
Cash and balances with banks and financial institutions - exchange of deposits	180,569	96,084
In liabilities:		
Due to banks and financial institutions – exchange of deposits (Note 16)	-	(8,357)
	180,569	87,727

The fair values of cash and balances with banks and financial institutions do not differ from their respective book values.

9 RECEIVABLES

Receivables principally comprise murabaha, wakala and istisna'a balances and are stated net of impairment as follows:

	2012 KD 000's	*2011* KD 000's
International murabahas	2,213,439	1,309,615
Local murabahas and wakala	4,731,204	4,908,602
Istisna'a and other receivables	131,197	153,632
	7,075,840	6,371,849
Less: impairment	(422,922)	(507,028)
	6,652,918	5,864,821

The distribution of receivables is as follows:

	2012 KD 000's	*2011* KD 000's
Industry sector		
Trading and manufacturing	3,180,240	2,673,100
Banks and financial institutions	507,551	644,162
Construction and real estate	1,716,356	1,789,029
Other	1,671,693	1,265,558
	7,075,840	6,371,849
Less: impairment	(422,922)	(507,028)
	6,652,918	5,864,821

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

9 RECEIVABLES (continued)

	2012	2011
	KD 000's	
Geographic region		
Middle East	4,103,950	4,094,560
Western Europe	150,204	67,392
Other	2,821,686	2,209,897
	7,075,840	6,371,849
Less: impairment	(422,922)	(507,028)
	6,652,918	5,864,821

Impairment of receivables from customers for finance facilities is analyzed as follows:

KD 000's

	Specific 2012	Specific 2011	General 2012	General 2011	Total 2012	Total 2011
Balance at beginning of year	244,019	353,695	263,009	132,160	507,028	485,855
Provided during the year	157,414	40,146	26,566	132,694	183,980	172,840
Amounts written off; net of foreign currency translation	(216,803)	(149,822)	(51,283)	(1,845)	(268,086)	(151,667)
Balance at end of year	184,630	244,019	238,292	263,009	422,922	507,028
International murabahas	80,706	85,933	16,631	16,556	97,337	102,489
Local murabahas and wakalas	95,192	140,816	215,081	243,324	310,273	384,140
Istisna'a and other receivables	8,732	17,270	6,580	3,129	15,312	20,399
	184,630	244,019	238,292	263,009	422,922	507,028

Non performing cash and non-cash financing facilities

At 31 December 2012, non-performing finance facilities include receivables, leased assets and non cash facilities amounted to KD 679,630 thousand (2011: KD 721,528 thousand), KD 627,697 thousand (2011: KD 688,199 thousand) after excluding deferred revenue and suspended profit and KD 316,915 thousand (2011: KD 542,759 thousand) after excluding eligible collateral in accordance with CBK regulations for specific provision calculation.

KD 000's

	Pre-invasion	Post liberation	Total
2012			
Finance facilities	10	679,620	679,630
Impairment	10	210,202	210,212
2011			
Finance facilities	14	721,514	721,528
Impairment	14	275,460	275,474

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The provision charged (released) for the year on non-cash facilities is KD 671 thousand (2011: KD 2,044 thousand). The available provision on non-cash facilities of KD 13,567 thousand (2011: KD 13,386 thousand) is included under other liabilities (Note 18).

Provisions include certain amounts purchased by the Central Bank of Kuwait. Such provisions must be ceded to the Central Bank of Kuwait when they are no longer required.

The fair values of receivables do not differ from their respective book values.

10 LEASED ASSETS

The net investment in leased assets comprises the following:

	2012	2011
	KD 000's	
Gross investment	1,741,992	1,513,612
Less: Unearned revenue	(42,357)	(40,511)
Impairment	(46,125)	(50,659)
	1,653,510	1,422,442

Impairment on leased assets is as follows:

KD 000's

	Specific 2012	Specific 2011	General 2012	General 2011	Total 2012	Total 2011
Balance at beginning of year	27,975	34,516	22,684	21,059	50,659	55,575
(Reversed) provided during the year	(5,109)	(3,100)	362	1,755	(4,747)	(1,345)
Write off; net of foreign currency translation	88	(3,441)	125	(130)	213	(3,571)
Balance at end of year	22,954	27,975	23,171	22,684	46,125	50,659

The future minimum lease payments receivable in the aggregate are as follows:

	2012	2011
	KD 000's	
Within one year	1,185,433	966,671
One to five year	315,573	332,130
After five years	240,986	214,811
	1,741,992	1,513,612

The unguaranteed residual value of the leased assets at 31 December 2012 is estimated at KD 34,128 thousand (2011: KD 41,393 thousand).

The fair value of leased assets at 31 December 2012 is KD 2,794,595 thousand (2011: KD 2,117,277 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

11 FINANCIAL ASSETS AVAILABLE FOR SALE

	2012 KD 000's	2011 KD 000's
Quoted equity investments	45,934	54,912
Unquoted equity investments	258,836	263,346
Managed portfolios	183,529	247,444
Mutual funds	285,043	272,576
Sukook	602,918	463,899
	1,376,260	1,302,177
Financial assets available for sale carried at fair value	752,412	854,230
Financial assets available for sale carried at cost less impairment	623,848	447,947
	1,376,260	1,302,177

Included in managed portfolios is an amount of KD 45,023 thousand (2011: KD 35,557 thousand) which represents the Group's investment in 55,584 thousand shares (2011: 34,115 thousand shares) of the Bank's shares on behalf of depositors, equivalent to 1.91 % of the total issued share capital at 31 December 2012 (2011: 1.27%). The results from activities relating to dealing in these shares are attributed only to the depositors, and hence these shares are classified under investments.

12 INVESTMENT IN ASSOCIATES

The major associates of the Group are as follows:

	Interest in equity % 2012	*Interest in equity %* 2011	*Country of registration*	*Principal Activities*	*Financial statements reporting date*
Direct investments in associates:					
Specialties Group Holding Company K.S.C. (Closed)	40	30	Kuwait	Holding Investments	30 September 2012
First Takaful Insurance Company K.S.C. (Closed)	28	28	Kuwait	Islamic Takaful Insurance	30 September 2012
Gulf Investment House K.S.C. (Closed)	20	20	Kuwait	Islamic Investments	30 September 2012
Sharjah Islamic Bank P.J.S.C.	20	20	United Arab Emirates	Islamic Banking Services	30 September 2012

	Interest in equity % 2012	*Interest in equity %* 2011	*Country of registration*	Principal Activities	Financial statements reporting date
Indirect significant investments in associates held through consolidated subsidiaries					
Diyar Al Muharraq W.L.L	52	52	Bahrain	Real Estate Development	30 November 2012
Diyar Homes Company W.L.L (Shoug Al Muharraq)	50	50	Bahrain	Real Estate Development	30 November 2012
Al Durrat Al Tijaria Company W.L.L	50	-	Bahrain	Real Estate Development	30 November 2012
A'ayan Leasing & Investment Company K.S.C. (Closed)	23	19	Kuwait	Investments	30 September 2012

The Group's investment in Diyar Al Muharraq W.L.L is accounted for as an associate as the Group does not exercise control over this entity.

During the year, the Group acquired 50% equity of Al Durrat Al Tijaria W.L.L and recognized gain on bargain purchase amounting to KD 3,447 thousands (Note 4).

	2012 KD 000's	2011 KD 000's
Share of associates' assets and liabilities:		
Assets	961,121	1,007,215
Liabilities	(541,088)	(564,798)
Net assets	420,033	442,417

	2012 KD 000's	2011 KD 000's
Share of associates' revenue and results:		
Revenue	79,916	92,818
Results	1,636	(2,305)
Capital Commitments	34,960	51,584

Investments in associates with a carrying amount of KD 151,382 thousand (2011: KD 165,720 thousand) have a market value of KD 100,922 thousand at 31 December 2012 (2011: KD 82,973 thousand) based on published quotes. The remaining associates with a carrying value of KD 301,450 thousand (2011: KD 324,342 thousand) are unquoted companies. The carrying amount of investments in associates includes goodwill of KD 32,799 thousand (2011: KD 47,645 thousand).

13 INVESTMENT PROPERTIES

	2012 KD 000's	2011 KD 000's
At 1 January	536,358	561,377
Arising on consolidation	48,088	6,873
Purchases	196,502	118,574
Transfer from property and equipment (Note 15)	739	5,087
Disposals	(198,796)	(136,287)
Depreciation charged for the year	(6,201)	(21,867)
Impairment losses (charged) reversed for the year (Note 6)	(19,426)	2,601
At 31 December	557,264	536,358

	2012 KD 000's	2011 KD 000's
Developed properties	391,108	357,896
Properties under construction	189,424	182,304
	580,532	540,200
Less: Impairment in value	(23,268)	(3,842)
	557,264	536,358

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

13 INVESTMENT PROPERTIES (continued)

Investment properties with carrying value of KD 43,777 thousand (2011: KD 54,451 thousand) and their rental income are mortgaged and assigned against murabaha payable amounting to KD 34,584 thousand (2011: KD 45,043 thousand).

The fair value of investment properties at the consolidated financial position date is KD 701,855 thousand (2011: KD 642,381 thousand).

14 OTHER ASSETS

	2012	*2011*
		KD 000's
Precious metals inventory	335,779	170,890
Trade receivable (Non banking subsidiaries)	176,185	149,254
Intangible assets	160,345	37,893
Clearing accounts	117,585	103,969
Goodwill	45,612	46,291
Receivables on disposals of investment	30,887	14,856
Deferred tax	28,715	15,825
Advances for purchase investment securities	7,703	29,466
Advances in investment purchases	5,550	1,696
Other miscellaneous assets	112,576	135,411
	1,020,937	705,551

Intangible assets include leasehold rights amounting to KD 126,097 thousands which are amortised over the lease period of 19.5 years, arising on business combination (Note 3).

15 PROPERTY AND EQUIPMENT

KD 000's

	Land	*Buildings*	*Aircraft and engines*	*Furniture, fixtures and equipment*	*Motor vehicles*	*Properties under development*	*2012 Total*
Cost							
At 1 January 2012	18,406	75,203	698,387	159,571	37,868	32,724	1,022,159
Additions	2,168	18,648	1,372	24,947	18,150	8,886	74,171
Disposals	(1,809)	(11,043)	(2,867)	(3,378)	(27,820)	-	(46,917)
Transfer to investment properties (Note 13)	-	-	-	-	-	(739)	(739)
At 31 December 2012	18,765	82,808	696,892	181,140	28,198	40,871	1,048,674
Accumulated depreciation							
At 1 January 2012	-	38,997	105,977	100,536	9,519	-	255,029
Depreciation charge for the year	-	14,842	28,898	18,980	3,602	-	66,322
Relating to disposals	-	(1,117)	(1,830)	(4,591)	(7,096)	-	(14,634)
Impairment loss charged for the year (Note 6)	-	1,099	7,182	-	-	-	8,281
At 31 December 2012	-	53,821	140,227	114,925	6,025	-	314,998
Net carrying amount							
At 31 December 2012	18,765	28,987	556,665	66,215	22,173	40,871	733,676

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

15 PROPERTY AND EQUIPMENT (continued)

	Land	Buildings	Aircraft and engines	Furniture, fixtures and equipment	Motor vehicles	Properties under development	2011 Total
							KD 000's
Cost							
At 1 January 2011	21,948	87,255	659,382	136,274	37,987	27,094	969,940
Additions	4,248	1,300	73,508	43,977	14,762	15,344	153,139
Disposals	(7,790)	(13,352)	(34,503)	(20,680)	(14,881)	(4,627)	(95,833)
Transfer to investment properties (Note 13)	-	-	-	-	-	(5,087)	(5,087)
At 31 December 2011	18,406	75,203	698,387	159,571	37,868	32,724	1,022,159
Accumulated depreciation							
At 1 January 2011	-	36,762	87,665	84,598	10,244	-	219,269
Depreciation charge for the year	-	2,396	27,038	23,336	4,746	-	57,516
Relating to disposals	-	(161)	(7,780)	(10,076)	(5,471)	-	(23,488)
Impairment loss (reversed) charged for the year (Note 6)	-	-	(946)	2,678	-	-	1,732
At 31 December 2011	-	38,997	105,977	100,536	9,519	-	255,029
Net carrying amount							
At 31 December 2011	18,406	36,206	592,410	59,035	28,349	32,724	767,130

Included in property and equipment are the head office building and all branches of the Bank. The ownership of the buildings as well as the net rental income from these buildings is attributable only to the equityholders of the Bank.

Buildings include the investment in Al-Muthana Complex in Kuwait which is constructed on land leased from the Government of Kuwait. The ownership of the building, as well as any results from the activities relating to the complex, is attributed only to the equityholders of the Bank.

One of the subsidiaries holds a fleet of aircraft with carrying value of KD 466,611 thousand (2011: KD 497,798 thousand) acquired under finance leases with the legal title of the aircraft being retained by the lender (Note 16). The aircraft are secured against the finance leases. The residual value of the aircraft is estimated at approximately 21% (2011: 26%) in aggregate of the purchase cost of the aircraft fleet.

The gross carrying value of fully depreciated property and equipment still in use at the financial position date is KD 58,501 thousand (2011: KD 47,235 thousand).

The future minimum lease rent receivable on the operating lease of motor vehicles, aircraft and engines is KD 253,153 thousand (2011: KD 244,317 thousand) and is receivable as follows:

	2012	2011
		KD 000's
Income receivable within one year	47,572	48,439
Income receivable within one year to five years	156,549	141,521
Income receivable after five years	49,032	54,357
	253,153	244,317

16 DUE TO BANKS AND FINANCIAL INSTITUTIONS

	2012	2011
		KD 000's
Current accounts	2,510	13,127
Exchange of deposits	-	8,357
Murabaha payable	1,786,278	1,388,326
Sukook payable	111,176	23,691
Obligations under finance leases (Note 15)	354,886	385,135
	2,254,850	1,818,636

The fair values of balances due to banks and financial institutions do not differ from their respective book values.

Property and equipment include 44 aircraft acquired by a subsidiary under finance leases denominated in US Dollars: 7 aircrafts with finance lease obligations maturing within 5 years and 37 aircraft with lease obligations maturing after 5 years. The obligations under finance leases are secured by the aircraft (Note 15).

Future minimum lease payments obligations under finance lease agreements together with the present value of the net minimum lease payments are as follows:

	2012		2011	
	Minimum payments	*Present value of payments*	*Minimum payments*	*Present value of payments*
	KD 000's	*KD 000's*	*KD 000's*	*KD 000's*
Within one year	41,147	32,760	46,611	37,717
After one year but not more than five years	180,157	156,769	179,203	154,352
After 5 years	174,696	165,357	205,854	193,066
Total minimum lease payments	396,000	354,886	431,668	385,135
Less: amounts representing finance charges	(41,114)	-	(46,533)	-
Present value of minimum lease payments	354,886	354,886	385,135	385,135

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

17 DEPOSITORS' ACCOUNTS

a) The depositors' accounts of the Parent Bank comprise the following:

1) Non-investment deposits in the form of current accounts. These deposits are not entitled to any profits nor do they bear any risk of loss as the Bank guarantees to pay the related balances on demand. Accordingly, these deposits are considered Qard Hasan from depositors to the Bank under Islamic Shareea'a.

2) Investment deposits comprise Khumasia, Mustamera, and Sedra deposits for unlimited periods and Tawfeer savings accounts. Unlimited investment deposits are initially valid for one year and are automatically renewable for the same period unless notified to the contrary in writing by the depositor. Investment savings accounts are valid for an unlimited period.

In all cases, the investment deposits receive a proportion of the profit as the board of directors of the Bank determines, or bear a share of loss based on the results of the financial year.

The Parent Bank generally invests approximately 100% of investment deposits for unlimited period ("Khumasia"), 90% of investment deposits for an unlimited period ("Mustamera"), 70% of investment deposits for an unlimited period ("Sedra") and 60% of investment saving accounts ("Tawfeer"). The Bank guarantees to pay the remaining uninvested portion of these investment deposits. Accordingly, this portion is considered Qard Hasan from depositors to the Bank, under Islamic Shareea'a. Investing such Qard Hasan is made at the discretion of the Board of Directors of the Bank, the results of which are attributable to the equityholders of the Bank.

b) On the basis of the results for the year, the Board of Directors of the Parent Bank has determined the depositors' share of profit of depositors of the Parent Bank at the following rates:

	2012 % per annum	2011 % per annum
Investment deposits - ("Khumasia")	2.147	1.920
Investment deposits - ("Mustamera")	1.932	1.728
Investment deposits - ("Sedra")	1.503	1.344
Investment savings accounts ("Tawfeer")	1.288	1.152

c) The fair values of depositors' accounts do not differ from their carrying book values.

18 OTHER LIABILITIES

KD 000's

	2012	2011
Trade payables (Non banking subsidiaries)	203,108	190,073
Accrued expenses	120,168	100,277
Certified cheques	114,395	139,925
Due to customers for contract work	93,593	59,330
Maintenance reserve	40,072	24,582
Employees' end of service benefits	37,186	35,787
Letter of guarantee covered	31,013	32,906
Refundable deposits	15,535	12,005
Provision on non cash facilities	13,567	13,386
Other miscellaneous liabilities	66,348	73,402
	734,985	681,673

Kuwait Finance House K.S.C. and Subsidiaries

19 FAIR VALUE RESERVE

Changes in the fair value of financial assets available for sale, currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts are reported in the fair value reserve. Other reserves represent change in the ownership interest in subsidiaries without loss of control. Management of the Bank is of the opinion that these reserves are attributable to both the depositors and equityholders. As a result, the reporting of these reserves as a separate item on the consolidated financial position enables a fairer presentation than its inclusion within equity attributable to the equityholders of the Bank.

KD 000's

	2012				2011
	Financial assets Available for sale	Currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts	Other reserves	Total	Total
Balance at 1 January	(13,378)	375	-	(13,003)	(42,999)
Change in fair value of financial assets available for sale	(29,576)	-	-	(29,576)	(29,497)
Currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts	-	1,337	-	1,337	(154)
Loss realized on financial assets available for sale during the year	1,883	-	-	1,883	4,957
Impairment loss transferred to consolidated statement of income (Note 6)	39,071	-	-	39,071	53,934
Share of other comprehensive income of associates	14	-	-	14	756
Acquisition of non-controlling interest (Note 24)	-	-	(8,920)	(8,920)	-
Balance at 31 December	(1,986)	1,712	(8,920)	(9,194)	(13,003)

20 FOREIGN EXCHANGE TRANSLATION RESERVE

The foreign exchange translation reserve arises on the consolidation of foreign subsidiaries and equity accounting of foreign associates. Management of the Bank is of the opinion that this reserve is attributable to both the depositors and equityholders. As a result, the reporting of this reserve as a separate item on the consolidated financial position enables a fairer presentation than its inclusion within equity attributable to the equityholders of the Bank.

Kuwait Finance House K.S.C. and Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

21 SHARE CAPITAL

Share capital

	2012 KD 000's	2011 KD 000's
Authorized, issued and fully paid :		
2,904,163,924 (2011: 2,689,040,671) shares of 100 fils each	290,416	268,904

The movement in ordinary shares in issue during the year was as follows:

	2012	2011
Number of shares in issue 1 January	2,689,040,671	2,489,852,474
Bonus issue	215,123,253	199,188,197
Number of shares in issue 31 December	2,904,163,924	2,689,040,671

Treasury shares and treasury share reserve.

The Group held the following treasury shares at the year-end:

	2012	2011
Number of treasury shares	61,237,670	47,520,217
Treasury shares as a percentage of total shares in issue	2.11%	1.77%
Cost of treasury shares (KD)	54,028,034	46,813,324
Market value of treasury shares (KD)	49,602,512	42,292,993

Movement in treasury shares was as follows:

	KD 000's		No. of shares	
	2012	2011	2012	2011
Balance as at 1 January	46,813	26,722	47,520,217	24,665,000
Purchases	7,215	32,374	9,915,819	32,877,500
Bonus issue	-	-	3,801,634	1,505,217
Sales	-	(12,283)	-	(11,527,500)
Balance as at 31 December	54,028	46,813	61,237,670	47,520,217

The balance in the treasury share reserve account is not available for distribution.

22 RESERVES

In the ordinary and extraordinary general assembly meeting of the equityholders of the Bank held on 14 March 2005, the ordinary general assembly resolved to suspend transfers to statutory reserve in excess of 10%. The extraordinary general assembly of the Bank held on 18 March 1996 approved an amendment to article 58 of its articles of association, in which the Ordinary General Assembly can approve an increase in the transfer of 10% each of the profit for the year attributable to the equityholders of the Bank to statutory and voluntary reserves, as appropriate, if proposed by the board of directors of the Bank.

As a result, an amount of KD 9,087 thousand equivalent to approximately 10% (2011: KD 8,203 thousand equivalent to approximately 10%), of the profit for the year attributable to the equityholders of the Bank (before contribution to Kuwait Foundation for the Advancement of Sciences, National Labor Support tax, Zakat and Directors' fees) has been transferred to statutory reserve to reach KD 271,578 thousand (2011: KD 262,491 thousand).

Only that part of the statutory reserve in excess of 50% of paid-up share capital is freely distributable and usable at the discretion of the ordinary general assembly in ways that may be deemed beneficial to the Bank. Distribution of the balance of the statutory reserve is limited to the amount required to enable the payment of a dividend of 5% of paid-up share capital to be made in years when accumulated profits are not sufficient for the payment of a dividend of that amount.

An amount of KD 21,118 thousand equivalent to 23% (2011: KD 11,004 thousand equivalent to 13%) of the profit for the year attributable to the equityholders of the Bank (before contribution to Kuwait Foundation for the Advancement of Sciences, Directors' fees, Zakat and National Labor Support tax) has been transferred to voluntary reserve to reach KD 286,973 thousand (2011: KD 270,950 thousand).

The share premium balance is not available for distribution.

23 PROPOSED DIVIDENDS AND DIRECTORS' FEES

The Board of Directors of the Bank has proposed a cash dividend of 10% for the year ended 31 December 2012 (2011: 15%) and issuance of bonus shares of 10% (2011: 8%) of paid up share capital as follows:

	2012		2011	
		Total KD 000's		Total KD 000's
Proposed dividends (per share)	10 fils	28,429	15 fils	39,623
Proposed issuance of bonus shares (per 100 shares)	10 shares	29,042	8 shares	21,512

This proposal is subject to the approval of the ordinary general assembly of the equityholders of the Bank and completion of legal formalities. Proposed dividends are shown separately within equity.

Directors' fees of KD 905 thousand (2011: KD 260 thousand) are within the amount permissible under local regulations and are subject to approval by the annual general assembly of the equityholders of the Bank.

Cash dividends of 15 fils per share on outstanding shares and bonus shares of 8% of paid up share capital proposed for the year ended 31 December 2011, to the Bank's shareholders on record as of the date of the Annual General Assembly, and directors' remuneration of KD 260 thousand, were approved by the Bank's Annual General Assembly of the shareholders held on 26 March 2012 and paid during the year.

Kuwait Finance House K.S.C. and Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

24 SUBSIDIARIES

Details of principal operating subsidiaries are set out below:

Name	Country of registration	Interest in equity % 2012	2011	Principal activities	Financial statements reporting date
Kuwait Finance House (Malaysia) Berhad	Malaysia	100	100	Islamic banking services	30 November 2012
KFH Private Equity Ltd.	Cayman	100	100	Islamic investments	30 September 2012
KFH Financial Service Ltd.	Cayman	100	100	International Real Estate Development and investments	30 September 2012
Al Muthana Investment Company K.S.C. (Closed)	Kuwait	100	100	Islamic finance and investments	30 September 2012
Al-Nakheel United Real Estate Company K.S.C. (Closed)	Kuwait	100	100	Real estate development and leasing	31 October 2012
Development Enterprises Holding Company K.S.C.	Kuwait	100	100	Infrastructure and industrial investments	30 September 2012
Baitak Real Estate Investment Company S.S.C.	Saudi Arabia	100	100	Real Estate development and investment	30 September 2012
Liquidity Management House K.S.C. (Closed)	Kuwait	100	100	Islamic finance and investments	30 September 2012
Saudi Kuwaiti Finance House S. S. C. (Closed)	Saudi Arabia	100	100	Islamic Investment	30 September 2012
International Turnkey Systems Company K.S.C. (Closed)	Kuwait	97	97	Computer maintenance, consultancy, and software services	30 September 2012
Kuwait Finance House B.S.C.	Bahrain	93	93	Islamic banking services	30 November 2012
Kuwait Turkish Participation Bank	Turkey	62	62	Islamic banking services	30 November 2012
ALAFCO – Aviation Lease and Finance Company K.S.C. (Closed)	Kuwait	53	53	Aircraft leasing and financing services	30 September 2012
Aref Investment Group K.S.C. (Closed)	Kuwait	52	52	Islamic investments	30 September 2012
Al Enma'a Real Estate Company K.S.C. (Closed)	Kuwait	50	50	Real estate, investment, trading and real estate management	31 October 2012

During the year, the Group acquired an additional 23.6% interest of the indirect subsidiary of the Group namely the Aref Energy Holding Company K.S.C. (Closed), increasing its ownership interest to 95.8%. Cash consideration of KD 23,727 thousands was paid to the non-controlling shareholders. The difference of KD 8,920 thousand between the consideration paid and the net asset value acquired has been recognized in other reserve within fair value reserve as the management of the Bank is of the opinion that this reserve is attributable to depositors and equityholders (Note 19).

25 CONTINGENCIES AND CAPITAL COMMITMENTS

At the consolidated financial position date, there were outstanding contingencies and commitments entered into in the ordinary course of business in respect of the following:

	2012	2011
	KD 000's	
Acceptances and letters of credit	209,079	142,951
Letter of Guarantees	1,220,710	994,683
Contingent liabilities	1,429,789	1,137,634
Capital commitments	1,702,187	1,544,753

26 CURRENCY SWAPS, PROFIT RATE SWAPS, FORWARD FOREIGN EXCHANGE AND FORWARD COMMODITY CONTRACTS

In the ordinary course of business the Group enters into currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts to mitigate foreign currency and profit rate risk. Currency swaps and forward commodity contracts are based on Wa'ad (promise) structure between two parties to buy a specified Shareea'a compliant commodity at an agreed price on the relevant date in future. It is a conditional promise to purchase a commodity through unilateral purchase undertaking. Currency swap structure comprises profit rate swap and currency swap. For profit rate swaps, counterparties generally exchange fixed and floating rate profit payments based on a notional value in a single currency. For currency swaps, fixed or floating payments as well as notional amounts are exchanged in different currencies.

The currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts are being used to hedge the foreign currency risk of the firm commitments.

Embedded swaps and profit rate contracts are balances with banks and financial institutions with rates of return tied to changes in value of precious metals.

At 31 December 2012, the Group held currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts designated as hedges of expected future collections from hedged items in foreign currency and variability in profit rate.

The table below shows the positive and negative fair values of these instruments, which are equivalent to the market values, together with the notional amounts. The notional amount is the amount of currency swap instruments' underlying asset, reference rate or index and is the basis upon which changes in the value of these instruments are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk.

KD 000's

	Positive fair value	*Negative fair value*	*Notional amount*	*Notional amounts by term to maturity* Within 3 months	3 to 12 months	More than 12 months
31 December 2012						
Cash flow hedges						
Forward contracts	15	(151)	60,340	33,798	26,542	-
Currency swaps	655	(159)	27,091	-	-	27,091
	670	(310)	87,431	33,798	26,542	27,091
Not designated as hedges						
Forward contracts	4,029	(1,077)	197,255	134,352	62,903	-
Profit rate swaps	1,959	(1,528)	25,599	-	-	25,599
Currency swaps	2,166	(100)	238,658	138,032	100,626	-
Embedded precious metals	-	(91)	230,637	230,637	-	-
	8,154	(2,796)	692,149	503,021	163,529	25,599
	8,824	(3,106)	779,580	536,819	190,071	52,690

Kuwait Finance House K.S.C. and Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

26 CURRENCY SWAPS, PROFIT RATE SWAPS, FORWARD FOREIGN EXCHANGE AND FORWARD COMMODITY CONTRACTS (continued)

KD 000's

	Positive fair value	*Negative fair value*	*Notional amount*	*Notional amounts by term to maturity*		
				Within 3 months	*3 to 12 months*	*More than 12 months*
31 December 2011						
Cash flow hedges						
Forward contracts	20	(441)	62,290	36,177	26,113	-
Profit rate swaps	215	(90)	10,237	-	-	10,237
Currency swaps	786	(115)	28,005	-	-	28,005
	1,021	(646)	100,532	36,177	26,113	38,242
Not designated as hedges						
Forward contracts	11,108	(8,599)	468,102	373,956	94,146	-
Profit rate swaps	2,123	(1,586)	28,122	-	-	28,122
Currency swaps	1,485	(1,533)	26,287	-	-	26,287
Embedded precious metals	-	(1,338)	174,600	166,188	8,389	23
	14,716	(13,056)	697,111	540,144	102,535	54,432
	15,737	(13,702)	797,643	576,321	128,648	92,674

In respect of currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts, the notional amount represents the gross cash flows. However, the amounts may be settled net. The following table shows the net cash flows:

KD 000's

	Notional amount	*Within 3 months*	*3 to 12 Months*	*More than 12 months*
31 December 2012				
Cash inflows	779,580	536,819	190,071	52,690
Cash outflows	(774,172)	(533,516)	(188,416)	(52,240)
Net cash flows	5,408	3,303	1,655	450
31 December 2011				
Cash inflows	759,285	576,322	128,648	54,315
Cash outflows	(756,627)	(572,449)	(130,434)	(53,744)
Net cash flows	2,658	3,873	(1,786)	571

In respect of profit rate swaps, notional amounts are not exchanged.

27 RELATED PARTY TRANSACTIONS

Certain related parties (directors and executive employees, officers of the Group, their families, associated companies and companies of which they are the principal owners) were depositors and financing facilities customers of the Bank, in the ordinary course of business. Such transactions were made on substantially the same terms, including profit rates and collateral, as those prevailing at the same time for comparable transactions with unrelated parties and did not involve more than a normal amount of risk. These transactions are approved by the ordinary general assembly of the equityholders of the Bank.

Transactions with related parties included in the consolidated statement of income are as follows:

KD 000's

	Major shareholders	*Associates*	*Board Members and Executive Officers*	*Other related party*	*Total 2012*	*Total 2011*
Financing income	36	1,549	434	3,081	5,100	7,576
Fee and commission income	5	4	-	56	65	181
Finance costs	7,806	93	-	889	8,788	8,661

Balances with related parties included in the consolidated statement of financial position are as follows:

KD 000's

	Major shareholders	*Associates*	*Board Members and Executive Officers*	*Other related party*	*Total 2012*	*Total 2011*
Receivables	-	61,364	11,003	108,376	180,743	169,054
Due to banks and financial institutions	1,014,533	11,268	-	21,117	1,046,918	550,343
Depositors' accounts	32,427	15,787	5,117	27,078	80,409	84,703
Contingencies and capital commitments	906	612	9	5,225	6,752	10,271
Investment managed by related party	-	-	-	48,583	48,583	31,104

Details of the interests of Board Members and Executive Officers are as follows:

KD 000's

	The number of Board Members or Executive Officers		*The number of related parties*			
	2012	*2011*	*2012*	*2011*	*2012*	*2011*
Board Members						
Finance facilities	6	5	2	1	6,834	8,086
Credit cards	9	5	3	-	43	38
Deposits	33	32	39	31	2,432	5,086
Collateral against financing facilities	5	4	-	-	7,982	8,357
Executive officers						
Finance facilities	14	12	6	5	4,621	4,773
Credit cards	11	10	4	3	28	26
Deposits	41	33	56	51	4,173	4,122
Collateral against finance facilities	8	9	1	3	6,940	6,921

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27 RELATED PARTY TRANSACTIONS (continued)

The transactions included in the consolidated statement of income are as follows:

	Parent	Subsidiaries	Total 2012	Total 2011
				KD 000's
Board Members				
Finance income	204	62	266	496
Executive officers				
Finance income	116	52	168	224
	320	114	434	720

Salaries, allowances and bonuses of key management personnel and remuneration of chairman and board members are as follows:

	Parent	Subsidiaries	Total 2012	Total 2011
				KD 000's
Salaries, allowances and bonuses of key management personnel	2,621	10,265	12,886	11,306
Termination benefits of key management personnel	89	859	948	650
Remuneration of chairman and board members *	905	1,988	2,893	2,092
	3,615	13,112	16,727	14,048

* Remuneration of chairman and board members includes special compensation for additional contributions related to participation in the executive committees in accordance with board of directors' decisions.

The remuneration of chairman and board members are subject to the approval of the Annual General Assembly.

Kuwait Finance House K.S.C. and Subsidiaries

28 SEGMENTAL ANALYSIS

Primary segment information

For management purposes, the Group is organized into three major business segments. The principal activities and services under these segments are as follows:

Treasury: Liquidity management, international murabaha investments, exchange of deposits with banks and financial institutions and international banking relationships.

Investment: Managing direct equity and real estate investments, investments in subsidiaries and associates, and international leasing.

Banking: Providing a range of banking services and investment products to corporate and individual customers, providing commodity and real estate murabaha finance, local leasing, wakala and istisna'a facilities.

31 December 2012	*Treasury*	*Investment*	*Banking*	*Other*	*Total*
					KD 000's
Total assets	2,938,301	3,838,578	6,395,987	1,530,435	14,703,301
Total liabilities	2,427,035	58,995	9,277,862	618,619	12,382,511
Income	52,711	112,230	664,044	103,815	932,800
Impairment	(3,034)	(62,946)	(185,821)	(3,547)	(255,348)
Finance costs	(23,464)	(23,879)	-	(11,794)	(59,137)
Profit before distribution to depositors	20,889	11,020	280,866	(15,168)	297,607

31 December 2011	*Treasury*	*Investment*	*Banking*	*Other*	*Total*
					KD 000's
Total assets	3,702,832	3,442,540	4,915,332	1,399,129	13,459,833
Total liabilities	2,044,983	143,117	8,746,134	447,920	11,382,154
Income	55,315	112,568	551,938	152,261	872,082
Impairment	560	(112,343)	(198,095)	(11,419)	(321,297)
Finance costs	(29,083)	(13,236)	-	(11,461)	(53,780)
Profit before distribution to depositors	41,431	(68,886)	193,481	25,497	191,523

Kuwait Finance House K.S.C. and Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

28 SEGMENTAL ANALYSIS (continued)

Secondary segment information

The Group operates in different geographical areas. A geographical analysis is as follows:

KD 000's

	Assets		*Liabilities*		*Contingencies and capital commitments*	
	2012	*2011*	*2012*	*2011*	*2012*	*2011*
Geographical areas:						
The Middle East	9,371,307	9,395,665	8,862,832	8,419,842	462,993	411,279
North America	478,985	243,756	104,694	78,986	118,007	326,136
Western Europe	685,568	501,791	399,550	411,247	1,201,547	917,048
Other	4,167,441	3,318,621	3,015,435	2,472,079	1,349,429	1,027,924
	14,703,301	13,459,833	12,382,511	11,382,154	3,131,976	2,682,387

KD 000's

	Local		International		Total	
	2012	*2011*	*2012*	*2011*	*2012*	*2011*
Income	485,733	477,179	447,067	394,903	932,800	872,082
Profit before distribution to depositors	158,568	114,250	139,039	77,273	297,607	191,523

29 CONCENTRATION OF ASSETS AND LIABILITIES

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

(a)The distribution of assets by industry sector was as follows:

KD 000's

	2012	2011
Trading and manufacturing	3,364,412	3,036,688
Banks and financial institutions	3,110,698	2,977,044
Construction and real estate	4,405,867	3,982,698
Other	3,822,324	3,463,403
	14,703,301	13,459,833

(b) The distribution of liabilities was as follows:

KD 000's

	2012			*2011*		
	Banking	Non-banking	Total	*Banking*	*Non-banking*	*Total*
Geographic region						
The Middle East	8,421,254	441,578	8,862,832	8,218,084	201,758	8,419,842
North America	45,610	59,084	104,694	2,296	76,690	78,986
Western Europe	78,794	320,756	399,550	70,846	340,401	411,247
Other	2,970,779	44,656	3,015,435	2,420,439	51,640	2,472,079
	11,516,437	866,074	12,382,511	10,711,665	670,489	11,382,154

30 FOREIGN CURRENCY EXPOSURE

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

KD 000's

	2012 Equivalent Long (short)	*2011* *Equivalent* *Long (short)*
U.S. Dollars	312,968	397,263
Sterling Pounds	12,970	18,393
Euros	8,602	13,232
Gulf Cooperation Council currencies	306,583	324,670
Others	(117,613)	(69,441)

31 RISK MANAGEMENT

Risk management is an integral part of the Group's decision-making process. It is managed through a risk management committee, comprising members of senior management drawn from all key areas of the Group, who guide and assist with overall management of the Group's risks. Each individual within the Group is accountable for the risk exposures relating to their responsibilities. The Group is exposed to liquidity risk, credit risk, concentration risk, profit return risk, equity price risk and currency risk.

The Group has an independent process whereby risks are identified, measured and monitored. The risk management unit is responsible for this process. The head of risk management has independent access to the Bank's Board of Directors.

a) Risk management structure

Board of Directors

The Board of Directors of the Bank is responsible for the overall risk management approach and for approving risk strategies and principles. The Board of Directors receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Group.

Risk management committee

The Bank's risk management committee has the overall responsibility for development of a risk strategy and implementing principles, frameworks, policies and limits. It is responsible for fundamental risk issues and manages and monitors relevant risk exposures.

Risk management unit

The Bank's risk management unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process and includes monitoring the risk of exposures against limits.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

31 RISK MANAGEMENT (continued)

a) Risk management structure (continued)

Credit Committee

The Bank's Credit Committee conducts a review and take action on the determination of the Bank's credit risk while ensuring compatibility with the approved risk tendency. The committee also included in general compliance with all credit risk policies adopted with obtaining the necessary approvals and exceptions.

Assets and Liabilities Committee

The Bank's Assets and Liabilities Committee is responsible of the effective supervision of liquidity risk management and finance, adoption of frameworks, and follow-up implementation in its regular meetings.

Treasury

Treasury is responsible for managing the Bank's assets and liabilities, and the overall financial position. It is also responsible for funding and liquidity management.

b) Risk management and reporting systems

The risk management committee is responsible for managing and monitoring risk exposures. The risk management unit measures risk through the use of risk models and provides reports to the risk management committee. The models use probabilities based on historical experiences adjusted to reflect the economic environment.

Monitoring and controlling risks are managed through limits set by the Board of Directors. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Bank's Board of Directors is willing to accept.

Risk mitigation

As part of its overall risk management, the Group uses currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts to manage exposures resulting from changes in yields, foreign currencies, equity risks and credit risks. The Group actively uses collateral to reduce its credit risks.

Excessive risk concentration

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. Selective hedging is used within the Bank to manage risk concentrations at both the relationship and industry levels.

In addition, each of the banking subsidiaries of the Bank has similar risk management structures, policies and procedures as overseen by the Bank's Board of Directors.

32 CREDIT RISK

Credit risk is the risk that the Group will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Group manages and controls 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 Group has established a decentralized credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process allows the Group to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Credit-related commitments risks

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

Maximum exposure to credit risk without taking account of any collateral

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 (net of impairment), before the effect of mitigation through the use of master netting and collateral agreements.

			KD 000's
Gross maximum credit risk exposure	*Notes*	*2012*	*2011*
Balances with banks and financial institutions		717,819	527,565
Short-term murabaha		1,185,723	1,478,052
Receivables	9	6,652,918	5,864,821
Leased assets	10	1,653,510	1,422,442
Financial assets available for sale – Sukook	11	602,918	463,899
Other assets – trade receivable (Non banking subsidiaries)	14	176,185	149,254
Total		10,989,073	9,906,033
Contingent liabilities	25	1,429,789	1,137,634
Commitments	25	1,702,187	1,544,753
Total		3,131,976	2,682,387
Total credit risk exposure		14,121,049	12,588,420

Where financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

Risk concentrations of the maximum exposure to credit risk

Concentration of risk is managed by counterparty by geographical region and by industry sector. The maximum credit exposure to a single counterparty as of 31 December 2012 was KD 89,599 thousands (2011: KD 102,724 thousands) before taking account of collateral which is fully covered by real estate collateral.

The Group's on-financial position financial assets, before taking into account any collateral held can be analyzed by the following geographical regions:

						KD 000's
	2012			*2011*		
	Banking	*Non-banking*	*Total*	*Banking*	*Non-banking*	*Total*
The Middle East	7,211,955	210,175	7,422,130	6,510,144	172,220	6,682,364
North America	71,321	17,301	88,622	49,886	102,610	152,496
Western Europe	181,186	14,922	196,108	103,800	11,672	115,472
Other	3,157,919	124,294	3,282,213	2,920,339	35,362	2,955,701
	10,622,381	366,692	10,989,073	9,584,169	321,864	9,906,033

Kuwait Finance House K.S.C. and Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

32 CREDIT RISK (continued)

Risk concentrations of the maximum exposure to credit risk (continued)

An industry sector analysis of the Group's financial assets, before taking into account collateral held is as follows:

KD 000's

	2012			*2011*		
	Banking	*Non-banking*	*Total*	*Banking*	*Non-banking*	*Total*
Trading and Manufacturing	3,073,401	24,574	3,097,975	2,700,120	25,045	2,725,165
Banks and financial Institutions	2,966,155	111,105	3,077,260	2,711,811	73,517	2,785,328
Construction and real Estate	2,991,407	144,551	3,135,958	2,750,949	149,035	2,899,984
Other	1,591,418	86,462	1,677,880	1,421,289	74,267	1,495,556
	10,622,381	366,692	10,989,073	9,584,169	321,864	9,906,033

Credit quality per class of financial assets

The table below shows the credit quality by class of asset for consolidated statement of financial position lines:

KD 000's

	Neither past due nor impaired			
	High grade	*Standard grade*	*Past due or impaired*	*Total*
31 December 2012				
Receivables:				
International murabahas	450,665	1,575,235	90,202	2,116,102
Local murabahas and wakala	-	3,677,922	743,009	4,420,931
Istisna'a and other receivables	282	70,762	44,841	115,885
	450,947	5,323,919	878,052	6,652,918
Leased assets (Note 10)	-	1,303,864	349,646	1,653,510
Financial assets available for sale – sukook (Note11)	272,084	316,771	14,063	602,918
	723,031	6,944,554	1,241,761	8,909,346

KD 000's

	Neither past due nor impaired			
	High grade	*Standard grade*	*Past due or impaired*	*Total*
31 December 2011				
Receivables:				
International murabahas	209,570	927,449	70,107	1,207,126
Local murabahas and wakala	-	3,971,306	553,156	4,524,462
Istisna'a and other receivables	248	111,434	21,551	133,233
	209,818	5,010,189	644,814	5,864,821
Leased assets (Note 10)	-	1,124,735	297,707	1,422,442
Financial assets available for sale – sukook (Note11)	150,426	271,376	42,097	463,899
	360,244	6,406,300	984,618	7,751,162

Aging analysis of past due but not impaired finance facilities by class of financial assets:

KD 000's

	Less than 30 days	*31 to 60 days*	*61 to 90 days*	*Total*
31 December 2012				
Local murabahas	287,592	168,986	128,807	585,385
Istisna'a and other receivables	38,011	639	1,931	40,581
Leased assets	31,151	24,274	82,362	137,787
	356,754	193,899	213,100	763,753
31 December 2011				
Local murabahas	235,400	109,038	48,009	392,447
Istisna'a and other receivables	35,418	250	172	35,840
Leased assets	19,547	45,799	20,502	85,848
	290,365	155,087	68,683	514,135

Collateral

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines established by the Bank's risk management and credit committee are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral accepted include real estate, securities, cash and bank guarantees. The Group also obtains guarantees from parent companies for finance facilities extended to their subsidiaries.

Management monitors the fair value of collateral and requests additional collateral in accordance with the underlying agreements when necessary.

The fair value of collateral that the Group holds relating to finance facilities individually determined to be past due or impaired at 31 December 2012 amounts to KD 326,943 thousand (2011: KD 252,901 thousand).

The fair value of collateral that the Group holds relating to finance facilities past due but not impaired as at 31 December 2012 was KD 83,483 thousand (2011: KD 86,590 thousand). The collateral consists of cash, securities, sukook, letters of guarantee and real estate assets.

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33 LIQUIDITY RISK

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

The Bank 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 Bank also has committed lines of credit that it can access to meet liquidity needs. 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 net liquid assets to customer liabilities, set to reflect market conditions. Net liquid assets consist of cash and short term murabaha. The ratio during the year was as follows:

	2012 %	*2011* %
31 December	23	22
Average during the year	24	22
Highest	27	25
Lowest	21	20

The table below summarizes the maturity profile of the Group's assets and liabilities. The maturity profile is monitored by management to ensure adequate liquidity is maintained. The maturity profile of the assets and liabilities at the year end are based on contractual repayment arrangement with the exception of investments and investment properties which are based on planned exit dates.

The maturity profile of assets and undiscounted liabilities at 31 December 2012 is as follows:

KD 000's

	Within 3 months	*3 to 6 months*	*6 to 12 months*	*After one year*	*Total*
Assets					
Cash and balances with banks and financial institutions	814,256	-	-	-	814,256
Short-term murabaha	1,185,723	-	-	-	1,185,723
Receivables	1,309,569	956,013	1,104,778	3,282,558	6,652,918
Trading properties	1,636	209,067	7,854	37,368	255,925
Leased assets	451,405	270,594	613,483	318,028	1,653,510
Financial assets available for sale	58,335	6,561	54,264	1,257,100	1,376,260
Investments in associates	-	-	-	452,832	452,832
Investment properties	-	-	-	557,264	557,264
Other assets	462,265	92,533	37,964	428,175	1,020,937
Property and equipment	-	-	-	733,676	733,676
	4,283,189	1,534,768	1,818,343	7,067,001	14,703,301
Liabilities					
Due to banks and financial Institutions	1,500,816	161,663	282,715	309,656	2,254,850
Depositors' accounts	6,022,441	409,692	209,532	2,751,011	9,392,676
Other liabilities	87,172	130,080	185,017	332,716	734,985
	7,610,429	701,435	677,264	3,393,383	12,382,511

The maturity profile of assets and undiscounted liabilities at 31 December 2011 is as follows:

KD 000's

	Within 3 months	*3 to 6 Months*	*6 to 12 months*	*After one year*	*Total*
Assets					
Cash and balances with banks and financial institutions	619,554	-	-	-	619,554
Short-term murabaha	1,478,052	-	-	-	1,478,052
Receivables	1,132,623	881,645	1,043,861	2,806,692	5,864,821
Trading properties	1,328	173,534	2,655	96,169	273,686
Leased assets	384,939	285,050	305,186	447,267	1,422,442
Financial assets available for sale	72,484	10,109	62,018	1,157,566	1,302,177
Investments in associates	-	-	-	490,062	490,062
Investment properties	-	-	-	536,358	536,358
Other assets	274,983	32,558	78,377	319,633	705,551
Property and equipment	-	-	-	767,130	767,130
	3,963,963	1,382,896	1,492,097	6,620,877	13,459,833
Liabilities					
Due to banks and financial Institutions	976,204	138,416	216,901	487,115	1,818,636
Depositors' accounts	4,949,100	650,509	284,987	2,997,249	8,881,845
Other liabilities	75,524	93,962	217,718	294,469	681,673
	6,000,828	882,887	719,606	3,778,833	11,382,154

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments.

KD 000's

	On demand	*Less than 3 Months*	*3 to 12 Months*	*1 to 5 years*	*Over 5 years*	*Total*
2012						
Contingent liabilities	419,241	295,931	270,616	351,723	92,278	1,429,789
Capital Commitments	371,068	-	3,850	249,251	1,078,018	1,702,187
Total	790,309	295,931	274,466	600,974	1,170,296	3,131,976

KD 000's

	On demand	*Less than 3 Months*	*3 to 12 Months*	*1 to 5 years*	*Over 5 years*	*Total*
2011						
Contingent liabilities	434,224	232,630	228,363	198,797	43,620	1,137,634
Capital Commitments	283,563	655	12,364	37,218	1,210,953	1,544,753
Total	717,787	233,285	240,727	236,015	1,254,573	2,682,387

The Bank expects that not all of the contingent liabilities or capital commitments will be drawn before expiry of the commitments.

Kuwait Finance House K.S.C. and Subsidiaries

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34 MARKET RISK

Market risk is the risk that the value of an asset will fluctuate as a result of changes in market prices.

Market risk is managed on the basis of pre-determined asset allocations across various asset categories, a continuous appraisal of market conditions and trends and management's estimate of long and short term changes in fair value.

The Group is not exposed to any risk in terms of the repricing of its liabilities since the Group does not provide contractual rates of return to its depositors and other financing arrangements are at fixed profit rate in accordance with Islamic Shareea'a.

Non-trading market risk

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Group is not exposed to interest rate risk as the Bank does not charge or pay interest. Changes in interest rates may, however, affect the fair value of financial assets available for sale.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

Currency risk is managed on the basis of limits determined by the Bank's Board of Directors and a continuous assessment of the Group open positions, and current and expected exchange rate movements. The Group, where necessary, matches currency exposures inherent in certain assets with liabilities in the same or a correlated currency. The Group also uses currency swap and forward foreign exchange contracts to mitigate foreign currency risk.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2012 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Kuwaiti Dinar, with all other variables held constant on the profit and the fair value reserve (due to the change in fair value of financial assets available for sale).

KD 000's

	2012			2011		
Currency	*Change in currency rate*	*Effect on profit*	*Effect on fair value reserve*	*Change in currency rate*	*Effect on profit*	*Effect on fair value reserve*
	%			*%*		
U.S. Dollars	+1	3,130	1,579	+1	3,976	3,566
Sterling Pounds	+1	130	160	+1	184	236

Equity price risk

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The non-trading equity price risk exposure arises from the Group's investment portfolio. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

The effect on fair value reserve (as a result of a change in the fair value of financial assets available for sale at 31 December) due to a reasonably possible change in equity indices, with all other variables held constant is as follows:

KD 000's

	2012		2011	
	Change in equity price	*Effect on fair value reserve*	*Change in equity price*	*Effect on fair value reserve*
	%		*%*	
Market indices				
Kuwait Stock Exchange	+1	2,045	+1	2,346
Other GCC indices	+1	585	+1	502

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 Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

The Bank has a set of policies and procedures, which is approved by its Board of Directors and applied to identify, assess and supervise operational risk in addition to other types of risks relating to the banking and financial activities of the Bank. Operational risk is managed by the operational risk function, which ensures compliance with policies and procedures and monitors operational risk as part of overall Bank-wide risk management.

The operational risk function of the Bank is in line with the CBK instructions concerning the general guidelines for internal controls and the sound practices for managing and supervising operational risks in Banks.

35 CAPITAL MANAGEMENT

The primary objectives of the Group's capital management are to ensure that the Group complies with regulatory capital requirements and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize 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 review the amount of dividend payment to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

A key Group objective is to maximise equityholders value with optimal levels of risk and to maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored regularly by the Group's management and are governed by guidelines of Basel Committee on Banking Supervision as adopted by the Central Bank of Kuwait. The Group's regulatory capital and capital adequacy ratios are shown below:

KD 000's

Capital adequacy	*2012*	*2011*
Risk Weighted Assets	11,085,751	10,399,742
Capital required	1,330,289	1,247,968
Capital available		
Tier 1 capital	1,503,852	1,404,493
Tier 2 capital	40,851	23,206
Total capital	1,544,703	1,427,699
Tier 1 capital adequacy ratio	13.57%	13.51%
Total capital adequacy ratio	13.93%	13.73%

The Bank is required to comply with Capital Adequacy Regulation for Islamic banks issued by Central Bank of Kuwait as stipulated in Central Bank of Kuwait circular number 2/RBA/44/2009 dated 15 June 2009.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS at 31 December 2012

36 MANAGEMENT OF PURCHASED DEBTS

In accordance with Decree 32/92 and Law 41/93 in respect of the financial and banking sector, the Bank is required to manage the purchased debts without remuneration in conformity with the terms of the debt purchase agreement.

37 FINANCIAL INSTRUMENTS

In the ordinary course of business, the Group uses primary financial instruments such as cash and balances with or due to Banks and other financial institutions, investments, receivables and payables. The Group also uses currency swaps, profit rate swaps, forward foreign exchange and forward commodity contracts for hedging purposes. Information about fair values of financial assets and liabilities are disclosed in note 39 of the consolidated financial statements.

38 FIDUCIARY ASSETS

The aggregate value of assets held in a trust or fiduciary capacity by the Group at 31 December 2012 amounted to KD 635,086 thousand (2011: KD 672,584 thousand).

Fees and commission income include fees of KD 3,029 thousand (2011: KD 2,054 thousand) arising from trust and fiduciary activities.

39 FAIR VALUE HIERARCHY

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

Level 1: quoted (unadjusted) prices in active markets.

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: other techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

KD 000's

	Level 1	*Level 2*	*Level 3*	*Total*
31 December 2012				
Quoted equity investments	45,934	-	-	45,934
Unquoted equity investments	-	2,299	74,010	76,309
Managed portfolios	106,600	30,401	7,288	144,289
Mutual funds	1,163	10,236	-	11,399
Sukook	335,021	131,379	8,081	474,481
Forward contracts	-	2,816	-	2,816
Profit rate swaps	-	431	-	431
Currency swaps	-	2,562	-	2,562
Embedded precious metals	-	(91)	-	(91)
	488,718	180,033	89,379	758,130

KD 000's

	Level 1	*Level 2*	*Level 3*	*Total*
31 December 2011				
Quoted equity investments	54,912	-	-	54,912
Unquoted equity investments	-	-	81,441	81,441
Managed portfolios	205,336	10,308	17,967	233,611
Mutual funds	-	15,705	111,081	126,786
Sukook	302,581	54,899	-	357,480
Forward contracts	-	2,088	-	2,088
Profit rate swaps	-	662	-	662
Currency swaps	-	623	-	623
Embedded precious metals	-	(1,338)	-	(1,338)
	562,829	82,947	210,489	856,265

The valuation technique or pricing models are used primarily for unquoted equities.

These assets are valued using models which sometimes only incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

No transfers have been made between levels of hierarchy.

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